Populism Arrives in Mexico

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Although his term of office just began on December 1st, President-Elect Andres Manuel Lopez Obrador, and his brand of populism, has already begun to have a major impact on the Mexican economy. Clients invested in peso-denominated assets or in Mexican equities may have reasons to worry.

Mexico's president clearly wanted to send a message that he answered only to the Mexican people and not the financial markets by recently scrapping the replacement to Mexico City's ageing Benito Juarez International Airport, Latin-America's busiest. The new airport was to be the largest public infrastructure project in Mexico in a century, with total construction costs of US$13.3 billion. Construction of Nuevo Aeropuerto Internacional de la Cuidad de Mexico (NAICM) commenced in 2016 and the airport was scheduled to open in 2020.

The poorly organized referendum which effectively canceled the project had an immediate impact on the Mexican markets, as investors began to realize there has been a dramatic change in the leadership of the country. The result of the recent election has given Obrador the strongest presidential mandate in a generation. He controls both houses of congress and can immediately influence the Bank of Mexico, where two seats have opened up on the five member board, and the Supreme Court, where two vacancies will become available early next year.

The implications of Obrador's policy platform are already becoming evident. The peso has plummeted and Mexican Bond rates are at decade highs. Credit default swaps are rising sharply and the peso is under pressure. Obrador has promised balanced budgets while at the same time intending to dramatically increase social programs. Plunging oil prices and US Congressional concerns about the USMCA trade agreement have the potential to exacerbate the weakness.

We believe investors that have significant exposure to Mexican markets should consider shifting assets into the US and other markets where the risks are considerably lower.

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