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FOR PUBLIC POLICY

MEXICO COUNTRY OUTLOOK 2020

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"Mexico Country Outlook 2020"

I. Introduction

No country has a greater impact on the daily lives of Americans than Mexico. Binational trade now exceeds $700 billion per year, encompassing the energy, manufacturing, agriculture, tourism, service, and retail industries. As many as 5 million U.S. jobs depend on America's commercial relationship with Mexico. Cooperation between the two nations is crucial as both governments work to stem the flow of illegal drugs and undocumented migration, and to ensure a stable and secure North American region.

Against this backdrop, the Center for the United States and Mexico conceived the idea for the Mexico Country Outlook, an annual program on the political, economic, regulatory, social, and security issues that will affect the process of doing business in Mexico in the coming year. The 2020 outlook also includes an analysis of current trends and expected developments, as well as insights on the U.S.-Mexico relationship during a period of heightened tensions.

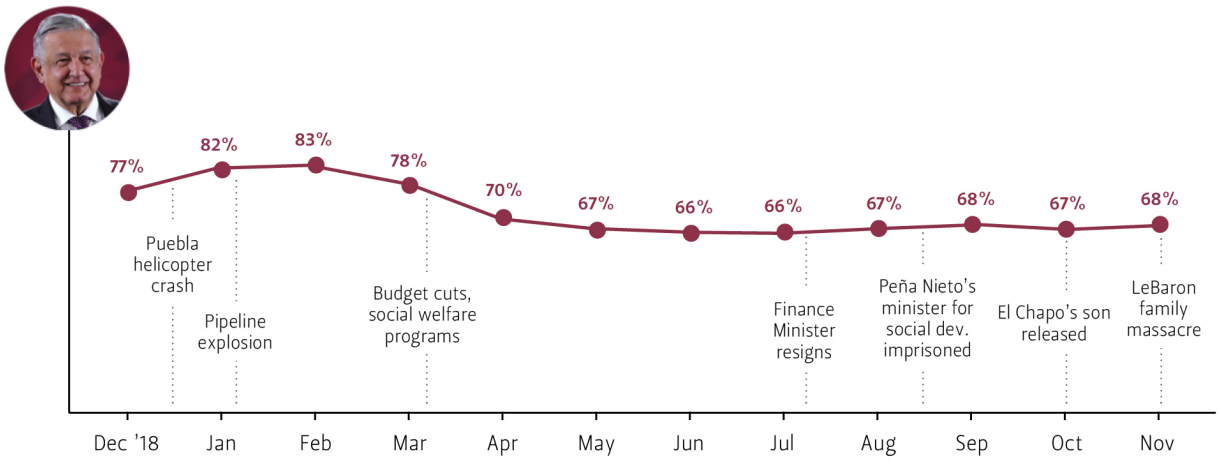
The content for the program draws on the expertise of center scholars, all of whom have lived and worked in Mexico for decades and whose perspectives are informed by rigorous, on-the-ground research and a network of academic, government and private-sector experts in Mexico and the United States.

This handbook was written with close attention to the impact of President Andrés Manuel López Obrador on Mexico's changing environment. While we also consider structural and external factors that the president cannot control, López Obrador is by far the most important voice in Mexico today—and his political and policy preferences are profoundly affecting not only the country's present but its long-term future.

II. Political Environment

President López Obrador has enjoyed relatively high approval ratings since his inauguration in December 2018 (Figure 1). This is partly because his political strategy includes visits to cities and towns throughout Mexico every weekend, which have strengthened an already robust connection with his voter base. Although independent and government experts widely question his policies, especially on economic and security issues, his political approach to staying in touch with his base will carry him relatively well through 2020. That said, Mexico's complex, longstanding economic and public security problems may begin to wear on his popularity toward the end of the year.

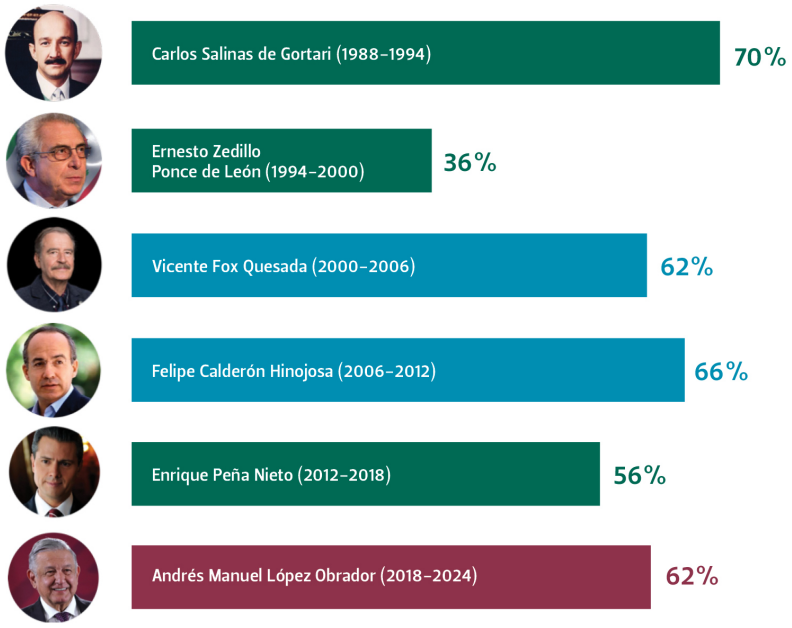
Figure 1. López Obrador Approval Ratings (2019)



Source: *El Financiero*, November 26, 2019

López Obrador's relatively strong showing in his first year as president is not unusual for Mexico's chief of state. Previous polls found that four of the country's last five presidents had similarly high approval ratings during their freshman year in office (Figure 2). The real test of López Obrador's popularity will come in 2020, when he faces the voters who gave him a landslide victory in 2018—and a mandate to end corruption, reduce violence, and address endemic poverty. Many expect him to deliver even more during his second year as president. Faced with mounting pressure to solve Mexico's difficult problems, López Obrador could undertake higher-stakes policies that carry a greater risk of conflict with his political opponents and that affect his ability to effectively govern.

Figure 2. First-Year Approval Ratings of Mexico's Presidents, 1989–2019



Source: Consulta Mitofsky, Mexico

Despite the advantage of having a large party majority in Mexico's House and Senate, as well as in the country's state legislatures, López Obrador has had difficulty building a national political consensus to govern. He has chosen not to call on opposition parties to join him in addressing Mexico's intractable problems, opting for a more adversarial tone toward them instead; this is meant to set him apart from what he considers a collection of corrupt, out-of-touch politicians. The president's inability to form a consensus on key issues affecting the country carries over to his own party, which is an amalgam of diverse groups ranging from communists to the evangelical right. These external and internal disagreements will increase, especially toward the end of 2020 as the midterm elections of 2021 come into focus, further eroding his ability to govern.

Even so, López Obrador's party majority in congress will promote his legislative priorities through most of 2020; no change is expected in the legislature's party composition this year. Toward the end of 2020, however, most members of the House will gear up for reelection and their legislative agenda is likely to shrink as they focus on campaigning. The next federal election will be held in June 2021, when the House of Representatives renews all seats and at least 15 governorships will be up for grabs.

