

AMLO's Presidency: Shifting From Rhetoric To Policy

Thursday 19 July 2018



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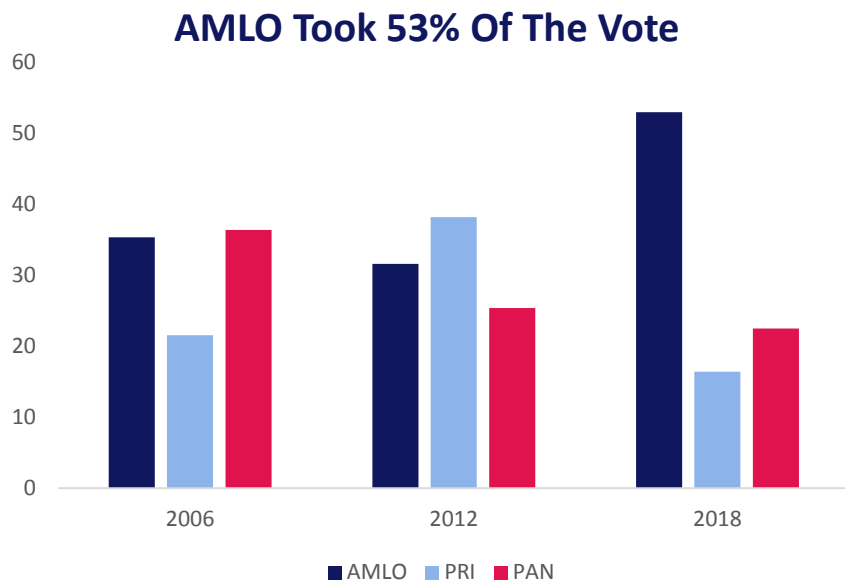
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Politics: AMLO Victory A Watershed Moment

- **Mexican politics will shift decisively to the left** for the first time in decades following the landslide presidential victory of leftist populist Andrés Manuel López Obrador (AMLO)
- **Dissatisfaction with the status quo** amid rising violence and distrust of 'established' politicians drove support for AMLO
- **Sweeping victory garnered majorities for his coalition** in both houses of Congress, but fell short of the two-thirds required to make constitutional changes



**In 2006 and 2012 AMLO ran under the PRD. Presidential Election Results, % of Total (LHC) and By Geographic Entity (RHC) Source: PREP, BMI*

Politics: Projecting Pragmatism In AMLO's Cabinet

- **AMLO's unorthodox economic policy mix is in stark contrast** to Mexico's traditional pro-business stance
- Investor fears that he will reverse key economic policies are **likely overblown**
- AMLO likely understands that abandoning trade agreements and re-inserting the federal government into the energy sector would **severely impede economic activity**, designated cabinet appointees suggesting as much in recent weeks:

Secretary of Economy: Graciela Marquez Colin

- Harvard-trained economist, with specialisations including fiscal policy and economic development
- "We recognize the importance that Mexico needs to take advantage of a global economy and foreign investors are fundamental."

Secretary of Finance: Carlos Manuel Urzúa Macías

- Oversaw responsible fiscal policies as Finance Minister of DF during AMLO's first term (2000-2003)
- "There are three principle points that we talk to investors about and always tell them: we will absolutely respect the autonomy of the central bank, a free floating exchange rate, and we're going to have very healthy finances from the first year in office"

Secretary of Energy: Rocío Nahle García

- Petrochemical engineer with experience at Pemex and Morena leader in Congress
- "We need to give confidence and certainty to all serious investors that have come to Mexico.. and if they have invested in the country and have done it the right way, without any influence peddling, they have nothing to fear."

