Macro scenario - Mexico

June 10, 2024

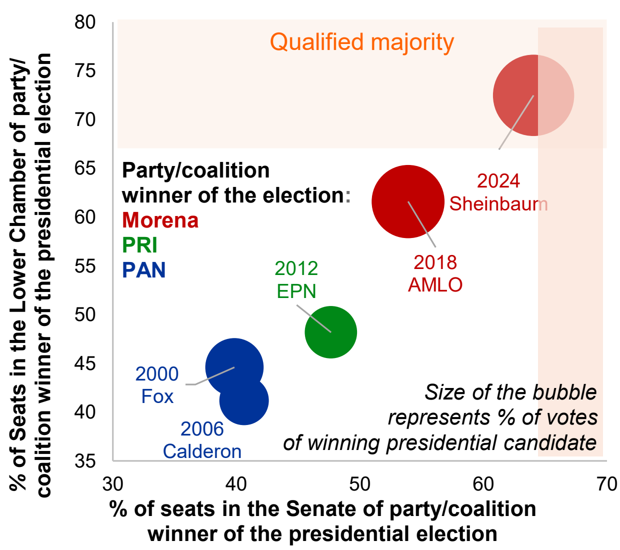
Sheinbaum's landslide

- Mexico will have its first female president after the ruling-party candidate, Claudia Sheinbaum, defeated the opposition-coalition candidate, Xochitl Galvez, in the presidential election by 32 percentage points. According to the latest estimates from the Ministry of Interior, the governing coalition also secured a qualified majority in the Lower Chamber and is close to one in the Senate, increasing the odds of major institutional changes (constitutional amendments).
- The new president is likely to maintain the direction of the current administration's economic policy. While the new administration will have the opportunity to reap the benefits from the nearshoring trend, it will also face challenges that include a sharp fiscal consolidation in 2025 and the review of the USMCA trade deal in mid-2026.
- According to the minutes of the latest monetary policy meeting, most board members are open to a rate cut at the next meeting. Despite recent market turmoil, our base-case scenario is a 25-bp policy rate cut at the June 27 meeting, with the policy rate ending the year at 10.75%. In total, we expect four 25-bp rate cuts followed by a pause for the remainder of 2024, taking our YE24 policy rate estimate to 10.00%. However, our rate scenario has an upside risk dependent on the persistence of uncertainty from the new political scenario.

Higher odds of radical institutional changes

Claudia Sheinbaum, the governing coalition candidate, was elected as the first female president in Mexico's history, with significant popular support. Sheinbaum won the election with 59.7% of the votes (35.9 million), above poll estimates and President AMLO's support (53.2% or 30 million votes). According to the latest estimates from the Ministry of Interior, the governing coalition achieved a qualified majority (two-thirds) in the Lower Chamber, with 74% of the seats, but not in the Senate, where it now has 65% of the seats – just two seats shy of the qualified majority, increasing the odds of approval of constitutional amendments. The electoral institute is expected to publish the final distribution of seats (considering the proportional election scheme) around mid-August, but it shouldn't change significantly from the aforementioned estimates. In 2018, AMLO brought a few opposition lawmakers over to his party, giving the ruling coalition a qualified majority in the Lower Chamber and coming very close to it in the Senate. We believe that Sheinbaum could use a similar strategy to achieve a qualified majority in both chambers. Besides the potential amendments to the constitution, the governing coalition will be able to easily pass secondary legislation reforms and budget proposals. Note that the very favorable congressional results for Sheinbaum's party and coalition were not priced in by analysts or the market, resulting in a negative reaction in domestic financial assets. The President-elect will take office on October 1 and the newly elected Congress will start on September 1.