Figure 3. Breakdown of Mexico's Congress by Political Party

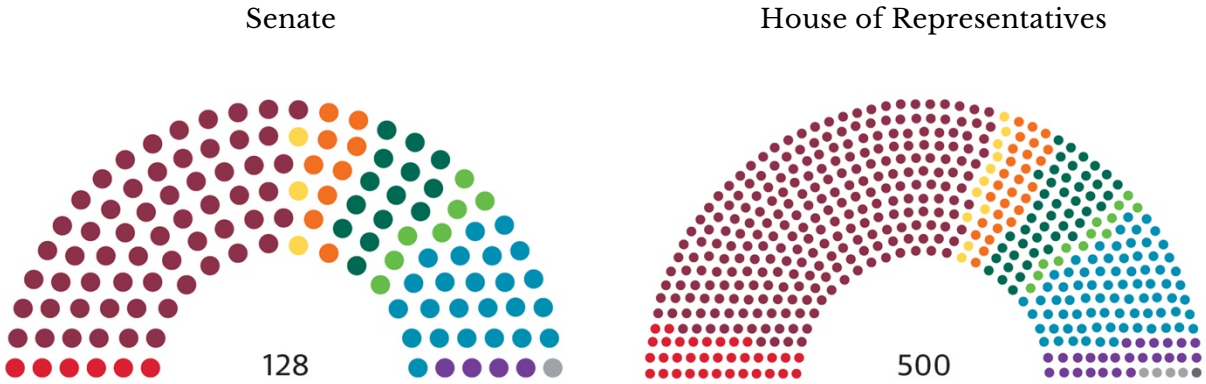


Table 1. Political Party Membership in Mexico's House and Senate

Senate			House		
	Morena	60		Morena	259
	PAN	24		PAN	78
	PRI	14		PRI	47
	MC	9		PES	26
	PT	6		PT	34
	PVEM	7		MC	28
	PES	4		PVEM	13
	PRD	3		PRD	11
	Independent	1		Independent	4

A. *State and Local Elections in 2020*

On June 7, 2020, two Mexican states will hold state and local elections. Voters in Coahuila will elect state legislators. Hidalgo State will choose mayors. Both states have a deep-rooted PRI tradition; to this day, all of its governors have been PRI members. The June 2020 elections will show if López Obrador still has political momentum in states governed by an opposition party. The elections will also indicate whether voters judge the work of federal and state governments separately.

B. *Checks and Balances*

So far, the López Obrador administration has had few checks on its authority. However, the president has spent much of his political capital breaking down and coopting key institutions that in the past have served as a check on the executive branch. The next section briefly discusses the institutions that are likely to continue to counterbalance the president.

1. The Judicial Branch and Supreme Court of Justice

Mexico's Supreme Court is composed of 11 justices who are appointed by the president and ratified by the Senate for a term of 15 years. Although these justices are theoretically nonpartisan, presidents tend to appoint justices that favor their ideological approach to public policy. To date, López Obrador has appointed three of the 11 Supreme Court justices. His latest choice, Margarita Ríos-Farjat, replaces Eduardo Medina Mora, who did not complete his term in part because he was pressured by López Obrador to step down. Medina Mora's exit opened the door for an appointee who is more ideologically in line with the president. We expect the administration to continue its pressure on the Supreme Court and members of the judicial branch through 2020.

Table 2. Justices Appointed to Mexico's Supreme Court by López Obrador

Incoming Justices	Outgoing Justices
Juan Luis González Alcántara	José Ramón Cossío
Yasmín Esquivel Mossa	Margarita Luna Ramos
Margarita Ríos–Farjat	Eduardo Medina Mora

2. Governors

The governors of Mexico's 32 states will remain a major counterweight to the López Obrador administration through 2020—especially the nine PAN party governors who have been the administration's most vocal opponents. Twelve PRI party governors have chosen a path of lesser confrontation, although not necessarily cooperation, with the president. The PRI is quite weakened, however, and these governors will continue to lie low.

Figure 4. Breakdown of Governors by Political Party

3. <u>Independent Agencies and Institutions</u>

During his first year in office, López Obrador has tried, sometimes successfully, to weaken institutions that can provide a check on his authority. Under the guise of promoting austerity and addressing the corruption of past administrations, the president has attempted to alter the rules, regulations, and composition of electoral institutions, energy regulatory commissions, and even the agency responsible for measuring the country's poverty.

a. Electoral Institutions

Through his Morena Party majority in congress, López Obrador has promoted reforms that, if implemented, would rewrite electoral rules and reframe the operation of Mexico's political institutions. One such change would effectively replace the current nonpartisan president of the National Electoral Institute, which organizes and oversees the country's elections, with an individual who favors Morena or the president in electoral disputes. Another proposed constitutional amendment would allow a midterm referendum on whether the president should stay in office. This would put López Obrador on the ballot in the 2021 midterm elections, which some critics say is a way to extend his popularity to his party's candidates down ballot. Other constitutional reforms aim to reduce public funding for political parties by 50% and eliminate the 32 state electoral institutes and tribunals, which oversee local elections, in favor of a centralized federal elections commission; this could presumably make it easier to manipulate elections. Such changes, among others, are seen by some as strategic moves that would tilt the playing field against political opponents and return Mexico to a time when elections were run by partisan, centrally controlled appointees.

b. Energy Regulatory Agencies
The execution of López Obrador's energy agenda relies in part on the Energy Regulatory Commission (CRE)[1] and the National Commission of Hydrocarbons (CNH).[2] Since December 2018, when López Obrador took office, these two energy regulators have seen an unusual number of commissioners depart, including their chairs. The responsibility to fill these seats rests with López Obrador. So far, he has appointed five of the seven CRE commissioners, including the chair. CNH commissioners have also left, some even before López Obrador took office, leaving him to appoint three. Of the seven CNH commissioners, López Obrador appointed the president of the commission in November 2019, while the remaining two seats remain unfilled. This is an important political achievement for the president, who intends to pause much of the country's historic energy reforms and could not do so without the assent of the commissioners—most of whom are now his political allies.

c. National Council for the Evaluation of Social Development (Coneval)
Since 2005, Coneval, a government research and accountability agency, has measured poverty in Mexico and evaluated the country's policies to combat it. López Obrador, who is largely distrustful of research agencies, has moved to dismantle much of its research capacity, preferring to manage poverty-related issues through his own political rhetoric; his policies to reduce poverty are largely based on his speeches and personal beliefs. He has accused Coneval and other agencies of advancing what he calls a "neoliberal" agenda that has perpetuated poverty and inequality throughout Mexico. In July 2019, López Obrador fired Coneval's director and appointed a political ally in his place. Most of the president's social programs are now based on direct cash transfers to the elderly and young, an effort poorly supported by accountability mechanisms or impact research. For some critics, López Obrador's cash transfer programs are inspired by Mexico's old politics of clientelism, whereby publicly funded initiatives were used to consolidate the governing party's political base.

C. *Extant and "New" Political Parties*

1. Extant Political Parties

Opposition parties have been slow to recover after López Obrador's 2018 victory. Most remain relatively weak, primarily because they do not have enough members in congress to form an opposing coalition. The legendary PRI, which ruled Mexico for 70 years, seems not to have understood that anger over political corruption was the main reason it was voted out of power: just a year after the 2018 presidential election, the PRI chose as its national president a former governor accused of corruption during his tenure.

[1] The CRE regulates the allocation of oil and gas fields to Pemex and the private sector. It also regulates the electricity sector to advance expanded competition and consumer protections.

[2] The CNH manages Mexico's energy data, conducts public tenders, ensures energy contract compliance, and oversees the technical coordination of all energy-related activities.

The PRD, once the main left-wing party and strongest opposition party in Mexico, is in danger of disappearing. Most members have switched to other parties, especially the Morena Party. The Movimiento Ciudadano (MC) is strong in certain regions of the country and has a few popular politicians. However, the MC does not have a strong presence in every state. The Green Party, or PVEM, mostly behaves as a free rider, always looking to be part of a party coalition instead of running its own candidates. Voters have not supported independent candidates as strongly as expected. Currently, Mexico's only politically independent governor is struggling to complete his term in office under accusations of misuse of public funds. The PAN Party seems to be the only real challenger to the Morena Party's hold on power. PAN did fairly well in the mid-2019 elections and its nine governors are a genuine counterweight to López Obrador and Morena.

2. "New" Political Parties

Every six years after the presidential elections, the National Electoral Institute opens a registration period for new political parties. Currently, there are potentially 70 new political parties, but only three will likely meet the requirements to run: a) Redes Sociales Progesistas, which lost its registration in 2018 and is connected to Elba Esther Gordillo, former head of the National Education Union; b) Encuentro Solidario, formerly the Social Encounter Party (PES)—which also lost its registration—and whose base is composed of evangelical churches; and c) Libertad y Responsabilidad Democrática (Mexico Libre), an organization connected to former President Felipe Calderón and Margarita Zavala, a former presidential candidate and Calderón's wife. None of these potential political parties has a broad enough base to challenge López Obrador and Morena, and they may even further fragment opposition to his policies.

