Mexican Growth To Slow In 2018, Rebound In 2019

27 February 2018
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The chances of reaching an easy deal got much harder in the wake of Mexico's threat to pull out of the NAFTA negotiations.

NAFTA Deadline Draws Near, No Deal In Sight

Mexico's threat to exit the negotiations may have thrown a wrench into the works but has not significantly altered analysts expectations. Analysts at Height Securities see the chances of a smooth resolution slowly eroding but do not think a new deal is impossible. The problem, as the March deadline draws near there is still no deal in sight.

Height Securities

"While we do not think that this meaningfully changes Trump's plan of attack at this time, we do feel that this indicates greater difficulty in reaching some comprehensive agreement in further negotiations. We will be carefully watching Trump's comments at the World Economic Forum in Davos, and we expect his tone there to provide the most timely update to his thinking."

President Trump has commented on the negotiations but not in any constructive or concrete manner, leaving actual talks to chief negotiator Robert Lighthizer. Trump is anxious to get the deal done by the March deadline although he says he's "flexible" on the time line, taking note of Mexico's upcoming elections scheduled for July 1st. His most notable comments pertain to the wall and how, if he gets his way with NAFTA, Mexico will pay for its construction indirectly through trade agreements.

"They can pay for it indirectly through NAFTA... We make a good deal on NAFTA, and, say, I'm going to take a small percentage of that money and it's going toward the wall. Guess what? Mexico's paying."

Meanwhile, In Mexico

Meanwhile, In Mexico, economic expansion continues as reforms take hold. The latest data shows inflation rising at a whopping 6.6% in 2017 due to the liberalization of gasoline prices at the first of the year. The liberalization was a systematic phase-out of government set gasoline prices.

Mexico's government had, for decades, set caps on prices that are now allowed to float on the open market. The change has been hailed as the most tangible of reforms since the end to the 75-year state run monopoly of the oil industry. The benefits of course are that Pemex,

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Mexico's government [illegible] ene[illegible] company, would be able to recoup the true cost of its sales as well as leverage its holdings through foreign investment.

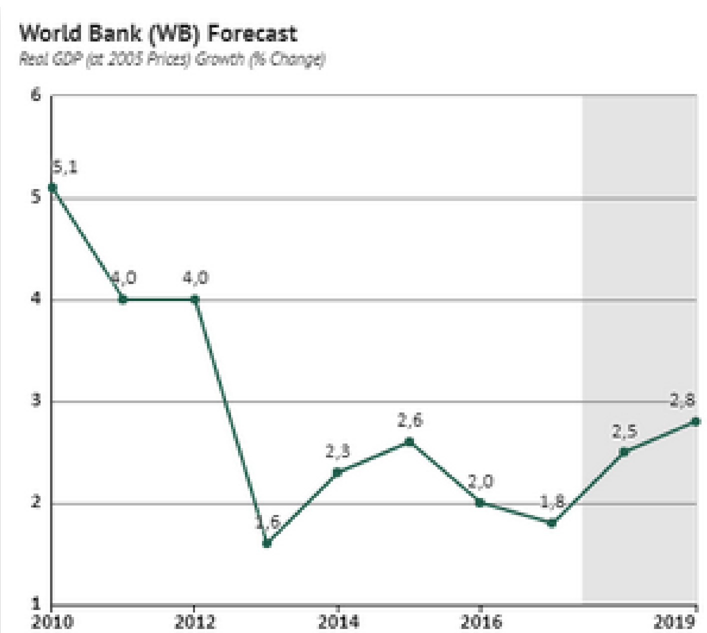
The Bank of Mexico expects the pace of inflation to tame to near 3% in the coming year as gas prices normalize. The risk is an outlook that has deteriorated to the point another interest rate hike is expected, and possibly very soon. Some say the next hike could come as early as the February 8 meeting if signs of cooling do not emerge.

