Central Bank revises Mexico´s growth forecast

Mexico´s Central Bank (Banxico) slashed its 2015 growth forecast from a range of 3 – 4 per cent to 2.5 - 3.5 per cent and estimated that growth in 2014 reached 2.1 per cent. Notwithstanding that Mexico´s economy has been showing signs of recovery since the second quarter of 2014, it has yet to accelerate as expected due to various headwinds.

Consumption remains weak particularly due to a decrease in real wages and a weakened peso, which suffered a 13.2 per cent depreciation against the dollar due to international financial volatility in 2014. Consumer confidence is on an upward trend and had a 7.8 per cent year-on-year increase in January, although decreased 1.01 per cent compared to the previous month and continues to be lower than 2013 levels.

In contrast to this, there are encouraging signs in terms of fixed investment, particularly in the construction sector, although construction within the public sector continues on a downward trend. Some of Mexico´s largest housebuiding companies were hard-hit two years ago when President Enrique Peña Nieto´s administration made a shift in housing policy, which moved away from large housing estate sprawls to high-rise dwellings, in order to improve residents´ access to services.

The manufacturing sector is also showing a modest recovery. According the Mexico´s National Institute for Statistics and Geography, said sector grew .19 per cent on a monthly basis in December and employment grew 3.4 per cent year-on-year. In line with this, fixed investment in national machinery and equipment is also on the rise.

External demand –driven by increased dynamism in the U.S. and the peso´s depreciation- has propped up the Mexican economy. Auto and non-auto exports continue to benefit from demand from Mexico´s northern neighbour yet have remained flat in regards to the rest of the world economy.

Despite these mixed signals, interest in Mexico from abroad has not waned. Even though the maturity for many government bonds expired in December –many of which were held by foreign investors- the number of foreign bondholders has continued to increase.

Furthermore, earlier this week the Executive Council of Foreign Companies in Mexico –comprised of 39 multinational companies that account for 10 per cent of the country´s GDP and 40 per cent of foreign direct investment- announced that it will invest $11, 172 billion USD in 2015. This represents a 57 per cent increase in comparison to its average yearly investment. The organization expects this boost to create more than 50,000 direct and indirect jobs.

This echoes Banxico´s earlier finding in January, namely that 58 per cent of the economic analysts from the private sector it surveys on a monthly basis responded that it was a good moment to invest in Mexico. Interestingly this is only a slight decrease from the same figure published in September (63 per cent) -prior to the fall in oil prices and a series of political scandals- which might suggest that investors are bullish about the results of the recent set of economic reforms.

It should be noted that the Central Bank –which is an autonomous institution- praised the government´s plans to implement budget cuts. In light of the fall in oil prices –oil revenues account for a third of the government´s funds- and a pledge to not raise new taxes after the 2013 fiscal reform, the government announced cut back spending by 0.7 per cent of GDP. Banxico pointed out that this prudent fiscal approach reduces the likelihood of a future increase in the government´s financing costs given that budget deficit had now reached 4 per cent of GDP.

In terms of risks ahead, Banxico is concerned about an uncertain and volatile economic scenario worldwide, a lagging domestic economy and deteriorating social conditions, as well as the implications from further external issues, such as the Fed's exit strategy and lower oil prices.

Upside risk factors for the economy include further acceleration in the U.S. economy due to falling energy prices and a larger than expected increase in investors´ appetite as a result of the implementation of the above-mentioned reforms.

Still, Banxico expressed confidence that the inflation rate will remain anchored at 3.0 per cent, while it did not discard that it could even end the year below said level.

Update on Mexico´s Energy Reform

Mexico´s Secretariat of Energy and the National Commission for Hydrocarbons revealed that there are currently 22 companies authorized to pay in order to access the data rooms for the first phase of Mexico´s Round One bidding for oil and gas opportunities. The list (found below) offers a glimpse of the first of many changes to come in Mexico´s energy landscape, which was recently opened to private investment for the first time in over 75 years.

Round One is divided in five phases, with each phase corresponding to different types of blocks tendered in order of difficulty. The first phase -which is currently underway and closes for registration on March 16th- is for shallow water blocks.

Given that the break event point for shallow water projects in Mexico is close to $23 USD, this phase of the Round One has remained somewhat protected from the oil price rout. This is also likely to be the case for deep-water projects –due to the long time frames for their development- which are considered to be the one of the most attractive opportunities for private companies within Mexico´s energy sector.

In addition to this new international players looking to enter the market, an array of new domestic companies have been created during the past year, looking to capitalize on opportunities across the energy value chain.

Examples of this are the announcement this week by Cemex –the large cement-maker- regarding the creation of its energy division, which aims to provide 5 per cent of the country´s electricity within five years. Moreover, mining conglomerate Grupo Bal and owner of the world´s largest silver producer launched its new exploration and production company, Petrobal, which will be headed by Carlos Morales Gil, a former Pemex executive who is considered to be one of the top oil engineers in the country. Likewise, telecoms magnate Carlos Slim´s Grupo Carso –which has experience in operating energy projects in Colombia- created its Mexican drilling division last year.

Another important change taking place in Mexico´s energy industry is the week´s announcement of one of the largest spending cuts in Pemex´ history, as part of its efforts not only to adapt to the decline in oil prices, but to better cope in what´s about to become a much more competitive environment.

The lion´s share of cuts will be focused on the state owned enterprise´s refining operations and changes to its exploration and production projects, particularly deepwater blocks. In regards to the former, Pemex has long-struggled to competitively produce gasoline amid a decades long political taboo in the country, which rejects the idea that a large oil producer should import gasoline.

Pemex´ refining activities last year closed at a loss of more than $6 billion USD. Furthermore the scheduled investment for the reconfiguration of its refining activities amounted to more than $15 billion USD. Although this move is very likely to result in large layoffs and the cancelation of contracts with contractors, it will also allow Pemex to streamline its operations and focus on its most profitable projects.

Regarding deepwater blocks, Pemex is considering increasing the number of farm-outs from 10 to 15, in order to minimize the impact of its spending cuts on its exploration and production activities. Moreover, Pemex will also postpone projects in shale, given that these have a much higher break even point that those in which it has most expertise such as shallow water blocks.

Furthermore the Mexican state owned enterprise will cease to transport gasoline through pipelines, opting to do so by tank trucks instead. This is an attempt by Pemex to stem the theft of hydrocarbon products in the country, which has increased significantly during the past 15 years and resulted in losses of $1.1 billion in 2014.

On a brighter note, Pemex signed an MOU with IEnova –the Mexican unit of natural gas utilities company Sempra Energy- in order to develop Mexico´s first LNG plant, which will be located in the western state of Baja California and will allow Pemex to strengthen its standing in the international gas market by opening access to new regions.

List of companies authorized to pay in order to access data rooms:

ExxonMobil, Chevron, Ecopetrol, BG Group, Shell, Hunt Overseas Oil, BHP Bilton, Cobalt, Sierra Oil and Gas, ONGC Videsh, Eni International, Diavaz Offshore, INPEX Corporation, Pacific Rubiales, NBL, Petróleo Brasileiro, Hess News Ventures, Casa Exploration, Galp Energía, Statoil, LUKOIL and Total.