D. *People to Watch*

In Mexico, like everywhere else, fortunes rise and fall. Under the López Obrador administration, some political figures have seen their stars rise, others have settled in their positions, while still others may have had difficulty maintaining their influence. To understand what policies are likely to find favor in the coming year, we recommend watching the following people in 2020 (Table 3), as they are the most likely to influence—or fail to influence—the president's decision-making. For instance, Foreign Affairs Minister Marcelo Ebrard is in a good position after advancing efforts to ratify the USMCA but Public Safety Administrator Alfonso Durazo fell into deep disfavor after a terrible decision to release the son of drug kingpin "El Chapo" Guzmán.

Table 3. People to Watch in 2020

Up	Stable	Down
Marcelo Ebrard *Foreign Affairs Minister*	Arturo Zaldívar *Chief Justice of the Supreme Court*	Alfonso Durazo *Public Safety Minister*
Claudia Sheinbaum *Mexico City Mayor*	Alejandro Gertz Manero *Attorney General*	Rocio Nahle *Energy Minister*
Francisco García Cabeza de Vaca *Governor of Tamaulipas*	Irma Eréndira Sandoval-Ballesteros *Public Administration Minister*	Olga Sanchez Cordero *Interior Minister*
Mauricio Vila *Governor of Yucatán*		Javier Jiménez Espríu *Communications and Transportation Minister*
Mario Delgado *Morena's Leader in the House of Representatives*		Cuauhtémoc Blanco *Governor of Morelos*
Ricardo Monreal *Morena's Leader in the Senate*		Cuitláhuac García Jiménez *Governor of Veracruz*
Santiago Nieto *Head of the Financial Intelligence Unit*		

III. Legislative and Regulatory Environment

A. *New Legislation*

In this section, we highlight legislation passed in 2019 that will have an impact in 2020.

1. Asset Forfeiture Law (Ley de Extinción de Dominio)[3]

In August 2019, Mexico's congress passed legislation that allows federal authorities to bring civil actions to seize assets from private individuals and/or companies accused of criminal acts; such acts include organized crime, drug trafficking, corruption, extortion, kidnapping, human trafficking, and obstruction of justice. It is important to note that unlike asset forfeiture in the United States, Mexican law does not require a prosecutor to first obtain a criminal conviction. Thus, assets may be subject to forfeiture if they are reasonably linked to criminal conduct, even if the titleholder himself has not engaged in criminal conduct. In addition, the law places the burden of proof on the private entity (individual or company) rather than the government. The private entity must prove beyond a reasonable doubt that its assets were legally obtained. We expect this controversial legislation will spark many legal and constitutional challenges.

[3] Read the law in full (Spanish) at https://www.dof.gob.mx/nota_detalle.php?codigo=5567625&fecha=09/08/2019.

2. Tax Legislation

a. Digital Platforms

Starting in 2020, Mexico will levy a 16% value added tax (VAT) on services purchased on foreign digital platforms such as Amazon, Netflix, Uber, and Airbnb. The statute defines digital platforms as intermediaries that facilitate the exchange of goods and services to the end user, easing the sale primarily through electronic payments. The foreign provider of digital services will be required to register in Mexico as a VAT taxpayer, provide a local legal representative and tax domicile, keep local books, and maintain a strict accounting of sales and expenditures by issuing receipts, which are used to audit business transactions. This legislation follows guidelines provided by the Organisation for Economic Co-operation and Development (OECD) to Mexico's government as a strategy to boost tax revenues.

b. Tax Fraud

Mexico's congress passed legislation that makes false invoicing—often used for money laundering—subject to the same penalties that are imposed in organized crime cases. Tax evasion of at least 7.8 million pesos (approximately $406K) is now considered a criminal offense under the law. Penalties range from seizure of the taxpayer's assets to imprisonment. An individual who fails to keep business-related receipts or fraudulently issues them—e.g., to launder money—could serve up to nine years in prison. This measure will give Mexico's tax authorities, especially the country's internal revenue service (the SAT), unprecedented power to reduce the country's high levels of tax evasion. The Mexican government estimates that $15.6 billion worth of false invoices and receipts are produced each year. This new law entered into force on January 1, 2020.

B. *New Bills for 2020*

In the following section, we highlight some bills that are likely to gain momentum in 2020.

1. Labor Legislation

Mexico's labor laws were significantly modified and expanded in May 2019 to meet Mexico's obligations under the USMCA. The new legislation facilitates the implementation of unionization rights through independent administrative bodies, including labor courts. In addition, the modified labor laws facilitate the registration of union elections and resolution of disputes, with a variety of safeguards for union organizing, including the use of secret ballot votes subject to clear time limits and independent verification. Transparency obligations also exist, including a requirement that collective bargaining agreements be made available to affected workers. It is possible that further amendments will be required for Mexico to comply with its new obligations under the USMCA protocol signed December 10, 2019.

At the end of 2019, Napoleón Gómez Urrutia, a Morena Party senator, chair of the Senate Labor Commission, and a powerful ally of the president, introduced a bill that eliminates most forms of manufacturing and service outsourcing; this could force companies to perform most work in-house. Under the bill, the only legal form of outsourcing or subcontracting would involve highly specialized services or activities that significantly

deviate from a company's primary business activity. If enacted, the law would presumably protect workers' human and labor rights and prevent tax evasion. It would also raise production costs. We expect the bill to gain momentum in 2020 given the government's ongoing efforts to collect more tax revenues.

2. Drug Law Changes: Marijuana
López Obrador has often signaled his willingness to legalize marijuana as part of a broader shift in public safety and security policy. Several bills regarding this subject are awaiting debate in congress. Most would regulate the personal use and sale of marijuana as well as research into its properties. The government is also planning to create a new regulatory agency to oversee these changes. We expect that the poor results of López Obrador's current security policies and the failure of the war against drug cartels will force the government to turn to new strategies. The marijuana legalization bill could gain momentum in 2020. This policy shift may, however, affect Mexico's relations with the United States, provided Washington does not make the change first.

3. Pension Reform
The budgetary burden of federal pensions will continue to increase, particularly since the government is considering a 10% hike in pension and retirement benefits in 2020. The added pressure on the federal budget may force the government to raise taxes or borrow more heavily. We expect congressional debate on the federal pension system to begin in the second half of 2020.

C. *Regulatory Changes*

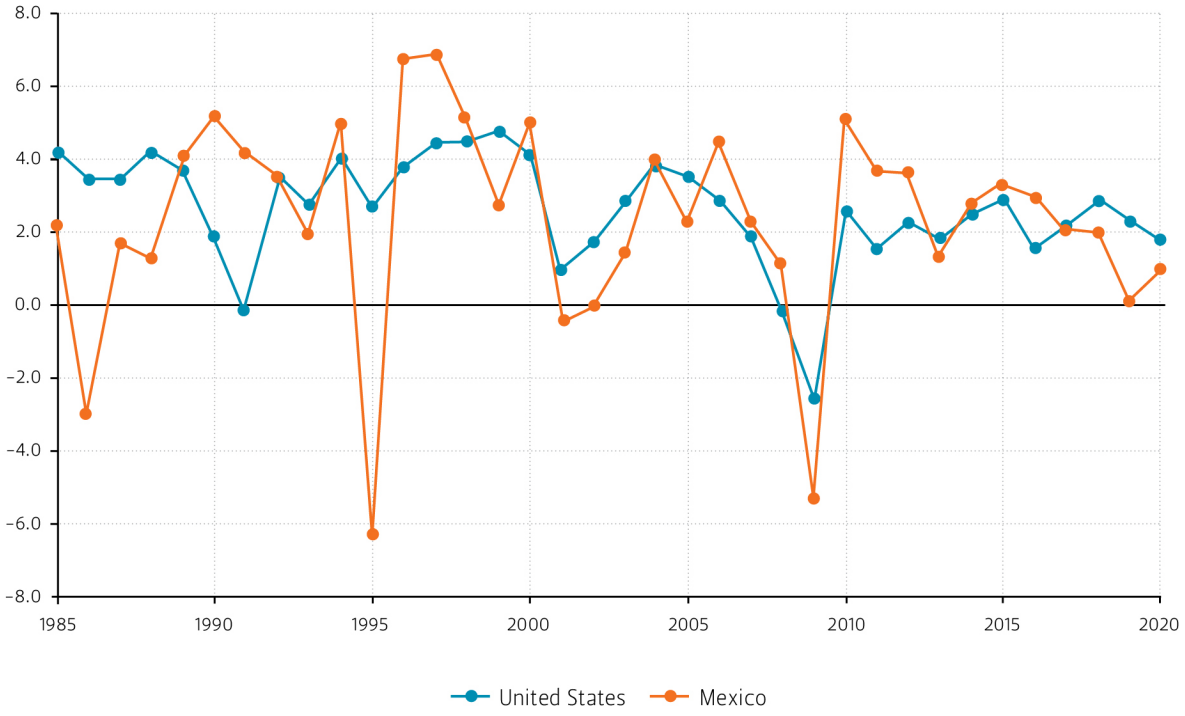
1. Energy (import/export controls)
Pemex's (Petróleos Mexicanos) domestic sales—primarily refined products such as gasoline, diesel, and fuel oil—dropped by almost 17% between January–September 2019 compared to the same period in 2018. This demonstrates that Pemex will continue to be under pressure as competition from private companies intensifies. Given López Obrador's nationalist stance on Pemex and the fact that he has appointed five out of seven members of the Energy Regulatory Commission, one should keep an eye on the fate of policies originally designed to increase energy sector competition, such as permits to import refined products and the storage of refined products.