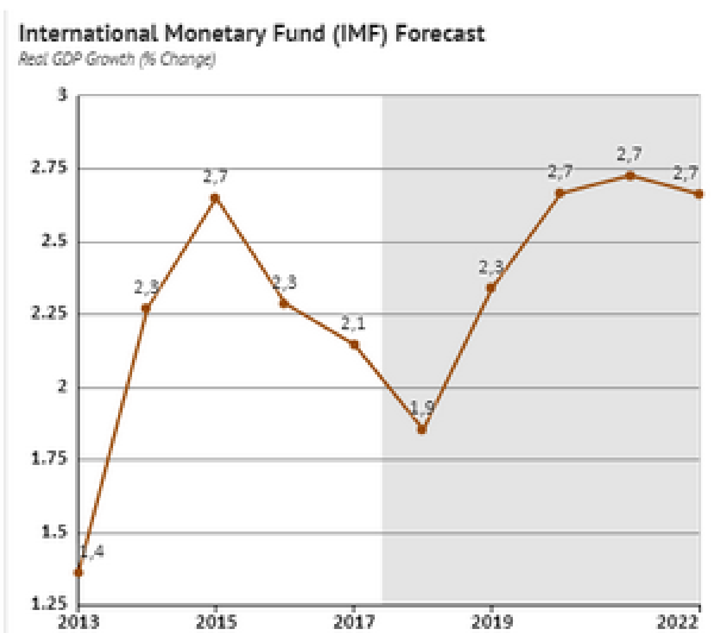
The peso has been under pressure from rising inflation and recently hit a long term low versus the dollar. The Bank of Mexico sold an additional $500 million of foreign exchange hedges in December in order to ease that pressure and has only partially succeeded. The USD/MXF pair has receded from the December peak but is still well above lows set last year. The downturn has recently begun to pick up momentum as US rate hike outlook subsides and looks like it will move down to retest the aforementioned lows.

Looking forward Mexican GDP growth has been decelerating in recent years and is expected to dip below 2% in 2018. This is however expected to be the bottom of a trough as growth re-accelerates in 2019 and beyond. Expansion could easily be triggered by a successful renegotiation of NAFTA, or by increased trade with other nations, an avenue for growth the country has also been working on.

Elections On The Horizon

Mexico hopes to complete the NAFTA renegotiation before next summer's elections. Incumbent president Enrique Pena Nieto hopes a successful deal and victory for Mexico will help his party win reelection. The problem for them is public perception;





Source; Knoema

officials throughout the current government and ruling party are suspected of corruption, casting a shadow of doubt on their ability to rule effectively. The latest to be uncovered is a former party treasurer alleged to run a scheme funneling public money to political campaigns.

The opposition, left-leaning Andres Manual Lopez Labrador, has gained favor in response to the growing scandal and is putting up good numbers in the polls. He currently leads a 6 man race with more than 30% responding positively when asked who they would vote for right now. His platform is a fight against inequality and corruption, a message that rings true in a country plagued by both. The risk to Mexico's market is the possibility he would undue energy reforms that are helping boost the economy.

Energy Reform Working

The privatization of the sector has allowed business to expand and investment money to enter the country from abroad. During the 2017 fiscal year the National Hydrocarbons Commission held four rounds of auctions for exploration and production of hydrocarbons. In addition Pemex awarded two more farm-outs to international companies bringing the total under their umbrella to three. Total investments from the auctions and farm-outs are more than $58 billion with further auctions expected in the coming years.

Fund managers at The Mexico Fund say energy reforms are working for the country although they choose to limit exposure at this time. Instead they've focused on infrastructure, financials and plays on the consumer in light of expected expansion across North America.

The Mexico Fund (MXF) is a closed end fund trading on the New York Stock Exchange. It is focused on Mexico's largest and best established companies and pays a quarterly dividend yielding about 3.2% at current market prices. The fund is trading at an 8 year high discount of -12.5% and offering value for investors seeking to gain exposure to this emerging market.