GBM

Mexico Economic Outlook 2024:
The party is not over yet

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THE PARTY IS NOT OVER YET

After a couple of years where the Mexican economy has surprised to the upside, we believe 2024 won't be the exception, as the party is far from over. Mexico's economic activity is bound to keep showing off its best moves in 2024, encouraged by strong consumption and investment dynamics, an expansionary fiscal policy, and the continued materialization of the unique opportunity brought by nearshoring. Moreover, we are about to see the end of the monetary tightening waltz while inflation may continue to recede, albeit slowly and with some upside risks. Without a doubt, elections will steal the show next year, as Mexico is likely to elect its first female President, and the U.S. balloting in November will also take the stage. Thus, although some risks emerge on the horizon, the night is still young for the Mexican economy, in our view.

ECONOMIC ACTIVITY. After an outstanding year, we foresee the Mexican economy will keep growing at a solid pace and rise by 2.8% YOY in 2024 (vs. 3.5% YOYe in 2023), on the back of strong consumption dynamics, supported by a resilient labor market and wage mass, and solid investment levels. Additionally, Mexico's economy will enjoy the benefits of an expansionary fiscal policy that, coupled with elections, is bound to show up in 1H24, particularly in the variables mentioned above. Furthermore, while the U.S. economy is expected to cool down, we remain confident in our nearshoring thesis and continue to see it as a major economic propeller.

INFLATION. Even as inflation is on a downtrend, we believe it will remain pressured and above the Central Bank's target, going from a YE23 level of 4.5% YOYe to 4.4% YOYe by the end of next year. Bear in mind that significant upside risks for inflation will be present throughout 2024, including the pressures stemming from a dynamic economic performance, an expansionary fiscal policy, and minimum wage increases, all of which could particularly affect core inflation.

MONETARY POLICY. After more than two years of a tightening cycle, we believe 2024 will be the year when Mexico's Central Bank starts to introduce rate cuts, although it will remain cautious along the way. Indeed, we foresee Banxico will begin with its easing cycle in March 2024 until reaching a YE24 level between 9.25-9.75%; however, it is worth noting that the real ex-ante interest rate is bound to remain in restrictive territory throughout the year, mainly given the persisting risks for inflation.

MEXICAN PESO. After a year of significant and rapid appreciation, we expect the Mexican peso to slowly begin losing steam in 2024 to a year-end range of 18.2-19.2 pesos per dollar, amid a series of factors that could cause volatility periods, including the reduction of the interest rate spread between the U.S. and Mexico, presidential elections in both countries, and increasing doubts on Mexico's fiscal prudence in the coming years.

GBM Estimates	
	2024
GDP (YOY %)	2.5-3.1
CPI (EOP, YOY %)	4.2-4.6
Core CPI (EOP, YOY %)	4.1 - 4.5
Monetary Policy Rate (EOP, %)	9.25-9.75
Mexican Peso (EOP)	18.2-19.2

THE PARTY IS NOT OVER YET

A SNEAK PEEK INTO 2024

2023 was a year for the books and definitely not what everyone thought it would be. First off, the Mexican economy continuously beat analysts' expectations, and inflation finally began to recede. While interest rates reached record highs, an easing cycle appears to be just around the corner. What's more, the once-forgotten Mexican peso showed up with an unforeseen appreciation due to strong carry trade and solid macroeconomic fundamentals.

As we head into 2024, we believe the party of Mexico's economic activity is far from over. For one, Mexico's economic activity is bound to keep showing off its best moves, boosted by strong consumption dynamics that will be helped by an incredibly resilient labor market and strong remittances. Furthermore, the expectation of an expansionary fiscal policy will further boost both consumption and investment, while the external sector will continue to thrive as it capitalizes on the unique opportunity brought by nearshoring.

Even as the worst of inflation seems to be yesterday's news and interest rates arrived at the party on time, the latter still must figure out how to get back home safely at the end of the night and without any mishaps. However, as everyone celebrates that the worst of inflation is behind us, central banks (around the world and in Mexico) are awkwardly standing on the sidelines, skeptical about joining the fun, as risks for inflation still loom on the horizon.

And like any other party, we might face some killjoys, and the MXN will be no exception. The seemingly unstoppable Mexican peso will slowly run out of energy and want to leave the gathering, particularly when electoral processes grab the microphone and the interest rate spread starts to lose its charm.

Everyone knows that partying comes at a price, but we can save the worries for another time. Before the sun rises, we might as well live in the moment, laugh with our friends, blast great music, and sway until our feet hurt. After all, the night is young and, with this economy, we can dance 'til dawn.

2024 will be a year to remember, and as we dress up and get ready for it, there are a couple of events to follow closely that are bound to dictate the mood of the evening.

01.

BANCO DE MÉXICO

The end of a long monetary waltz. More than two years after the start of its hiking cycle, the Bank of Mexico seems ready to put an end to this long waltz and begin cutting rates in early 2024. While inflation has remained on a steady downtrend, we believe the last mile could be the toughest for Banxico, mainly due to increasing inflationary pressures on the core and non-core components, making it likely for the Central Bank to remain cautious on the way down. Thus, we expect Banxico to begin its easing cycle in March 2024 and the overnight interest rate to reach a YE24 level of 9.5%.

02.

A karaoke contest between female presidential candidates. In 2024, Mexico is likely to elect its first female president, which we believe will give continuity to the incumbent party MORENA. While Claudia Sheinbaum remains the clear favorite to win the presidential election, echoing the harmonies of President López Obrador, we think opposition parties will manage to conquer the stage of legislative elections. Furthermore, the electoral period is bound to crank up the volume of economic activity in the first half of the year.

03.

Nearshoring will be the frosting of an already-tasty cake. Amid what will be another good year for the Mexican economy, we are convinced that nearshoring will further consolidate in 2024. As Mexico continues to gain market share in U.S. imports and foreign investments become visible in the country, nearshoring will become the cherry on top for the external sector, adding to economic dynamism. Indeed, we expect that nearshoring and its multiplier effect will contribute with an additional 45 bps. to GDP.

04.

The neighbors could turn down the beat... While Mexico enjoys its party, other relevant events around the globe are likely to make an appearance throughout the year. At the top of the guest list, the U.S. presidential election in November (most likely to be a rematch of Biden vs. Trump) could bring some volatility to the markets. As investors seek safe havens, we believe the Mexican peso will gradually depreciate. Furthermore, elections could hold back remittances and foreign direct investment in Mexico, as has been the case in other U.S. electoral periods.

05.

...and uninvited guests could spoil the fun. It is all laughs and cheers until someone on the other side of the world reminds us that we cannot rule out geopolitics. The Russian invasion of Ukraine, the Israel-Gaza war, and growing tensions between China and Taiwan could continue to show up unannounced. Although no high risks are expected for trade, supply chains, or commodities in 2024, the world will keep an eye out for anything that might stir some trouble.

2024 CALENDAR

Save the date...

FEBRUARY

FEB. 15-22
Registration of presidential candidates

MARCH

MAR. 1
Presidential campaigns kick off.

APRIL

APR. 1
2025 Preliminary Economic Policy Guidelines are sent to Congress.

MAY

MAY 29
Closure of electoral campaigns

JUNE

JUN. 2
Presidential, Legislative, and Local Elections

SEPTEMBER

SEPT. 1
New Congress takes office.

SEPT. 8
2025 Budget Bill is sent to Congress.

OCTOBER

OCT. 1
New administration takes office.

NOVEMBER

NOV. 5
U.S. Elections

NOV. 30
Luis María Aguilar concludes his term as Supreme Court Justice

DECEMEBR

DEC. 31
Irene Espinosa concludes her term as Deputy Central Bank Governor.

Pending events: Possible panel resolution to the disputes on energy and GM corn matters under the USMCA

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ECONOMIC GROWTH

ECONOMIC GROWTH

We believe the Mexican economy will continue to dance the night away in 2024, albeit at a slower rhythm, pushed by strong consumption dynamics and an expansionary fiscal policy. (2.8% YOYe vs. 2.2% consensus)

After a year in which the Mexican economy continuously outperformed analyst expectations, we foresee it will keep growing at a solid pace (2.8%e vs. 3.5% in 2023). Just as we have seen throughout 2023, we anticipate consumption will remain the economy's main driver, on the back of an incredibly resilient labor market and wage mass, coupled with lower inflation levels. Furthermore, while exports are expected to slow down next year, mainly as an effect of a cooler U.S. economy, we remain confident in our nearshoring thesis and continue to see this phenomenon as a major economic propeller.

Moreover, as we head into an electoral year, we think most of this economic dynamism will occur in 1H24. First and foremost, the expansionary fiscal policy expected for next year, as outlined in the 2024 Budget Bill, will most likely play a crucial role in economic activity. As we have recently analyzed, multiple macroeconomic variables tend to perform better in the first half of electoral years due to higher public spending that brings spillover effects on consumption and gross fixed investment (GFI).

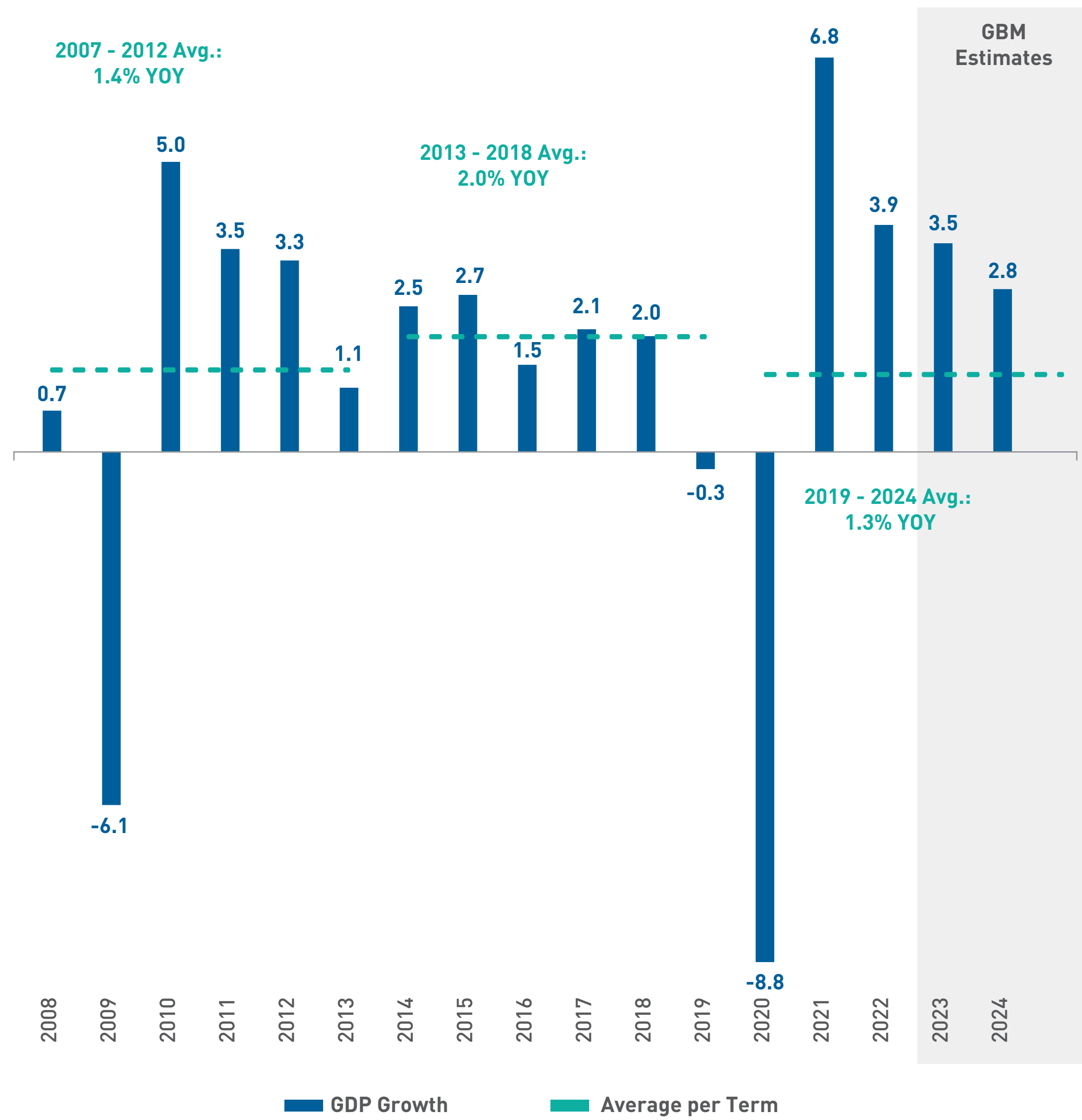
However, we also note that the Mexican economy might start to groove at a calmer rhythm in the second part of the year (1.3% YOYe in 2H24 vs. 4.2%e in 1H24), led by the change of government, as this time, the new administration will take office in October instead of December as was the practice in the past.

Breakdown of GDP Growth Estimates
-YOY %

	2024
GDP	**2.8**
Private Consumption	2.8
Gross Fixed Investment	5.0
Government Spending	3.2
Exports	3.2
Imports	4.5

Sources: GBM Estimates with data from the National Statistics Agency (INEGI)

After an exceptional year for economic growth, we expect the Mexican economy to grow at a solid pace.
-Mexico's GDP; YOY %



ECONOMIC GROWTH

Mexico's GDP expands faster in electoral times, concentrating the economic expansion in the first semester of the year.

Looking at the big picture, Mexico's economic activity tends to rise faster in electoral years, on average, when compared to non-electoral periods. Of course, a faster pace of expansion is the result of multiple variables growing at once. One of them is that private consumption tends to gain traction in electoral years, helped by a more dynamic labor market in these periods. Moreover, private investment fuels industrial activity, yielding higher growth rates in electoral years.