2. Monetary policy
Although López Obrador has appointed two of the five vice-governors of Mexico's central bank, the administration has so far adhered to a disciplined monetary policy and is likely to remain fiscally moderate through 2020. This is by no means assured, however, as pressure on the peso will build over the coming year.

IV. Economic Outlook

Mexico's economic performance has been directly linked to the U.S. economy for at least two decades, partly because of the strong bilateral trade and investment relationship. The U.S. receives nearly 80% of Mexico's exports and Mexico is a top recipient of U.S. foreign investment. However, the economy during López Obrador's first year has been on a downward trend, and it dramatically lags behind the U.S. economy. Mexico's GDP growth is expected to barely reach 0.1% in 2019; our forecast has the economy growing at 1.0% in 2020 (Figure 5).

Figure 5. GDP Growth Rates (%) for the United States and Mexico, 1985–2020



Source: World Bank; 2020 is authors' estimate

We do not foresee dramatic, positive changes in the variables affecting Mexico's economic development and growth (some of which are described in the next section). Moreover, a high degree of political and regulatory uncertainty in Mexico means that foreign investment is not likely to pick up this year.

A slowdown in the U.S. economy would add even more downward pressure on Mexico's economy, as the country relies heavily on U.S. economic performance for much of its own growth. This situation would also likely influence political support for the López Obrador administration.

A. *Factors Influencing Mexico's Economic Underperformance in 2020*

Several key factors are expected to negatively impact Mexico's economic performance in 2020, with some related to specific decisions made by the López Obrador administration. These include:

1) Cancellation of major infrastructure projects, including a new international airport in Mexico City
2) Cancellation of all bid rounds for new oil and gas exploration and production, placing the burden for increased production on Pemex—a strategy that we consider impractical (more on this below)
3) Cancellation of important conditional cash transfer programs—including childcare subsidies, the health care program *Seguro Popular*, and the well-liked social program *Prospera*—in favor of unconditional cash transfer programs that have few operational rules and poor government accountability, which will result in economic inefficiency
4) Dramatic cuts to the budgets of multiple government agencies and the judicial branch (primarily to funnel additional resources to the faltering Pemex)
5) Underinvestment in infrastructure
6) Lower investor confidence
7) A volatile regulatory environment, with rules quickly and unexpectedly changing

The adverse impact of the López Obrador administration's decisions will not be cushioned by international factors, which also appear unfavorable in 2020. These include:

1) A U.S. presidential election
2) The ongoing U.S.-China trade war
3) Volatility in global financial markets
4) The slowdown in the global economy

Thus, a major challenge for the administration this year is to create conditions that ramp up growth while maintaining macroeconomic stability. Progress toward a stronger rule of law would help the administration in this regard, but that is a long-term project. Unfortunately, the administration has not offered clear mechanisms or strategies to foster economic growth. On the contrary, political agendas will have a major influence on economic decisions, posing further downside risks to the GDP.

B. Labor

We expect Mexico's unemployment rate to rise to about 3.7% in 2020, up from 3.5% in 2019 and 3.3% in 2018. Given the absence of employment insurance programs in Mexico, the unemployed tend to move to the informal sector. As a result, informal employment—which includes domestic workers and unregistered vendors—will increase this year in Mexico. About 58.5% of jobs are expected to be in the informal sector in 2020. The informal economic sector is not part of the tax base and therefore tax collection may drop, giving the government even fewer resources to spend and invest.

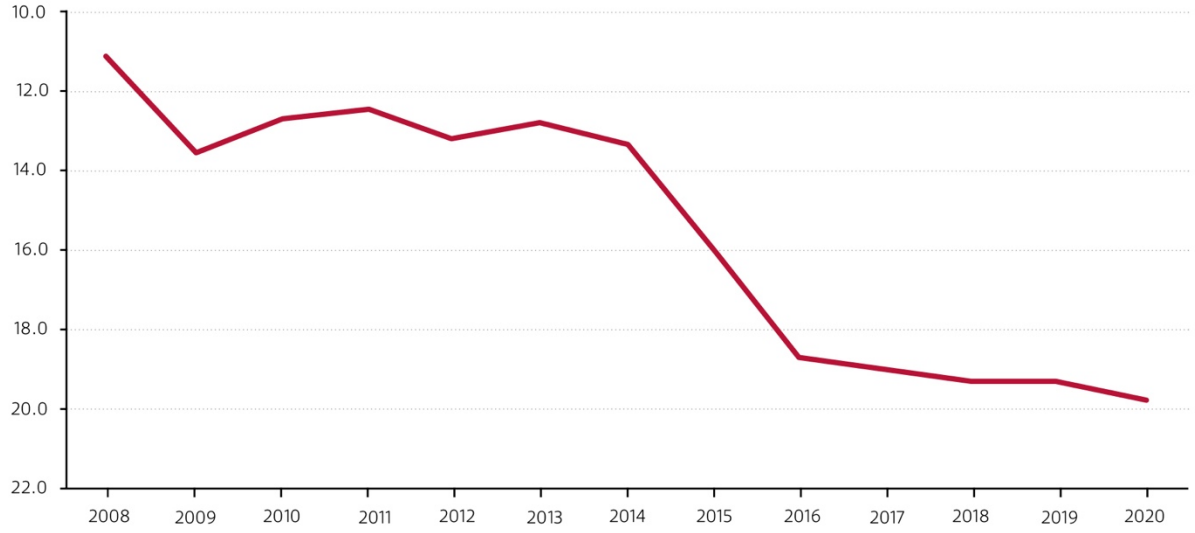
C. *Inflation and Consumer Demand*

Lower economic growth in 2020 will cause demand for goods and services to drop, leading to lower prices that will eventually hold steady for the year. Our estimates show the consumer price index (CPI) will be 3.5% and CPI core inflation (excluding food and energy) will reach 3.4% in 2020. This level of inflation is within the central bank's inflation target at 3%, plus or minus one percentage point.

D. *Currency*

Mexico's currency has been under pressure due to the uncertainty of the country's domestic and international policies in recent years. The floating exchange rate has played a leading role in helping Mexico's economy adjust to external shocks. But in 2020, the Mexican peso will be affected by factors such as the U.S. presidential election, the U.S.-China trade war, international oil prices, and less investment in Mexico's public infrastructure. We project that the Mexican peso will depreciate slightly, to an average 19.7 pesos per dollar in 2020 from an average 19.3 in 2019 (Figure 6).

