North America & Caribbean Monthly Insight

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A2 Global Risk

Andrés Manuel López Obrador / Shutterstock.com

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Status Key

↗　　Risk incline

→　　Risk neutral

↘　　Risk decline

Mexico in transition: How will Amlo's presidency change doing business in the country?

The victory of Andrés Manuel López Obrador in July's presidential election marked a highly significant moment in Mexico's recent history. López Obrador, or 'Amlo' as the veteran leftist from the south-eastern state of Tabasco is commonly known, had finished runner-up in the two previous presidential races. On this occasion, however, López Obrador and his recently-formed *Movimiento Regeneración Nacional* (Morena) party won by a landslide, with Amlo himself winning over 53 per cent of the popular vote in a four-candidate race. Morena, together with its *Partido del Trabajo* (PT) and *Partido Encuentro Social* (PES) coalition partners, secured a majority in both houses of congress. Morena's success came at the expense of Mexico's two established political forces: the centrist *Partido Revolucionario Institucional* (PRI) which has governed the country for all but 12 years since the Mexican revolution's 1920 conclusion, and the conservative *Partido Acción Nacional* (PAN).

Prior to his election, many of López Obrador's domestic critics warned that his brand of left-wing populism would see Mexico follow the path taken by Venezuela under former president Hugo Chávez. While López Obrador's policy platform is ostensibly less pro-business than that of incumbent president Enrique Peña Nieto, both Amlo's legislative agenda and record as mayor of Mexico City from 2000 to 2005 show that comparisons with Chávez are very wide of the mark.

Since the election on 1 July, López Obrador and his team of advisors have been formulating policy, deciding on nominees for political appointments and meeting with a wide range of domestic and international interlocutors. Although López Obrador does not take office until 1 December, given Mexico's five-month transition period, announcements made since his election victory have begun to shed light on the operating environment which businesses will face during his six-year presidential term. To what extent the policies of the new administration will alter the business environment for companies depends on the sector in which they operate and is discussed in greater detail below.

Macroeconomic policy

On taking office on 1 December, López Obrador will inherit a mixed macroeconomic picture. The country's economy has continued to grow in recent years, despite the election and protectionist impulses of U.S. President Donald Trump, with yearly growth of 2.7 per cent recorded in July 2018. However, other indicators point to a less healthy economy. One of the most notable of these is a weakening of the peso, which has fallen by approximately 4 per cent against the U.S. dollar in the past month alone, as well as higher food and energy costs which have pushed up inflation, which currently stands at 6.6 per cent. Furthermore, while Mexico has

maintained relatively high fiscal discipline since the 1994 peso crisis, the debt-to-GDP-ratio has increased significantly under Peña Nieto, with public debt growing from 33.8 per cent of GDP in 2012 to 45.4 per cent in 2018. Moreover, the country's budget deficit has also risen substantially, reaching 2.9 per cent of GDP in the first quarter of 2018, up from 1.6 per cent of GDP in 2017.

While Amlo has pledged to cut the deficit and has already begun enacting a programme of so-called republican austerity, which has included slashing congress's budget and promising to sell the presidential plane, he has simultaneously committed to boosting spending on social services, and on balance a small increase in public spending is likely overall. Markets will be reassured, however, by the credentials of Amlo's nominees for leadership roles. Carlos Urzúa, an economics professor who previously served under Amlo as Mexico City's finance secretary between 2000 and 2003, will be finance minister, while Alfonso Romo, a prominent Nuevo León businessman who has been one of Amlo's main economic advisors for several years, will be chief of staff. Despite a likely boost to overall public spending, these appointments should reassure markets that Mexico's public finances will remain in check during Amlo's mandate.

Energy policy

Since his 1 July election win, López Obrador has sent mixed signals about how his administration will approach Peña Nieto's 2013 energy reform, which opened up Mexico's sizeable reserves of oil and gas to foreign investment. Despite labelling the reform a 'vile trick' at a meeting with oil sector executives in Villahermosa, Tabasco as recently as 8 September, López Obrador's administration has committed to continuing tenders for drilling oil wells, and appears to accept that Pemex, the state-owned oil giant, does not have the capacity to ramp up output in either the short or medium-term. Furthermore, while the president-elect's advisors have been revising more than 100 oil contracts which were awarded to companies in the last few years, including Royal Dutch Shell and BP, for irregularities and signs of corruption, none of these have yet been revoked or modified.

While López Obrador's fiery, nationalistic campaign rhetoric likely alarmed those with interests in Mexico's energy sector, with the president-elect declaring in February 2018 that he would not allow the country's oil to 'fall back into the hands of foreigners', announcements made during the transition period, including regarding the construction of a new refinery in Tabasco, should provide reassurance to investors. Similarly, the incoming administration has mostly nominated experienced figures for key energy policy roles, including chemical engineer Rocío Nahle as energy secretary and veteran former interior minister Manuel Bartlett as director of the *Comisión Federal de Electricidad* (CFE). One curious appointment, however, is that of Octavio Romero Oropeza as the new director of Pemex. The 59-year-old, who does not have a background in the energy sector, takes over the heavily indebted state giant at a time when both crude production and refined output are decreasing.

