SYNCICAP ASSET MANAGEMENT

MARKET INSIGHTS

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Mexico: El Dorado to come or temporary prosperity?

Xinghang LI
Managing Director
SYNCICAP AM

Pierre-Emmanuel HUBERT
Emerging Market Fund Manager
SYNCICAP AM

Next month, Mexico will hold its presidential and legislative elections. Claudia Sheinbaum, currently leading the polls, is well placed to become the country's first female president. Nevertheless, the composition of the Mexican Congress remains uncertain and could be a source of imbalance.

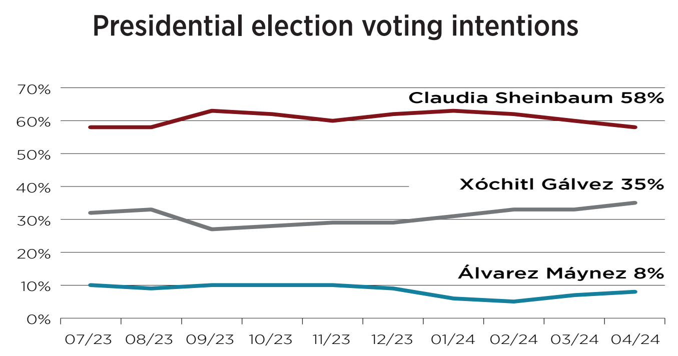
In recent years, Mexico has distinguished itself by its economic dynamism. A key player in the United States-Mexico-Canada Free Trade Agreement (USMCA), the country is benefiting from the growing phenomenon of «nearshoring». This practice, in which companies, particularly American ones, relocate their production close to their place of consumption, has recently strengthened Mexico's position as an essential hub for international trade and industrial production.

With a population of over 130 million, Mexico also boasts a large and diversified economy valued at over 1,800 billion dollars. Nevertheless, the country faces significant structural challenges. Corruption, insecurity and a lack of respect for the rule of law are severely hampering the country's long-term growth potential. To maintain its economic trajectory, strengthen its institutional stability and increase its attractiveness as an investment destination, the next government will need to effectively tackle these issues.

PRESIDENTIAL AND LEGISLATIVE ELECTIONS

On June 2, 2024, Mexico will hold its presidential and legislative elections. Claudia Sheinbaum, maintaining a strong lead with 58% of voting intentions in the latest polls, could become the country's first female president. As the candidate of the MORENA party, founded by current president Andrés Manuel López Obrador (AMLO), Sheinbaum is seen as a continuity candidate. However, although Claudia Sheinbaum appears more moderate than the current president, MORENA's populist and left-wing nature could be a source of imbalance. AMLO's recently proposed constitutional reforms, particularly those affecting the independence of the judiciary, threaten institutional stability. For the moment, voting intentions by party indicate that the MORENA-PT-PVEM coalition will only have a simple majority in Congress, which alleviates the risks of major constitutional reforms requiring a two-thirds supermajority. However, the inability of the opposition parties to unite could leave the field wide open for controversial reforms, which could increase the uncertainties surrounding Mexico's future governance.

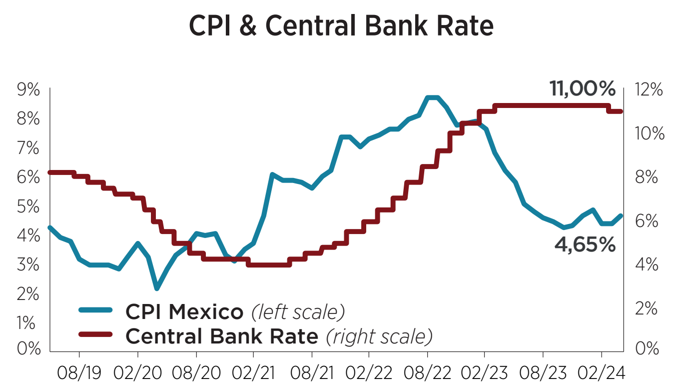
Claudia Sheinbaum *Xóchitl Gálvez* *Jorge Álvarez Máynez*