Figure 6. Exchange Rate: Mexican Peso per USD (annual average, inverted axis), 2008–2020



Source: Banco de Mexico; 2020 is authors' estimate

E. *Interest Rates*

The relative stability of the exchange rate and an improved inflation forecast will allow Mexico's central bank to lower its benchmark interest rate. The interest rate target remained at 7.5% at the end of 2019, but we expect it will drop to 7% by the end of 2020. To promote economic growth, Mexico needs low real interest rates and investments in fixed and human capital formation. An expansionary monetary policy in 2020 will allow the central bank to boost GDP growth in the short-term, while a lower interest rate can provide some protection against internal political risk and a slowdown in global growth.

Mexico's federal government is committed to strong fiscal discipline in 2020. Austerity has been a central tenet of the López Obrador administration. However, there may be an increase in fiscal pressure this year, making it necessary to set the public debt ratio on a downward path. The priority should be to raise non-oil tax revenues, have a primary budget surplus of at least 0.5% of GDP, and provide certainty to the markets. Unfortunately, we expect that spending pressures will threaten the fiscal balance this year. Mexico should increase non-energy related public investment through a fiscal stimulus. Public investment spending planned by the government in its 2020 Economic Package is 5.4% lower than in 2019.[4] And uncertainty regarding the government's decisions and policies could further affect the level of public and private investments in 2020.

A major problem for Mexico continues to be its dependence on Pemex for government revenues. Lower oil and gas production has created a drag on revenues. The country's 2020 Economic Package depends in part on Pemex boosting production by approximately 15%, which is a highly unlikely scenario. The government will therefore obtain most of its revenue from taxes. However, if the economy grows slowly, we have to expect that Mexico's revenue will be similarly slow to grow. The challenge will be to increase revenues to provide social programs and invest in Pemex oil and gas production.

Access to foreign markets is the primary factor that can help Mexico's weak economic prospects in 2020. We expect the current account deficit to be around 1.9% of GDP by 2020. The expected deficit for this year can be financed with foreign direct investment (FDI). However, as noted earlier, FDI is expected to be lower in 2020 than in previous years. Based on our calculations, we expect FDI net inflows to be around $25.5 billion this year, a reduction of approximately 4% compared to 2019.

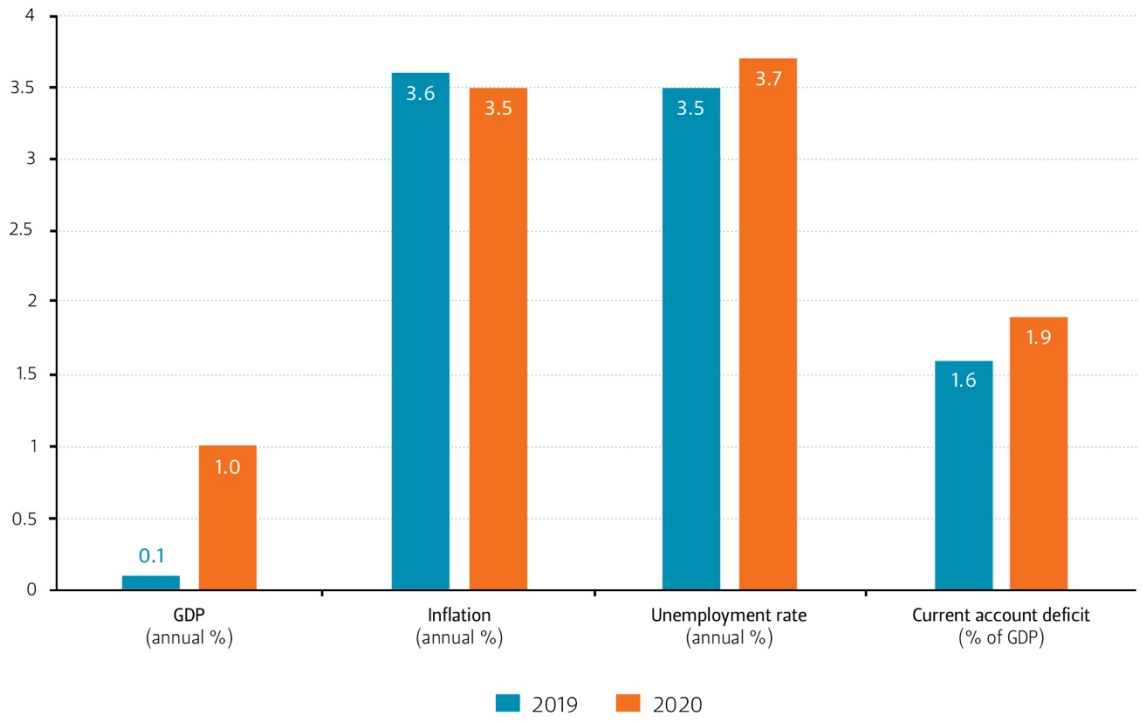
The confidence of investors declined in 2019 and this trend will continue in the coming year. We expect that investor confidence will weaken in the three main sectors of Mexico's economy: construction, commerce, and manufacturing.

Due to government austerity policies, the López Obrador administration has diverted resources from cancelled programs and budget cuts to unconditional cash programs for the poor. The popularity of these programs helps to explain the president's high approval

[4] The 2020 Economic Package (Spanish) is available at Secretaría de Hacienda y Crédito Público, "Paquete Económico para el Ejercicio Fiscal 2020," https://www.ppef.hacienda.gob.mx/.

ratings. We expect consumer confidence to continue to increase in 2020 due to the president's populist policies.

Figure 7. Major 2019 Economic Indicators and 2020 Estimates



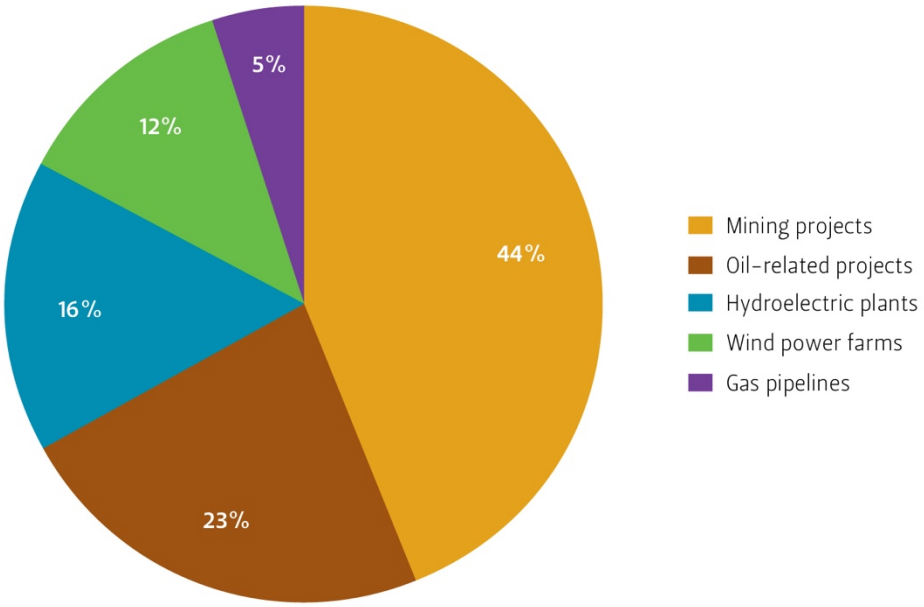
Source: Authors' estimates for 2020

V. Social Conflict

After Mexico's 2013-2014 energy reforms, social conflict with indigenous communities became a major problem for the country's investors. This was because industry and government failed to engage vulnerable communities before energy-related development and expansion gutted their land. Protests, legal challenges, and sometimes violence followed; projects were delayed or halted, costing millions of dollars, but few regulations or consistent processes existed to address the conflicts.

Unsurprisingly, recent data shows that social conflict has increased in Mexico in the last 10 years. Conflicts primarily arise in the states of Chiapas, Oaxaca, Guerrero, Zacatecas, Puebla, Coahuila, Sonora, Durango, and Michoacán, where mining, oil, hydroelectric, wind power and gas pipeline activities are present. The most violent protests are related to mining projects on indigenous lands. Tabasco, Chiapas, and Veracruz have also seen conflicts related to oil and gas infrastructure projects.