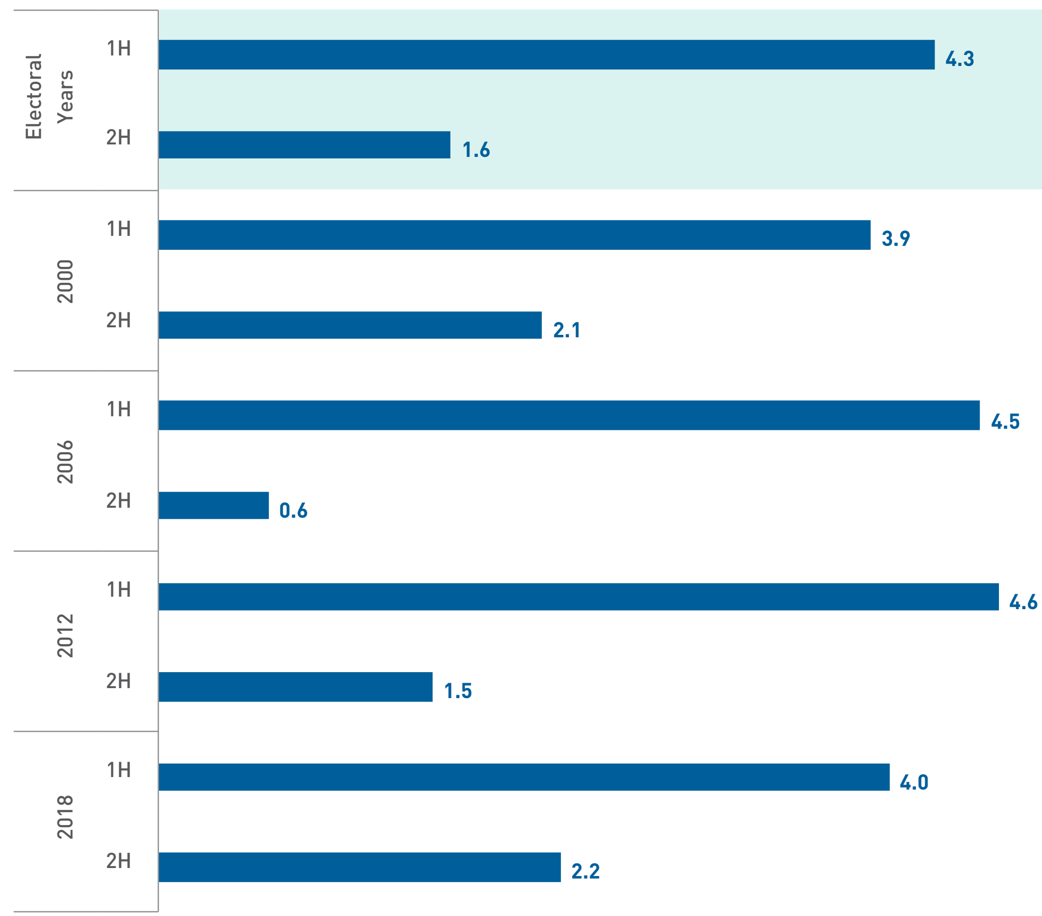
Furthermore, we note that the expansion of economic activity in electoral times is more pronounced in the first half of the year. In other words, a larger output is seen in the months preceding the election, typically held in June or July, as more resources are poured into production before cooling down once the electoral process is over.

Multiple variables help explain the larger economic expansion seen in electoral years, with most presenting statistically significant differences.
–Mean Differences in Economic Variables in Electoral Years vs. Non-Electoral Years

	Electoral (%)	Non-Electoral (%)	Mean Difference (pp.)
Gross Domestic Product (GDP)	3.9	1.7	2.2***
Supply Side			
Primary Activities	3.0	1.7	1.2
Industrial Activities	3.6	1.3	2.3***
Mining	-0.5	0.1	-0.5
Utilities	2.0	3.9	-1.9
Construction	5.2	0.8	4.4**
Manufacturing	4.2	1.8	2.4***
Services Sector	4.1	2.0	2.1***
Wholesale	5.6	2.7	2.8***
Retail	5.0	2.2	2.8**
Transport	4.9	2.7	2.2**
Media	6.3	6.9	-0.5
Finance Services	6.3	6.5	-0.3
Real Estate	3.3	2.5	0.8***
Professional Services	3.1	2.1	1.0
Corporate Services	7.5	3.4	4.1***
Support Services	4.0	-1.2	5.2***
Education	0.9	1.2	-0.4
Health	3.4	1.8	1.6**
Leisure	2.8	3.6	-0.8
Hospitality Services	4.5	1.5	3.0
Other Services	3.1	1.0	2.1***
Government	2.7	0.2	2.5***
Demand Side			
Consumption	4.3	2.1	2.2***
Gross Fixed Investment	6.6	2.0	4.6**
Public	5.9	0.5	5.4
Private	7.1	2.3	4.8**
Government	2.9	1.2	1.7***
Exports	9.6	5.7	3.9***
Imports	11.5	5.2	6.3***

Data for 1994-2023
*Significance levels at confidence intervals (%): * at 90%; ** at 95%; *** at 99%*
Source: GBM estimates with INEGI data

As seen in GDP, this expansion is clearer in the time prior to the elections, as administrations tend to allocate all their resources to the electoral process.
–Government Component of GDP by Semester, Avg. YOY %



PRIVATE CONSUMPTION

Consumption is the reigning dancing queen in Mexico, as the labor market blasts all its favorite tunes.

Despite rising more slowly, we expect private consumption to remain under the economic spotlight in 2024 and to beat GDP growth (2.8% YOYe vs. 4.3% YOYe in 2023). The extraordinary performance of consumption should prevail, given its solid fundamentals —namely, the labor market and remittances.

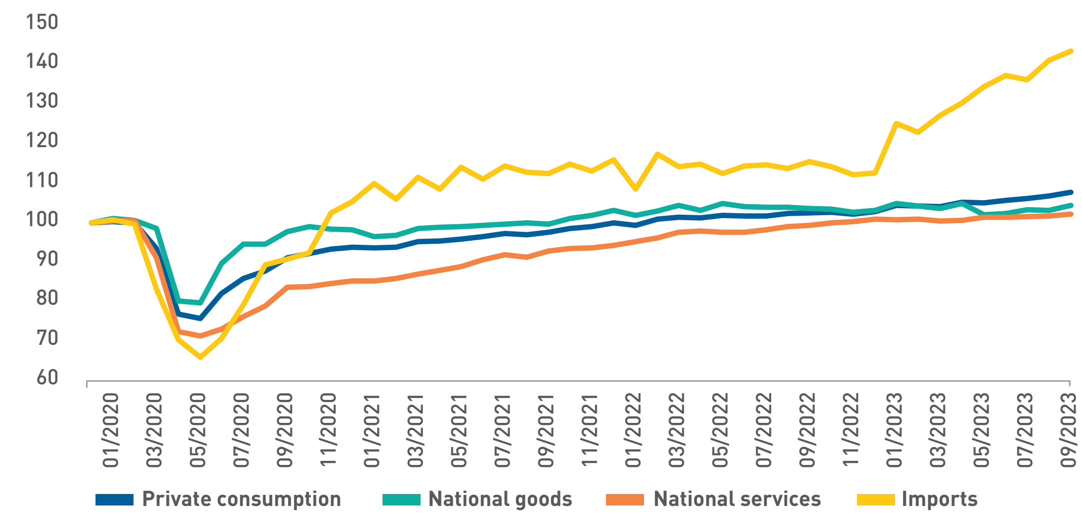
We have repeated time and again, but we firmly believe that the labor market is setting the pulse for consumption in Mexico. The former has not only been quick in recovering from the COVID pandemic in 2019 —particularly in the formal sector— but has also revealed its capacity to absorb other adverse shocks, including the effects of the 2021 outsourcing law reform and an extended annual paid leave for employees. Furthermore, we cannot fail to highlight that the unemployment rate reached an all-time low of 2.6% (seasonally adjusted) in October 2023 —resilience that should extend into 2024.

As for the wage mass, it has exhibited remarkable growth in the after-pandemic period, boosted by both employment and salaries. In this regard, it is worth recalling that the minimum wage will increase by 20% in 2024.

And, as if it weren't enough, the expansionary fiscal policy will help prolong the party for consumption. Indeed, electoral years prompt a noticeable uptick in private consumption —a trend that reflects in the broader sphere of total tertiary activities (as we can observe in the previous slide). Interestingly, this heightened consumer activity is more pronounced in the first half of the year. When delving into the services sector, data becomes even more compelling, as higher growth rates are typically seen in categories including wholesale and retail trade.

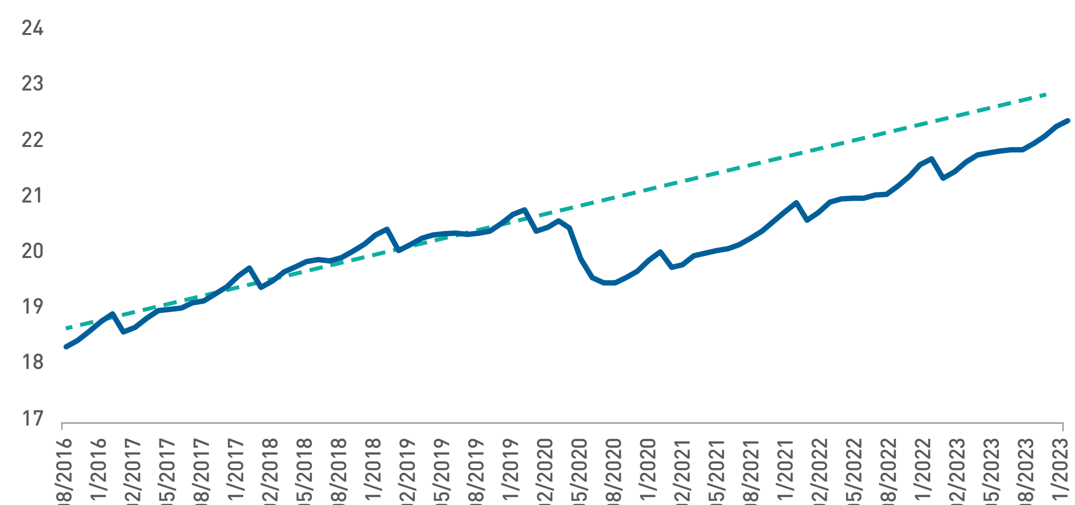
Private consumption has gradually found its footing and kept a positive trend, while imports have notably outperformed domestic categories.

–Private Consumption Index; Dec. 2019 = 100



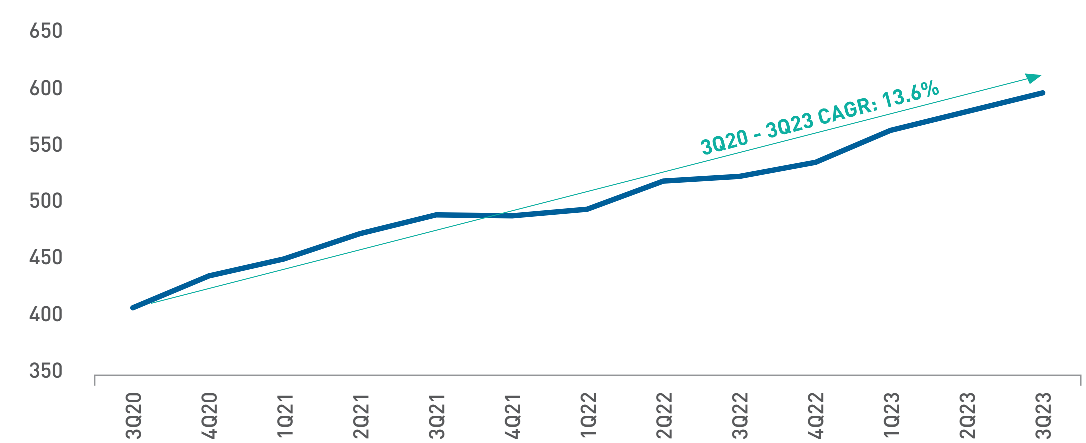
Formal employment could close the gap with its pre-pandemic trend in 2024.

–Million Jobs



The total wage mass, reflecting employment and salaries, is still expected to grow next year.

–Wage Mass (MXN Billion)



Sources: Data from the National Statistics Agency (INEGI) and the Mexican Social Security Institute (IMSS)

PRIVATE CONSUMPTION

Remittances will still be an honorable guest but might find it difficult to fully enjoy the party.

Without a doubt, remittances have become a VIP guest for consumption. The remittances from Mexicans living abroad should remain robust in 2024 but no longer at double-digit growth rates (9.7%e vs. 16% in 2020-2023). Still, the expansion seen in 2024 will be solid enough to back consumption among Mexican households.

Indeed, remittances will continue to be paramount as we head into 2024, but we recognize they may face some downside and upside risks, simultaneously. Be mindful that remittances tend to grow at a slower average rate in electoral years in the United States, which could play to the downside, as our northern neighbor will hold presidential elections next November. However, after being slightly affected by a rapid appreciation of the Mexican peso in 2023, the expected depreciation for 2024 could help remittance recipients recover some of their purchasing power in local currency. Hence, while remittances face both risks, the question remains as to which will offset the other.

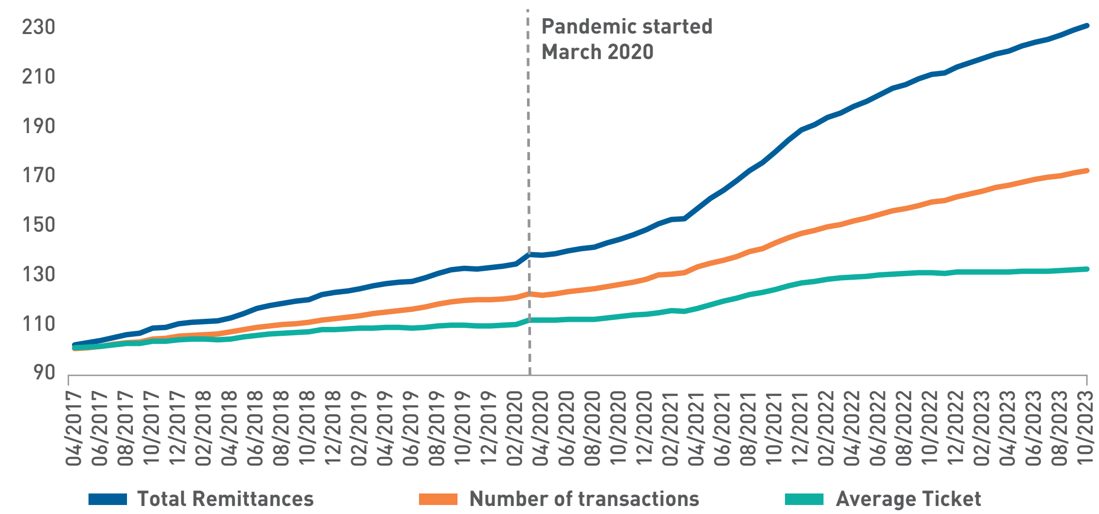
Lastly, we expect consumer confidence —another driver for private consumption— to remain upbeat. In our view, the most tangible component of the index —consumers' possibility to buy durable goods—, which is bound to translate into actual purchases in the immediate future or the short term, could be on an uptrend in 2024, reflecting the additional minimum wage increase, the expansionary fiscal policy, and the positive impact of electoral years on consumption.

