FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms Mexico at 'BBB-'; Outlook Stable

Thu 07 Dec, 2023 - 12:31 ET

Fitch Ratings - New York - 07 Dec 2023: Fitch Ratings has affirmed Mexico's Long-Term Foreign Currency Issuer Default Rating (IDR) at 'BBB-'. The Rating Outlook is Stable.

A full list of rating actions follows at the end of this rating action commentary.

KEY RATING DRIVERS

Credit Strengths and Weaknesses: Mexico's rating is supported by a prudent macroeconomic policy framework, stable and robust external finances, and a government debt/GDP projected to remain below the 'BBB' median. The rating is constrained by weak governance indicators, a record of muted long-term growth performance and fiscal risks related to rising budget rigidities and contingent liabilities from Pemex.

Rising Fiscal Pressures: Fitch anticipates a general government deficit (including federal government plus social security, an approximation used by Fitch for comparison purposes) of 3.5% of GDP in 2023, up from 3.2% in 2022. Fiscal deterioration through 2023 led the government to defer spending into next year. Government revenues faced downward pressure in 2023 from lower oil-related revenues, while tax revenues continue to prove resilient, benefited by the gradual reinstatement of the gasoline tax and robust income taxes.

Spending pressures have mostly come from increased domestic borrowing costs, given high interest rates, and rising capital spending mostly related to the public infrastructure projects in the south of Mexico.

Wider 2024 Budget: Fitch anticipates a material increase of the general government fiscal deficit to 5% of GDP in 2024 (in line with the Non-Financial Public Sector target of 4.9% of GDP), lifting Mexico's deficit well above the 'BBB' forecast median of 2.8%. The much larger budget deficit results from weaker oil revenues, increasing borrowing costs driven by the prolonged period of high interest rates, deferral of current and capital spending from 2023, and increases of social transfers, particularly to the elderly population.

Fitch anticipates election-related spending will also add to the higher fiscal deficit next year. The agency forecasts the wider deficit will contribute to an increase in general government debt to GDP to 47.7% in 2024 from 44.9% this year and a steady increase in the medium term, but expects it will remain below the 'BBB' median (currently 56%) through the forecast horizon.

Budget Support to Pemex: The 2024 proposal specifies support measures for Pemex in a budget for the first time; previously, support was provided ad hoc depending on economic conditions. Its inclusion improves transparency and highlights the government's willingness to support Pemex. Government support will include a reduction in its profit-sharing duty (DUC) payments to 30% from 40% (worth USD3 billion) and direct transfers of USD8.5 billion. This provides sufficient funding to cover Pemex's 2024 external bond maturities (USD10.9 billion).

The government support to Pemex through this administration (a cumulative USD74 billion since 2019, 4.0% in 2023 GDP) has facilitated a decline in Pemex's debt, which reached USD106 billion in 3Q23, down from its peak of USD113 billion in 2020. This has fallen even more as a share of GDP to 5.7% in 2023 from its peak of 10% in 2020.

Macroeconomic Stability Through Election Cycle: General elections - to determine the president, both chambers of congress and nine state governorships - are scheduled for June 2, 2024. While it is still early in the election cycle, polls have shown a consistent lead for official MORENA party candidate Claudia Sheinbaum. The opposition coalition Fuerza y Corazon por Mexico's candidate Xochitl Gálvez benefitted from an initial steep rise in popularity at the time of her candidacy announcement, but is now struggling to maintain momentum and outpace Sheinbaum's popular support.

Fitch does not anticipate major political disruption during the election cycle that could negatively affect growth prospects for 2024. Fitch anticipates limited policy change if MORENA wins the presidential election, although there is still limited visibility on the actual policy agenda.

One critical component of the elections will be the composition of both chambers of the congress. Fitch expects MORENA will retain a simple majority in both the upper house and the lower chamber, although not a supermajority. This could support Sheinbaum's capacity to execute her policy agenda but result in political gridlock should the opposition win the presidential election. Fitch anticipates the 2024 candidates will enjoy far less popular support than president Lopez Obrador and will likely face steeper challenges in passing politically difficult reforms. This includes a fiscal reform to boost government revenues, and/or executing a material spending reduction to significantly improve the fiscal balance.

Robust Growth: Fitch expects real GDP growth will reach 3.4% in 2023, down from 3.9% in 2022, and projects a slowdown to 2.4% in 2024. Growth has benefited from a steep increase in private investment and robust consumption. Private investment has grown by 20% in the year through September, which provides an early signal of increasing demand for Mexican manufacturing production due to nearshoring effects. A sizeable increase in investment, particularly non-residential construction, relates to the execution of public infrastructure projects in the south of Mexico (Tren Maya and the Interoceanic Corridor of the Isthmus of Tehuantepec).