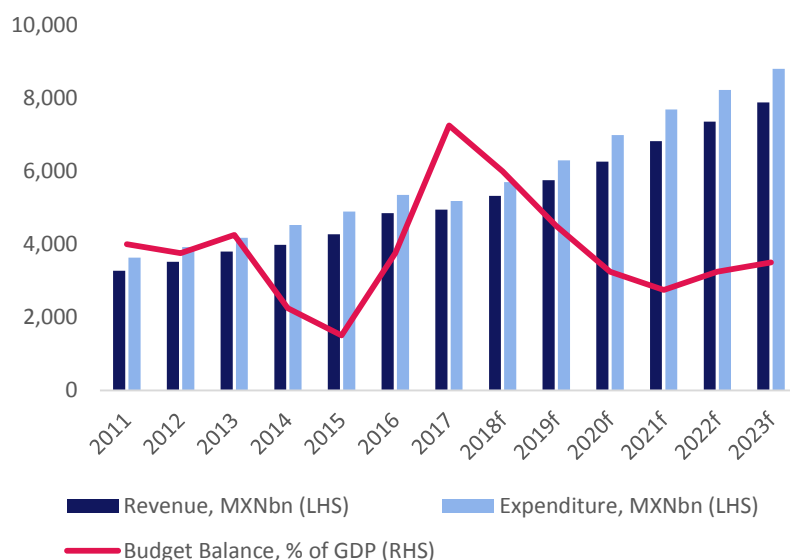
NAFTA Trade Negotiator: Jesus Seade

- Oxford-trained economist and ex official of the WTO, IMF and World Bank
- "We are basically supporting what Mexico has been putting forward [in regards to NAFTA].. and we will be more than happy to explore, proactively, ways to energize the negotiation."

Economics: Public Spending Set To Ramp Up

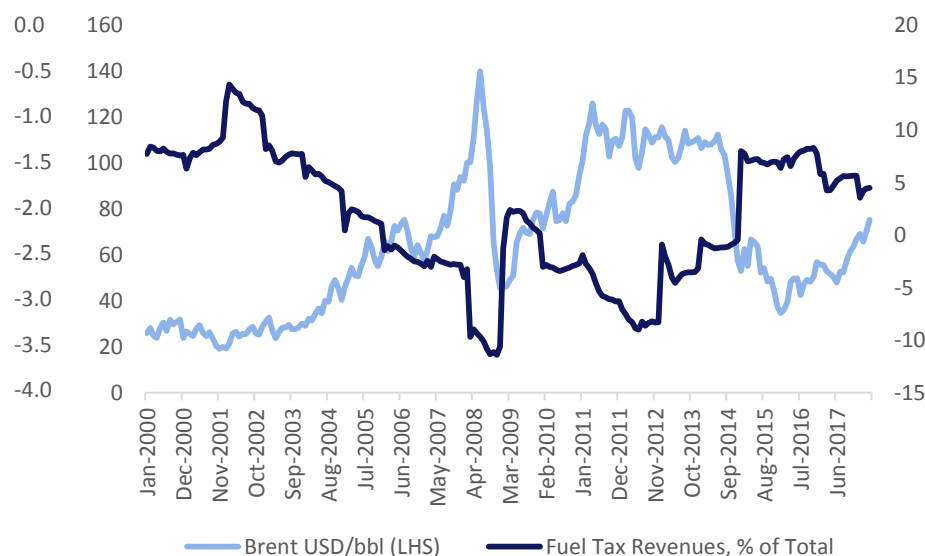
- **AMLO will likely increase spending** on social programmes and infrastructure in the coming years, driving a widening of the budget deficit from 2019
- **Will walk back some of his more radical propositions**, such as doubling of retirement benefits
- **The fiscal deficit will narrow gradually from 2022**, but highlight risks to our outlook should AMLO carry through with some of his more radical policy proposals

AMLO To Widen, Not Blow Up Budget Deficit



Fiscal Balance. f = BMI forecast. Source: Banxico, BMI

Fuel Price Support Would Be Costly

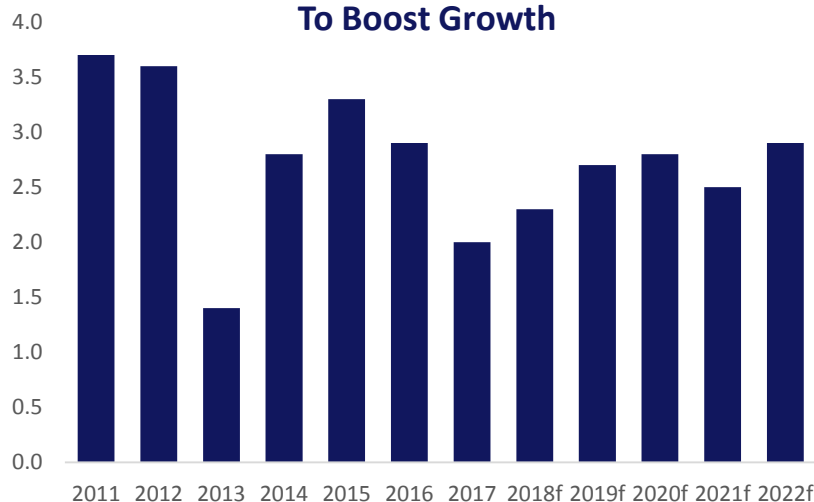


Oil Price & Diesel & Gas IEPS Revenues, % of Total Budgetary Revenues. Source: BCRP, Bloomberg, BMI

