FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms Mexico at 'BBB-'; Outlook Stable

Tue 17 May, 2022 - 12:50 ET

Fitch Ratings - New York - 17 May 2022: Fitch Ratings has affirmed Mexico's Long-Term Foreign Currency (FC) and Local Currency (LC) Issuer Default Rating (IDR) at 'BBB-'. The Rating Outlook is Stable.

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

KEY RATING DRIVERS

Credit Fundamentals: Mexico's rating is supported by a prudent macroeconomic policy framework, stable and robust external finances, and government debt/GDP projected to remain stable at levels below the 'BBB' median. The rating is constrained by weak governance, muted long-term growth performance, continued policy intervention affecting investment prospects, and the potential contingent liabilities from Pemex.

The Stable Outlook is supported by stable public finances and the priority policymakers attach to this and broader macroeconomic stability, notwithstanding challenges from muted economic growth prospects. This supports our assessment of macro policy credibility as a rating strength and backstop to private-sector confidence despite continued microeconomic policy interventions and governance challenges.

Conservative Fiscal Policy: Mexico's public finances continue to outperform rating and regional peers, partly reflecting a relatively small stimulus during the pandemic. The 2022 budget adheres to the government commitment to keep a stable debt/GDP ratio, targeting moderate fiscal deficits. The government has shown strong willingness to cut expenditures in favor of maintaining moderate fiscal deficits. Fitch anticipates a general government deficit (Federal Government plus Social Security, an approximation used by Fitch for comparison purposes) of 3.3 % of GDP in 2022 and 3.0% in 2023, from 3.0% in 2021. Fitch does not expect any revenue-enhancing fiscal reform through this administration. The government is focusing on tax collection efficiency and expanding the tax base through administrative measures but the effects on revenues will not materialize in the near term.

Federal Fiscal Deficit Neutral to Oil Price: Higher-than-budgeted oil-related revenues at the federal government level will be offset by the impact of the gasoline fiscal stimulus as the government is committed to maintain stable gasoline prices at the pump in real terms. The government is managing prices by reducing the gasoline excise tax IEPS (now at 0%) and giving tax credits to gasoline suppliers. Fitch expects higher federal government oil-related revenue to compensate for lower gasoline-related tax collection if the annual average Mexican oil price mix remains below USD100 a barrel (currently at USD92.36/bbl, average through April).

Reduced Near-Term Pemex Support: Pemex will benefit directly from higher oil prices, although the financial improvement will be short-lived given structural financial weaknesses and our expectation that oil prices will moderate to USD80 per barrel in 2023. Fitch expects the federal government will remain committed to financially support PEMEX. The government reduced PEMEX's profit-sharing tax (DUC, derecho de utilidad compartida) to 40% from 54% in the 2022 budget and injected capital to cover PEMEX's 1Q22 maturities (USD2.2 billion, 0.16% of GDP). Fitch anticipates the need for further financial support this year will diminish as current oil prices benefit PEMEX. However, the government will resume its financial support to PEMEX if oil prices revert to lower levels.

Stable Debt/GDP Ratio: Fitch projects general government debt (federal government, social security, states and municipalities and IPAB, but excluding PEMEX and CFE) to remain below 47% of GDP through 2023, below the 2022 'BBB' rating category forecast median of 55.9%. Our projections indicate a gradual increase over the medium term given low economic growth prospects coupled with higher borrowing costs. Debt/GDP will benefit in the near term from a higher nominal GDP level given the steep increase of prices (particularly producer prices). Local market financing capacity remains ample, although non-resident holdings of local market government debt have steadily fallen since the outset of the pandemic.

Economic Recovery to Underperform Peers: Fitch expects real GDP growth will slow down to 2% in 2022 and remain at this level in 2023. As a result, Mexico's real GDP level will not reach pre-pandemic levels until 2023, lagging both rating and regional peers. Risks are tilted to the downside given ongoing external disruptions to prices and supply chains due to Russia's invasion of Ukraine and China's lockdown measures. External demand from the U.S. will remain supportive in the near term, but on a lesser scale than in 2021.

Gradual Economic Recovery: Mexico's quarterly GDP data signals a gradual recovery as annual growth reached 1.6% in 1Q22 after stalling in the 2H21. Private investment continues to underperform as a pattern of political interventions (most recently higher state intervention in the electricity sector) have affected business confidence. Consumption has reached pre-pandemic levels, benefiting from easing mobility restrictions, labor market improvement and relatively strong remittances.

Rising Inflationary Pressures: Inflation accelerated to 7.7% in April 2022, the highest since January 2001, due to higher commodity prices, supply-chain disruptions and pandemic-related demand shifts as lockdown measures eased. High levels of inflation may increase its persistence outside Banxico's range and continue to affect short-term expectations. Banxico began to tighten monetary policy in June 2021, raising the policy rate by 300bp to 7.0% as of May. Tightening of U.S. monetary policy, a prolonged duration of Russia's invasion of Ukraine and supply chain disruptions from China's lockdown measures will likely result in further rate hikes from Banxico in the near term.

