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# Mexico looks to oil and central bank windfalls

Bank of Mexico surplus may beat records even as hedging programme falls short


*Workers aboard a jack-up rig in the Gulf of Mexico © Bloomberg*

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YESTERDAY by: **Jude Webber** in Mexico City

Mexico can expect a windfall of as much as $2.9bn next month from its annual oil hedging programme, but that will be dwarfed by an expected bonanza from the central bank that could pour close to $20bn into government coffers in April, analysts say.

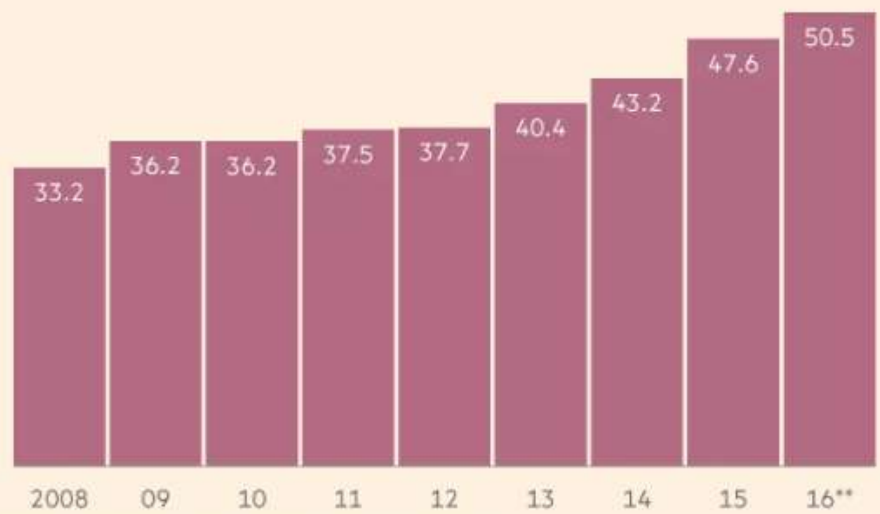
For a government facing bitter spending cuts, an increasingly uncertain economic outlook, sharply lower growth prospects next year and the threat of a ratings downgrade, the central bank transfer will come as a silver lining after the collapse in the peso following Donald Trump's US election victory.

While the surplus from the Bank of Mexico's dollar reserves is likely to beat the previous record — in April the government received 239bn pesos (almost $14bn at the exchange rates at the time) — the oil hedging proceeds will be smaller than last year's record, reflecting the tough oil price environment. The finance ministry expects to announce the result of the trade after November 30.

Mexico has spent an average of about $1bn a year for the past decade buying options in deals with banks including Goldman Sachs, Citigroup and JPMorgan Chase to protect against oil price falls. It is typically the biggest operation of its kind in derivatives markets and netted $6.4bn last year as the 2015 programme hedged crude at a price of $76.4 a barrel, before oil prices fell sharply.

The programme for this year was for 212m barrels hedged at $49 a barrel, a more modest level that means the difference between the hedged price and the market price is far smaller. For next year, the government has hedged at $42 a barrel.

Mexico: Public debt*
% of GDP




* Historic balance of public-sector borrowing requirements
** Estimated
Source: Bank of Mexico

FT

Carlos Capistrán, chief Mexico economist at Bank of America Merrill Lynch, noted that Mexico's Maya crude has averaged $35 a barrel so far this year and the Mexican mix is typically a few dollars higher. "If the Mexican mix averages $40 a barrel in 2016, then Mexico will receive about $2bn," he noted.

Alonso Cervera, chief Latin America economist at Credit Suisse in Mexico City, estimates that the bottom line for Mexico's 2016 public accounts is a net gain of $1.9bn, after factoring in a $5 a barrel cost of the hedge.

The profit is the difference between the 2016 hedge price and the average cost of the Mexican oil mix for the year.

The International Monetary Fund says, however, that the cost was already incurred last year and so is "water under the bridge". When the options are exercised, the IMF says the government can expect a payout of some $2.9bn, based on an expected average Mexican oil price of $35.4.

"But this won't come as a surprise," says Mr Cervera. "It's not that they won the lottery. The government accounted for this money and has executed the budget accordingly."

What is more, the profit — the first time in the 16 years the hedging programme has been running that Mexico has turned a profit from the trade for two consecutive years — will plug a hole in government accounts left by lower income from oil, as state company Pemex struggles with falling output.

"Oil revenues will probably be about $2bn lower than last year so it's not like this is a sudden windfall," said Neil Shearing, chief emerging markets economist at Capital Economics. Oil revenues now make up less than a fifth of government income.

By contrast, the central bank surplus from gains on its dollar reserves has not been factored into the budget. "We're expecting it to be much bigger than last year," said Guillermo Aboumrad, director of market strategy at Finamex, a brokerage.

Last year's surplus was 378.2bn pesos. Of that, Banxico kept 148.5bn pesos and transferred 239bn to the Treasury in April, a record sum. The previous year, it had transferred just 31.4bn pesos.

If the exchange rate remains around current levels until the end of the year, Mr Aboumrad estimates that the bank's overall surplus could be 540bn. So if the board decided to retain a similar level to last year, "it could be handing back 400bn pesos".

Mr Cervera noted that the total surplus could be equivalent to some 2.5 per cent of GDP. "It's going to be an important transfer and more importantly, this money should be used to pay down debt." By law, the government has to use 70 per cent of the transfer for debt reduction and the remainder goes into boosting an oil stabilisation fund.

Mexico's rising debt levels have become a growing cause for concern. S&P Global Ratings — which, like Moody's Investors Service earlier this year cut its outlook on Mexico to negative, raising the spectre of a downgrade — said it expected debt to reach 45 per cent of GDP this year.

"The debt ratio has risen steadily from only 28 per cent of GDP in 2005. Though the debt burden is moderate, Mexico enjoys less fiscal room to manoeuvre than it did a decade ago," S&P Global said.