

MEXICAN ELECTIONS

Federal Elections held on Sunday in Mexico yielded unexpected results as the incumbent Morena party gained the public's backing both for the presidency as well as in Congress

- Ruling party candidate Sheinbaum was elected with roughly 60% of the vote, 30 percentage points more than the opposition
- Morena, PT & PVEM obtain a majority in Congress (Including a qualified majority in the lower house) and will likely not face major opposition for their attempts at reform, including disruptive ones
- Result highlights the opposition's overall weakness
- Mexican stock, bond and FX markets react negatively to the news in the immediate aftermath, shedding value

ELECTION NIGHT RESULTS

On June 2nd, 2024, Mexican Elections were held to select a new President, all 500 seats in the Lower House as well as all 128 seats in the Senate. In addition, Chiapas, Ciudad de México, Guanajuato, Jalisco, Morelos, Puebla, Tabasco, Veracruz and Yucatán also had elections for governor and all states either local Congress elections or municipal elections.

In line with polls and expectations, the Program of Preliminary Electoral Results (PREP) shows that Claudia Sheinbaum is set to win the presidential election to become the first female president in Mexico. The preliminary count shows a vast advantage for Claudia Sheinbaum (Morena, PT & PVEM), with ~60% of the votes, against Xóchitl Gálvez (PAN; PRI & PRD) with ~28% and Jorge Álvarez Maynez (MC) with ~10.5%.

While expectations were for the Morena candidate to win the election, the negative surprise for markets was the larger than expected margin of victory, as polls were showing the gap between her and the opposition's candidate narrowing during the last couple of weeks.

The legislative elections result also surprised markets negatively, which to us is more relevant. The large margin of victory is setting up Morena to have a qualified majority in the Lower House and in practical terms for the Senate House as well. If confirmed, this would give Morena and allies enough power to approve constitutional reforms that were previously blocked. In the Lower House, Morena's party and allies will be taking between 346 and 380 out of the 500 seats (334 votes needed to have qualified majority), while in the Senate AMLO's party is expected to have between 76 and 88 seats (85 seats needed for qualified majority).
















RISKS GOING FORWARD

The key risk is that with these legislative results, Claudia and Morena will be able to make any constitutional reforms and push for AMLO's pending reforms. Key reforms include:

- 1) The Judiciary: Proposed structural changes to the Federal Judicial Branch, like reduction of the required votes for Supreme Court decisions to be binding from 8 to 6, and the ministers to be elected by popular vote.
- 2) The Electoral process: Transform the National Elections and Consultations Institute (reduction of the number of counsels and selection through popular vote) and eliminating the autonomous bodies.
- 3) Strategic Industries: key sectors energy generation, state internet service and others, to be exclusive to the Mexican State and exempt from monopoly considerations.

- 4) The National Guard: proposes to define National Guard's role in crime investigation, alongside the office of Public Prosecutor and the police.
- 5) Comprehensive, universal and free healthcare: proposes a state guarantee for free, integral, and universal access to health services for all citizens.
- 6) Pensions: guarantee a retirement pension for those contributing to IMSS and ISSSTE since 1997, matching their final salary, capped at the IMSS average salary.

It is important to mention that the new congress will take office on September 2024, while Claudia Sheinbaum will do so on October 2024; for this reason, AMLO will have at least 1 month with qualified majority in Congress to make any constitutional amendments