Remittances usually slow down in election years in the U.S.
-Avg. YOY %

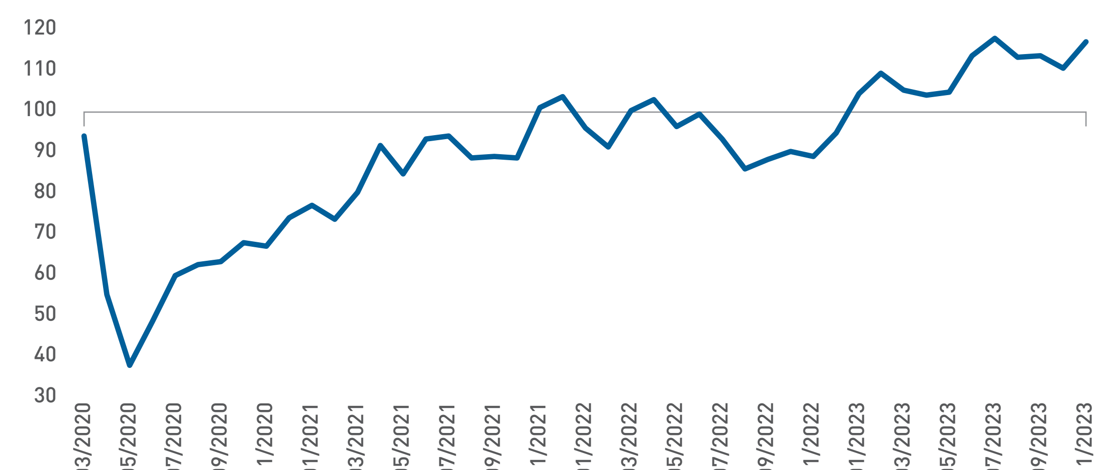
	Electoral (%)	Non-Electoral (%)	Mean Difference (pp.)
Remittances	8.1	12.6	-4.5***

*Significance levels at confidence intervals (%): *** at 99%*
Source: INEGI data

Since the pandemic struck, an upswing in remittances to Mexico has been observed — a trend that should extend into 2024.
–12M Moving Average; Index Jan. 2017 = 100



Consumers' possibility to buy durable goods could backtrack, as an expansionary fiscal policy may further boost consumption.
–Consumers' possibility to buy durable goods; Index Jan. 2020 = 100



GROSS FIXED INVESTMENT

GFI is poised to remain strong in 2024, propelled by public and private investment.

After an extraordinary year, we anticipate private and public investment will keep conquering the dance floor in 2024, being one of the main drivers of economic activity. We estimate gross fixed investment will grow by 5.0% YOY in 2024 —a moderation compared to the outstanding figure expected for 2023 (+9.8% YOYe) but still well above its ten-year average (+1.2% YOY). However, we recognize there are significant differences in the strength recently observed in private and public investment.

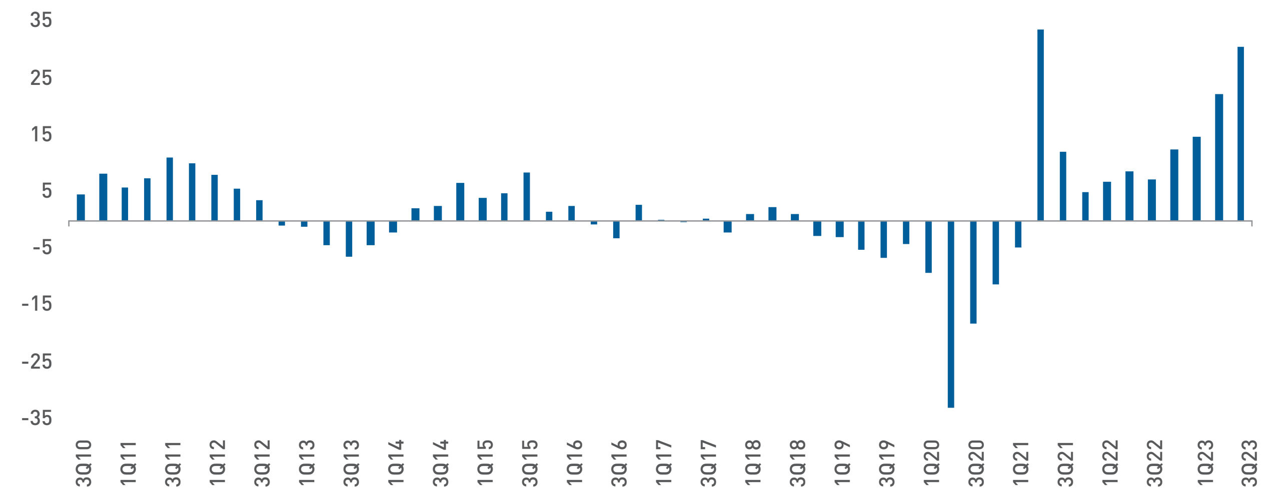
The private investment boom, which we attribute to nearshoring factors, is a structural change that could drive up Mexico's potential growth, with industrial activity as a first derivative. The impact of investments in the private sector related to nearshoring is evident in the machinery & equipment component of GFI, which has consistently exhibited positive behavior since bouncing back from the pandemic aftermath. From our perspective, this recovery marked a period in which Mexico emerged as a more attractive alternative for global investors.

Besides the latter, Mexico's industrial sector has posted an outstanding performance despite a U.S. industrial deceleration. Even as the U.S. industrial sector is cooling down, Mexico's industrial activity is about to crank the music up, an unusual occurrence likely influenced by the appearance of nearshoring-related private investment. This unprecedented behavior is noteworthy considering the historical correlation between Mexico and the U.S. industrial sectors. Although, traditionally, Mexico's industrial output tends to be slightly weaker compared to the U.S., this year's trend shift could potentially be attributed to nearshoring trends that are bolstering the sector in Mexico.

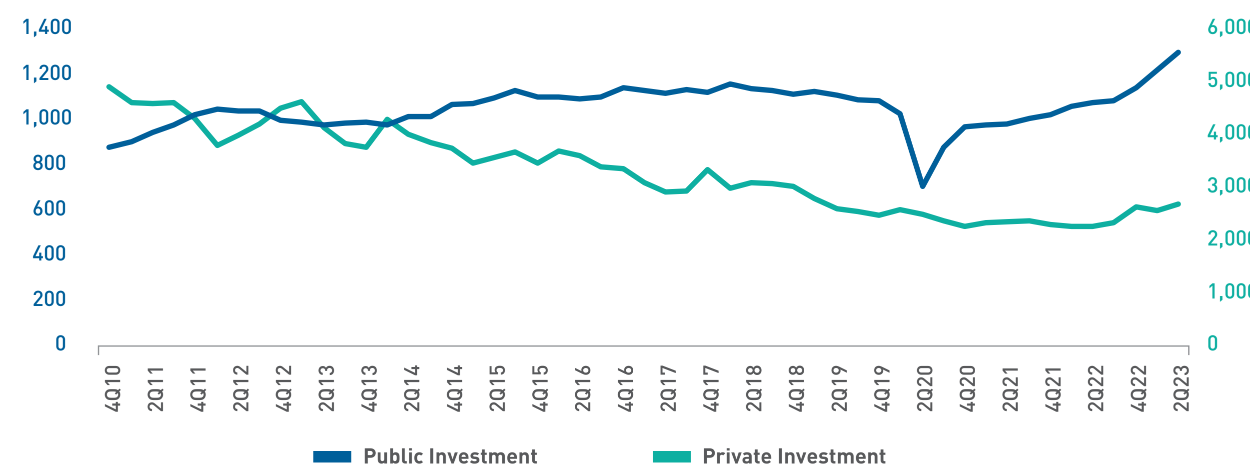
Unlike private investment, public investments could only produce temporary benefits, in our view. While the impact of public investment is distinctly visible in the construction sector, which has experienced a notable uptrend since the last year, we believe that government infrastructure projects might continue to stimulate economic activity in 1H24, but this effect could fade in 2H24.

The amount allocated to priority infrastructure projects in 2024 was P$222.7 billion, equivalent to 2.5% of the total budget for the year. Indeed, as we approach the end of President López Obrador's term, these projects have gained relevance, as the government is trying to complete them before the election period. After that, there are no significant new projects planned. Consequently, once the ongoing infrastructure initiatives conclude, public investment should experience a hiatus for several quarters. Furthermore, in 2025, Mexico is scheduled for fiscal consolidation in adherence to the Fiscal Responsibility Law, aligning with the Finance Ministry's forecasts.

Gross fixed investment has shown consistent growth in annual terms for over two years, with its expansion rate gaining momentum in the past year.
–GFI; YOY %



Private investment is at its highest since 2010, and the uptick in scheduled public investment could be an additional boost.
–Private and Public Investment (MXN Billion)

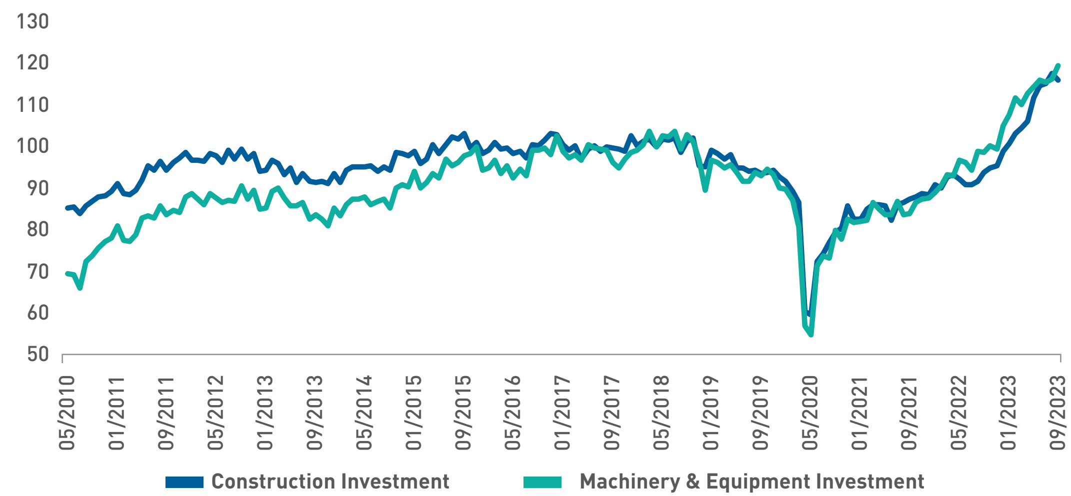


Sources: INEGI data

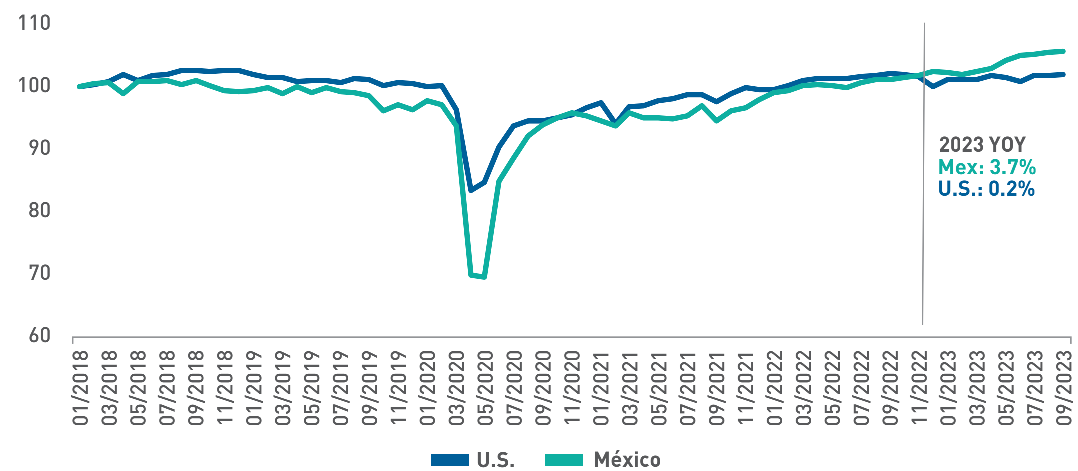
PUBLIC AND PRIVATE INVESTMENT

While private investment, propelled by nearshoring, holds the potential to drive growth, public investment, tethered to the political agenda, may be more indicative of a one-time effect.

