IHS COUNTRY RISK

# Mexico – IHS Country Risk Insight

1 June 2017

IHSmarkit.com


*Summary*

- **Policymaking focuses on implementation of the 2013 and 2014 constitutional amendments, and macroeconomic policies to contain the negative external environment.**
- **President Peña Nieto continues his pro-business agenda that is focused on attracting foreign investment.**
- **Leading opposition candidate Lopez Obrador has promised to reverse Nieto's economic reforms if he wins the 2018 elections.**
- **The negative shock of possible changes in US trade policy has already affected monetary, tax and regulatory policies.**


## Risk scores

Risk Ratings

| | | |
|---|---|---|
| Overall | 2.0 | ELEVATED |
| Political | 2.6 | High |
| Economic | 1.2 | Moderate |
| Legal | 1.5 | Moderate |
| Tax | 1.9 | Elevated |
| Operational | 2.6 | High |
| Security | 2.3 | Elevated |

More Risk Ratings


| Low | Moderate | Elevated | High | Very high | Severe | Extreme |
|---|---|---|---|---|---|---|
| 0.1-0.7 | 0.8-1.5 | 1.6-2.3 | 2.4-3.1 | 3.2-4.3 | 4.4-6.4 | 6.5-10.0 |

Structure and calculations

Analysts determine scores based on qualitative guidance. Each score represents the average expected level of risk over the coming year, and each outlook represents the projected direction of risk trends after that 12-month period. Overall risk scores are calculated as equally weighted averages of the six aggregate categories – Political, Economic, Legal, Taxation, Operational and Security. Risk is scored on a 0.1-10 scale. The scale is logarithmic, with intervals of 0.1 magnitude. This range is split into seven bands, ranging from Low to Extreme risk.

IHS Markit

IHS™ COUNTRY RISK

## Business environment – strengths and weaknesses

| Strengths | Weaknesses |
|---|---|
| Mexico has abundant natural resources, a strong manufacturing base, a vast internal market, and good access to the United States. | Bureaucracy is slow and cumbersome, with corruption widespread nationwide, particularly at the state and local levels. |
| The government is pro-business and has updated the regulatory framework of the energy and telecoms sector to attract foreign investment. | About 81% of Mexico's exports are shipped to the US. The prospects of a detrimental NAFTA renegotiation and increased US protectionism increase the country's economic vulnerabilities. |
| In most economic activities, foreign investors may participate freely and are allowed to hold up to 100% of stocks in any company incorporated in Mexico. | The security environment has been deteriorating rapidly over the past year as warring drug cartels have fragmented, increasing homicides, extortion and cargo and hydrocarbon theft risks. |

## Country risk – overall statement

*President Enrique Peña Nieto's low approval rating is hurting the ruling party's electoral prospects, increasing the probability of a new party taking power via election in 2018. His low popularity is being driven by corruption scandals, sluggish economic growth, rising insecurity and unpopular budget cuts. Mexico has sound macroeconomic fundamentals and the government has passed important reforms to attract investment in the energy and telecommunications sector, but the prospects of a NAFTA renegotiation combined with increased US protectionism can potentially slow down growth and investment in Mexico. The fragmentation of drug cartels has intensified existent turf wars and increased homicides nationwide. Top violent hotspots include Colima, Guerrero, Jalisco, Michoacán, Tabasco, Tamaulipas, and Veracruz states.*

## Detailed analysis

**Policymaking focuses on implementation of 2013 and 2014 constitutional amendments, and implementation of macroeconomic policies to contain negative external environment.**

President Enrique Peña Nieto’s government has worked towards updating Mexico’s regulatory framework, with the aim of making the country more attractive to foreign investment. Since taking office in 2012, his government has opened the energy and telecoms sectors to private investment, reduced the regulatory burden on public-private partnerships and for the registration of businesses, and set up a new regulatory framework that will allow the creation of special economic zones, where foreign investors will have a favourable fiscal and regulatory framework in the south of Mexico. Policymaking is stable and foreign investors are almost always given time to understand regulatory changes. The president rarely rules by decree, and most legislation is passed with the consent and approval of Congress. President Nieto's administration is tightening fiscal policy to face the various challenges deriving from the plunge in international oil prices and declining oil revenues.

