MEDIO: THE NEWS
SECCION: BUSINESS
PAGINA: 17
FECHA: 12/SEPTIEMBRE/2013

CUARTOSCURO/GUILLERMO PERFA

Fitch says tax bill proposal highlights the commitment of the gov't to make progress on its reform agenda.

Fitch upgrades Mexican credit

Agency says tax reform is 'broadly neutral'

FITCH

CHICAGO -The Mexican government's recently proposed fiscal reform and the 2014 budget are broadly neutral for its sovereign creditworthiness, according to Fitch. The positive impact from the expansion of the government's revenue base needs to be counterbalanced by the near-term weakening of the economy and higher-than-expected fiscal deficits in the coming years.

Fitch upgraded Mexico's sovereign ratings by one notch on May 8, 2013, to reflect the country's improving fundamentals and the greater-than-anticipated reform momentum under the Peña Nieto administration.

One of the key assumptions underpinning our upgrade of Mexico was the expectation that Mexico will continue to make progress on reforms that improve its fiscal flexibility and promote economic growth. In this regard, the announced tax reform proposal highlights the continued commitment of the government to make progress on its reform agenda.

The fiscal reform seeks to increase the overall federal government revenues by 1.4 percent of GDP in 2014, increasing to 2.9 percent of GDP by 2018. The package involves an increase in the marginal income tax rate for Mexicans earning above 500,000 pesos, introduction of a 10 percent tax on capital gains from stock market transactions and dividends, and imposition of taxes on soft drinks.

Authorities also estimate greater revenues from the excise taxes on gasoline. Moreover, the reform includes a new fiscal regime for Pemex to enhance its investment flexibility.

Measures to reduce high labor informality are positive too.

However, the government refrained from imposing the value-added tax (VAT) on food and medicines that could have had a large positive impact on revenues.

A narrow, non-oil tax base for the federal government (only about 10 percent of GDP) and the high dependence on oil for non-financial public sector revenue (over 33 percent) have been highlighted as key structural weaknesses of Mexico's public finances. In this regard, the proposed reform should allow progress on expanding the overall tax base, although fiscal dependence on oil revenue will remain high.

The creation of a Sovereign Wealth Fund and the implementation of a structural fiscal balance rule, including caps on current spending, represent progress on strengthening the institutional framework. However, the effectiveness of these measures will depend on how the final rules are defined and implemented, as well as the actual economic and fiscal performance of Mexico.

It remains to be seen whether the current package will be passed without significant changes that dilute its final impact. Moreover, even after passage, the effectiveness of the measures to raise the government's revenue intake can only be judged over the coming years and will depend critically on their implementation.

Effective implementation will help ensure that the projected expansion of the tax base materializes, especially in light of the new spending commitments.

Despite the revenue enhancing measures, the 2014 budget envisions a non-financial public sector deficit (excluding Pemex investment) of 1.5 percent of GDP for next year as the government responds to the weakening economy.

The authorities estimate a gradual reduction in this deficit, which is expected to reach a balanced position by 2017. The new fiscal trajectory could moderately increase the general government debt/GDP ratio.

We do not anticipate an immediate positive rating impact from the passage of the fiscal reform.

Instead, we will monitor how well the reform is implemented and to what extent it boosts the country's fiscal flexibility over time.

We have noted that a sustained period of high growth that bridges Mexico's wealth gap with the higher rated sovereigns and material gains in fiscal flexibility will be the key considerations for improving Mexico's credit profile.