Investments in Machinery & Equipment and Construction have reached a decade-long high.
–GFI Breakdown, Index 100 = 2018



Mexico's industrial activity sang its lungs out in 2023, even as U.S. industrial activity took a seat and grabbed a drink.
–Industrial production (seasonally adjusted); Index 2018 = 100



Spending on Priority Projects and Programs
–MXN Billion

Mayan Train	120.0
Projects to build and preserve the hydraulic infrastructure of the National Water Commission (CONAGUA)	39.5
Projects for the construction and maintenance of transportation and communication routes	35.1
Development of the Isthmus of Tehuantepec region	21.1
Mexico-Toluca Interurban Train	4.0
Line 1 (Lecheria-Jaltocan-AIFA) of the Suburban Train	2.0
Cultural space of Los Pinos and Chapultepec Park	1.0
TOTAL	**P$222.7**

Sources: INEGI data, Ministry of Finance (SHCP)

EXTERNAL SECTOR

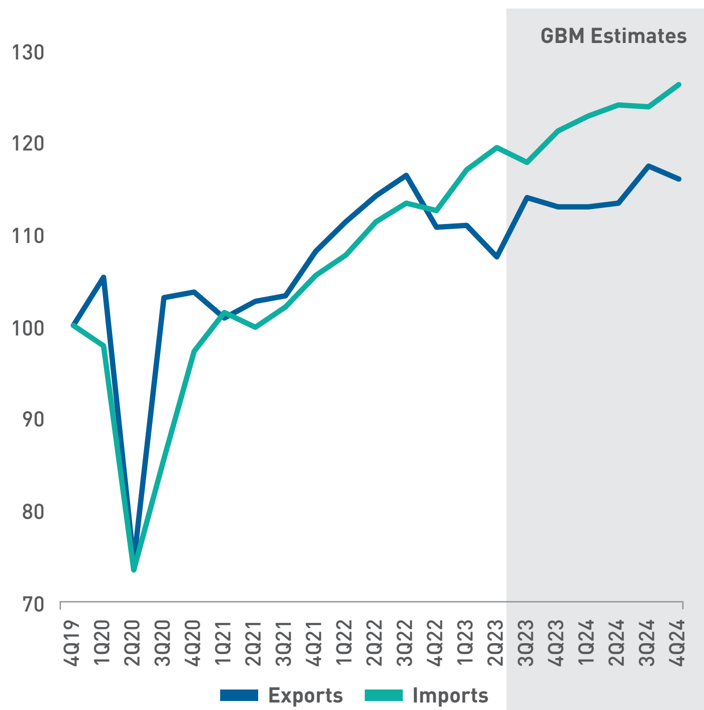
Mexico's external sector is stayin' alive in 2024, moving to the beat of nearshoring.

After briefly twisting an ankle in 2023, exports should make a comeback in 2024. We forecast that exports will rebound by 3.2% YOY in 2024 (vs. -1.6% YOYe in 2023). What's more, we stand by our nearshoring thesis, and its positive impact makes us dream of a boogie wonderland for Mexico's external sector. As we have mentioned earlier, Mexico is poised to be the ultimate winner of the nearshoring dance-off, as it offers unique geographical, demographic, financial, and economic advantages to foreign investors and companies looking to supply the U.S. market. While we will delve into nearshoring later, we believe that an unequivocal leading indicator of it is the astounding increase in capital goods imports (+22.0% YOY in 10M23 vs. +19.1% in 2022), as they could subsequently translate into additional exports, especially for the manufacturing sector.

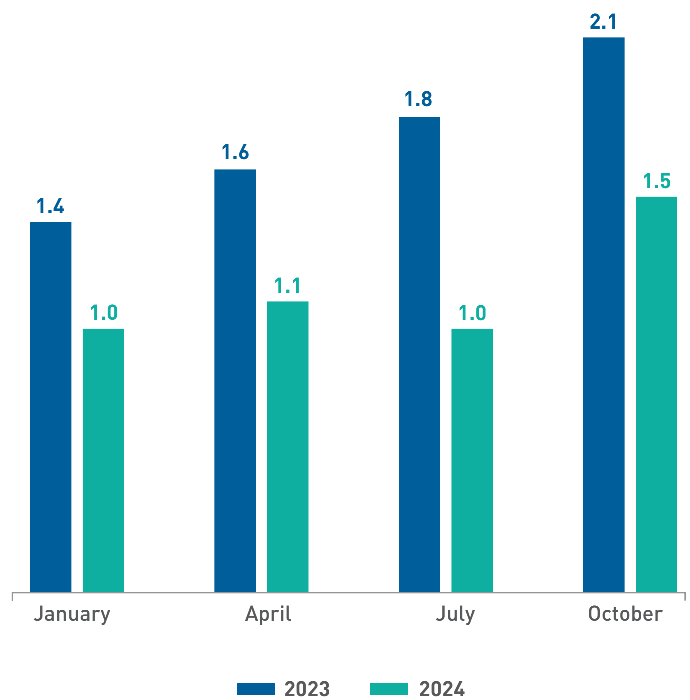
We do recognize that some downside risks —like the possibility of a steeper slowdown in U.S. economic activity— persist. However, the economic outlook for the United States is much more optimistic now than it was at the start of this year. In that sense, the International Monetary Fund anticipates a deceleration for the U.S. economy in 2024, from 2.1 to 1.5% YOY, but still up from the expansion of 1.0% projected in January 2023. What's more, it appears that the once-feared recession won't show up at the party anytime soon. Furthermore, and contrary to what was observed this year, a depreciation of the Mexican peso against the U.S. dollar could help boost Mexican exports even further.

As for imports, we project they will lose steam, going from +6.9% YOY in 2023 to +4.5% YOY next year. The expected decline could be partly attributed to the reduction in purchasing power that will come with a peso depreciation. Nonetheless, this effect might be offset again by a continued strong performance of capital goods imports and solid final goods imports, boosted in turn by robust domestic demand.

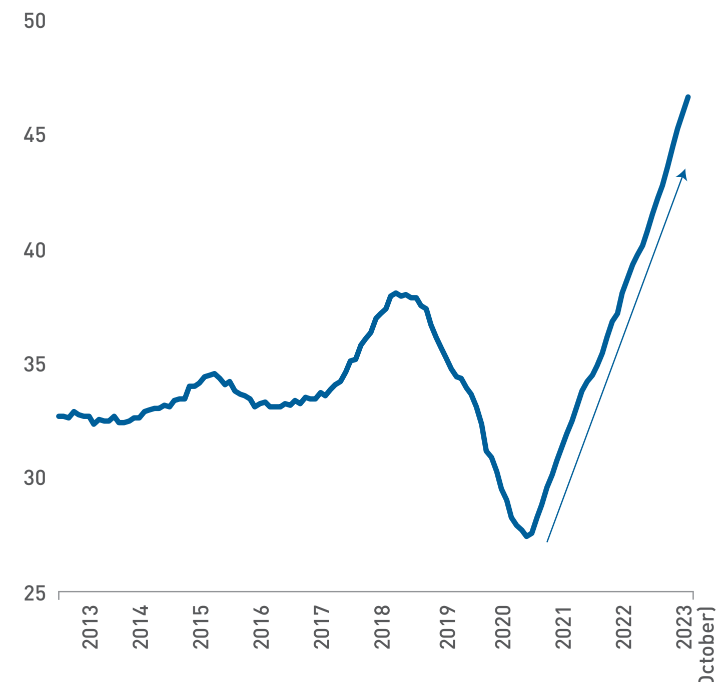
Overall, Mexico's external sector will stay resilient in 2024.
–Mexican Exports and Imports; Index (4Q19 = 100)



Mexican exports sing "I Will Survive" amidst a milder economic downturn in the United States.
–IMF's U.S. Economic Growth Projections; GDP YOY %



The remarkable increase in capital goods imports will eventually lead to more manufacturing exports.
–Capital Goods Imports; LTM (USD Billion)



Sources: GBM Estimates with data from the National Statistics Agency (INEGI), International Monetary Fund (IMF)

NEARSHORING

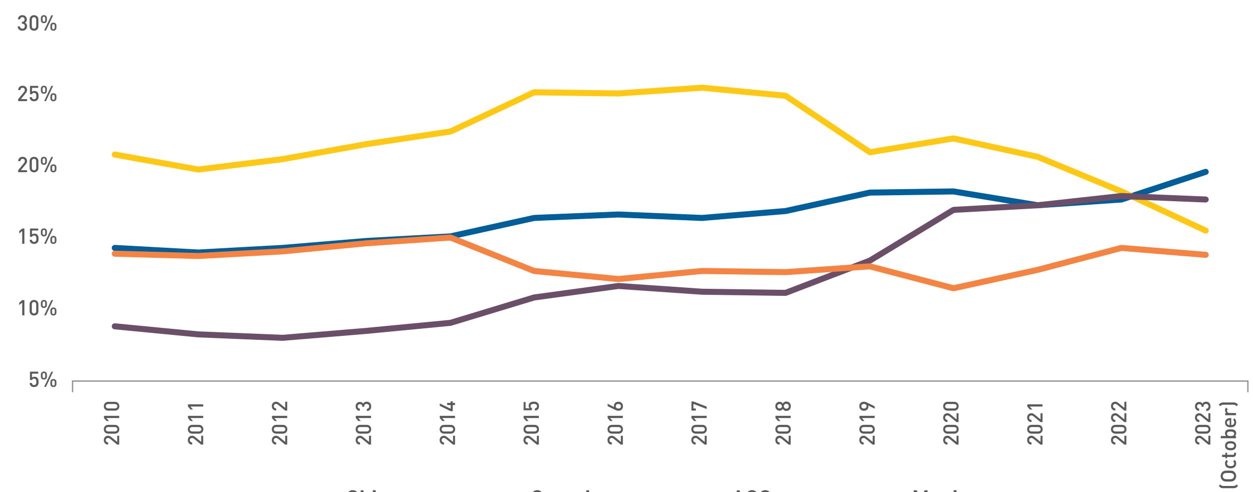
Nearshoring will bring good vibes to the gathering, contributing 45 bps. to GDP growth.

We reaffirm that nearshoring is hot stuff for the Mexican economy and for more than just the evening. Mexico has made significant progress, gaining market share in U.S. total imports of the selected categories included in our GBM Nearshoring Ranking. Mexican exports to the United States increased by US$23.1 billion from the preceding twelve months, in line with our substitution estimate at the beginning of the year. The manufacturing industries have reaped the most benefits of this burgeoning nearshoring opportunity, especially in electric machinery, nuclear reactors, and vehicles & parts.

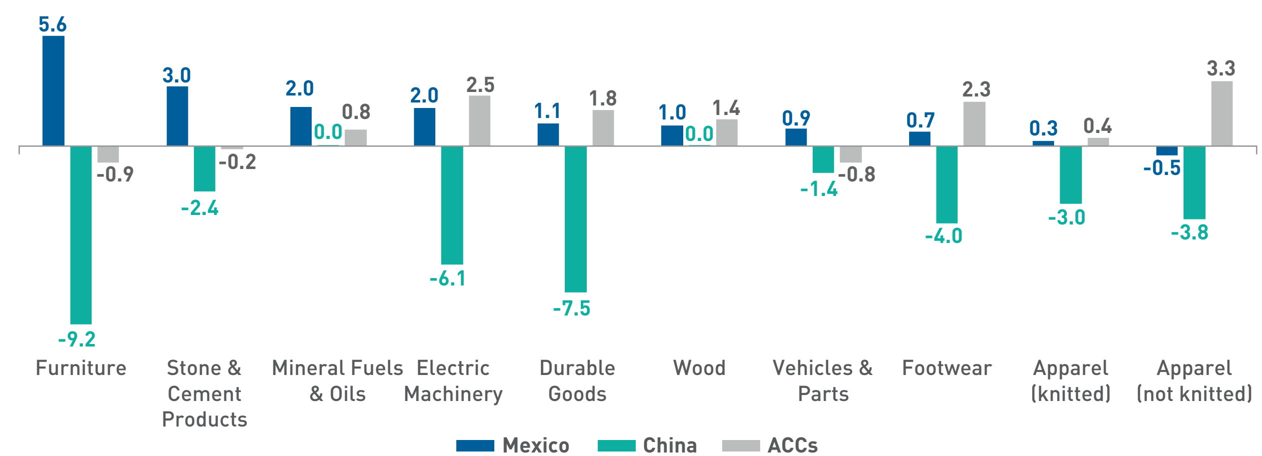
Based on the historical median elasticity between variables, we estimate the ripple effect of this substitution could attract an additional US$9 billion in gross fixed investment in 2024, a windfall that we anticipate will boost annual GDP growth by 15 bps. Further dissecting the potential effects, our elasticity analysis suggests that this positive shock in investment could trigger a multiplier effect of an additional 30 bps. on private consumption, contributing to an overall incremental GDP expansion of 45 bps. annually.

Until now, the surge in Mexican exports to the U.S. has been facilitated by Mexico's existing installed capacity, which has proven adequate to extend the export platform, capitalizing on the current global opportunity. Going forward, the expected increase in physical investments is set to address bottlenecks, thereby laying the foundation for consistent and sustained export growth.

Mexico's gain in the categories featured in our GBM Nearshoring Ranking has been outstanding.
–% of Total U.S. Imports; Ten Selected Categories



Among the categories of our Nearshoring Ranking, Mexico is putting on a show in Furniture, Stone & Cement Products, and Electric Machinery. Mexico has also outplayed Asian competitors in most categories, including Vehicles & Parts.
–Market Share Variation between 2021 and October 2023, in Percentage Points



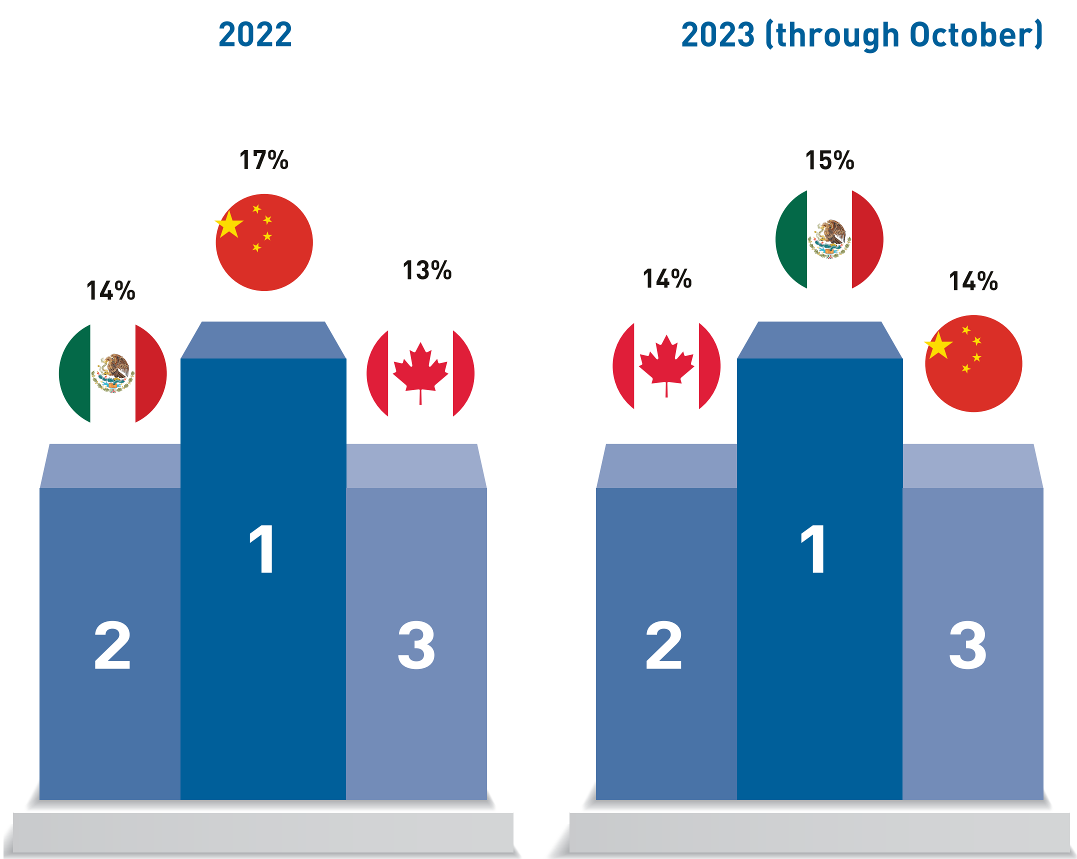
Sources: GBM Estimates with data from the U.S. Census Bureau

NEARSHORING

Mexico is now the life of the party in global trade after dethroning China as the United States' main supplier and continues to gear up and keep the band playing.