**President Peña Nieto continues his pro-business agenda that is focused on attracting foreign investment.**

President Enrique Peña Nieto is a member of the Institutional Revolutionary Party (Partido Revolucionario Institucional: PRI). He took office on 1 December 2012 and will remain in power until the next presidential election, which is in 2018. Peña Nieto is a pro-business politician whose main priority is to attract foreign investment. Shortly after taking office, he formed a political pact, which has ceased to exist, known as the Pact for Mexico with the opposition National Action Party (Partido Acción Nacional: PAN) and the Democratic Revolution Party (Partido de la Revolución Democrática: PRD). The pact allowed the passage of taxation, education, economic competition, electoral, energy, and telecoms reforms in 2013. The PRI currently controls 41% of the seats in the Lower House and 42% of the Senate on its own, although this rises to 52% and 48%, respectively, owing to its alliance with smaller parties. Despite the breakdown of the Pact for Mexico, the PRI is likely to continue to rely on the PAN, particularly at the Senate, for the passing of new legislation. This is positive for the business environment due to the PAN's pro-business stance and commitment to the promotion of investment. The PRD controls 11% of the Lower House seats with about 7% controlled by the National Regeneration Movement (Movimiento Regeneración Nacional: MORENA). Both parties represent left-wing views, but MORENA is more radical than the PRD. Nevertheless, both parties are fierce political rivals.

**Leading opposition candidate Lopez Obrador has promised to reverse Nieto's economic reforms if he wins the 2018 elections.**

MORENA is led by former presidential candidate Andrés Manuel López Obrador, who plans to run in the 2018 presidential election. Obrador has vowed to reverse the reforms introduced by Peña Nieto via referendum and increase the state's control over the economy if elected. The ability of the PRI to secure re-election (Peña Nieto cannot be elected) will depend on the government's ability to maintain economic growth in a context of low oil prices and economic uncertainty generated by a more protectionist United States (which wants to renegotiate NAFTA) as well as the ability to combat insecurity and reduce the perception of high corruption among the electorate. This includes successfully attracting FDI in the energy and telecoms sectors. The president's low-approval rating is hurting the PRI's electoral prospects. The PAN won 7 of the 12 governorships that were up for grabs in the June 2016 gubernatorial elections, including 3 that were won in strategic alliance with the PRD. The most significant electoral defeats for the PRI came from the states of Tamaulipas and Veracruz, which it lost for the first time in the party's history. The PRI will need to secure the governorship in Estado de Mexico, the country's largest state, in an election currently scheduled for June 2017, to re-energise its presidential election prospects in 2018.

**The negative shock of possible changes in US trade policy has already affected monetary, tax and regulatory policies.**

Financial markets volatility, driven by the uncertainty of future US policy, will affect the real economy through various channels: higher interest rates that discourage investment and consumption; delayed or cancelled investment owing to the aforementioned uncertainty, and lower trade if NAFTA is actually review or terminated. The sharp depreciation of the Mexican peso in the aftermath of the US election has pushed the Central Bank of Mexico (Banxico) to further tighten monetary policy and increase the policy rate from 4.75% to 6.75% in only five months. Inflation will accelerate as the more expensive US dollar filters into domestic prices of imported goods. Banxico will further increase rates when the US Federal Reserve (Fed) proceeds with the normalization of its monetary policy and increases the targeted Fed funds rate. The recent correction (appreciation) of the peso is not enough to avoid pass-through effects of a higher exchange rate on domestic prices. Compared with May 2015, the peso is still 20% weaker. Mexican authorities are committed to a high quality framework, which under current conditions, requires fiscal tightening and also a restrictive monetary policy, despite inflation being relatively low. On the fiscal front, for the past two years, the government has promised to lower the deficit but has not delivered great results. In August 2016, ratings agency Standard & Poor's (S&P) put Mexico's sovereign rating on a negative outlook for a possible downgrade, as public debt is rapidly increasing to levels considered unsustainable by S&P. For 2017, additional budget cuts have been announced and the government expects to reduce the overall deficit and to post a primary surplus, which is the fiscal balance before accounting for interest payments on public debt.

 