Economics: Growth To Accelerate Despite Uncertainty

- **Real GDP growth will accelerate in 2018 and 2019**, driven by rising household consumption, investment into the energy sector, and higher public spending. However, uncertainty will weigh on in near term investment
- **We note downside risks to investor confidence and growth** should AMLO push through with some of his more radical proposals around labour and energy policy
- **NAFTA renegotiations remain a major risk** to the Mexican economy. AMLO's team will likely tow the line of the outgoing administration, but we note potential complications around agriculture policy

**Energy Investment And Public Spending
To Boost Growth**



Real GDP, % y-o-y. f = BMI forecast. Source: Banxico, BMI

Investors Coming To Terms With AMLO

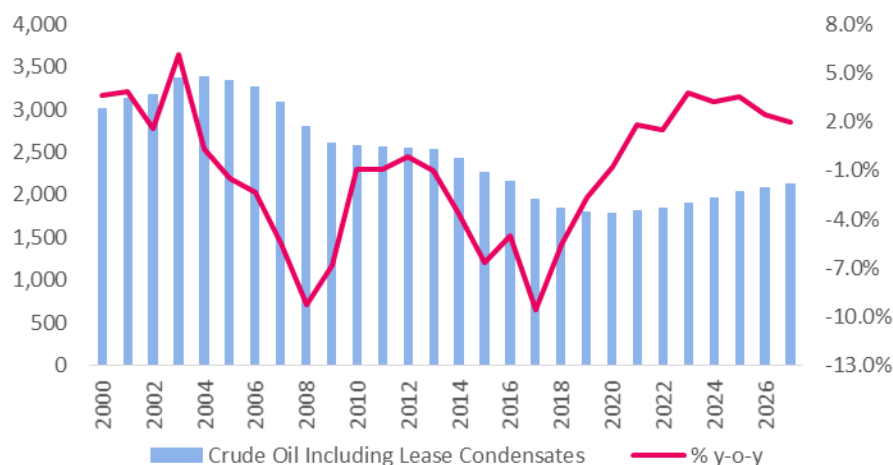


Exchange Rate, MXN/USD. Source: Bloomberg, BMI

Oil & Gas: Liberalisation Facing Fewer Risks

- **AMLO has become more supportive of reforms**, pledging to review contracts for transparency rather than revoke the process entirely
- **Active upstream contracts are unlikely to be reneged on**, potential fiscal and upstream benefits will encourage pragmatism; near-term forecast facing limited downside risk
- **Future rounds under greater threat**; likely reduction in size and frequency, increase in government take and local content requirements, removal of Pemex farmouts
- **Rising geopolitical and financial risks** also threaten private investment, long-term growth

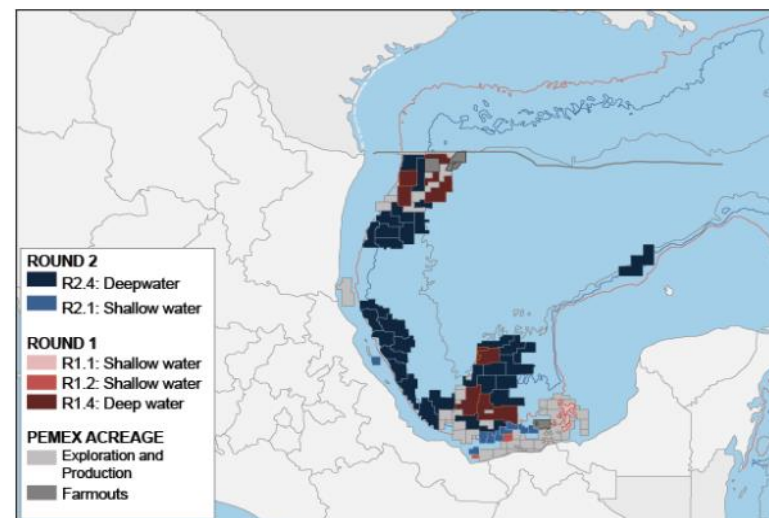
Production Turnaround Is Nearing



Note: 2018-2027 = BMI forecast. Source: SENER, BMI

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Offshore Blocks Offer Upside

