



# Monarch News

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## A Note from the Editorial Team

*With the unprecedented challenges created by the COVID-19 context, a different approach to the Monarch newsletter seems more appropriate to your needs. Rather than bimonthly, the new newsletter will appear more regularly, usually monthly, and it will be more focused and analytic with less emphasis on recapping the news. It is designed to give you a better sense of the most important developments in Mexico and their political, economic and business implications. We hope you enjoy this new format.*

## CEO's Executive Summary

Recent events show that Mexico's president, Andrés Manuel López Obrador (AMLO) is in a strong position politically despite the very difficult public health and economic situation in the country. These events also highlight once again AMLO's deep-seeded nationalism, especially with regard to the energy sector, and his persistent mistrust of the private sector. But they also reveal a president whose actions are still tempered from time-to-time by a significant dose of pragmatism.

## I. COVID-19 and the Economy

Mexico has registered [nearly 60,000 deaths from COVID-19](#), the third highest national figure in the world. But even this number is estimated to be half to one-third of the real number because so many sick Mexicans prefer (and indeed have been encouraged by the president) to remain at home instead of going to the hospital. As a result, their malady does not add to the COVID-19 totals, even when this is the cause of their sickness and death. At the same time, Mexico has one of the lowest rates of testing in the world, leaving its overall case numbers, officially well over half a million now, artificially reduced as well. Mexico's bad situation is thus even worse than it appears. This reflects weaknesses in Mexico's healthcare system, the country's half-hearted measures to limit the spread of the coronavirus, and the president's belief that this pandemic is in fact a temporal challenge that will be over soon.

The impact of COVID-19 on the economy has been enormous. [Private investment and consumption](#) collapsed during the second quarter, resulting in an [18.9% contraction in the Mexican economy](#). The IMF estimates that Mexico's GDP will shrink by 10.5% this year. ([The Bank of Mexico's most recent estimate, from late May, is for a 4.6%-8.8% drop.](#)) This would be the largest economic retrenchment since the Great Depression, and one from which Mexico is not expected to recover for several years due, in part, to the lack of government support for businesses and workers who have lost income because of the pandemic. It is also attributable to a large counter-cyclical [increase in tax revenue](#) during the first quarter thanks to a refreshing effort to collect back taxes from large firms that have long evaded them, but one that comes at a time with negative consequences for growth. Also, the economy continues to be restrained by one of the highest benchmark interest rates in the world, which currently stands at 4.5% even after repeated cuts, [including a half-point cut on August 13](#).

The tourism sector, which accounts for 9% of the Mexican economy, has been hit particularly hard. [Foreign visitors fell 41% during the first half](#) of 2020, a blow from which [the sector is not expected to recover until 2023](#) according to the Ministry of Tourism.

Put simply, the public health and economic situation continue to be very difficult and are unlikely to return to the pre-COVID situation soon. Indeed, [Mexico is at risk of losing its](#)

[investment grade](#) debt rating next year. And yet, AMLO's popular support and governing position remain strong.

## II. AMLO's Political Position Strengthens

[AMLO's approval rating sits at 58%](#), similar to the numbers he posted at the start of the pandemic and ensuing economic crisis in March. In part, this reflects income support for an important proportion of lower income Mexican families. Some of this comes from government social spending, but it is also due to the surprising [resilience of remittances, which have reached a historic high](#).

Recent events should help AMLO sustain his strong popular support in the coming months, which, in turn, will enable him to maintain control over politicians in his governing coalition and, through them, sustain his power over the federal legislature and the majority of state legislatures. Two events, in particular, help support AMLO's political position: the arrest and extradition from Spain of former Pemex CEO Emilio Lozoya and the arrest in the United States of former Secretary of Public Security Genaro García Luna, who is accused of being on the take of the Sinaloa Cartel.

The arrival in Mexico of Emilio Lozoya to face corruption charges, and his ensuing testimony about corruption in previous governments, perfectly fits the political needs of the AMLO government for at least four reasons. First, it has brought a much needed distraction from the public health and economic crises that AMLO has fumbled. Mexicans are riveted by testimony that accuses former presidents and ministers, former presidential candidates, and two sitting governors to acts of corruption. Second, it has allowed AMLO to finally show that he is making real progress in his long-promised anti-corruption effort just as attention starts to focus on next June's midterm elections. Despite historic suspicions, never before has such a high-ranking group of politicians been formally accused of corrupt acts.

Third and more important, the agreement under which Lozoya agreed to be extradited to Mexico has led to [testimony](#), apparently complete with documents and videos, that identifies a PRI-orchestrated plan to divert funds from Pemex to the presidential campaign of former President Enrique Peña Nieto and to pay off legislators in exchange for their votes in favor of the 2013 energy reform.

AMLO's real political target, however, is neither Peña Nieto nor his accused co-conspirator, former Finance Minister Luis Videgaray, but the PAN politicians who Lozoya identified as having received these bribes and, most importantly, former President Felipe Calderón. Lozoya accused Calderón of irregularities related to his administration's dealings with the Brazilian-based conglomerate, Odebrecht.