Risk Traffic Light for AMLO's Reform Initiatives		
Low	Medium	High
 <p>Indigenous and Afro-Mexican people and communities. Strengthening the rights of indigenous and Afro-mexican communities</p>	 <p>Right to food, clean environment and water. Prohibition of fracking and GMO corn. Conserve biodiversity and rural development.</p>	 <p>Judicial Power. Proposes structural changes to the Federal Judicial Branch, like reduction of the required votes for SCJ decisions to be binding from 8 to 6.</p>
 <p>Protection and care for animals. Establishment of a legal framework for the protection, conservation, and care of animals.</p>	 <p>Salaries. Guarantee that annual minimum wage adjustments are never below the inflation rate for the corresponding period.</p>	 <p>Pensions. Guarantee a retirement pension for those contributing to IMSS and ISSSTE since 1997, matching their final salary, capped at the IMSS average salary.</p>
 <p>Health protection from the use of toxic substances. Ban the production, distribution and sale of electronic cigarettes and vaping devices.</p>	 <p>Welfare. Guarantee direct economic support to vulnerable groups and the primary sector of the economy.</p>	 <p>National Guard. Proposes to define National Guard's role in crime investigation, alongside the office of Public Prosecutor and the police.</p>
	 <p>Passenger railway transportation service. Resumption of the right to use railway tracks to provide passenger transportation services by the state.</p>	 <p>Strategic Industries. Key sectors energy generation, state internet service and others, are exclusive to the Mexican State and exempt from monopoly considerations.</p>
	 <p>Republican austerity and public servant remuneration. Strengthening mechanism to enforce constitutional limits on the remuneration of public servants.</p>	 <p>Comprehensive, universal and free healthcare. Proposes a state guarantee for free, integral, and universal access to health services for all citizens.</p>
	 <p>Penal. Extend application to serious tax offenses such as tax fraud and smuggling.</p>	 <p>Electoral. Transform the (INE) into the National Elections and Consultations Institute. Reduction of the number of counsels and selection through popular vote.</p>

Additionally, we have yet to hear Claudia's views on several issues including private investment, fiscal policy, energy, autonomous bodies, the judicial system, etc. as she was very quiet during the campaign given the large lead she enjoyed.

There are also the US elections in November. Let's remember that the USMCA allows for some input from the United States and Canada into Mexican politics, as witnessed during the Energy Reform controversy in 2023. Moreover, there will be a USMCA review in 2026 that Claudia Sheinbaum will need to manage, and, in our view, she is going to be pragmatic on this front, especially if Trump wins in November, as noise on this front could be very negative for the country.

OUR VIEW

While the risks outlined above are likely to bring some short-term volatility to all Mexican assets, we believe there are many opportunities that will surface.

Mexico is entering this period of uncertainty in a good fiscal position with manageable debt/GDP levels, so short term fiscal deficits should be manageable.

Additionally, we believe Mexico's geographical position is an advantage that is hard to ignore and there are larger geopolitical risks (China invading Taiwan for instance) that on a relative basis continue to place Mexico in a good position when it comes to receiving private investment.

Moreover, the already implemented pension reform (that should double the AFORE's AUM in the next 5 years) should remain in place securing funding for the government initiatives and providing support to local capital and private markets.

Taking a deeper dive into local markets, we see a solid opportunity forming in local rates with the 10yr benchmark trading around historical highs of ~10% and the spread differential with the US treasury widening to 550bps. Recall, that Claudia Sheinbaum reiterated her intentions of keeping Banco de Mexico independent in her acceptance speech, so we expect a continuation of orthodox monetary policy going forward.

On the equity side, we see 3 main proposals that could impact the Mexican market: 1) Dissolution of the independent structures (e.g. INE, COFECE, IFT, etc.), 2) risk on concessions and 3) fiscal reforms that could impact different industries. This puts airports, concessions and banks as the most high-risk sectors while the aforementioned uncertainty lingers. However, while we acknowledge the risks and lack of positive catalysts in the short-term, we highlight the very attractive valuation levels (12x P/E vs. 17x for the 10yr average) and the robust balance sheets of most Mexican companies, which make the local equity market an interesting value play.

Lastly, regarding FX, we view the correction as healthy. We believed the MXN was somewhat expensive close to the 16.50 range given the current monetary policy outlook and thus see MXN levels above 17.50 to be closer to fundamentals.

To sum up, while this news is clearly marginally negative, we believe the tailwinds that have made Mexico one of the best performing EM markets in the post-pandemic era remains positive. The nearshoring trend, the positive pension reform, the strong fiscal position, and attractive valuations (for all asset classes) are all still present; and while the qualified majority for Morena brings another level of uncertainty to the story, we believe the positive fundamentals outlined above should allow the country to navigate the storm.

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