Figure 8. Social Conflicts by Economic Activity, 2019



Source: Conversing with Goliath, https://conversingwithgoli.wixsite.com/misitio/datos-y-mapas

While the president would like to strengthen the rights of indigenous people and vulnerable communities in development-related matters, doing so would present challenges to his administration: three of its high priority infrastructure projects go through contested land.

Compounding the situation is proposed legislation that requires prior consultation with indigenous communities before development begins on their land. Although the previous administration introduced the law, three unrelated reasons have prevented ratification: the lack of political will; the incompatibility of the law with international treaties and instruments; and the dominance of economic interests, particularly those of extractive industries.

We foresee a complex scenario involving an attempt to gain approval for a law that could conflict with the development of the three projects that, as noted, are flagship items on López Obrador's short-term agenda: 1) the ongoing construction of the Mayan Train, a railroad traversing the Yucatán Peninsula; 2) the construction of a modern freight railroad connecting the Gulf of Mexico with the Pacific Ocean; and 3) the construction of a new oil and gas refinery in Dos Bocas, Tabasco. In the end, we do not expect the government to expand indigenous rights in 2020.

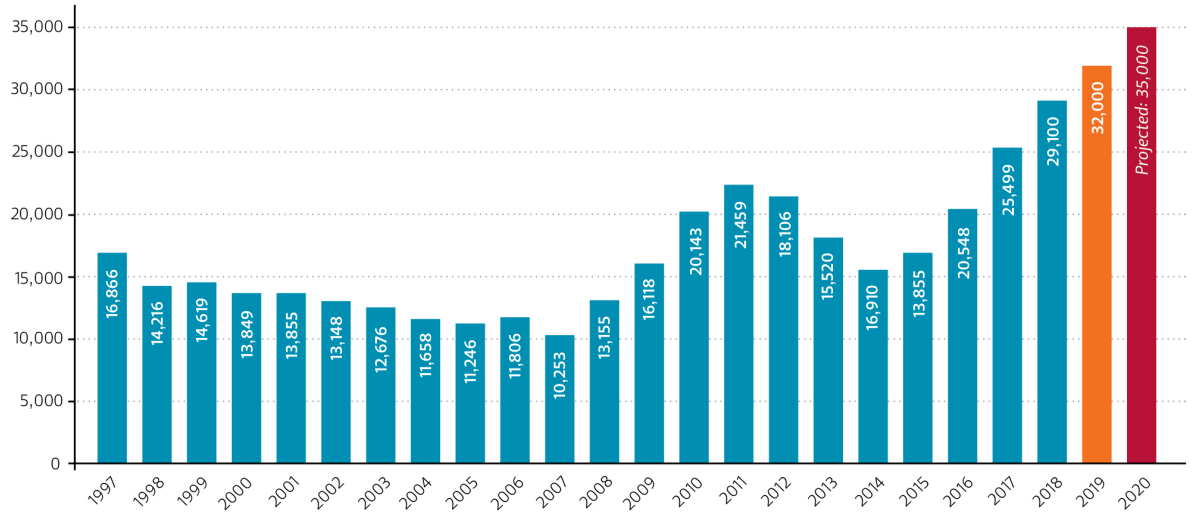
VI. Public Safety and Security

Public safety and security in Mexico continue to deteriorate, with homicides in particular reaching unprecedented heights (Figure 9). The apparent absence of a strategy to strengthen law enforcement in Mexico is deepening the problem. This section briefly examines current trends and expectations for issues related to the rule of law in Mexico, including crime, violence, corruption, and judicial reform.

A. *Crime and Violence*

López Obrador's Achilles' heel is Mexico's weakening rule of law, especially as it relates to public safety and security. In his first year in office (2019), the country's already high murder rate rose by more than 10% over the previous year (Figure 9). Mexico ended 2019 with roughly 30 murders for every 100,000 people—numbers that resemble those in Central America—or approximately 32,000 homicides. Given the lack of a coherent government strategy, crime and violence are expected to rise again in 2020. Moreover, this year López Obrador's ability to blame these trends on his predecessors, especially President Felipe Calderón (2006-2012), will likely weaken, which will add pressure to change his strategy or replace his public safety and security team.

Figure 9. Homicides in Mexico, 1997–2020



Source: Mexican Secretariat of the Interior's (Secretaría de Gobernación, SEGOB) and Mexico's Secretary General of National Public Security (Secretariado Ejecutivo del Sistema Nacional de Seguridad Pública, SESNSP); 2020 number is the author's estimate

B. *Factors Influencing Rates of Crime and Violence*

In 2019, Mexico's legislature approved a National Guard, a new law enforcement body meant to fight crime and reduce violence. Despite this development, the government's current security strategies and actions do not suggest that conditions on the ground will markedly improve in 2020. At best, we expect the rate of deterioration to slow but not reverse. The main factors impeding progress on public safety and security issues include:

1) The administration's lack of political will to confront criminals in high-risk situations, reasoning that confrontation exacerbates violence and results in additional deaths. This was illustrated by an October 2019 incident in Culiacán, Sinaloa, where police ordered the son of drug kingpin El Chapo Guzmán released rather than continue a violent confrontation with the Sinaloa cartel over his detention. Similar high-profile incidents would somewhat erode López Obrador's public support.
2) The apparent absence of a comprehensive strategy to reduce crime and violence.
3) A bureaucratic struggle to configure the National Guard, which comprises military personnel, former federal police officers, and new recruits. This issue will likely linger into 2021, given the resistance to merging the Federal Police with the National Guard, and the fact that the military continues to oppose the discharge of military personnel who are now part of the Guard.
4) The questionable deployment of the National Guard's 50,000 members. Half have been sent to contain or detain migrant caravans traversing through Mexico. The other half is thinly spread throughout the country, and is unlikely to have the numbers needed to face down the 75 or so criminal groups operating in Mexico.
5) The continued lack of coordination between the federal government, governors, and mayors on public safety and security matters; this makes for a disjointed system for addressing crime and violence. The situation is likely to worsen toward the end of 2020, when campaigns for the mid-2021 elections begin to heat up. Interestingly, whereas governors resisted former President Felipe Calderón's efforts to coordinate security matters, it is the federal government that today appears dismissive of the governors' desire for greater coordination. For example, several governors have asked, to no avail, for a National Guard presence in their states and there appear to be very few federal-state initiatives.
6) We expect the López Obrador administration to undermine the work of agencies charged with compiling crime-related statistics in 2020; this could be an effort to avoid highlighting publicly available information. In addition, federal funds, such as the Fund for Public Safe and Security (FASP) and the Public Safety and Security Strengthening Program (FORTASEG), will likely be used to reward state and local political allies and punish administration critics.

2019 statistics revealed a sobering fact: crime and violence still greatly affect some of the states where Mexico's so-called war on drugs began in 2007. Criminal groups have long been present in Michoacán, Jalisco, Sinaloa, Baja California, and Guerrero, and there they

remain. We expect these states to continue to lead the country in crime and violence, although the carnage has spread to most of the national territory. High levels of crime and violence will also continue in Veracruz, Mexico State, Chihuahua, Sonora, Morelos, and Guanajuato, where new criminal groups have emerged or consolidated their power. However, Tamaulipas' public safety and security situation is likely to improve in 2020. The governor in that state is entirely focused on this issue and is currently engaged in strengthening rule of law institutions.

C. *Corruption and Impunity*

According to the Transparency International Index on Corruption, which assesses perceived public sector corruption, Mexico ranked 138th out of 180 countries measured in 2018, with a low score of 28 out of a maximum of 100. Although this ranking is largely based on perception—a questionable methodology—corruption was the single most important issue that propelled López Obrador to the presidency. López Obrador continues to make corruption a centerpiece of his daily rhetoric. This appears to give him a considerable boost in public opinion, and he will continue to emphasize the issue through 2020.

Since most corruption indices are based on perception, López Obrador's continued emphasis on his administration's efforts to address the issue will begin to change perceptions. This will presumably result in a somewhat better Transparency International score for Mexico in 2020—even if the reality on the ground remains roughly the same.

