FitchRatings

RATING ACTION COMMENTARY

# Fitch Affirms Mexico at 'BBB-'; Outlook Stable

Fri 16 Jun, 2023 - 13:44 ET

Fitch Ratings - New York - 16 Jun 2023: Fitch Ratings has affirmed Mexico's Long-Term (LT) Foreign Currency (F
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' media The rating is constrained by weak governance indicators, muted long-term growth performance, micro policy intervention affecting investment prospects in Fitch's view, and the potential contingent liabilities from Pemex.

The Stable Outlook is supported by stable public finances and the priority policymakers attach to this and broac macroeconomic stability, notwithstanding challenges from subdued economic growth prospects. This supports assessment of macro policy credibility as a rating strength despite continued microeconomic policy interventio and governance challenges.

**Sound Fiscal Policy:** The government continues to show firm commitment to moderate fiscal deficits that maint stable debt/GDP. Fitch does not anticipate a change to the fiscal policy stance ahead of the 2024 presidential elections. Mexico's 2024 preliminary budget guidelines revised the Non-Financial Public Sector (including Pem deficit forecast to 3.7% of GDP for 2023 (3.6% previously) and to 2.7% for 2024 (2.2% previously).

**Challenging Fiscal Context:** Fitch anticipates a general government deficit (including the federal government pl social security, an approximation used by Fitch for comparison purposes) of 3.5% of GDP in 2023 and 3.2% in 2( from 3.3% in 2022. Both revenues and expenditures are now expected to be lower compared to the 2023 budg pressured by borrowing costs, given high inflation and interest rates, as well as higher input costs. This administration seeks to complete its priority infrastructure projects (the Maya and Isthmus trains and the Dos Bocas refinery) before elections are held in June 2024. The budget, therefore, projects a sharp fall in capex in 20 although an adverse shock on government revenues may result in delays on investment execution into next yea

**Broadly Stable Debt Dynamics:** Fitch projects general government debt/GDP will remain stable at 47.0% in 20 8pp below our forecast 'BBB' category median at 55%, and will then have a gradual upward trajectory. Debt/GD will benefit in the near term from a higher nominal GDP level given economic activity resiliency and higher-thar average inflation (partially offset by adjustments on inflation-indexed bonds, which are 28% of local securities). projections indicate a gradual increase over the medium term to 51% at end-2027 due to secular low economic growth rates.

**Continued Pemex Support:** Fitch expects the government will remain committed to financially supporting Pem as part of its priority of strengthening the role of state-owned companies in the energy sector, and will continue provide ad hoc support to the company. This has included tax relief, the servicing of debt on behalf of the compa and financing of the Dos Bocas refinery project. Fitch does not expect the government will guarantee Pemex's d given current legislation that restricts this.

**Moderating Growth:** Fitch projects real GDP growth to slow modestly to 2.5% in 2023 from 3.0% in 2022, bett than previously expected, and decline to 1.8% in 2024. Growth will benefit from statistical carryover effects giv the sustained quarterly growth in 2022, strong labor market performance and further post-pandemic catch-up this process has been relatively slow. External demand continues to be supportive although Fitch expects the economy will face challenges from the ongoing U.S. economic slowdown, affecting both manufacturing export demand and remittances.

In Fitch's view, Mexico's economic growth has been hindered by sluggish investment affected by both pandemic related disruptions and unpredictable microeconomic interventions and regulatory uncertainty, particularly in energy sector.

**Nearshoring Growth Opportunity:** Nearshoring remains an important growth opportunity for Mexico, given increased U.S.-China tensions and manufacturers' desire for shorter and more resilient supply chains. Mexico ha surpassed China as the second top trade partner to the U.S. since 2021. There are increasing signals of greater demand for Mexico's manufacturing production. Industrial park occupancy reached a record high in 2022 (averaging 97%, according to the Mexican Association of Private Industrial Parks). The automotive sector seem be benefiting from nearshoring as global companies have announced investment plans of up to USD10 billion (0 surge. Fitch projects inflation will fall to 4.8% at end-2023 and Banxico will ease monetary policy later in 2023 a keeping it at 11.25% for most of the remaining year.

**ESG - Governance:** Mexico has an ESG Relevance Score (RS) of '5' for both Political Stability and Rights and for Rule of Law, Institutional and Regulatory Quality and Control of Corruption. Theses scores reflect the high weig that the World Bank Governance Indicators (WBGI) have in our proprietary Sovereign Rating Model (SRM). Me has a low WBGI ranking at the 32nd percentile reflecting a recent track record of peaceful political transitions, 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 du fiscal deterioration or weaker economic growth;

--Structural: Deterioration in governance that results in political instability or undermines policy-making and th 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: Addressing weaknesses in public finances via revenue-enhancing reforms that would increas confidence in a declining government debt path, and a reduction in contingent liability risks related to Pemex;

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

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

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 tl SRM. The authorities continue to emphasize macroeconomic stability in both fiscal and monetary policy, which 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 lo 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 thr year centred averages, including one year of forecasts, to produce a score equivalent to a LT FC IDR. Fitch's QO 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 ratin 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 comple 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 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 Mexicc a percentile rank below 50 for the respective Governance Indicator, this has a negative impact on the credit pro

Mexico has an ESG Relevance Score of '4' for Human Rights and Political Freedoms as the Voice and Accountab 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 relev 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'. Thi means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their natur to the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Score 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 | 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

Country Ceilings Criteria (pub. 01 Jul 2020)

Sovereign Rating Criteria (pub. 06 Apr 2023) (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, v1.7.3 (1)

Debt Dynamics Model, v1.3.2 (1)

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

Sovereign Rating Model, v3.13.3 (1)

## ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

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