Economic Analysis

Fiscal space is limited

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Carlos Serrano

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How much fiscal space does the country have? Is it possible to borrow more to support Pemex or to cope with a possible recession with a countercyclical fiscal expansion? In order to answer these questions, it is necessary to analyze Mexico's public debt profile.

Observing the gross debt ratio as a percentage of GDP, we see a significant increase in the last decade: between 2008 and 2018 this increased from 37% to 54%. Increases of this magnitude are not common in other countries and often lead to macroeconomic crises when they do occur. Furthermore, it is regrettable that this increase in debt is not due to increased investment — the country's debt has increased but not in exchange for roads, hospitals or schools; at best, it is due to public expenditure.

However, despite this high and inexplicable growth in debt, we see that debt is not particularly high in comparison with other countries; in advanced economies such as the United States, France or Belgium, it is common to see this indicator standing close to, or higher than 100%, without considering the unique case of Japan—whose debt amounts to 237% of GDP. Other large economies in Latin America also have higher debt-to-GDP ratios, such as Argentina (75%) and Brazil (90%).

However, the debt-to-GDP ratio alone is not enough to perform a debt sustainability analysis. It is necessary to look at other factors. One such factor is the growth rate of the economy in relation to interest rates. A country in which the growth rate of the economy is higher than the interest rate at which it borrows, can sustainably increase its amount of debt, because over time the interest burden will be lower in relation to GDP. This is the case for the United States. Its debt has grown significantly since the outbreak of the 2008 economic crisis, but it is debt that was borrowed with very low interest rates, meaning it does not jeopardize its sustainability. The situation in Mexico is different. Today the interest rates at which debt is issued (above 8% for both short and long term) are far higher than the rates at which the economy has been growing — about 2%. In my opinion, increasing the level of debt in these circumstances would be a mistake as that debt would grow as a percentage of GDP and could become unsustainable.

This is reflected in the fact that Mexico has a much higher debt-servicing burden than countries that have similar or even higher debt levels as a percentage of GDP than those seen in Mexico. While Mexico, as I mentioned, has a debt of 54% of GDP and annually pays 2.4% of the product to service its debt, France, whose debt is 124% of GDP only pays 1.7%. Even Greece, whose debt is more than three times greater than ours (188%) pays little more than us (2.9%) to service its debts. This means that Mexico faces very high interest rates that translate into high levels of debt-service payments, which in turn indicate that increasing debt would be a dangerous strategy.

Another way to analyze debt is to compare it, not against the size of the economy, but against the fiscal resources that the government will ultimately have available to pay said debt. This analysis also suggests that the country has little leeway since we have historically had low tax collection rates. Mexico's tax collection (14% of GDP) is the lowest in the OECD and one of the lowest in Latin America.

The above suggests that Mexico should be very careful fiscally in the coming years. In this regard, it is important to recognize the adjustments announced by the Ministry of Finance which, faced with lower-than-expected economic growth, has decided to prioritize the primary fiscal surplus targets by adjusting expenditure for this year and next.

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CONTACT DETAILS:

BBVA Research – BBVA Bancomer: Paseo de la Reforma 510, Colonia Juárez, C.P. 06600, Mexico City, Mexico
bbvaresearch@bbva.com www.bbvaresearch.com