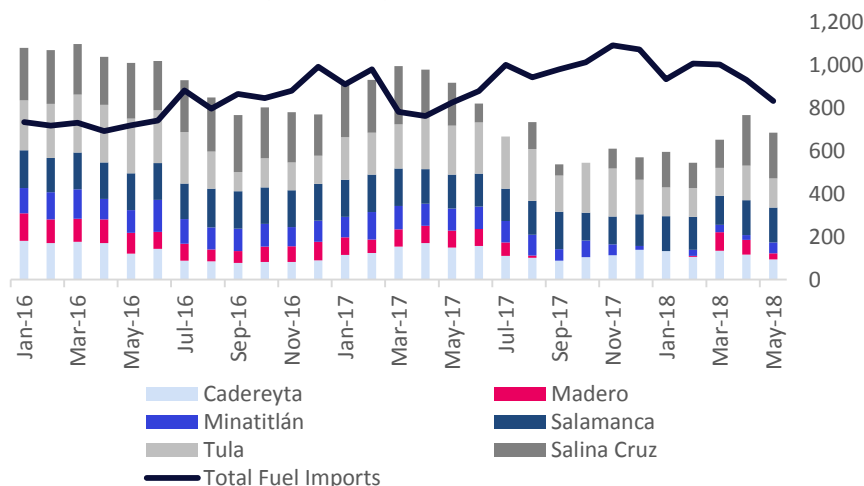


Source: CNH, BMI

Oil & Gas: Pemex Under Pressure

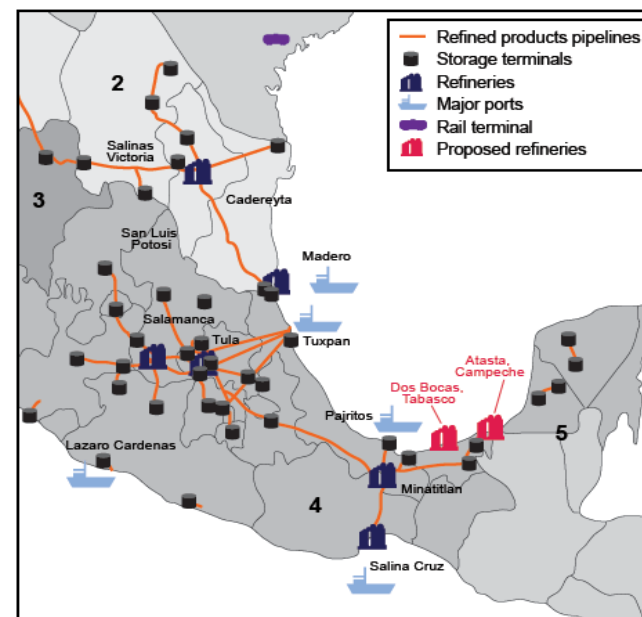
- **AMLO hopes to strengthen Pemex** by reasserting its dominance in the market
- **Fuel price freeze will come at a cost**, particularly as oil prices rise
- **Renewed downstream focus will bring much-needed benefits**, but will face financial limitations
- **Mexican demand for refined fuels is on the rise**, significant midstream buildouts are necessary to serve the market

Refineries Operating Well Below Potential






Refinery throughput and total fuel imports, 000b/d. Source: SENER, BMI

AMLO's Downstream Vision



Source: CNH, BMI

Heavy Industries: All Signs Point To Growth

	AMLO's Position	Our Take	Signal
Power	<ul style="list-style-type: none"> • Reduce reliance on imported natural gas for power generation • Revamp CFE hydropower plants and build new hydro plants • Unclear on sector's reform 	<ul style="list-style-type: none"> • New power plants and pipelines mean gas will remain key for sector • Funding hydro expansion with savings of lower gas consumption will prove challenging • Renewables auctions needed 	
Infrastructure	<ul style="list-style-type: none"> • Potentially cancel NAICM project • Increase investment in rural transport and social infrastructure • Enhance anti-corruption 	<ul style="list-style-type: none"> • Airport likely to continue given progress and prohibitive costs of cancellation • Rural infrastructure projects and anti-corruption changes likely given congressional majority 	
Agriculture	<ul style="list-style-type: none"> • Achieve domestic self-sufficiency in food • Amplify/improve farm subsidy programmes • Support for NAFTA 	<ul style="list-style-type: none"> • Self-sufficiency not accomplished, but growth will occur • Greater/more effective investment in agri-infra • Remain dependent on US imports 	

Key Takeaways

- *Mexican politics will shift decisively to the left for the first time in decades under AMLO*
- *Real GDP growth will accelerate in 2018 and 2019, driven by rising household consumption, investment into the energy sector, and higher public spending*
- *Investor fears regarding a reversal of key economic policies are overblown*
- *NAFTA renegotiations remain a major risk to the Mexican economy.*
- *AMLO has become more supportive of energy reforms, with upstream licensing unlikely to be suspended*
- *Renewed downstream focus will bring much-needed benefits, but will face financial limitations*

Questions?