Calderón is not merely AMLO's nemesis as the man who defeated AMLO in the "fraudulent" 2006 presidential election, according to AMLO and his supporters. He is a supposed ring-leader of the "conservative" opposition whose existence AMLO exploits to unify his base. Calderón is also the founder of an upstart party that, if successful in the June 2021 midterm elections, could create a real opposition to AMLO and his Fourth Transformation strategy for Mexico.

In short, AMLO hopes that Lozoya's testimony will further weaken the PAN while discrediting prominent PAN politicians, most particularly Felipe Calderón. This promises to weaken their capacity to challenge AMLO's Morena party and other AMLO-allied candidates in the June 2021 elections.

Fourth and potentially most important, Lozoya's testimony accuses the Peña Nieto government of buying the votes needed to approve the 2013 energy reform. This is likely to discredit the energy reform and help garner support for AMLO's efforts to undermine and ultimately to reverse it. While AMLO has publicly stated that he will not seek a constitutional change to overturn this reform until 2021, he has consistently sought out other means to reverse it. This was the gist of [a July 22 memo](#) from AMLO to the energy regulatory institutions calling on them to find ways to achieve this objective without undertaking a constitutional reform.

Equally important to AMLO's efforts to strengthen his political position by undermining former President Calderón and his fledgling political party was [the December arrest in Texas](#) of Calderón's former secretary of public security on charges of colluding with the Sinaloa drug cartel. The case against him seems strong, and as such it will allow AMLO to argue that Calderón either knew of García Luna's operations making him complicit in the corruption, or he did not know and is thus incompetent. In either case, this arrest strengthens AMLO's position politically.

These two corruption-related arrests are good news for AMLO and the continuation of his Fourth Transformation suite of policies, including nationalist energy and infrastructure policies and broader economic policies that actively avoid favoring the interests of the private sector. But the implementation of the Fourth Transformation continues to be tempered by a degree of pragmatism. This was evident in the approval of four new, independent members of the National Electoral Institute (INE) and the reform of Mexico's retirement savings account system.

### **III. The Reappearance of Pragmatism**

Thirty-three members of Morena's radical faction in the Chamber of Deputies, in alliance with the Labor Party, [led a failed rebellion](#) against the constitutionally mandated manner for vetting new members of the National Electoral Institute. After the completion of the vetting process, these legislators were demanding that the process be cancelled and done again with the objective of including AMLO loyalists in the mix. Their unstated but obvious aim was to pack the INE and thereby ensure that it would tilt the electoral playing field in favor of Morena in next year's midterm elections. Their efforts were clearly unconstitutional, but that fact did not seem to dissuade them.

Rather than backing this rebellion, however, AMLO sided with his more moderate congressional leadership team and apparently ordered the radicals to stand down. [Most of them ultimately voted with the overwhelming majority](#) of the Deputies to select four highly-qualified consensus candidates to serve on the National Electoral Institute.

This victory of the moderates and pragmatism is very important, but it does not mean that the radicals, or even AMLO, will cease their attacks on the INE or accept a bad outcome as a fair election. To the contrary, we suspect the radicals will continue to question the INE's independence including their efforts to force its head, Lorenzo Córdova, to resign to make way for a more favorable commissioner. In the process, they will lay the groundwork for rejecting as fraudulent a bad electoral outcome.

AMLO'S pragmatism has also been on display with respect to the reform of Mexico's retirement accounts. The need for a reform of these accounts has been evident for quite a while. They are simply not accruing enough money for their beneficiaries to live on in retirement. The fear again was that AMLO would listen to the radicals in his coalition

and nationalize these funds, known as *Afores*, as was done in Argentina under President Cristina Fernández de Kirchner. Instead, Finance Minister Arturo Herrera [negotiated a solution with the private sector](#) with which everyone seems to be satisfied.

Under the agreement, the private sector will increase its contribution from 5.15% to 13.87% of their employees' wages, implemented gradually over the next eight years. Neither workers nor the government will increase their payments into the system, and the government will redirect its contributions toward the lowest paid workers. Finally, the reform will allow workers to access these funds after just 15 years of work instead of the previous 25 year minimum. This reform does not mean that workers will be able to fully fund their retirement from their *Afores*, but it is a huge advance.

Most important, it is a moderate reform supported by both the private sector and AMLO. The private sector likes its gradual character, and AMLO likes that all the new money comes from the private sector. In that sense, it's like a mini fiscal reform. This means that AMLO is unlikely to return to this issue in the future and call for a more radical solution, which in turn gives the private sector the predictability that the Fourth Transformation government often denies it.

Together, the agreements on new INE members and *Afores* reform demonstrate a significant degree of pragmatism on the part of President López Obrador, something rarely seen in the past year. We are also encouraged by the recent effort, led by the ministries of economy and foreign affairs, [to position Mexico as a reshoring location](#) for U.S. firms interested in moving their Asian/Chinese supply chains closer to home. Mexico has so far missed enormous opportunities to take advantage of the building tensions between Washington and Beijing by positioning itself as a preferred destination for manufacturing. The COVID-19 pandemic presents another opportunity for Mexico in this respect; only time will tell whether the country can take advantage of it.

Stay safe out there!

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