Sources: Oraculus, Syncicap AM, April 2024

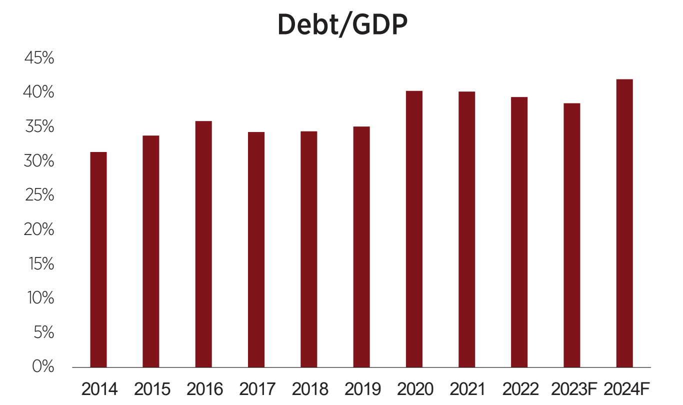
PARTICULAR VIGILANCE

In this period of transition, the financial markets will be paying close attention to the country's future monetary and fiscal policies. A major asset is the independence of the central bank, which has reinforced its credibility through its relatively skillful management of post-Covid inflation. The Mexican Central Bank took proactive steps by raising its key rate from 4% in June 2021 to 11.25% in March 2023. These adjustments were essential to control rising inflation, currently at 4.65%, and to strengthen the Mexican peso, whose value has risen by over 35% against the US dollar since April 2020.



Sources: Bloomberg, Syncicap AM, April 2024

On the fiscal front, Mexico seems to be departing from its traditional budgetary rigor. The country's deficit is expected to be around 6% of GDP this year, a situation fueled in part by substantial spending on infrastructure, the economic effectiveness of which is open to debate. For the time being, Mexico's public debt (representing around 42% of GDP) remains moderate, but the absence of concrete tax reform projects is raising questions among investors as to the country's ability to reduce its budget deficit in the long term. It will therefore be important for the next administration to rapidly implement a viable fiscal strategy, and optimize infrastructure spending to maintain Mexico's attractiveness as an investment destination. Liquidity risk remains low, however, as the country benefits from abundant foreign exchange reserves - around $185 billion, or more than 10% of GDP - and the current account deficit has fallen sharply in recent years, owing in particular to substantial flows of "remesas" (money sent by the Mexican diaspora to their families), which recently reached over $63 billion, or 3.5% of GDP.



Sources: Moody's, Syncicap AM, April 2024

Bear in mind: the US elections in November could also be a source of imbalance, particularly in the context of a relationship already strained by issues of immigration and illegal border crossings. Although trade relations appear stable under the USMCA agreement, and despite an American strategic interest in maintaining the status quo to diversify its supply chains away from Asia, the possible re-election of Donald Trump could introduce a protectionist dimension. In particular, the USMCA is due for review in 2026, and the next US administration could consider using trade levers to extract concessions on immigration issues. Here too, Mexico will have to be diplomatic and tactful to preserve stability and a legislative framework favorable to nearshoring.

As far as Mexican financial assets are concerned, the current risk premium appears attractive. In particular, peso-denominated sovereign bonds offer an average yield of around 10%, while inflation is expected to be around 3.2% next year. If the political context remains stable, with no major constitutional reforms, Mexican debt should continue to perform well (after an already significant 22% rise against the euro in 2023). The currency, meanwhile, should remain stable given high yields (both relative and absolute), especially if new foreign direct investment materializes following the elections. Our emerging debt strategies currently overweight the country, with exposure of around 11%.

www.syncicap.com
2801-02, 28/F, Man Yee Building, 68 Des Voeux Road Central, Central, Hong Kong • Tel.: +852 3842 8204

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