Nearshoring Growth Opportunity: Nearshoring remains an important growth opportunity for Mexico, given increased U.S.-China tensions. Mexico has seen a steady upward trend in its market share in the U.S. imports, overtaking China and Canada as the U.S.'s main trading partner. Mexico surpassed China in terms of U.S. import market share in mid-2023. Major automotive companies recently announced large infrastructure investment plans in Mexico of about USD11 billion. This increase of FDI could raise non-oil export growth (assuming the current relationship between the two variables remain the same) by about USD100 billion in 2025, according to the IMF.

Easing Inflationary Pressures: Inflation continues to decline, reaching 4.3% in October 2023 from its peak of 8.7% in September 2022. Core inflation has been stubbornly high at 5.5%, affected mostly by the lagged demand recovery for services following pandemic-related disruptions. Banxico (Mexico's Central Bank) increased its policy rate by 725bps since 2021 to its peak of 11.25% in March 2023 to anchor expectations amid the inflation surge.

Banxico's board continues to stress the need to maintain the policy rate at current levels to ensure inflation convergence to the central bank's target range (3% +/-1%). Fitch anticipates Banxico will start its monetary policy easing by 1Q24 absent lingering inflationary pressures, particularly in services and other core items.

ESG - Governance Mexico has an ESG Relevance Score (RS) of '5' for both Political Stability and Rights and for the Rule of Law, Institutional and Regulatory Quality and Control of Corruption. Theses scores reflect the high weight that the World Bank Governance

Indicators (WBGI) have in our proprietary Sovereign Rating Model (SRM). Mexico has a low WBGI ranking at the 32nd percentile reflecting a recent track record of peaceful political transitions, a moderate level of rights for participation in the political process, moderate institutional capacity but relatively weak rule of law and control of corruption.

RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

--Macro: A weakening in the consistency and credibility of the policy framework, for example if unorthodox microeconomic policy interventions become more widespread, negatively affecting growth prospects and/or leading to a reassessment of the upward notching in our rating adjustment for this factor;

--Public Finances: A marked upward trajectory in the gross general government debt/GDP ratio, for example due to fiscal deterioration or weaker economic growth;

--Structural: Deterioration in governance that results in political instability or undermines policy-making and the business climate.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

--Macro: Improvement in growth prospects to a level closer to the 'BBB' median, underpinned by credible macroeconomic policies;

--Public Finances: Greater fiscal consolidation, for example via revenue-enhancing reforms, that would increase confidence in debt/GDP stabilization, improvement in fiscal rigidity, and/or a reduction in contingent liability risks related to Pemex;

--Structural: Improvement in governance, for example, reflected in convergence in governance indicators closer to the rating category median.

SOVEREIGN RATING MODEL (SRM) AND QUALITATIVE OVERLAY (QO)

Fitch's proprietary SRM assigns Mexico a score equivalent to a rating of 'BBB-' on the Long-Term Foreign-Currency (LT FC) IDR scale.

Fitch's sovereign rating committee adjusted the output from the SRM to arrive at the final LT FC IDR by applying its Qualitative Overlay (QO), relative to SRM data and output, as follows:

- Macro: +1 notch, to reflect Mexico's track record under successive administrations of prudent, credible and consistent macroeconomic policies, which is not captured by the weak governance indicator score included in the SRM. The authorities continue to emphasize macroeconomic stability in both fiscal and monetary policy, which has contained macroeconomic imbalances.

- Public Finances: -1 notch, to reflect: a) our expectation that ongoing sovereign support for Pemex will result in a lower tax take and/or higher general government debt burden, negatively impacting public finances; and b) rising budget rigidity due to increasing social transfers, pension expenditures, and interest amid a narrow revenue base.

Fitch's SRM is the agency's proprietary multiple regression rating model that employs 18 variables based on three-year centered averages, including one year of forecasts, to produce a score equivalent to a LT FC IDR. Fitch's QO is a forward-looking qualitative framework designed to allow for adjustment to the SRM output to assign the final rating, reflecting factors within our criteria that are not fully quantifiable and/or not fully reflected in the SRM.

COUNTRY CEILING

The Country Ceiling for Mexico is 'BBB+', two notches above the Long-Term Foreign Currency IDR. This reflects strong constraints and incentives, relative to the IDR, against capital or exchange controls being imposed that would prevent or significantly impede the private sector from converting local currency into foreign currency and transferring the proceeds to non-resident creditors to service debt payments.

