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Economic Analysis

Fiscal consolidation underway despite optimistic growth assumptions

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- **The 2026 Preliminary General Economic Policy Guidelines confirm the federal government's intention to reestablish fiscal discipline, with a primary surplus target of 0.6% of GDP, and aim to stabilize public debt at 52.3% of GDP in 2025 and 2026—both of which are positive signals.**
- **However, the economic growth forecasts of 1.5% for 2025 and 2.1% for 2026 appear optimistic when compared to the 0.8% and 1.8% projections, respectively, from the consensus of economic analysts.**
- **Last year's high fiscal deficit—the largest since the late 1980s—necessitates fiscal consolidation and leaves the current administration with no room to implement countercyclical fiscal policy.**
- **If a scenario of weaker economic activity in 2025 and 2026 materializes—more in line with analysts' consensus—the achievement of the primary surplus targets for this year and next will become more difficult, likely requiring further cuts in public spending. This would be a considerable challenge in a context of limited fiscal space.**
- **In the medium term, a tax reform and a change in Pemex's business model will be necessary, considering that fiscal pressures will persist due to equity support for Pemex, the expansion of social programs, debt servicing costs, and pension payments. This is especially relevant given that Mexico has the lowest tax revenue (as a % of GDP) among OECD countries and one of the lowest in Latin America.**
- **A shift in Pemex's business model is essential so that the company no longer represents a burden on public finances. In this regard, greater private investment participation is considered key to boosting oil production and reducing refining activity, as the latter generates the greatest financial losses.**

The 2026 Preliminary Guidelines are characterized by three main elements: 1) a reduction in the fiscal deficit is anticipated this year; 2) a prudent fiscal policy is proposed to keep public debt at stable levels; and 3) a tax strategy that aims to strengthen revenue without creating or increasing taxes. Nonetheless, both this year and the next pose major challenges for the national economy due to the implementation of the judicial reform, uncertainty surrounding U.S. trade policy, and the impact of tariffs on global economic growth. These three factors, together with the complex international economic outlook, will significantly limit the federal government's room for maneuver in a scenario likely to result in lower public revenues than forecasted.

The Preliminary Guidelines confirm the federal government's commitment to restoring fiscal discipline by setting primary surplus targets of 0.6% and 0.5% of GDP for 2025 and 2026, respectively. This would represent a more restrictive fiscal policy compared to the 1.5% primary deficit projected for 2024. The document projects Public Sector Borrowing Requirements (PSBR) of [-4.0%, -3.9%] and [-3.5%, -3.2%] of GDP for 2025 and 2026, respectively. It also anticipates a Historical Balance of PSBR of 52.3% of GDP by the end of this year and the next. Our forecasts for this balance are 53.1% and 54.3% of GDP, respectively.

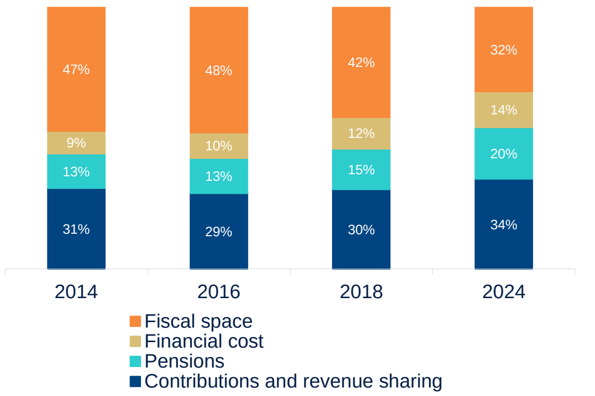
Using real GDP growth assumptions of 1.5% and 2.1% for 2025 and 2026, the federal government projects that tax revenues will grow at annual real rates of 3.0% and 1.7%, respectively. This unquestionably presents an upside risk to the evolution of the PSBR and the aforementioned debt stock.

Given the high degree of uncertainty surrounding the global economic outlook for 2025 and 2026, the risk balance for public revenues will be tilted to the downside. Particularly noteworthy is the macroeconomic framework’s assumption regarding GDP growth in the Preliminary Guidelines. The overestimation of real GDP growth for 2025 (1.5% vs. consensus estimate of 0.8%) and 2026 (2.1% vs. consensus estimate of 1.8%) is the primary source of downside risk for projected tax revenues.

Regarding oil revenues, the lower estimated oil price for 2026 compared to 2025 would lead to a real annual decline of 12.1% in those revenues. This negative outlook for oil revenues affects overall budgetary revenue, which is projected to fall by 0.9% in real annual terms in 2026.

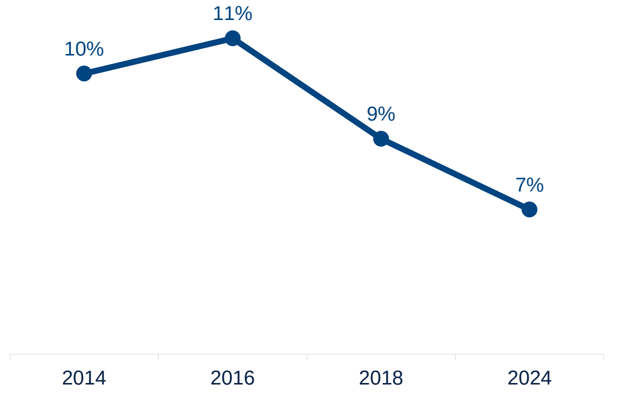
In terms of tax revenues, it is a positive sign that the Preliminary Guidelines do not propose new taxes or changes to the tax code, given the expected economic weakness for this year and the next. Undoubtedly, greater tax collection—ceteris paribus—will rely more heavily on digitalization, more efficient tax auditing, and stronger efforts to combat tax evasion. In any case, we believe it was appropriate not to raise the income tax or VAT rates, given the contractionary effect these taxes can have on the economy in the short term.

Figure 1. **UNAVOIDABLE EXPENDITURES VS. FISCAL SPACE**
(% OF BUDGETARY INCOME)



Source: BBVA Research with SHCP data

Figure 2. **FISCAL SPACE**
(% OF GDP)



Source: BBVA Research with SHCP data

In the medium term, the country will need to implement a fiscal reform that increases tax revenue, considering that pressures on public spending will continue due to capital support for Pemex, the expansion of social programs, financial costs, and pension payments. A change in Pemex's business model is also required so that the company no longer represents a strain on public finances. To achieve this, we believe that greater private investment should be allowed with the goal of increasing oil production and reducing refining activity, since the latter generates the greatest financial losses.

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