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Economic Insights:
Is Mexico fixing what is not broken?

Key takeaways

- Recent actions by the new Mexican president are creating economic uncertainty.
- Since he took office, business confidence has deteriorated and growth expectations are trending downwards.
- We believe that Mexico could benefit from a more pragmatic approach that addresses social concerns but does not radically depart from existing economic policies.

About Economic Insights
Analysis of key economic developments and their implications for the global re/insurance industry.

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In a nutshell

Mexico's new president is considering a number of policy changes that could have long-lasting effects on economic growth and the Mexican insurance industry. For now, investors appear to be more wary than hopeful. We believe Mexico would ultimately benefit from maintaining the economic policies that created stability and improved the nation's competitiveness.

Andrés Manuel López Obrador (AMLO) was sworn in as Mexico's president on 1 December for a six year term. He and his coalition now also control the Congress and are well-positioned to advance his left-leaning populist agenda. Two weeks in, he has already taken some unexpected decisions. Markets are now pricing in the perceived risk, which we believe is justified.

Despite facing significant external adversity, the Mexican economy has been quite resilient since 2014. The downturn in commodity prices, the gradual tightening of monetary policy by the Federal Reserve in the US, the election of Donald Trump, and the lengthy and complex renegotiation of the North American Free Trade Agreement (NAFTA) have all hampered Mexico's growth prospects. Yet, the economy still achieved an average real GDP growth rate of 2.7% and an average inflation rate of 4.0% over the past five years. This is far better than other countries in the region that faced fewer headwinds.

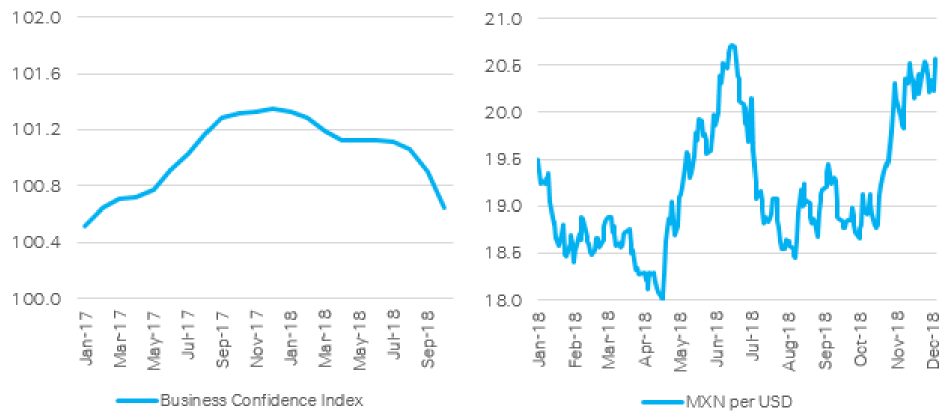
During the presidential transition phase, investors had expected a shift from the market-friendly principles that prevailed during Enrique Peña Nieto's presidency (from 2012 to 2018) to a more socially-conscious AMLO administration. While on the campaign trail, AMLO promised to address the social ills that affect Mexico (eg crime, corruption and inequality) and maintain the economic policies that had created macroeconomic stability and helped increase competitiveness.[1]

Although there had been some positive developments early on, like the appointment of a well-respected independent economist to the central bank's board of governors and the promise to honour the revisited NAFTA terms, other developments are giving investors reason to believe AMLO is about to embark on a different course. For example, he has wasted no time in using referendums to establish support for his policy decisions. Following the results of a questionable public poll in late October, the incoming government announced plans to scrap a USD 13 billion airport project in Mexico City that is already one-third complete. AMLO recently made a second appointment to the central bank's board of governors - his economic adviser during the campaign trail – a move that raised concerns about how independent the appointee will be.

[1] Mexico ranked 61st in the Global Competitiveness Index 2014-2015 edition. In the 2017-18 edition, it ranked 51st.

Business confidence has been dipping since the elections (Figure 1). The peso is now trading near its all-time low, and real GDP growth for 2019 has been revised downward to 2.0%, from 2.2% in July.[2] The weaker peso could pass through higher import prices to consumer price inflation and prompt further policy rate hikes by the central bank at a time when interest rates are already curbing domestic credit.

Figure 1:
Business confidence index and foreign exchange rate



Source: OECD, Banxico, Swiss Re Institute

The Mexican insurance industry is closely monitoring AMLO's policy proposals. As part of his austerity plan, he has pledged to strip public servants of private life insurance coverage. As a result, life and health insurers could lose up to USD 250 million a year in premiums. If his proposal to reverse the privatisation of the Mexican oil sector is accepted, it could mean the loss of significant business opportunities in the non-life sector and lessen the demand for engineering and surety insurance products.

We believe that some of AMLO's proposals like the rethinking of public spending to reduce bureaucratic inefficiency could support Mexico's long-term economic growth and resilience. In our view, increasing access to credit for small businesses and farmers can help reduce income inequality – as it democratises the access to productive opportunities. For this reason, we believe that the Mexican economy would be better off if AMLO is more measured in his approach without overhauling the core economic policies that have prevailed in recent decades.

[2] Central bank's macroeconomic expectations surveys from July 2nd and December 3rd.