Congress Dismisses Electricity Reform: The government's constitutional reform proposal to modify the electricity sector in a bid for a greater state role was rejected after failing to attain a super majority in Congress. A lack of a super-majority in Congress will also hinder passage of other reforms proposed by the administration. Nevertheless, Fitch expects private investment in the electricity sector will be dissuaded by regulatory uncertainty and remain insufficient. New power projects will continue facing headwinds when attempting to obtain production permits. Mexico's electricity sector investment needs in order to meet demand are approximately USD10 billion per year for the next 15 years.

Robust External Finances: External risks appear contained by Mexico's free-floating exchange rate and adequate international reserve levels. Mexico continues to benefit from the IMF's Flexible Credit Line (about USD50 billion, one fourth of international reserves) although treats the facility as precautionary. U.S. external demand continues to benefit Mexico's manufacturing sector (although the auto sector in particular continues to be affected by supply chain issues) while remittances continue to materially increase. Mexico posted a small current account deficit of 0.4% of GDP in 2021, fully funded by foreign direct investment.

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. Mexico has a medium WBGI ranking at the 35th 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 macroeconomic policy framework, for example if unorthodox 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 indicators that widens the gap further to the scores of 'BBB' category peers and further undermines 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;

--Structural: Improvement in governance indicators to a level closer to the rating category median;

--Public Finances: Addressing weaknesses in public finances via revenue-enhancing reforms that would increase confidence in a declining government debt path, and a reduction in contingent liability risks related to PEMEX.

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 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. The long-term sustainability of this positive notch adjustment could be threatened by a prolonged pattern of microeconomic interventions by the government, potentially weakening governance quality and impacting macroeconomic outturns.

- Public Finances: -1 notch, to reflect 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.

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.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

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 World Bank Governance Indicators 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 World Bank Governance Indicators 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 World Bank Governance Indicators 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.

Except for the matters discussed above, the highest level of ESG credit relevance, if present, is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or to the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

RATING ACTIONS

ENTITY / DEBT	RATING	PRIOR

Mexico	LT IDR	BBB- Rating Outlook Stable	Affirmed	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

Charles Seville
Senior Director
Secondary Rating Analyst

+1 212 908 0277
charles.seville@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

Country Ceilings Criteria (pub. 01 Jul 2020)

Sovereign Rating Criteria (pub. 11 Apr 2022) (including rating assumption sensitivity)

APPLICABLE MODELS

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

Country Ceiling Model, v1.7.2 (1)

Debt Dynamics Model, v1.3.1 (1)

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

Sovereign Rating Model, v3.13.1 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Mexico	EU Endorsed, UK Endorsed

DISCLAIMER & DISCLOSURES

All Fitch Ratings (Fitch) credit ratings are subject to certain limitations and disclaimers. Please read these limitations and disclaimers by following this link: https://www.fitchratings.com/understandingcreditratings. In addition, the following https://www.fitchratings.com/rating-definitions-document details Fitch's rating definitions for each rating scale and rating categories, including definitions relating to default. ESMA and the FCA are required to publish historical default rates in a central repository in accordance with Articles 11(2) of Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 and The Credit Rating Agencies (Amendment etc.) (EU Exit) Regulations 2019 respectively.

Published ratings, criteria, and methodologies are available from this site at all times. Fitch's code of conduct, confidentiality, conflicts of interest, affiliate firewall, compliance, and other relevant policies and procedures are also available from the Code of Conduct section of this site. Directors and shareholders' relevant interests are available at https://www.fitchratings.com/site/regulatory. Fitch may have provided another permissible or ancillary service to the rated entity or its related third parties. Details of permissible or ancillary service(s) for which the lead analyst is based in an ESMA- or FCA-registered Fitch Ratings company (or branch of such a company) can be found on the entity summary page for this issuer on the Fitch Ratings website.

In issuing and maintaining its ratings and in making other reports (including forecast information), Fitch relies on factual information it receives from issuers and underwriters and from other sources Fitch believes to be credible. Fitch conducts a reasonable investigation of the factual information relied upon by it in accordance with its ratings methodology, and obtains reasonable verification of that information from independent sources, to the extent such sources are available for a given security or in a given jurisdiction. The manner of Fitch's factual investigation and the scope of the third-party verification it obtains will vary depending on the nature of the rated security and its issuer, the requirements and practices in the jurisdiction in which the rated security is offered and sold and/or the issuer is located, the availability and nature of relevant public information, access to the management of the issuer and its advisers, the availability of pre-existing third-party verifications such as audit reports, agreed-upon procedures letters, appraisals, 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.

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.

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.

Sovereigns Latin America Mexico