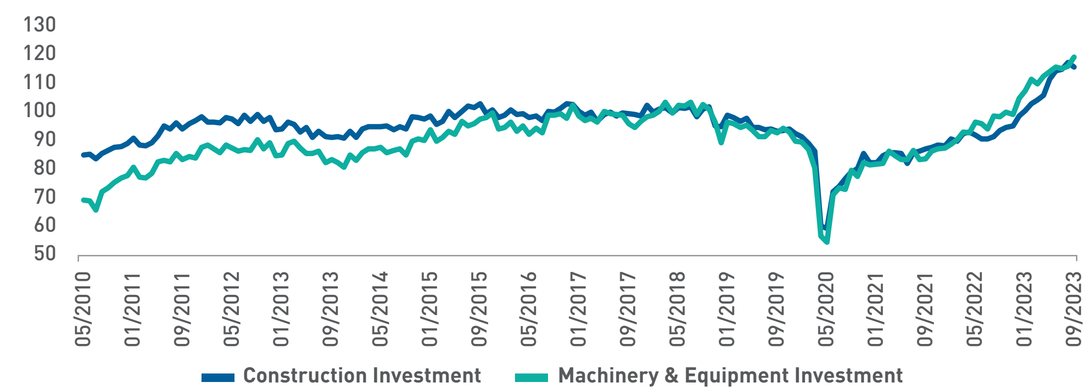
Mexico is glowing under the disco ball, as its market share in U.S. imports has seen a remarkable surge, positioning itself as the primary supplier of the United States in 2023, surpassing China, which held that status until 2022. In 2022, China accounted for 17% of U.S. total imports, while Mexico contributed 14%. However, by October 2023, Mexico had surpassed China, taking the lead with a 15% share of U.S. imports, while China's share has dipped to 14%. We highlight the importance of that gain because, even though the U.S. economy is slowing down and its imports are decreasing, it seems that Mexico found a way to eat an even larger slice of a smaller cake.

In 2023, Mexico dethroned China as the U.S. main supplier of tradeable goods.
–% of Total U.S. Imports

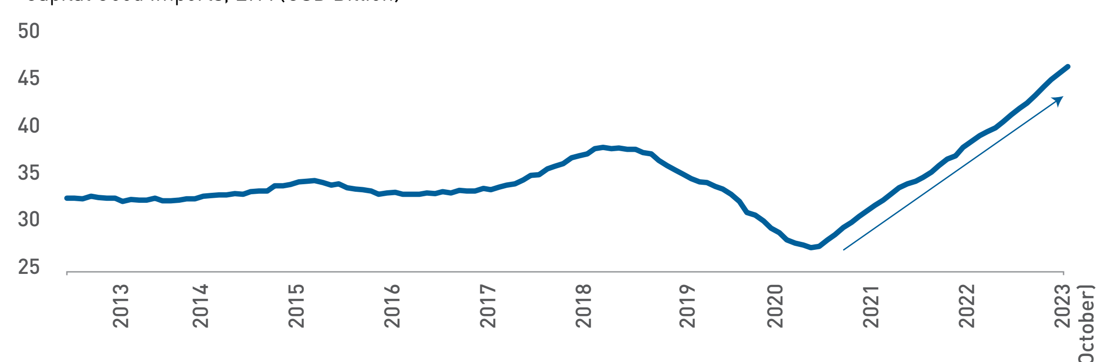


Mexico's production capacity is wearing its best suit, as two important indicators attest: i) investment in machinery & equipment, which is at a record high, and ii) imports of capital goods, which, as a leading indicator for manufacturing activity, is following a seemingly unbeatable trajectory, showing growth rates close to 20% over the last year. Also, the manufacturing sector has gained relevance in Mexico's GDP, while employment in this industry has maintained a steady uptrend. Hence, the first beneficiary of nearshoring in Mexico so far is, without a doubt, the manufacturing industry.

Investments in machinery & equipment and construction are still singing the greatest hits, reaching a decade-long high...
–GFI Breakdown; Index 100=2018



...whereas capital good imports are playing the latest chart-toppers.
–Capital Good Imports, LTM (USD Billion)



Source: INEGI data, U.S. Census Bureau

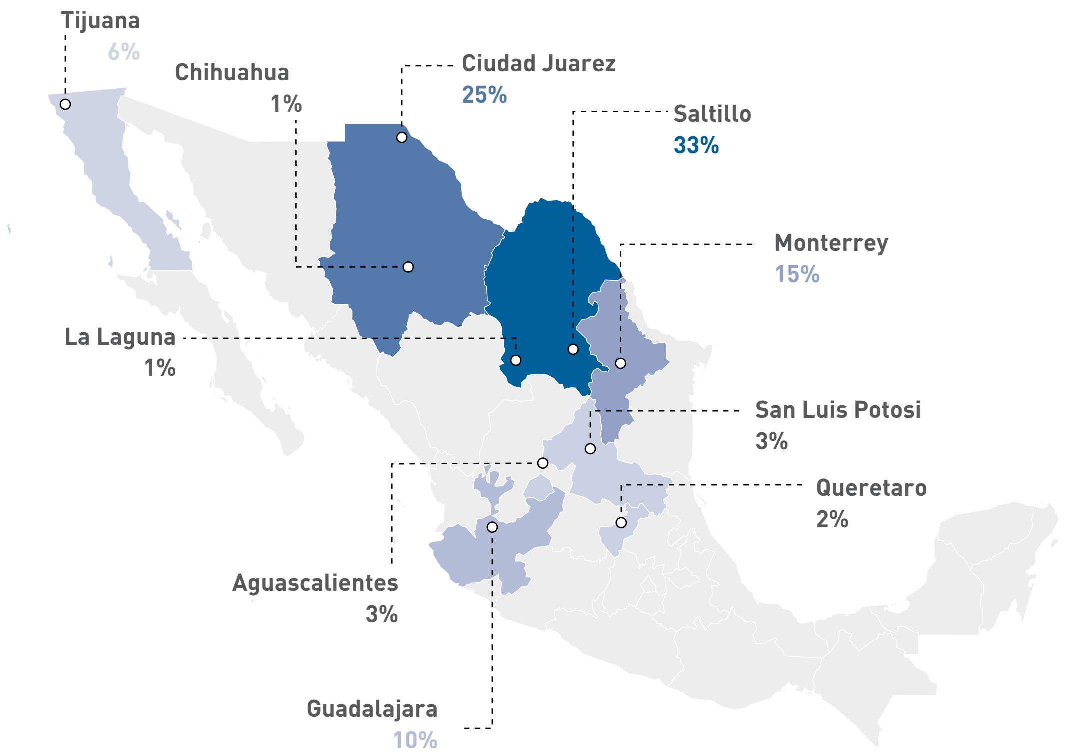
NEARSHORING

As the north continues to receive guests, other regions are proving they can play hosts in the future, preparing their best banquet for foreign companies and aiming to serve the U.S. East Coast.

Everyone is dying to have a dance with industrial real estate. During the COVID-19 pandemic, while many industries struggled to maintain solid demand and pricing, the industrial real estate market began delivering its best metrics in history, boosted by several companies looking to move their operations to Mexico. With this, industrial real estate —once an industry that found it difficult to raise prices in U.S. dollars above inflation— started recording some of the biggest rental price increments in history, with some markets growing beyond the 15% mark each year.

These dynamics have been mostly seen in the north of Mexico due to the proximity to the United States, but recent data shows that the Central and Bajio regions have also started to reap benefits due to their appeal to consumer-centric businesses seeking proximity to metropolitan hubs.

Through June 2023, nine of the country's thirty-two states hosted all the nearshoring guests (vs. four states in 1Q23). However, the most popular alternatives remain in the north.
–% of Foreign Firms that Relocated Production to Mexico by City (Jan.-Jun. 2023)

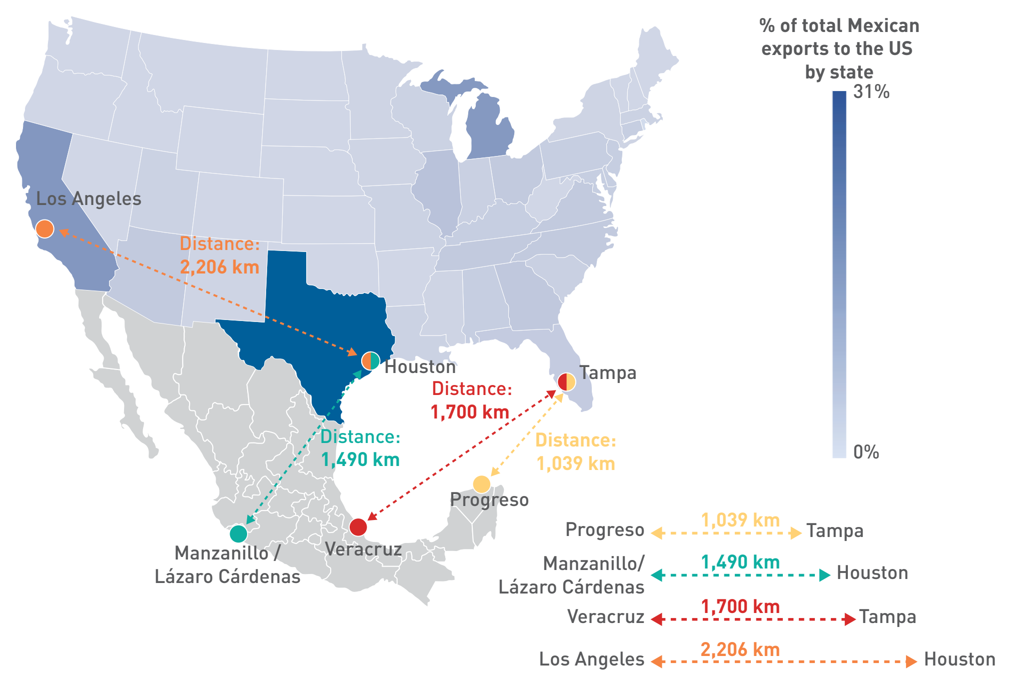


When thinking about possible venues to host nearshoring, the South is surging as a viable option for the coming years. Going one year back, we already had our eyes set on the South's potential, and 2023 did nothing but prove us right, hyping our expectations for 2024 and onwards.

Indeed, the consolidation of the Corridor of the Isthmus of Tehuantepec along with the Mayan Train in 2024 will continue to attract investments and business development to the region. The industrial expansion of the south will soon have the platform required to tend to the demands of the U.S. East Coast —a region that remains widely unattended by Mexico.

The latter, coupled with a nearshoring strategy from local governments and an exceptional availability of natural resources, will present the South as an attractive destination for foreign companies. We have been following the proposals made by the Yucatan Government to promote nearshoring, and the strategy includes the expansion of the Progreso seaport to increase connectivity, investments in renewable energy sources, and security optimization. Also, the region's water availability could become appealing to those industries with water-intensive processes.

Infrastructure development in Mexico's South could boost exports to the East Coast of the United States.



Sources: CBRE, U.S. Census Bureau, Yucatan Government

NEARSHORING

FDI inflows might be the last to arrive but certainly won't miss the show.

Despite recent stability in FDI, we anticipate an upswing in the coming months due to the surge in announcements from foreign companies totaling over US$45 billion in investments over the past twelve months, signaling Mexico is the best possible host. While some of these investments may not align directly with the nearshoring concept, they undeniably reflect the country's heightened appeal. In the following months, FDI is expected to soar, boosted by these recent announcements and others on the horizon. After all, a crowd always attracts a bigger crowd. The enhanced industrial and trade activity in Mexico demonstrate the sector's vitality, with the initial stages of nearshoring already in progress.

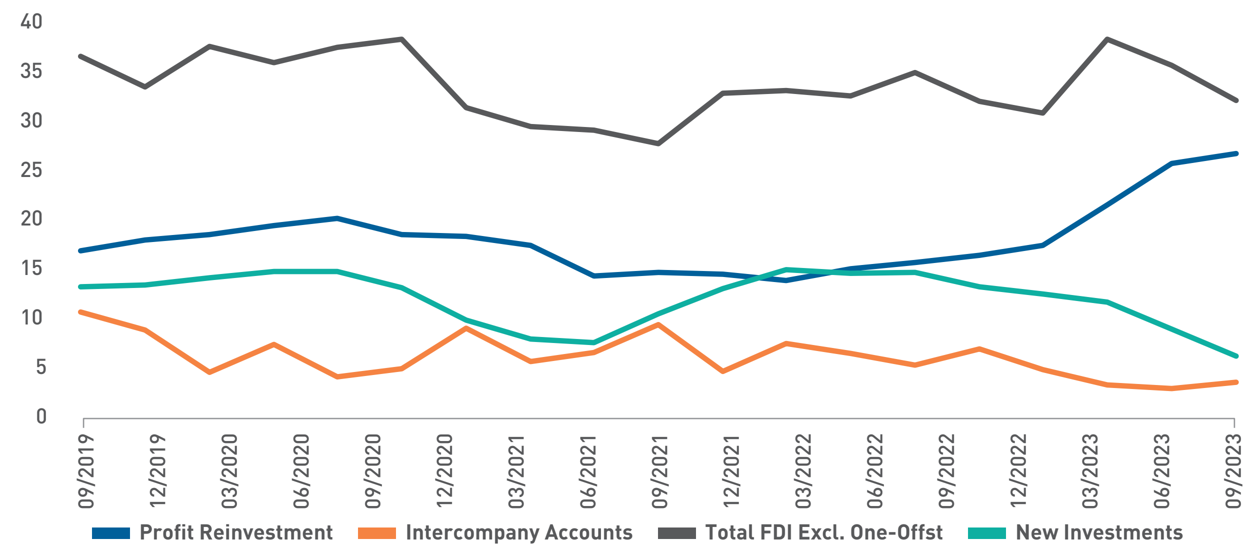
It is all fun and games until someone calls the cops. Hence, the following risk factors should be closely monitored in 2024.