Trade policy

On 27 August, Mexican and U.S. negotiators reached agreement on new terms for the North American Free Trade Agreement (Nafta). The updated terms mostly address U.S. concerns, including by raising the percentage of automobile content made in the North America region required to qualify for Nafta's tariff-free access from 62.5 to 75 per cent, as well as increasing the automotive sector's wage floor, a move which should incentivise manufacturers to base themselves in the U.S.

The recent deal, which was negotiated by Peña Nieto's administration in consultation with the incoming government, is subject to the U.S. concluding bilateral negotiations with Canada, after which the three countries party to the agreement will have 90 days to

sign off on the deal. As López Obrador will assume the presidency before this period concludes, his administration will have the chance to propose modifications to the deal or even reject it outright, although this is highly unlikely given its involvement in shaping the current agreement. With a revision of the E.U.-Mexico trade agreement signed in April and an updated Nafta deal imminent, there is likely to be little substantial change to Mexico's open approach to trade during López Obrador's administration.

Security policy

One area of concern shared by all firms with operations in Mexico is the country's fragile security environment. Since 2006, Mexico has been in the midst of an ongoing battle between the state security forces, including both the army and the navy, and numerous drug cartels and organised crime groups. While the Mexican authorities have not released figures on the human cost of the so-called 'war on drugs', figures from the executive secretariat of the *Sistema Nacional de Seguridad Pública (SNSP)*, Mexico's public security agency, revealed that over 170,000 people were murdered in organised crime-related incidents in the decade from 2006 to 2016. The incoming administration takes charge as violence and crime continue to proliferate; there were over 15,000 murders in the first six months of 2018 – the highest figure since records began in 1997 and up 16 per cent on the same period last year.

While López Obrador has announced several important changes to Mexico's public security apparatus, including the re-establishment of the *Secretaría de Seguridad Pública* (SSP), such changes have become relatively common in the past two decades and have mostly had little success in reducing crime. More significant will be López Obrador's efforts to raise the minimum wage and reduce the number of young people in neither education nor work, known in Mexico as *ninis,* through social programmes. Despite these addressing many of the root causes of organised criminality in the country, such long-range solutions are unlikely to have much immediate impact. For the foreseeable future, López Obrador will continue the policy of using the army and navy in law enforcement activities, announcing on 24 August that there is currently 'no alternative' to employing the military to counter criminal groups.

Outlook: The Fourth Transformation?

Throughout his election campaign and during the transition period, López Obrador has frequently stated that his administration will oversee the *Cuarta Transformación* (Fourth Transformation) of Mexico, following independence in 1810, the liberal reforms of Benito Juárez from 1855 to 1863, and the Mexican Revolution, which concluded in 1920. While López Obrador has not explicitly defined what the Fourth Transformation means, he seeks to make Mexico more democratic and inclusive, while reshaping the current economic model to one which develops strong national industries. Unlike the three previous transformations, however, the fate of Amlo's project depends as much on the forces of globalisation as it does on domestic political will, and as such, López Obrador's project is by no means guaranteed success.

From a commercial perspective, the first half of the transition period has been largely risk-positive. López Obrador has rowed back on some of his most controversial campaign pledges, such as clamping down on foreign involvement in the energy sector, and his administration's participation in shaping the revised Nafta deal should reassure those concerned about the possibility of more trade barriers going up across the Rio Grande. Despite areas of concern, particularly regarding the effectiveness of the new

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security policy and the state of Mexico's public finances, the incoming administration is likely to be constrained by financial limitations, existing legislation, treaty obligations, and global economic conditions, and as a result policies may not vary greatly from the status quo. Firms with interests in Mexico should continue to follow updates on the transition and the policies of López Obrador's government, which will take office on 1 December. Those considering market entry should follow announcements from the new administration and adjust strategic planning in light of the new operating environment. ♦

UNITED STATES: The midterm elections – a referendum on President Trump?

Risk rating: ➔

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On 6 November, voters in all 50 U.S. states will head to the polls to vote in midterm elections, the most significant electoral test for President Donald Trump since taking power in January 2017. Voters will choose all 435 members of the House of Representatives, where the Republican Party currently holds a modest majority, as well as 35 members of the 100-seat Senate, where the Republicans have a slender 51-49 majority. Furthermore, there will also be 36 gubernatorial races and a number of mayoral elections, including in major cities such as San Francisco, Phoenix and the capital Washington, D.C. The results of the midterms will have major implications for the U.S.'s political stability and Trump's ability to deliver on the rest of his legislative agenda for the final two years of his presidential term, and will offer clues as to how the 2020 presidential race may play out.