Fitch's Country Ceiling Model produced a starting point uplift of +1 notch above the IDR. Fitch's rating committee introduced a further +1-notch qualitative adjustment to this under the Balance of Payments Restrictions pillar. This reflects Mexico's open capital account and its flexible exchange rate, while modest financial dollarization and high trade and financial integration (partly reflected in high foreign participation in the banking sector) reduce the incentives of the authorities to impose capital controls.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

Mexico has an ESG Relevance Score of '5' for Political Stability and Rights as WBGIs have the highest weight in Fitch's SRM and are therefore highly relevant to the rating and a key rating driver with a high weight. As Mexico has a percentile rank below 50 for the respective Governance Indicator, this has a negative impact on the credit profile.

Mexico has an ESG Relevance Score of '5' for Rule of Law, Institutional & Regulatory Quality and Control of Corruption as WBGIs have the highest weight in Fitch's SRM and are therefore highly relevant to the rating and are a key rating driver with a high weight. As Mexico has a percentile rank below 50 for the respective Governance Indicators, this has a negative impact on the credit profile.

Mexico has an ESG Relevance Score of '4' for Human Rights and Political Freedoms as the Voice and Accountability pillar of the WBGIs is relevant to the rating and a rating driver. As Mexico has a percentile rank below 50 for the respective Governance Indicator, this has a negative impact on the credit profile.

Mexico has an ESG Relevance Score of '4[+]' for Creditor Rights as willingness to service and repay debt is relevant to the rating and is a rating driver for Mexico, as for all sovereigns. As Mexico has a track record of 20+ years without a restructuring of public debt and captured in our SRM variable, this has a positive impact on the credit profile.

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

RATING ACTIONS

ENTITY / DEBT	RATING		PRIOR
Mexico	LT IDR Affirmed	BBB- Rating Outlook Stable	BBB- Rating Outlook Stable

	ST IDR F3 Affirmed	F3
	LC LT IDR BBB- Rating Outlook Stable Affirmed	BBB- Rating Outlook Stable
	LC ST IDR F3 Affirmed	F3
	Country Ceiling BBB+ Affirmed	BBB+
senior unsecured	LT BBB- Affirmed	BBB-
senior unsecured	ST F3 Affirmed	F3

VIEW ADDITIONAL RATING DETAILS

FITCH RATINGS ANALYSTS

Carlos Morales
Director
Primary Rating Analyst
+1 646 582 3546
carlos.morales@fitchratings.com
Fitch Ratings, Inc.
Hearst Tower 300 W. 57th Street New York, NY 10019

Todd Martinez
Senior Director
Secondary Rating Analyst
+1 212 908 0897
todd.martinez@fitchratings.com

Douglas Winslow
Senior Director
Committee Chairperson

+44 20 3530 1721
douglas.winslow@fitchratings.com

MEDIA CONTACTS

Elizabeth Fogerty
New York
+1 212 908 0526
elizabeth.fogerty@thefitchgroup.com

Additional information is available on www.fitchratings.com

PARTICIPATION STATUS

The rated entity (and/or its agents) or, in the case of structured finance, one or more of the transaction parties participated in the rating process except that the following issuer(s), if any, did not participate in the rating process, or provide additional information, beyond the issuer's available public disclosure.

APPLICABLE CRITERIA

Sovereign Rating Criteria (pub. 06 Apr 2023) (including rating assumption sensitivity)

Country Ceiling Criteria (pub. 24 Jul 2023)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Country Ceiling Model, v2.0.0 (1)

Debt Dynamics Model, v1.3.2 (1)

Macro-Prudential Indicator Model, v1.5.0 (1)

Sovereign Rating Model, v3.14.0 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Mexico	EU Endorsed, UK Endorsed

DISCLAIMER & DISCLOSURES

actuarial reports, engineering reports, legal opinions and other reports provided by third parties, the availability of independent and competent third- party verification sources with respect to the particular security or in the particular jurisdiction of the issuer, and a variety of other factors. Users of Fitch's ratings and reports should understand that neither an enhanced factual investigation nor any third-party verification can ensure that all of the information Fitch relies on in connection with a rating or a report will be accurate and complete. Ultimately, the issuer and its advisers are responsible for the accuracy of the information they provide to Fitch and to the market in offering documents and other reports. In issuing its ratings and its reports, Fitch must rely on the work of experts, including independent auditors with respect to financial statements and attorneys with respect to legal and tax matters. Further, ratings and forecasts of financial and other information are inherently forward-looking and embody assumptions and predictions about future events that by their nature cannot be verified as facts. As a result, despite any verification of current facts, ratings and forecasts can be affected by future events or conditions that were not anticipated at the time a rating or forecast was issued or affirmed. Fitch Ratings makes routine, commonly-accepted adjustments to reported financial data in accordance with the relevant criteria and/or industry standards to provide financial metric consistency for entities in the same sector or asset class.