1. **Elections in Mexico**. The incoming administration's stance on private investment will likely set the beat for nearshoring over the next six years. Notably, the energy sector may become a bottleneck for nearshoring-related investments in the country, and the active involvement of the private sector could help smooth things out.

2. **Elections in the U.S**. In electoral years in the United States, FDI into Mexico usually grows at a more muted rate, on average, chiefly due to a slackening in new investments. This situation could be attributed to the fact that the United States is Mexico's predominant investor, accounting for 43% of Mexico's total FDI in 1H23. The uncertainties inherent to U.S. elections further curb new investments in Mexico compared to non-electoral years in the United States. (See: Mapping Mexico's Economy in Presidential Election Years).

3. **USMCA Compliance**. In 2024, pending dispute resolutions under the USMCA, specifically the panels related to energy, GM corn, and automotive rules of origin, may become more prominent, and the resolution of these issues will set a precedent for the overall strength and compliance of the USMCA.

Despite the recent slowdown in new investments, we anticipate the announcements already made by companies will begin to translate into higher flows.
-USD Billion, 12M



Mexico is where the party's at, leading foreign companies to announce over US$45 billion in investments over the last twelve months.

Source: CBRE

INFLATION, KEY INTEREST RATE, AND FOREIGN EXCHANGE

INFLATION

While core CPI will continue on a downtrend, the non-core component might spoil the party (4.4% YOYe vs. 4.0% consensus).

Even as core inflation will remain on a downtrend, headline CPI will stay close to its YE23 levels, above the Central Bank's target, pressured by the non-core component. We see headline inflation ending at 4.4% and core inflation at 4.3% in 2024 (vs. 4.5 and 5.2% in 2023, respectively). Thus, we don't expect convergence to the Bank of Mexico's target range until 2025.

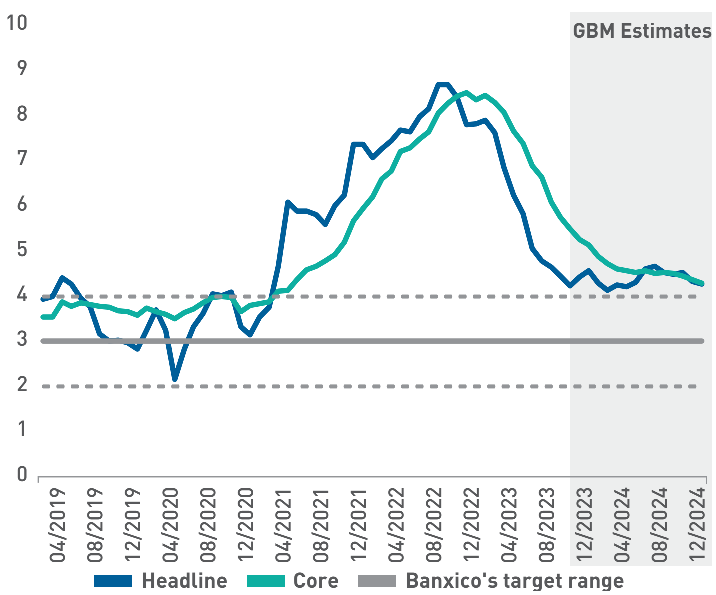
The price pressures observed throughout 2023 have continued to ease, particularly as merchandise prices have slowed down steadily. However, core CPI remains stubbornly high, particularly in the services category. While the Bank of Mexico's restrictive monetary policy stance has begun to act on inflation, we believe that some risks may arise going forward, pushing Banxico to remain cautious at the beginning of its easing cycle.

Significant upside risks for inflation will be present throughout the year. First off, Mexico's output gap is bound to remain positive. Therefore, a dynamic economic performance, alongside an expansionary fiscal policy, could continue to pressure aggregate demand, and, ultimately, core inflation. Furthermore, the minimum wage in Mexico will increase by another 20% next year, after swelling by 135% in the 2019-2023 period.

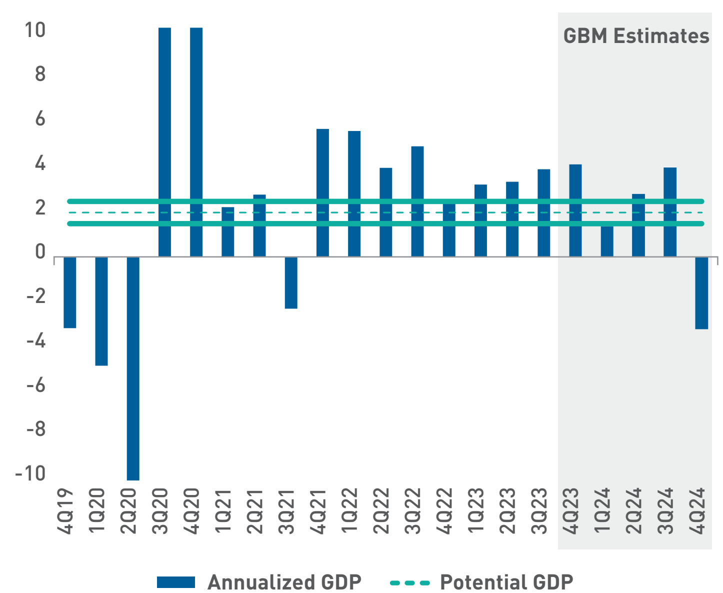
Additionally, non-core CPI could also pick up ahead. First, higher oil prices affected by supply cuts and geopolitical conflicts could add inflationary pressures. However, in that case, the Mexican government may seek to subsidize the excise tax, curbing the impact on inflation. Even if energy prices remain constant, they will no longer benefit from the comparison base effect in YOY terms observed throughout this year after scoring record highs in 2022.

GBM Estimates (YOY %)	
	YE24
Headline Inflation	**4.40**
Core CPI	**4.29**
Merchandise	3.95
Services	4.66
Non-Core CPI	**4.73**
Basic Food	4.00
Energy & Tariffs	5.25

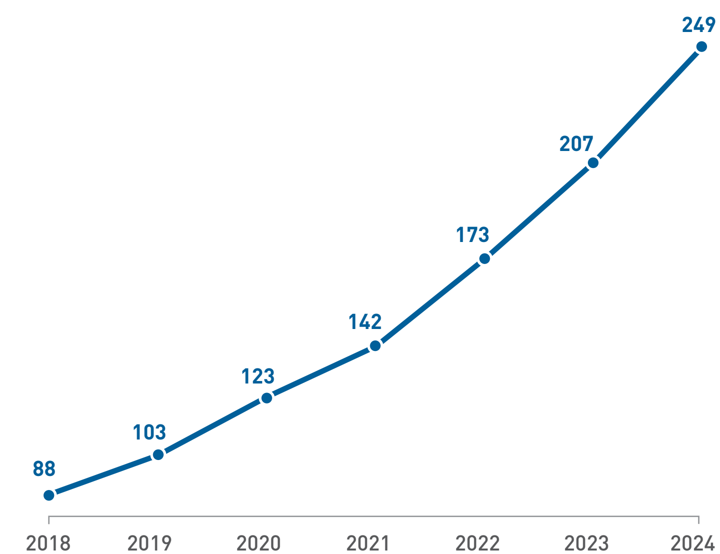
Headline and core CPI should remain on a downtrend but above Banxico's inflation target range.
–CPI, YOY %



Mexico's positive output gap could further pressure core CPI, especially in 1H24.
–Annualized GDP, QOQ %



Additional minimum wage increases could begin to pressure prices.
–Daily Minimum Wage (MXN)



Sources: GBM Estimates with data from the National Statistics Agency (INEGI), Mexican Employers' Confederation (Coparmex), Mexican Social Security Institute (IMSS)

MONETARY POLICY

Before throwing any confetti, the Bank of Mexico will remain on chaperone duties, preventing inflation from getting out of hand. (9.5% EOPe vs. 9.25% consensus)

Even with rate cuts looming on the horizon, we believe Mexico's Central Bank is bound to remain in restrictive territory throughout 2024. While inflation is long past its peak, reached in September 2022, the last stretch of the fight against inflation might be the toughest for the Bank of Mexico, which will likely remain cautious on the way down. Thus, we foresee Banxico could begin with its easing cycle in March 2024, until reaching a YE24 level of 9.5%. In this sense, the ex-ante real interest rate will remain in restrictive territory next year, between 5.8 and 7.0%.

No party is like another, and there is hardly a benchmark for cutting cycles, as only three have occurred since the introduction of the overnight interest rate as a monetary policy tool in 2008. Besides, each of them took place amid very different economic periods, such as the 2008 financial crisis and the COVID-19 pandemic. Inflation and interest rate levels were unlike what we have seen in the current monetary cycle, and the cutting cycle of Banxico and the Federal Reserve was each unique in terms of pace and duration. While acknowledging the historical trend where Banxico would lower rates only after the Fed did so in two out of three instances, we contend that the current situation deviates from this pattern. Our belief is grounded in the notion that the Bank of Mexico now has the latitude to initiate rate cuts independently, even if the Federal Reserve delays its cutting cycle, as this time, Mexico's Central Bank commenced its hiking cycle well ahead of the Fed.

Because of the latter, we believe the spread between Mexico's Central Bank and the Federal Reserve has entered a new stage. Indeed, after being around 600 bps. between March 2022 and July 2023, the spread started to narrow last August, and we estimate it will reach its historical average as soon as the end of next year.

Yet, as the cutting cycle begins, the Central Bank is skeptical about celebrating ahead, as certain risks loom. A positive output gap and the expansionary fiscal policy expected for 2024 might pose a challenge for Banxico, as more inflationary pressures could arise, especially for the core component. Thus, the balance of risks for the key interest rate is tilted to the upside, and Banxico's cutting cycle could be slower than anticipated.

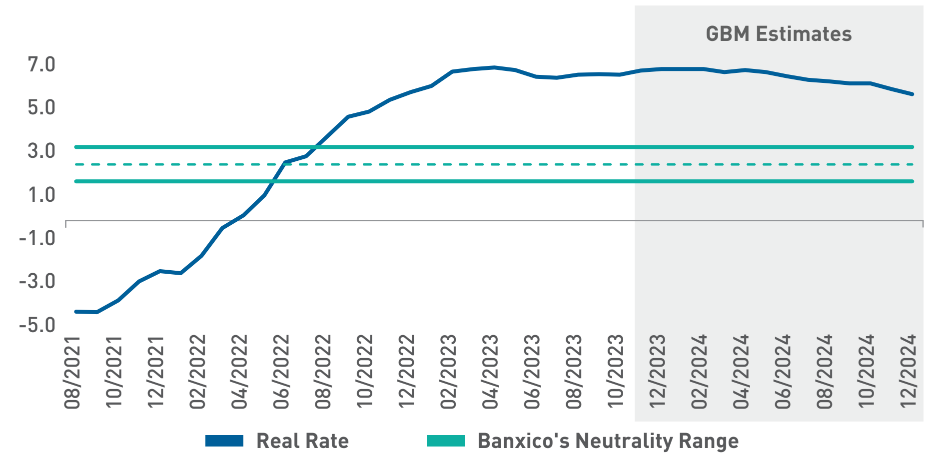
2024 will probably be the last year that the gang is all here. Recall that the term of Deputy Governor Irene Espinosa will conclude in December 2024. While her nomination for a second term is viable, this appointment will fall in the hands of the incoming president, giving rise to uncertainty. Since Espinosa is regarded, in our view, the most hawkish member of the Board, the risk ahead is a more dovish Board.

2024 could mark Deputy Governor Irene Espinosa's last year as part of Banxico's Governing Board.

Sources: GBM Estimates with data from the Bank of Mexico and the U.S. Federal Reserve

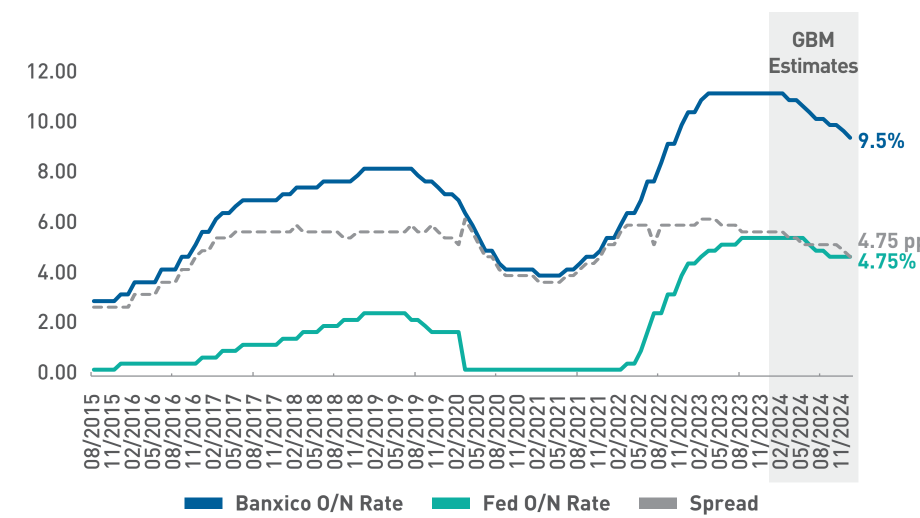
Even as Banxico begins its easing cycle, the real interest rate is bound to remain in restrictive territory.

–Ex-Ante Real Interest Rate



As monetary policy normalizes in Mexico and the U.S., the interest rate spread between both economies may return to its historical average.

–Banxico and Fed MPR (%); Spread (pp.)