A major issue with López Obrador's approach to fighting corruption, however, is that his crusade led him to close valuable and popular social programs that he said—but did not prove—were corrupt. In their place are centralized cash transfer programs with few or no mechanisms for accountability; this, ironically, is likely to create opportunities for corruption. López Obrador has also reduced the independence of regulatory bodies—such as those in the energy sector—which erodes the ability of these agencies to check corruption. Consequently, we expect institutional weakness[5] to increase in Mexico over the course of 2020.

The exception in this area of policy is the important role of financial intelligence in the López Obrador administration. The Financial Intelligence Unit (UIF in Spanish), located in Mexico's Treasury Department, is engaged in a major effort to develop a follow-the-money strategy to combat money laundering by political figures and organized crime groups. The head of the unit, Santiago Nieto, has been very active in pursuing this strategy. However, there is not yet a pattern to the work of the Financial Intelligence Unit, as it has often selectively implemented its strategies and, at times, has even been guided by the president himself. UIF's efforts will continue in 2020, and it is possible that it will emerge as the most important agency to fight corruption in Mexico. The temptation to use the UIF to investigate political rivals, however, is likely to grow in 2020.

[5] Institutional weakness is found when rules are absent or inconsequential; when rules are poorly enforced; and existing rules rapidly change.

Impunity, a related rule of law issue, is pervasive in Mexico. Most studies show that well over 90% of all crime in Mexico is not reported, primarily because Mexicans do not believe the government will follow up on police reports. In 2019, the government did not grow its institutional capacity to encourage citizens to report crime or to investigate crimes to their final resolution. Thus, we expect impunity in Mexico to remain at the levels that have existed for the last two decades.

D. *Judicial Reform*

López Obrador is highly suspicious of most national institutions. He prefers to centralize decision-making in his office, instead of delegating work to his cabinet or trusting government and civil society institutions to help with governance. His skepticism extends to the judiciary. Thus, we expect no progress on the implementation of the already stalled 2008 judicial reforms. López Obrador largely sees judicial power as an arm of the executive branch, which means he is not shy about interfering with the judicial system—as shown by his use of government powers to force out Supreme Court Justice Eduardo Medina Mora. We should see more evidence of this during 2020 at every level of the judiciary—from the Supreme Court to the lower courts. López Obrador has already threatened to publish the names of federal judges who do not rule "the right way" in cases of corruption.

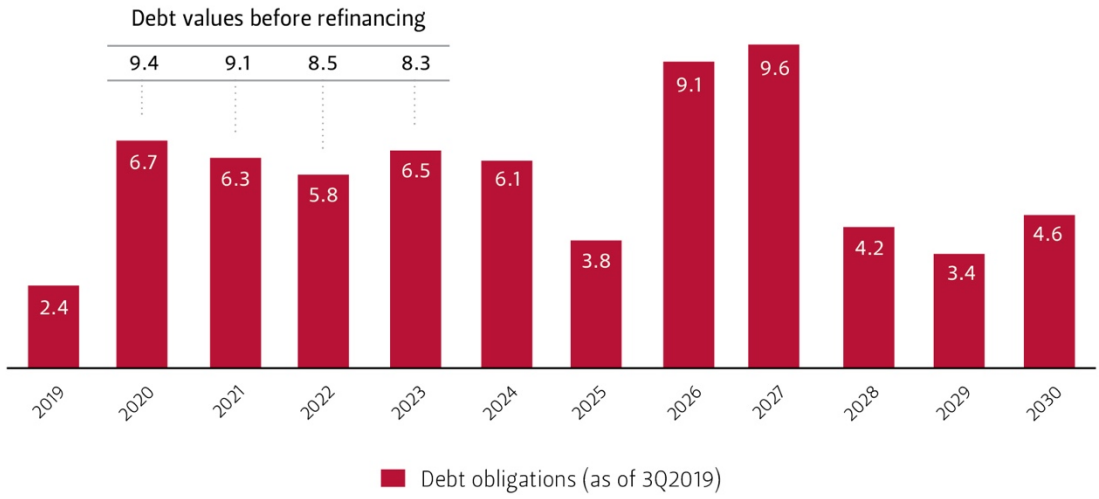
VII. Energy

López Obrador has adopted a nationalist stance on energy issues, mostly with respect to hydrocarbons. Pemex, the country's largest company and most important taxpayer, is considered the instrument that will advance the president's agenda through greater domestic production of oil, gas, and petroleum products. It is hoped that success in this area will lessen Mexico's dependence on energy imports and strengthen the country's energy sovereignty.

A. *Pemex's Finances*

Due to refinancing and debt swaps in recent months, the burden of Pemex's short-term obligations has eased somewhat. Annual debt maturity averages $6.26b for the 2020 to 2022 period, down from a previous average of $9b. However, pressure on Pemex's finances will persist as pension liabilities grow. From the fourth quarter of 2018 to the third quarter of 2019, this long-term obligation jumped 25%, from $57.44b to $69.26b. As of September 2019, overall liabilities totaled to $191.77b, up from $179.55b in December 2018. In 2020, we anticipate that Pemex's financial obligations—debt service, overdue payments to service suppliers, principal payments, mature debts, and pension liabilities—will interfere with the company's financial and production goals.

Figure 10. Pemex's Debt Profile (in billions USD), 2019–2030

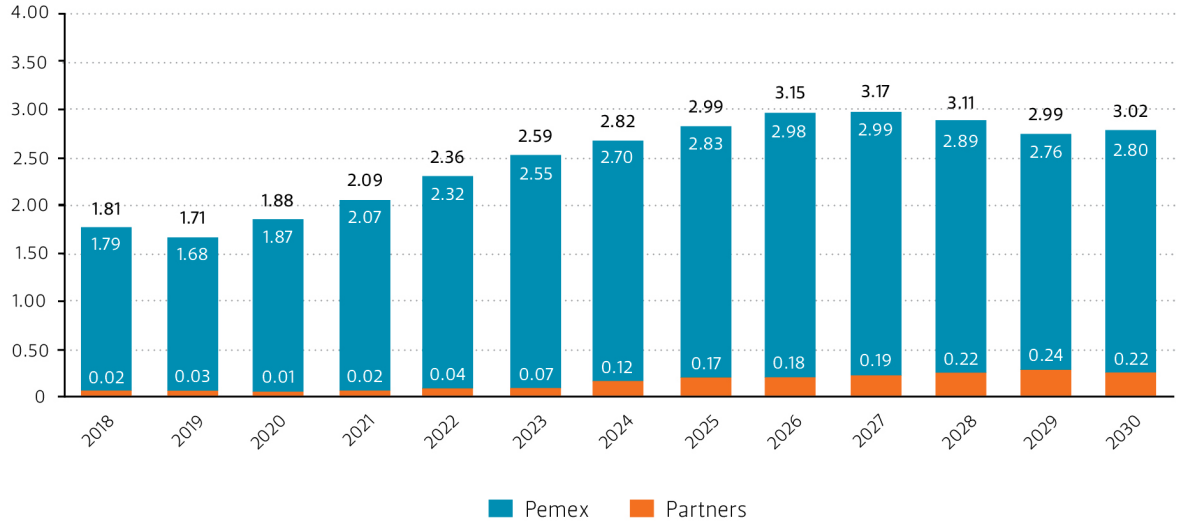


Source: Pemex

B. *Production Prospects*

Pemex had marginal production increases between June–September 2019. Year-end 2019 figures released in early 2020 are expected to show a decline of 0.1 million barrels per day (MMbd) compared to 2018. However, by the end of 2020, Pemex foresees that production will stand at 1.88 MMbd—an increase of 0.17 MMbd over 2019. The company's success depends on the development of 16 shallow water and four onshore high-priority fields, which could yield an estimated 0.256 MMbd by December 2020 and help offset the production decline of existing fields. Production levels will not see significant contributions from Pemex's partners, but their participation will become more relevant toward the end of the current administration. As Pemex's financial and operational woes persist in 2020, we anticipate that the company—as in previous years—will likely miss its production targets.