Landslide victory



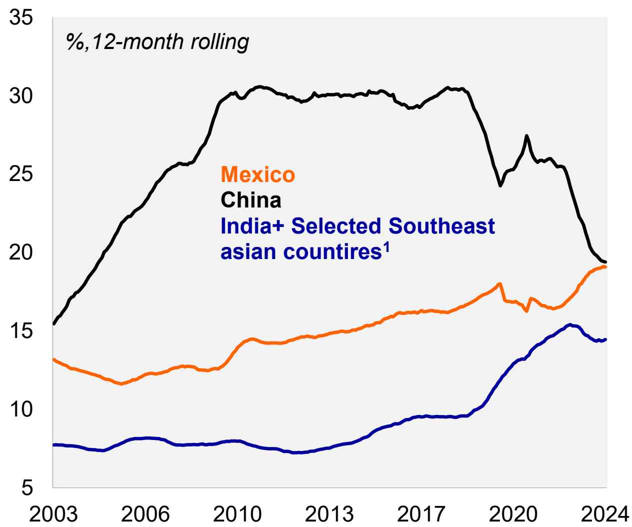
Source: INE, Itaú.

The new administration is likely to maintain the current economic policy direction. Macroeconomic stability will continue to be a key focus of the incoming administration, and fiscal expenditure in AMLO's social programs will not change. Note that Sheinbaum has emphasized that a fiscal reform is not necessary (at least in the short term), given that digitalization and a reduction in the bureaucracy surrounding tax payments should increase fiscal revenues. The minimum wage will continue to rise, but at a slower pace than the current administration (11% vs. 20%). AMLO's legacy reforms – currently stuck in Congress – are also likely to be supported by the President-elect (for details, see our report here). We note some of them imply radical institutional changes, such as the judicial reform which would allow for the election of judges by popular vote, which have resulted in a further negative market reaction considering the ruling party & coalition are more likely to garner support to approve them. On the energy sector, state oil company PEMEX is likely to continue to benefit from government support. While Sheinbaum seems open to private participation in the electricity sector (including renewable energy sources), the new administration would like for the public sector to maintain a market share of more than 50%.

However, the incoming administration will face a challenging fiscal consolidation in 2025. According to the preliminary economic policy guidelines, the new administration should reduce the nominal fiscal deficit from 5.0% of GDP in 2024 to 2.5% in 2025, keeping the debt to GDP ratio at 50.2%. The primary fiscal balance should improve from a deficit of 1.4% of GDP to a surplus of 0.9% of GDP. While lower interest rates will contribute to the fiscal consolidation next year, primary expenditure must be reduced by 2.7% of GDP considering also MoF's expectations of lower fiscal revenues and rigid fiscal expenditure, pressured by social programs. The current administration will prepare the 2025 budget for delivery to the new Congress by September 8. However, a transition team led by the President-elect will likely participate in the design and size of the budget. Of course, the fact that current minister of finance will retain his post in the new administration should help the transition. Still, the fiscal consolidation will also be challenged by the drag on activity caused by the transition pains during the first year of a new administration, although the effect is likely to be smoother this time, given political continuity.

On a positive note, Sheinbaum's administration will have the opportunity to reap the benefits from the nearshoring trend. Mexico's share in U.S. manufacturing imports has increased recently, while China's has declined, suggesting that a nearshoring trend is indeed in place. We estimate that a 1-pp increase in the share of manufacturing-related U.S. imports results in a 1.2% increase in GDP growth in Mexico, on average and all else being equal. According to our sensitivity analysis, Mexico's GDP growth (currently at ~2.0%) could rise to 2.6%-3.0% if the nearshoring-driven benefits materialize in the next few years (for details on the our estimates, see our report here). However, trade friction with the U.S. could limit these benefits. The presence of China in Mexico's trade flows to the U.S. and domestic investment could become a contentious topic of discussion in the upcoming U.S. elections and in the review of the trade deal in July 2026.

Share in U.S. manufacturing related imports by region



[1] Cambodia, Indonesia, Malaysia, Philippines, Thailand, Vietnam.

Source: U.S. Census.

Another rate cut is likely

The minutes of the unanimous monetary policy decision to keep the policy rate unchanged at 11.00% suggest that most board members are open to a rate cut at the next meeting. One board member noted that the current environment, while still challenging, is less adverse than in 2022 and early 2023, and the country is therefore entering a new stage that will allow for an assessment of potential policy rate cuts, depending on the evolution of the inflation outlook. Another member highlighted that the inflation gap is significantly smaller than the level of tightness, and that under appropriate circumstances, it may be appropriate to adjust the restrictive stance going forward. A third member stated that an adjustment to the policy rate at the next meeting may be considered if the intermediate inflation targets are met, and that continuing the rate adjustments does not imply abandoning a restrictive stance. Overall, it seems that a rate cut at the next meeting is likely, despite recent market turmoil as long as inflation is broadly in line with the updated inflation forecast. However, our rate scenario has an upside risk dependent on the persistence of uncertainty from the new political scenario.