As with most midterm elections for first-term presidents, the polls are set to be a referendum on the president's performance. In 2018, this dynamic is likely to be especially accentuated given the polarisation and divisiveness of Trump's presidency. While Trump

claims that his administration has kept its 2016 campaign promises, particularly with regards to its pro-business economic policy and tough stance on illegal immigration, the Democratic Party has argued that the Trump presidency has been chaotic and that the New York billionaire is unfit to govern the country. Such a dispute has been playing out as an investigation continues into possible collusion between Trump's 2016 election campaign and the Russian government. Despite Trump's efforts to discredit the investigation and those who lead it, particularly Special Counsel Robert Mueller, it has resulted in various indictments of Trump's campaign team and has the backing of Democratic and most Republican legislators.

Given that congress is relatively finely balanced between Republicans and Democrats, a victory for either side is theoretically possible. Despite this, current polling indicates that the Democrats are likely to win control of the House of Representatives, where they are likely to take between 220 and 240 seats. In the Senate, however, the electoral calendar will likely favour the Republicans, with 26 of the 35 seats being defended by the Democrats. There, the latest polls suggest that Republicans will maintain control, albeit likely with a narrow one or two seat majority. While the exact numerical balance of congress may not appear vital to many casual observers, it is the most significant constraint on or enabler of the president and his agenda. Most importantly, however, the partisan balance of congress will determine Trump's fate if the Mueller investigation concludes that the president's team, and possibly even Trump himself, colluded with Russia to win the 2016 race. In such a scenario, which looks increasingly plausible given the indictments of Trump's campaign associates, a simple majority would be needed in the House of Representatives to initiate impeachment proceedings, and ultimately a two-thirds vote in the Senate could strip Trump of the presidency.

Risk scenarios:

Highly likely: Democrats win control of the House of Representatives but Republicans hold the Senate. Mueller's investigation finds that Trump's campaign team collaborated with Russia to elect Trump, although there is no conclusive proof that Trump ordered collusion. House Democrats initiate impeachment proceedings but the Republican-controlled Senate blocks impeachment. Trump governs until 2020 and stands for re-election.

Possible: Democrats take control of both the House and the Senate. Mueller's investigation offers conclusive proof that Trump conspired with Russia to win the 2016 presidential election. House Democrats initiate impeachment proceedings, which are supported by a majority of Republican legislators. Trump is impeached and replaced by Mike Pence, who stands as the Republican candidate in the 2020 election.

Unlikely: Republicans extend their majorities in both the House and the Senate. Trump enacts immigration reform and receives funding to complete the U.S.-Mexico border wall. Trump's popularity reaches 50 per cent as the economy continues to grow at 4 per cent. Trump stands in 2020 election. ♦

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Chronology - August 2018

CANADA

5 August: The Saudi foreign ministry announced that it was ceasing all new trade and investment with Canada and expelling the Canadian ambassador. It accused the Canadian Foreign Ministry of interfering in Saudi domestic affairs on 3 August when it called for the release of civil rights activists who were being detained.

30 August: The Federal Court of Appeal ordered that construction on the expansion of the Trans Mountain oil pipeline be halted until the National Energy Board (NEB), a government agency, adequately consults with affected indigenous communities and assesses the pipeline's possible effects on waters off British Columbia province.

COSTA RICA

25 August: A large anti-xenophobia march was held in the capital San José to protest against a rise in anti-Nicaraguan sentiment in the country.

MEXICO

21 August: Eight people were murdered in a series of separate incidents in the popular beach city of Cancún, in the south-eastern state of Quintana Roo. Incidents occurred across the city, including in the western Paseos del Mar residential development, where two bodies were found in the boot of a taxi, as well as in the southern Lagos del Sol residential area, 6.4km north of Cancún International Airport (CUN), where police found a body wrapped in a plastic bag.

MEXICO, UNITED STATES OF AMERICA

27 August: Mexican and U.S. negotiators reached agreement on new terms for the North America Free Trade Agreement (Nafta).

NICARAGUA

29 August: The United Nations (U.N.) Human Rights Office issued a report widely condemning human rights violations perpetrated by Nicaragua's security services and paramilitary groups loyal to the government of President Daniel Ortega during the ongoing violent civil unrest. The report, which covers the four-month period between 18 April and 18 August this year, documented cases of extrajudicial killings by the police and widespread arbitrary detentions. Over 300 people have died in fighting between pro-government forces and members of the ACJD opposition.

UNITED STATES OF AMERICA

13 August: President Donald Trump signed into law the Foreign Investment Risk Review Modernization Act (FIRRMA), which gives U.S. authorities further powers to scrutinise business dealings involving foreign companies.

16 August: The U.S.'s main federal law enforcement agency, the Federal Bureau of Investigation (FBI), sent a confidential alert to banks warning of the growing threat of automatic teller machine (ATM) 'jackpotting'. The jackpotting method, as it is commonly known, sees criminals install malware on the system which governs ATM cash dispensers, ordering the machine to release all the cash it holds.

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