**Per FOMC December 2023 Projections*

FOREIGN EXCHANGE

Like a worn-out party balloon, the momentum of the Mexican peso will slowly deflate but still hold some air. (18.7 EOPe vs. 18.8 consensus)

After a year of significant and rapid appreciation, we expect the Mexican peso to slowly begin losing steam next year amid some factors that could cause volatility episodes. Many of the variables that supported the Mexican peso in 2023 will no longer hold true as we enter 2024. Therefore, we see the currency ending 2024 at 18.7 per dollar (vs. YE23 estimate of 17.7). However, we must note that said level would still reflect the strength of the peso, standing below its YE22 level of 19.5, aided by solid external accounts.

Unlike this year, the Mexican peso will hardly be the cool kid at the party.

- **The FX carry might lose momentum as the interest rate spread reduces**. As mentioned earlier, we forecast the Bank of Mexico will gradually lower its interest rate differential with the Federal Reserve until hovering around 450 bps. by the end of 2024.
- **As both Mexico and the United States are set to hold presidential elections in 2024, this could pressure the Mexican peso even further**. Aside from the noise that could arise domestically, the peso is more susceptible to sharp depreciations during U.S. electoral cycles, likely influenced by a heightened market risk aversion. While the Mexican peso typically depreciates at an annualized rate of 2.1% during non-electoral years, this rate escalates to an average of 6.8% in U.S. election years (Please refer to **Mapping Mexico's Economy in Presidential Election Years**).
- **The 2024 Budget Bill cast doubt on fiscal prudence**, as it foresees a twenty-year-high primary deficit of 1.2% of GDP (vs. +0.1%e in 2023), while the country's debt-to-GDP ratio is expected to increase from 46.5 to 48.8% of GDP. While we think this doesn't pose a risk to Mexico's credit rating, such a deterioration does raise eyebrows, making investors more wary of any fiscal proposal by the new administration.

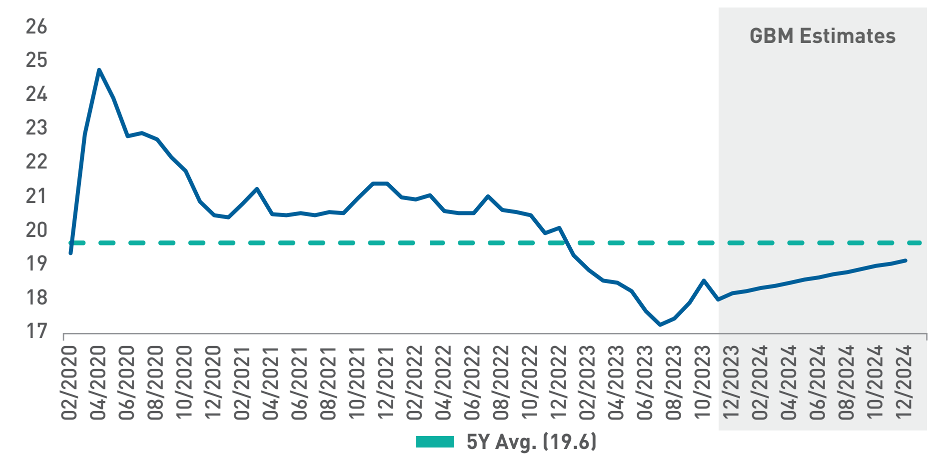
Upside Risks

- **There are still USMCA disputes pending resolution** (energy, GM corn) that could build on the tensions between trade partners.
- **Global instability could reduce the demand for the Mexican peso and other EM currencies**. Ongoing geopolitical events, including wars in Gaza and Ukraine, could lead global investors to seek safe havens, such as the US dollar, weakening other emerging market currencies, including the Mexican peso.
- **A quicker easing cycle could make the Mexican peso less attractive**. If the inflation downtrend intensifies, Mexico's Central Bank might be inclined to accelerate interest rate cuts, reducing the spread with the Fed more than expected.

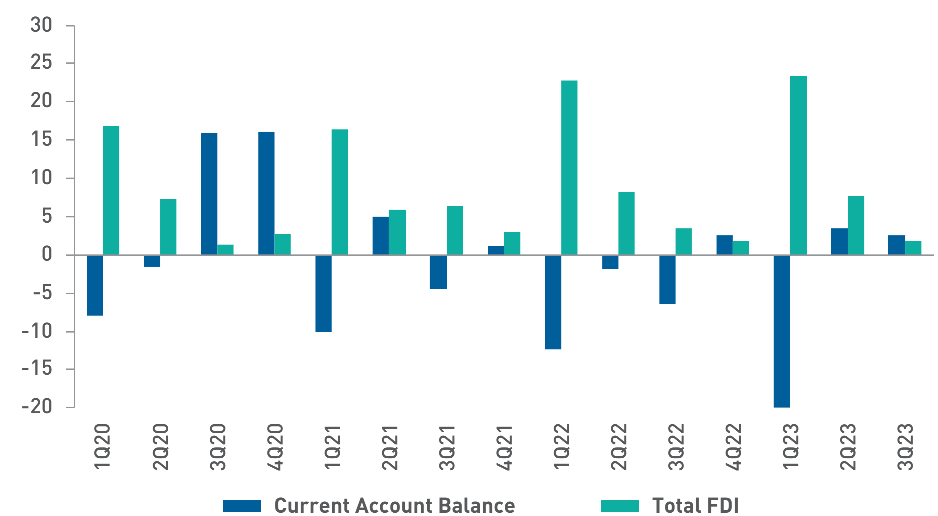
Downside Risks

- **Stubborn inflation and a hawkish Banxico could give a final push to the Mexican peso**. A wider interest rate spread could continue to support the Mexican peso, as seen throughout most of 2023.
- **An electoral surprise, particularly in Mexico's presidential contest, could bring market relief**. While we don't see the Mexican peso depreciating any further in case incumbent party MORENA wins (as this appears to be the market's base case scenario), a surprising victory from the opposition, unlikely for the presidency but likely for Congress, could boost investor confidence in the Mexican currency.

Even as we expect a peso depreciation in 2024, the currency will remain strong, standing below its five-year average.
–MXN



Foreign direct investment in 9M23 (US$32.9 billion) covered the YTD current account deficit (-US$13.9 billion). Moreover, the latter has now summed two quarters with a surplus for the first time since the pandemic struck.
–FDI (USD Billion); Current Account Balance (USD Billion)



Sources: GBM Estimates with data from Banxico and the Ministry of Economy (SE)

PUBLIC FINANCE AND POLITICAL OUTLOOK

PUBLIC FINANCE

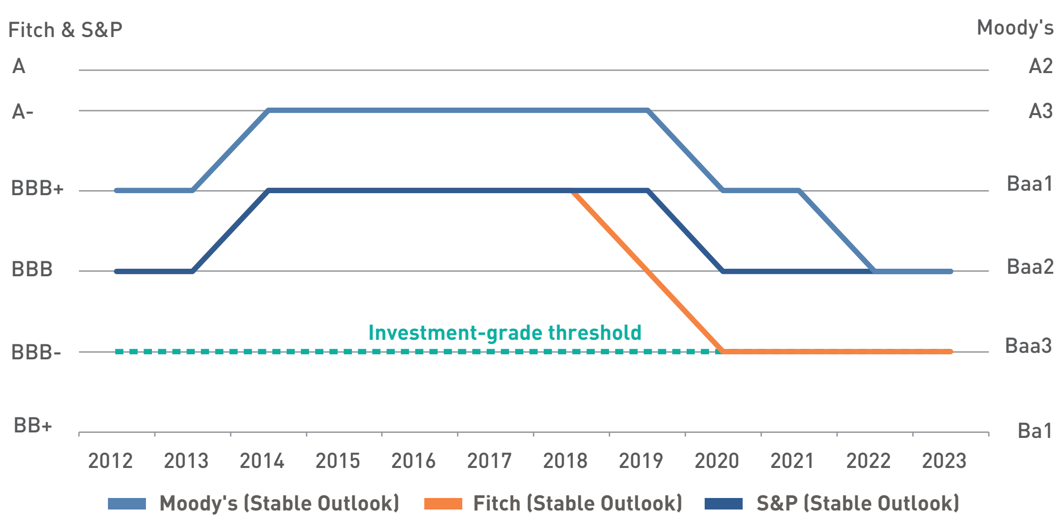
Mexico's public finances remind us that extravagant parties come at a price...

Although the 2024 Budget Bill was a surprise, as it considers the largest primary deficit in the last twenty years, Mexico's public finance ratios remain in place, especially when compared to peers. Hence, we do not foresee negative credit rating actions in the following twelve months. In that sense, rating agencies have voiced their intention to wait for more information on the next administration's agenda before making any adjustments.

However, we must note that the 2024 Budget Bill could also represent a challenge for the incoming administration, set to take office next October, as it may need to resort to fiscal consolidation to stabilize the debt-to-GDP ratio in the years to come. In this regard, although MORENA's presidential candidate Claudia Sheinbaum has pledged to be fiscally prudent, she has ruled out tax increases if she wins the presidency. **Amid spending pressures (especially due to social programs and pensions), Pemex's troubled financial situation —which may continue to burden public finances—, and the depletion of the rainy funds, we see a heightened risk of fiscal slippage in the following years.**

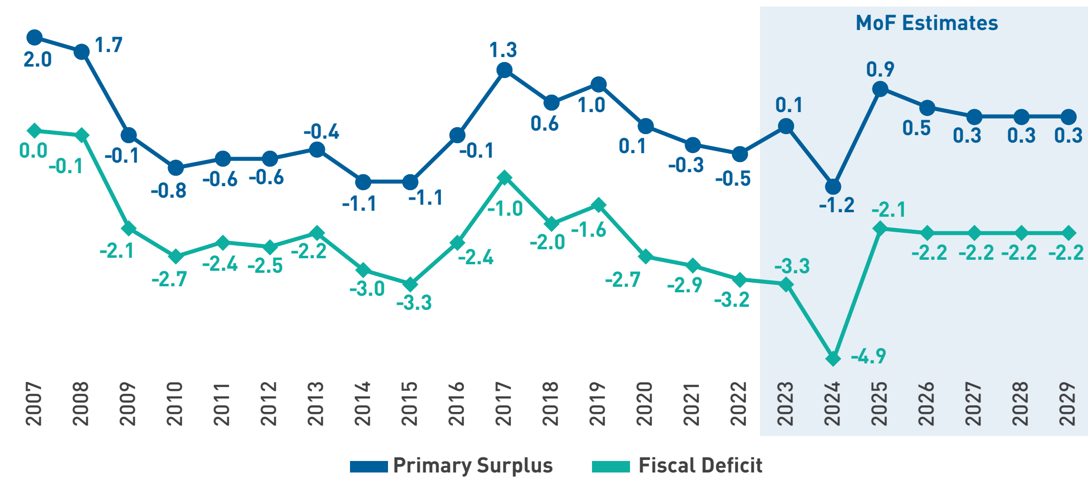
Indeed, Pemex will pose the biggest challenge of all going forward, in our view. The state-run oil company is more financially reliant on the federal government, as evidenced not only by the expected transfers to the oil major but also by the fact that its profit-sharing duty (DUC, in Spanish) has been diminished from 65 to 30%. While Pemex might be able to cover its financial obligations in 2024 and 2025, the new government's strategy for the state company will likely be one of the first questions asked by rating agencies.

The trajectory of Mexico's debt rating is unlikely to face downside revisions before the next administration takes office.



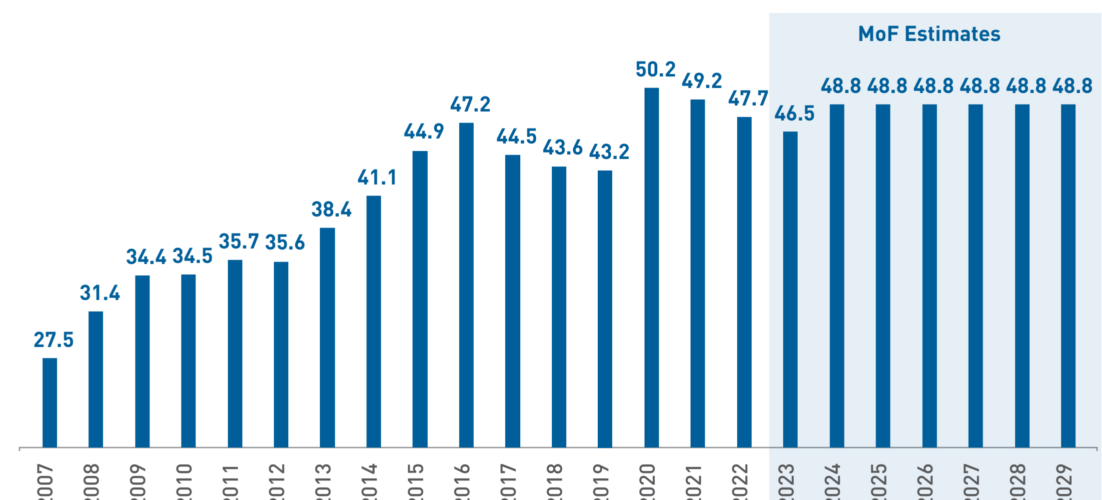
The Ministry of Finance (MoF) expects the largest primary and fiscal balance deficits in more than twenty years.

–Primary Surplus vs. Public Deficit, % of GDP



Regarding the public debt, the government now foresees it will increase in 2024 while remaining at that level until 2029.

–Historical Balance of the Public Sector's Financial Requirements, % of GDP



Source: GBM Estimates with data from the Ministry of Finance (SHCP)

PUBLIC FINANCE

...but one can still have a good time while remaining within budget.