In this context, the available inflation figures as yet released in 2Q24 seem consistent with the central bank's inflation forecasts. Annual average headline and core inflation for April and May came in at 4.67% and 4.29%, respectively, which compares with Banxico's 2Q24 headline and core inflation forecasts of 4.6% and 4.3%, respectively. Note that headline inflation has been pressured by volatile non-core agricultural prices, which began to ease during the second half of May and will likely continue to decelerate in June, suggesting that 2Q24 headline inflation is likely to be in line with Banxico's forecast.

Stable macro scenario

Our GDP growth forecast for this year stands at 2.3%. After a soft 1Q24 GDP, we expect activity to recover in 2Q24, supported by an expansionary fiscal stance. However, activity is likely to be softer in 2H24, as fiscal expenditure drops after the elections and the government transitions from the current administration to the next. That said, resilient activity in the U.S. is supportive for Mexico's growth outlook.

Our end-of-year currency forecast is at 17.9 pesos to the U.S. dollar. However, our call has an upside risk dependent on the persistence of uncertainty from the new political landscape.

We expect the Central Bank of Mexico to resume its easing cycle with a 25-bp rate cut at the next meeting, scheduled for June 27, despite recent market turmoil. Further rate cuts are likely this year, but with another pause given the lingering risks to inflation (we forecast an inflation rate of 4.3% for YE24). In total, we expect four 25-bp rate cuts followed by a pause for the remainder of 2024, taking our year-end policy rate estimate to 10.00%. Similar to our currency call, our rate scenario has an upside risk also dependent on the persistence of uncertainty from the new political scenario.

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Mexico | Forecast

	2019	2020	2021	2022	2023	2024F		2025F	
						Current	Previous	Current	Previous
Economic Activity									
Real GDP growth - %	-0.4	-8.4	6.0	3.7	3.2	**2.3**	2.3	**1.9**	1.9
Nominal GDP - USD bn	1,298	1,129	1,318	1,463	1,794	**2,029**	2,035	**2,010**	2,016
Population (millions)	125.6	127.7	129.0	130.1	131.2	**132.3**	132.3	**133.4**	133.4
Per Capita GDP - USD	10,335	8,844	10,218	11,241	13,672	**15,334**	15,382	**15,076**	15,120
Unemployment Rate - year avg	3.5	4.4	4.1	3.3	2.8	**2.7**	2.7	**2.7**	2.7
Inflation									
CPI - %	2.8	3.2	7.4	7.8	4.7	**4.3**	4.3	**3.9**	3.9
Interest Rate									
Monetary Policy Rate - eop - %	7.25	4.25	5.50	10.50	11.25	**10.00**	10.00	**8.00**	8.00
Balance of Payments									
MXN / USD - eop	18.9	19.9	20.5	19.5	17.0	**17.9**	17.9	**18.9**	18.9
Trade Balance - USD bn	5.4	34.2	-10.8	-26.9	-5.5	**-14.0**	-14.0	**-17.0**	-17.0
Current Account - % GDP	-0.3	2.4	-0.3	-1.2	-0.3	**-0.6**	-0.6	**-0.7**	-0.7
Foreign Direct Investment - % GDP	2.3	2.8	2.7	2.7	1.7	**3.0**	3.0	**3.5**	3.5
International Reserves - USD bn	180.9	195.7	202.4	199.1	212.8	**220.0**	210.0	**225.0**	215.0
Public Finances									
Nominal Balance - % GDP	-1.6	-2.8	-2.8	-3.2	-3.3	**-5.0**	-5.0	**-2.5**	-2.5
Primary Balance - % GDP	1.1	0.1	-0.3	-0.4	-0.1	**-1.4**	-1.4	**0.9**	0.9
Net Public Debt - % GDP	43.9	49.9	48.9	47.6	46.8	**49.9**	49.9	**50.3**	50.3

Source: IMF, Bloomberg, INEGI, Banxico, Haver and Itaú

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