Macroeconomic Analysis

The tax authority publishes its 2015 macroeconomic and fiscal framework

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- For 2015, the tax authorities estimate GDP growth of 3.7%, a balance sheet of -3.5% of GDP, and real annual growth of 0.9% in net public sector spending
- The figures published indicate that GDP growth will be driven by an increase in exports, higher private investment and to a lesser degree by an improvement in private and public consumption
- There are no tax changes, unless the taxes applicable to private firms participating in the oil sector as a result of the sector reform are published

The Ministry for Finance and Public Credit (SHCP in the Spanish acronym) has published the General Economic Policy Criteria (CGPE, idem), the proposed Revenue Law and the draft Mexican Federation's Spending Budget for the 2015 tax year. These documents lay out the estimates of the macroeconomic variables and income and expenditure estimates for 2015 and the medium term.

Macroeconomic variable estimates for 2015

According to the CGPE criteria, in 2015 the Mexican economy's GDP growth rate will reach 3.7%, that is, one percentage point higher than expected by the SHCP itself for 2014. The greater momentum in GDP forecast for 2015 compared to 2014 is to a large degree accounted for by an improvement in productive activity in the United States, which is expected to grow by 3.0% in 2015, after 2.1% growth in 2014. This can be seen in the increased estimate for exports growth, which will rise by 4.7% in 2014, but by 6.5% in 2015, according to the SHCP. Furthermore, the tax authorities estimate that investment will also accelerate its rise, from 1.4% in 2014 to 4.0% in 2015.

The greater influence which increased US economic growth will exert on the Mexican economy in 2015 is important in the light of the public finance figures which the SHCP forecasts for 2015. By next year, the SHCP estimates that the Net Expenditure and Budgetary Revenue items will enjoy modest growth of 0.9% and 1.0% respectively, in real terms. This contained momentum in the public sector items will result in the public balance sheet posting a 2015 deficit of 3.5% of GDP in 2015, slightly lower than the 3.6% deficit expected for 2014. The continuation of a deficit in public finances in 2015 similar to 2014 suggests that the effect of the drive which public spending will have on economic activity will be moderate, so most of the impetus in the country's economic growth will have to come from greater GDP momentum in the US, from gross fixed capital formation and from private consumption. Here, it would be helpful for the bulk of public spending to be on infrastructure investment, since this contributes more to economic growth in the medium term. On the other hand, the considerable improvement estimated in gross fixed capital formation, against the containment in public capital spending (4.6% of GDP in 2015 vs. 4.8% of GDP in 2014), suggests that this greater momentum in investment will be to a large degree a result of a better macroeconomic climate and greater private participation in infrastructure and energy projects, such as those announced recently.

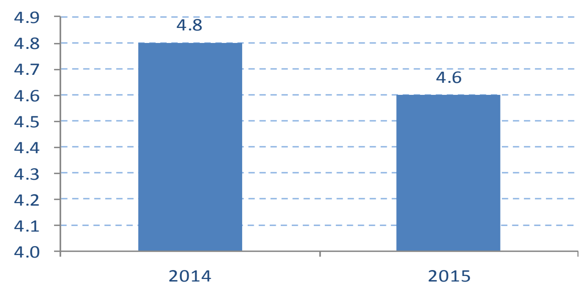
In terms of the greater impetus in consumption expected in 2015, this may start to become gradually visible as the external sector improves, with the concomitant knock-on effect to other economic sectors, resulting in higher employment creation.

Figure 1
Expected GDP growth rate (%)

	2014	2015
GDP	**2.7**	**3.7**
Consumption	2.3	3.4
Investment	1.4	4.0
Exports	4.7	6.5
Imports	2.9	6.0

Source: General Economic Policy Criteria 2015 – SHCP.

Figure 2
Public sector capital expenditure (% of GDP)



Source: General Economic Policy Criteria 2015 – SHCP.

The new tax environment for hydrocarbon exploration and extraction

Thanks to the energy reform, the authorities will be awarding contracts to private parties, some of which will be shared-profit contracts, shared production contracts, licences and service contracts. In consequence of operating in the oil sector under these contracts, individuals will have to pay the following economic duties:

1) Income tax.

2) Contractual quota for the exploration phase, which will be applied throughout the different phases of the contract as an incentive not to delay development in the areas contracted, and to ensure that the state has a minimal flow of resources during the exploration phase.

3) Tax on hydrocarbon exploration and extraction. This tax will be calculated every month, imposing a quota for every square kilometre where activities are carried out. The resources generated by this tax will be handed over to the federal governments and municipalities, for the latter to invest in infrastructure to mitigate the negative effects of oil activity.

4) Royalties. These will calculated on the gross revenues, that is, relative to the production and price of oil, making the duty more straightforward.

5) Payment on Signature of Contract. This will only affect licencing contracts and represents an indication of the credibility of the offer.

6) State compensation on licencing contracts. This is the equivalent of raising the royalties ("super-royalties"). This duty will be adjusted over time according to a predefined "adjustment mechanism" formula which varies depending on prices, productivity and greater than expected amounts exploited.

7) Distribution of the operating profit between the profit and shared production contracts. The State will receive a percentage of the operating profit (i.e. the total value of the hydrocarbons extracted, less the payment of royalties and costs). The costs will be limited to a percentage of revenue and should be directly related to the activity covered under contract.

Assessment

The 3.7% estimate of GDP growth being used by the tax authorities for 2015 is similar to the 3.5% BBVA Research estimate for this year. These growth rates will be achievable as long as the US economy and gross fixed investment show positive behaviour which translates into higher job creation.

Key macroeconomic variables

	2014	2015
GDP (YoY % change)	2.7	3.7
Percentage of GDP		
Balance of the Financial Requirements of the Public Sector	42.2	43.3
Traditional Balance	-1.5	-1.0
Balance with Public Productive Companies Investment	-3.6	-3.5
Budgetary Income	22.40	21.90
Net Paid Expenditures	26.0	25.4
Current Account	-1.9	-2.0
Oil		
Average price per barrel (dollars)	94	82
Export Platform (mbd)	1,115	1,090
Crude Production Platform (mbd)	2,350	2,400
Average Exchange Rate (pesos/dollar)	13.1	13.0
U.S. GDP (YoY % change)	2.1	3.0

Source: General Economic Policy Criteria 2015 – SHCP. mbd=millions of barrels a day.