IIF – Banorte Mexico Economic Forum

Mexico at a sweet spot amid a difficult global environment

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- **Last week, the Institute of International Finance (IIF), together with Banorte, held a conference attended by Chief economists, as well as local and international investors**

- **During the conference, discussions over important issues for the short and medium-term global outlook were held, particularly:**

  (1) Trade tensions and the possible negative effect on the global economic outlook;
  (2) The favorable outlook in terms of NAFTA renegotiation;
  (3) The challenges that Mexico's incoming administration will face when they take office on December 1st;
  (4) Emerging markets turmoil on the back of lower levels of global liquidity along with domestic vulnerabilities; and
  (5) Other geopolitical factors that continue to dominate the scenario, such as *Brexit*

- **In our opinion, the conference made it clear that Mexico is at an exceptional place after solving trade issues with the U.S., amid an environment of higher levels of protectionism expected going forward**

- **In addition, the Mexican economy has solid macroeconomic fundamentals, including sound fiscal accounts and an autonomous central bank**

- **In this context, while it is true that the administration that will take office on December 1 has great challenges, the market is willing to give a vote of confidence as they have shown a commitment to macroeconomic stability**

IIF – Banorte Mexico Economic Forum. Last week the Institute of International Finance (IIF) held an investors conference in Mexico City, sponsored by Banorte. The conference was attended by nearly 190 investors, both domestic and foreign, discussing -throughout about 11 sessions-, the issues defining the global outlook going forward, with an emphasis on Emerging markets and Mexico in particular. Among the most pressing issues there were discussions on: (1) The impact of protectionist measures; as well as (2) monetary policy normalization in G3; and (3) the outlook for the new administration taking office in Mexico on December 1st.

Mexico at a sweet spot amid a challenging backdrop in terms of trade. One of the main issues discussed was protectionism and its negative impact on the global outlook. Against this backdrop, Mexico has an advantage vs. other countries -as it is the case of China-, after reaching an understanding with the U.S. regarding trade issues. Secretary of Economy, Ildefonso Guajardo, was satisfied with recent agreement while he was hopeful that Canada will join the agreement shortly. Among other agreements reached -details will be known next September 30th-, there is the exclusion of Mexico from the application of any additional measure under section 232, by which the US president can impose restrictions on imports under the argument of national security, which could eventually include the car industry (investigations under this section on cars and uranium imports are currently taking place). Moreover, seasonality in agricultural sector was excluded while they agreed on a modified version on the *sunset clause* (for details see: "*NAFTA Renegotiation - Resolution of bilateral issues Mexico-US increases possibilities of signing NAFTA 2.0*", <pdf>, published on August 27).

In addition, it is possible that Canada will soon join the agreement. Most participants, including as we already mentioned by Secretary Guajardo, were optimistic about the possible participation of Canada in NAFTA. This country is still in the process of negotiating its most concerning issues, having to do with the agricultural sector and the mechanism for settling disputes (Chapter 19). It is worth mentioning that, even if Canada ends up not joining the agreement, President Trump's administration will publish the details of the agreement on September 30 and will continue with the approval process as a bilateral agreement.

Moreover, the agreement could be delayed as midterm elections approach in the United States. President Trump notified the US Congress, on August 30, that it had reached an agreement with Mexico and that Canada would probably join shortly. With this notice, the 90-day period required under TPA rules for Congress to vote the deal, started running. This implies, among other things, that NAFTA will probably be included in the agenda of the next Congress, where the House of Representatives could pass to hands of the Democratic Party, according to the most recent polls, thus reducing the possibilities of the approval of this bill.

Wide consensus on the challenges for the new administration in Mexico. During the conference, the outlook for the Mexican economy under the ingoing administration was also discussed by the main economists as well as by future officials under Mr. Lopez-Obrador, such as the next Head of the Office of the President, Alfonso Romo; the next deputy Finance Minister, Arturo Herrera; and Congressman Mario Delgado (Morena's majority leader at the Lower House). In this context, economic analysts agreed that it will be crucial for the next administration to commit to macroeconomic stability amid a difficult international context, especially for emerging markets. This includes a prudent fiscal stance, as well as the reinforcement of macroeconomic fundamentals, which includes, among others, an autonomous central bank.

In our view, investors have granted a vote of confidence to the incoming administration, with a lower risk premium embedded in local assets. Nevertheless, there are some doubts that need to be resolved within the first few days of the administration, particularly in terms of implementation. In general, market participants focus on the fiscal budget, Pemex strategy, social programs and infrastructure projects (including the resolution of the new airport in Mexico City), along with all the mechanisms to combat corruption and insecurity. For details see: "*Rating agencies maintain confidence in Mexico after the electoral process*", <pdf>, published on July 3, 2018.

These discussions took place in a context in which risk in emerging markets has increased in recent weeks. In addition to protectionism, emerging markets are dealing with more restrictive monetary conditions, particularly by US Fed, as well as with the imbalances inherent to each of these economies, on top of important electoral calendar (elections in October in Brazil and next year in Argentina, for example).

The political outlook in Brazil is highly uncertain. Investors are focusing on the October 7th elections (First Round), with polls showing a multimodal distribution of preferences. It seems that the most relevant fight will be between right-wing Jair Bolsonaro, and former Mayor of São Paulo, Fernando Haddad (having support from Lula). However, Ciro Gomes and Marina Silva could also make the Second Round. Brazilian economy is trying to leave behind the economic recession from 2015-2016, with a significant social distress. Overall, it was recognized that five things are having an adverse effect in Brazil: (1) A significant political crisis (not only stemming from the uncertainty about next month's elections, but also by the corruption scandals under the famous "Operation Car Wash"); (2) an effect of slack in the economy; (3) the EM contagion; (4) the divergent monetary policy cycle with respect to the U.S.; and (5) still depressed commodity prices in most of their top exports (i.e. iron ore, crude oil, soybeans, sugar and poultry).

The views on Argentina were more negative. In tandem with Turkey, this country is one of the most significant risks in the EM spectrum. The US$50 billion bailout announced by the IMF in June, together with other emergency policy responses such as hiking the repo rate to 60%, cutting government spending and increasing taxes on exports have not been enough to prop up the currency, which is the most depreciated currency vs. the USD in the YTD comparison, almost loosing half of its power against the dollar. It seems that the BoP and financial crisis is not over yet, with investors worried about the effects of contagion to other countries.

Geopolitical factors will still dominate the global outlook. In addition to the factors we have already mentioned: NAFTA renegotiation, US-China trade war, and the Brazilian election, the global scenario ahead is complicated by the *Brexit* process. With around 200 days for the United Kingdom to leave the European Union, a summit will be held this week in Salzburg to discuss the proposal made by Theresa May's government, before announcing an extraordinary summit in November, where details could be announced in terms of a post-*Brexit* EU-UK agreement. The European negotiating leader, Michel Barnier, wants to reach a formal agreement within the next eight weeks, although important issues, such as Ireland's border are still at an *impasse*.

All in all, the risks going ahead remain tilted to the downside. The mounting risks stemming from the normalization of monetary policy in advanced economies -particularly in the US-, and it impact on the world economy, as evidenced by the recent turmoil in EM countries, continue to cloud the outlook ahead. Moreover, the rise of protectionism, as evidenced by the recent actions taken by the US, will continue to pressure global growth in the months to come. In the specific case for Mexico, it seems to be at a sweet spot, partially shielded from the global turmoil, given the recent deal reached between Mexico and the US. Nevertheless, the new administration faces important challenges such as strengthening macroeconomic fundamentals as well as improving the rule of law, among others.

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