The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Fitch also provides information on best-case rating upgrade scenarios and worst-case rating downgrade scenarios (defined as the 99th percentile of rating transitions, measured in each direction) for international credit ratings, based on historical performance. A simple average across asset classes presents best-case upgrades of 4 notches and worst-case downgrades of 8 notches at the 99th percentile. Sector-specific best- and worst-case scenario credit ratings are listed in more detail at https://www.fitchratings.com/site/re/10238496

The information in this report is provided “as is” without any representation or warranty of any kind, and Fitch does not represent or warrant that the report or any of its contents will meet any of the requirements of a recipient of the report. A Fitch rating is an opinion as to the creditworthiness of a security. This opinion and reports made by Fitch are based on established criteria and methodologies that Fitch is continuously evaluating and updating. Therefore, ratings and reports are the collective work product of Fitch and no individual, or group of individuals, is solely responsible for a rating or a report. The rating does not address the risk of loss due to risks other than credit risk, unless such risk is specifically mentioned. Fitch is not engaged in the offer or sale of any security. All Fitch reports have shared authorship. Individuals identified in a Fitch report were involved in, but are not solely responsible for, the opinions stated therein. The individuals are named for contact purposes only. A report providing a Fitch rating is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. Ratings may be changed or withdrawn at any time for any reason in the sole discretion of Fitch. Fitch does not provide investment advice of any sort. Ratings are not a recommendation to buy, sell, or hold any security. Ratings do not comment on the adequacy of market price, the suitability of any security for a particular investor, or the tax-exempt nature or taxability of payments made in respect to any security. Fitch receives fees from issuers, insurers, guarantors, other obligors, and underwriters for rating securities. Such fees generally vary from US$1,000 to US$750,000 (or the applicable currency equivalent) per issue. In certain cases, Fitch will rate all or a number of issues issued by a particular issuer, or insured or guaranteed by a particular insurer or guarantor, for a single annual fee. Such fees are expected to vary from US$10,000 to US$1,500,000 (or the applicable currency equivalent). The assignment, publication, or dissemination of a rating by Fitch shall not constitute a consent by Fitch to use its name as an expert in connection with any registration statement filed under the United States securities laws, the Financial Services and Markets Act of 2000 of the United Kingdom, or the securities laws of any particular jurisdiction. Due to the relative efficiency of electronic publishing and distribution, Fitch research may be available to electronic subscribers up to three days earlier than to print subscribers.

For Australia, New Zealand, Taiwan and South Korea only: Fitch Australia Pty Ltd holds an Australian financial services license (AFS license no. 337123) which authorizes it to provide credit ratings to wholesale clients only. Credit ratings information published by Fitch is not intended to be used by persons who are retail clients within the meaning of the Corporations Act 2001.Fitch Ratings, Inc. is registered with the U.S. Securities and Exchange Commission as a Nationally Recognized Statistical Rating Organization (the “NRSRO”). While certain of the NRSRO's credit rating subsidiaries are listed on Item 3 of Form NRSRO and as such are authorized to issue credit ratings on behalf of the NRSRO (see https://www.fitchratings.com/site/regulatory), other credit rating subsidiaries are not listed on Form NRSRO (the “non-NRSROs”) and therefore credit ratings issued by those subsidiaries are not issued on behalf of the NRSRO. However, non-NRSRO personnel may participate in determining credit ratings issued by or on behalf of the NRSRO.

dv01, a Fitch Solutions company, and an affiliate of Fitch Ratings, may from time to time serve as loan data agent on certain structured finance transactions rated by Fitch Ratings.

READ LESS

SOLICITATION STATUS

The ratings above were solicited and assigned or maintained by Fitch at the request of the rated entity/issuer or a related third party. Any exceptions follow below.

ENDORSEMENT POLICY

Fitch's international credit ratings produced outside the EU or the UK, as the case may be, are endorsed for use by regulated entities within the EU or the UK, respectively, for regulatory purposes, pursuant to the terms of the EU CRA Regulation or the UK Credit Rating Agencies (Amendment etc.) (EU Exit) Regulations 2019, as the case may be. Fitch's approach to endorsement in the EU and the UK can be found on Fitch's Regulatory Affairs page on Fitch's website. The endorsement status of international credit ratings is provided within the entity summary page for each rated entity and in the transaction detail pages for structured finance transactions on the Fitch website. These disclosures are updated on a daily basis.