Figure 11. Past and Projected Crude Oil Production (MMbd), 2018–2030



Source: Pemex

C. *The Important Role of Regulators*

The prospect for Pemex to lose domestic market shares of its petroleum products looms large; in certain cases, private firms are finding ways to expand operations, increase imports, and bypass Pemex's infrastructure. From January to September 2019, domestic sales of Pemex's petroleum products fell by 15.3% compared to the same period in 2018. In 2020, we anticipate that private players—who, for instance, sell gasoline to end users—will likely gain market share at Pemex's expense. But with government pressure on institutions such as the CRE, where five out of the seven commissioners[6] have been appointed by López Obrador, certain decisions made by the CRE concerning competition are expected to reflect the government's nationalist stance on Pemex.

[6] As of the time of printing, one seat remains vacant.

VIII. The Binational Relationship

The consensus on binational relations that emerged from the North American Free Trade Agreement in 1994 has in part supported the generally stable political and diplomatic relationship enjoyed by the United States and Mexico for the past quarter century. However, both the Trump and López Obrador administrations have apparently dispensed with the idea of a strategic partnership within a larger continental framework. The relative calm in the binational relationship today is partly due to López Obrador's acquiescence to Trump's wishes, especially on immigration. This is likely to continue, though specific binational issues could flare up in 2020. This section discusses some of them.

A. *Immigration*

Citing his broad authority under the International Emergency Economic Powers Act, Trump in May 2019 threatened to impose tariffs of 5%, ultimately rising to 25%, on all U.S. imports from Mexico, unless Mexico stepped up efforts to intercept immigrants from El Salvador, Guatemala, and Honduras before they reached the United States. The administration did not carry out the threats, but they could be revived at almost any time if Trump decides that Mexico is not doing enough in this area. There is also a risk that the threat of tariffs could be revived if illegal immigration from Mexico to the United States increases in the coming months.

The ebb and flow of migrants and refugee seekers should continue in 2020. And although the issue will occasionally heighten tensions between Washington and Mexico City, the López Obrador administration (as noted earlier) seems inclined to appease Washington by hardening the Mexican government's stance toward migrants transiting through the country. The López Obrador administration has in fact internalized U.S. immigration policy partly because of tariff threats from the Trump administration and because ratifying the USMCA is a top priority for Mexico in 2020.

B. Border Security

Border security continues to be affected by the arrival of asylum seekers; the smuggling of weapons into Mexico, which puts superior firepower into the hands of organized crime; and drug smuggling, particularly heroin, cocaine, methamphetamines, fentanyl and other synthetic drugs. None of these three issues is expected to change in 2020. The market incentives for drugs and weapons are still in place. The number of asylum seekers from third countries is likely to drop but still fluctuate through 2020—perhaps prompting Trump to threaten tariffs on Mexico when the numbers rise. The number of Mexicans seeking asylum, however, could rise slightly in 2020 as Mexico's economic conditions weaken and public safety and security continue to deteriorate in Michoacán, Guerrero, and Jalisco, among other states.

Trump's 2020 presidential campaign will direct much attention to the U.S.-Mexico border, even though overall conditions there are relatively stable. This will likely create more volatile conditions on the ground and lead to border management brinksmanship,

including threats by Trump to close ports of entry and order uncommon deployments of border law enforcement personnel.

C. *Trade: USMCA Approval*

The U.S. House of Representatives passed the USMCA on December 19, 2019, by a margin of 385–41. The Senate is expected to approve the legislation early this year, after the impeachment trial of President Donald Trump. Once the three USMCA parties agreed with the Democratic House leadership on a lengthy Protocol of Amendment on December 10, approval in the United States was not in serious doubt. This action followed months of negotiations between the House leadership, U.S. Trade Representative Robert Lighthizer, and Mexican government officials, along with the participation of the House leadership. They and Canadian officials were ultimately able to agree on a series of key changes to the USMCA. The Protocol of Amendment signed in December focuses on improved enforcement of the USMCA's labor and environment provisions, including an annex providing for a "faculty-specific rapid response labor mechanism." Also significant are provisions relaxing protections for pharmaceutical patent holders and eliminating the 10 years of special protection originally afforded to manufacturers of biologic drugs. In addition, provisions of the protocol seek to make it more difficult for any party to block the formation of state-to-state dispute settlement panels, and further tighten automotive rules of origin by requiring after seven years that steel be "melted and poured" rather than simply fabricated in the United States in order to qualify for North American content requirements.

Without approval in 2019 or early 2020, consideration of the USMCA in the United States would probably have been deferred until early 2021 because of the presidential election, with the Democratic primaries beginning in February and many Democrats becoming unwilling to cast a politically unpopular vote for freer trade in an election year.

Democrats were far more likely to support this revised USMCA than any previous trade agreement, including NAFTA, because the USMCA offers: a) the prospect of increasing U.S. auto industry employment through tougher rules of origin and salary minimums; b) greatly improved unionization and collective bargaining rules under recent Mexican labor legislation now effectively enforceable by the USMCA; c) improved environmental protections; and d) the elimination of investor-state dispute settlement with Canada and a reduced scope for investor-state dispute settlement with regard to Mexico. The endorsements of the amended USMCA by the powerful AFL-CIO and Teamsters unions also make it far easier for Democratic members of the House to support the agreement.

Speaker of the House Nancy Pelosi and other members of the House leadership have repeatedly stated that they viewed USMCA ratification and the impeachment inquiry as separate legislative actions that could proceed on independent tracks. The conclusion of the USMCA protocol confirms this pledge.

The action by Congress and the USMCA parties means that the USMCA should enter into effect by the end of March 2020. (Approval of the protocol by Mexico's congress, and of

the original agreement and protocol by Canada's parliament, were not considered in doubt.) Earlier threats by the Trump administration to terminate NAFTA are no longer relevant. For the first time in three years, the approval and entry into force of the USMCA should give enterprises in all three USMCA countries confidence to increase investment and hiring, potentially improving the economy of Mexico as well as the United States and Canada.

D. *The U.S. Trade Deficit*

Largely because of the U.S.-China trade war, many enterprises that produce goods in China for the U.S. market are relocating to other nations, particularly Mexico. This has made Mexico the United States' largest single source of imports, eclipsing China. Such moves have also increased the U.S. trade deficit with Mexico. Since the Trump administration is very much opposed to large trade deficits with individual countries, it is possible that it could take measures intended to reduce the deficit, such as imposing penalty tariffs on Mexico. However, by doing so, Trump runs the risk of causing serious economic disruption in the U.S. and a further slowdown in the U.S. economy, which he probably would prefer to avoid before the 2020 election.

E. *Diplomatic Relations*

Surprisingly, and despite his criticism of the approach taken by previous administrations to the U.S.-Mexico relationship, López Obrador has prioritized good relations with the United States. His administration has actively cooperated with the U.S. on immigration issues; continued to collaborate on anti-drug policy, albeit quietly; and employed direct shuttle diplomacy to calm tense situations. As a result, Trump has praised López Obrador dozens of times for his cooperation on U.S. policy objectives. López Obrador's approach to binational relations will continue through 2020, and especially while the USMCA remains unratified. This game plan, however, has an important weakness. Mexico appears to lack a coherent diplomatic strategy and a way to coordinate and communicate policy with Washington. This has led Washington officials to criticize the Mexican government's overall approach to security—including drug trafficking. These occasional tensions are expected to continue through 2020.

IX. Conclusion

2020 will be a difficult year for Mexico. The greatest challenges will be to restore economic growth and address declining public safety and security. So far, we have seen few strategies or plans from the López Obrador administration that could achieve either objective. His bet on investing in Pemex to return economic vitality to the country is highly questionable—and even if his goal is realized, it will not happen in 2020. However, foreign direct investment will help curb the economy's downward trend, assuming López Obrador's policies, particularly in the energy sector, do not drive off foreign investors. And in an environment of political and regulatory uncertainty, one way to assure foreign investors is through the ratification of the USMCA by the U.S. and Canada. Another path involves changing López Obrador's populist strategy that, through policies that weaken both autonomous institutions and the rule of law, is affecting democracy in Mexico.

On the political front, the opposition is expected to begin forming coalitions in preparation for the 2021 midterm elections. Thus, López Obrador's window of opportunity to correct his current course will begin to close over the course of the year. This will make it more difficult for him to achieve the political consensus he requires to resolve the major challenges facing his administration today.