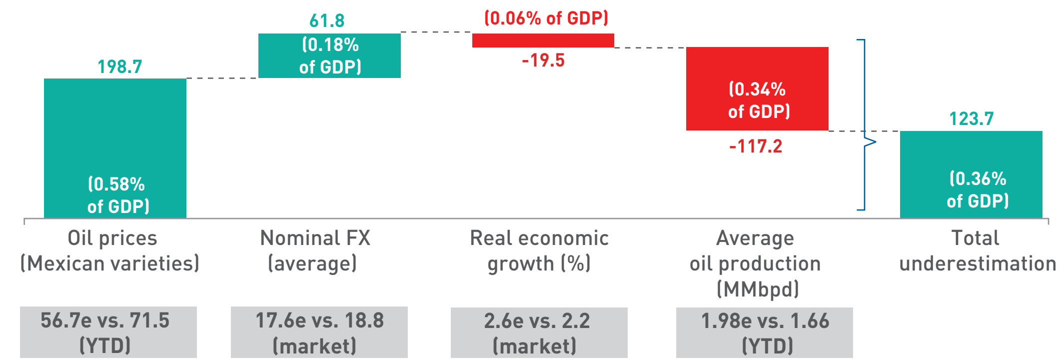
Specifically on next year's public finance metrics, revenues could be underestimated in the 2024 Budget Bill due to the government's conservative assumptions for oil prices and FX. Nevertheless, the upbeat forecasts for economic growth and oil production would partially compensate for this effect.

Assuming the Mexican oil mix rises beyond US$80 per barrel in 2024, the primary deficit would be lower than expected in the Budget (-1.2% of GDP), even if the Mexican peso rallied and stood at 16 per dollar. However, we must be mindful that this upside risk will rely on the government's strategy regarding the excise tax subsidy.

Similarly, the financial cost might be underestimated because of the Finance Ministry's estimate on FX, although the conservative expectation for the key interest rate would partially offset this overestimation.

Sensitivity of Public Revenues in 2024 (MoF Estimate vs. Market Consensus)

- MXN Billion; as a % of GDP



Primary Balance Sensitivity to Oil Prices (Mexican Varieties) and FX Projections

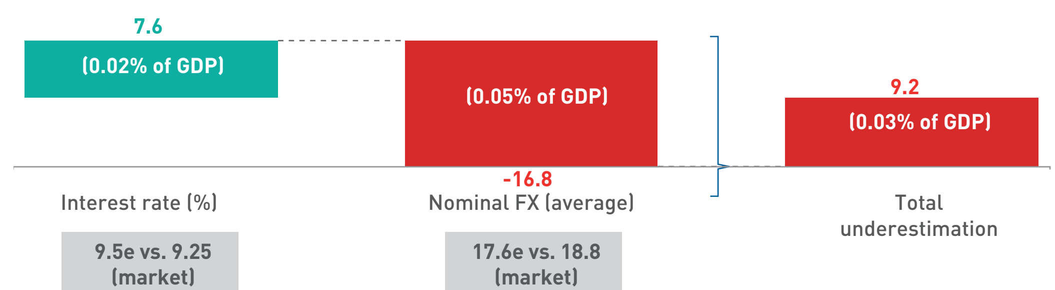
-Assuming the YTD oil production average (1.66 MMbpd) and the MoF's estimate for real economic growth (2.6%); as a % of GDP

Oil Prices	FX (MXN per dollar)						
	16	17	18	19	20	21	22
40	-2.43	-2.28	-2.13	-1.98	-1.83	-1.68	-1.53
50	-2.04	-1.89	-1.74	-1.59	-1.44	-1.29	-1.14
60	-1.65	-1.50	-1.35	-1.20	-1.05	-0.90	-0.75
70	-1.26	-1.11	-0.96	-0.81	-0.66	-0.51	-0.36
80	-0.87	-0.72	-0.57	-0.42	-0.27	-0.12	0.03
90	-0.48	-0.33	-0.18	-0.03	0.12	0.27	0.42

Source: GBM Estimates with Finance Ministry data

Sensitivity of Financial Cost in 2024 (MoF Estimate vs. Market Consensus)

–MXN Billion; as a % of GDP



	Interest Rate, %						
	8.25	8.75	9.25	9.75	10.25	10.75	11.25
Financial Cost Sensitivity (% of GDP)	0.12	0.07	0.02	-0.02	-0.07	-0.11	-0.16

Sensitivity of Public Revenues to Oil Prices and the % of subsidy to the Excise Tax

Oil prices (USD per barrel)	% of subsidy to the Exice Tax				
	20%	40%	60%	80%	100%
56.7	-0.25	-0.49	-0.74	-0.99	-1.23
60	-0.12	-0.36	-0.61	-0.86	-1.11
70	0.27	0.02	-0.22	-0.47	-0.72
80	0.66	0.41	0.17	-0.08	-0.33
90	1.05	0.80	0.56	0.31	0.06
100	1.44	1.19	0.95	0.70	0.45

2024 ELECTIONS IN MEXICO

A party is not complete without a cake to share, and Mexico's political contest will feature plenty of flavors in 2024...

Our Base Case Scenario for 2024

While the night is still young for the electoral process and a lot can happen until June 2, 2024, we have built our base case scenario as follows:

- **We are inclined to believe that MORENA will keep playing its greatest hits**. Indeed, the candidate for MORENA, Claudia Sheinbaum, remains the favorite to win the presidential election and succeed Andrés Manuel López Obrador.

- **However, a MORENA majority in Congress seems like a stretch**. While Ms. Sheinbaum has a large support base, it is hard to imagine she will be able to replicate President López Obrador's landslide win with full support in both Chambers of Congress. Instead, **we expect the latter to become more divided, which would force Sheinbaum to negotiate with opposition parties and may reduce the likelihood of fast-track approval of laws as has happened in the current administration**. Recall that MORENA and its allies currently hold a simple majority in the Senate (61%) and the Lower Chamber (55%).

- **As for gubernatorial elections, opposition candidates are yet to be defined in each state; however, early polls do not hint at potential changes to the political map in 2024.**

States holding gubernatorial elections in 2024

Party	States currently governed	States holding elections in 2024
morena	22	6
PAN	4	2
PAN PRI PRD	3	0
Movimiento Ciudadano	2	1
VERDE	1	0

Offices that are up for grabs in 2024

Presidency

Full Congress
- **Senate:** 128 seats
- **Chamber of Deputies:** 500 seats

Local Offices
- Thirty states will hold elections for municipal offices

Governorships
- Mexico City, Chiapas, Guanajuato, Jalisco, Morelos, Puebla, Tabasco, Veracruz, and Yucatan

Source: National Electoral Institute (INE)

2024 ELECTIONS IN MEXICO

Presidential candidates will bring their best recipes to impress the crowds.

As the presidential race is underway, some proposals have started to emerge from the different contenders.

Claudia Sheinbaum
(MORENA and allies)

- Maintain the economic policy that the administration of President López Obrador has followed so far while capitalizing on present and future economic opportunities, such as nearshoring.
- Accelerate the energy transition by moving toward more renewable energy sources and energy efficiency.
- Cooperate with the private sector to facilitate investment.
- Not to raise taxes but rather simplify the process for taxpayers and make tax collection more efficient.
- Cut public expenditure by digitalizing procedures and fighting corruption.

Xóchitl Gálvez
(Opposition coalition)

- Reduce the age to be entitled to a senior citizen pension from 68 to 60 years.
- Increase expenditure on health and stabilize the judiciary's budget.
- Open the energy sector to private investment and end the government aid for Pemex.
- Increase the budget for public security and social programs for women.
- Destine 2% of GDP for education and 1% for science and culture and allocate more resources to states and municipalities.
- Resume the construction of the New Mexico City International Airport (NAIM) in Texcoco and invest in the modernization and expansion of connectivity infrastructure.

Recent polls predict another victory for the ruling party MORENA in the 2024 presidential elections

-If the presidential candidates were the following, who would you vote for? (%)

Undefined: 12% . El Financiero (December 2023).
**Note that percentages do not add up to 100.*

Balance of Risks

Upside

- A market-friendlier Claudia Sheinbaum would become an additional upside risk to our economic growth outlook. Clear openness to cooperation between the government and the private sector could become crucial to boosting growth, especially for the energy sector and, ultimately, nearshoring.
- While unlikely, a win by an opposition candidate could give way to a turnaround, particularly in terms of private investment and the rule of law.

Downside

- A more radical agenda from Claudia Sheinbaum, further prioritizing the role of the State in the economy, could discourage private investment in the country.
- Deterioration of public finances. Public overspending, with no de facto changes regarding Pemex, could mean the end of fiscal austerity and have severe repercussions on the health of public finances in the medium to long term.

POLITICAL OUTLOOK

The Supreme Court will play an important role in the next administration.

The early resignation of Supreme Court Justice Arturo Zaldivar to join Claudia Sheinbaum's team allowed President López Obrador to propose a fifth Supreme Court Justice instead of leaving this to the next administration. The President has thus far designated four Supreme Court Justices. However, only two of them (Yasmín Esquivel and Loretta Ortiz) have remained staunch loyalists of his project. Although this appointment will not give the President full control of the Court, it will balance it more and may constrain future administrations since Justices' fifteen-year terms outlast the six-year presidential mandates.

In our view, the Supreme Court will continue to provide an effective check on President López Obrador for the rest of his term. His successor, however, will likely tilt the balance in MORENA's favor in the next administration. The incoming administration will be able to fill four vacancies (one in December 2024, one in 2026, and two in 2027). Claudia Sheinbaum seems to concur with President López Obrador's criticisms of the Supreme Court.

Thus far, the Supreme Court has been an important counterbalance to the Executive. However, the Court still has unresolved issues at hand, including the reforms to the Hydrocarbons, Aviation, and Mining Laws, and a potential injunction filed by opposition parties against the current administration's attempt to eliminate the judiciary's sources of funding.

In this regard, President López Obrador will leave some unresolved matters for his successor. In that sense, he stated that, in September 2024, he will put forward a constitutional amendment for the judiciary. Specifically, he will propose that Supreme Court Justices get elected by citizens —a move that would politicize this branch of power and jeopardize its autonomy. Said reform would require a two-thirds majority vote in each Chamber and at least 50% + 1 of state legislatures to be passed.

Supreme Court Justices

Nominated by President López Obrador

Juan Luis Alcántara Carrancá

Term ends Dec. 2033

Yasmín Esquivel

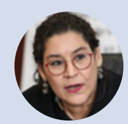
Term ends Mar. 2034

Ana Margarita Ríos Farjat

Term ends Dec. 2034

Loretta Ortiz

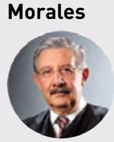
Term ends Nov. 2036

Lenia Batres Guadarrama

Term ends Dec. 2038

Nominated by Presidents Calderón or Peña Nieto

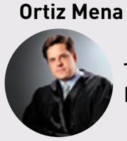
Norma Lucía Piña Hernández

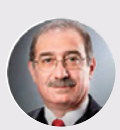
Term ends Dec. 2030

Luis María Aguilar Morales

Term ends Nov. 2024

Jorge Mario Pardo Rebolledo

Term ends Feb. 2026

Alfredo Gutiérres Ortiz Mena

Term ends Dec. 2027

Alberto Pérez Dayán

Term ends Dec. 2027

Javier Laynez Potisek

Term ends Dec. 2030

Other pending issues:

- **The Administrative Law Reform is still pending at Congress**. In March 2023, the current government proposed an amendment to the Administrative Law that, among other things, granted the government the power to revoke concessions and cap compensation payments. However, this reform is yet to be voted on at both Chambers of Congress, where it would need a simple majority to be approved.

- **President López Obrador has been vocal about his intention to push again for the National Guard to be under the umbrella of the Ministry of Defense**. Even as the Supreme Court of Justice ruled that this was unconstitutional in April 2023, the outgoing President will try again at this.

OTHER RISKS TO KEEP IN MIND

USMCA DISPUTES

Standing in the corner, the USMCA disputes could soon be asked onto the dancefloor, although that could bring some challenges.

As we head into an electoral year in both Mexico and the United States, pending disputes under the USMCA could gain relevance. Some of them, like the GM corn, could be solved in the first leg of next year, with a judgment against Mexico. Although the tariffs that could be applied won't be significant for Mexico's total exports, the resolutions could create uncertainty around the bilateral relationship.

Where are we?

Trade Dispute	Details	Status
Energy	The United States and Canada argue that Mexico's energy policies are protectionist and detrimental to trade, as they benefit state companies over foreign private firms.	Talks have continued beyond the minimum negotiation period. The United States and Canadian governments could request the establishment of a dispute settlement panel at any time to settle the issue. It is known that the U.S. is compiling a file on the companies that have been affected.
GM Corn	The U.S. argues that President López Obrador's order banning genetically modified corn imports violates the USMCA.	The formal arbitration panel members were selected and are expected to rule on the matter next year —they have 180 days to resolve.
Auto Rules of Origin	The U.S. pleaded for a stricter interpretation of a rule requiring an automobile's core parts to be original from North America to qualify for preferential tariff treatment.	The USMCA arbitration panel ruled against the U.S. in December 2022, but the country is yet to comply with the ruling.

Moving forward

Trade Retaliation

- **The possible application of trade tariffs represents a downside risk, although limited, to Mexican exports and would likely take effect once the electoral processes are over.**
- Assuming the ongoing arbitration panels rule against Mexico, the country would have a 45-day window to comply with the decision, likely involving overturning Mexico's policy.
- **In our view, the negligible probability of a reversal in Mexico's policy would likely lead to trade retaliation from the U.S. and Canada.**
- The USMCA establishes that said retaliation, likely in the form of tariffs, may be enforced discretionally to applicable categories. **We believe, however, that this scenario would affect the agricultural sector, given the strong reliance the U.S. has on the Mexican manufacturing industry.**

Deterioration of Credibility

- **If the United States refuses to abide by the panel's resolution on automotive rules of origin, the treaty will lose credibility**. Moreover, Mexico and Canada wouldn't have incentives to observe the pact either in case the ongoing arbitration panels rule in favor of the United States.
- **Although 2026 seems far away, it will be important to have all the pending disputes resolved when the time comes for the USMCA to be revised**. Furthermore, the mechanisms to ensure the parties abide by a panel's deliberation must be enforced.

Source: Data from the Ministry of Economy (SE), Eurasia Group

2024 ELECTIONS IN THE UNITED STATES

Leave it to the neighbors to either call the cops or crash the party.

Like every twelve years, Mexico and U.S. elections will coincide. This time, however, the presidential contest in the United States is likely to be a close call, giving way to an even more uncertain outlook. With almost an entire year to go before the U.S. general election (November 5, 2024), the electoral cycle is in full throttle. While presidential nominees are yet to be confirmed, the 2024 election is likely to be a remake of the 2020 contest (Biden vs. Trump), although they each now stand in very different positions than last time.

Joe Biden

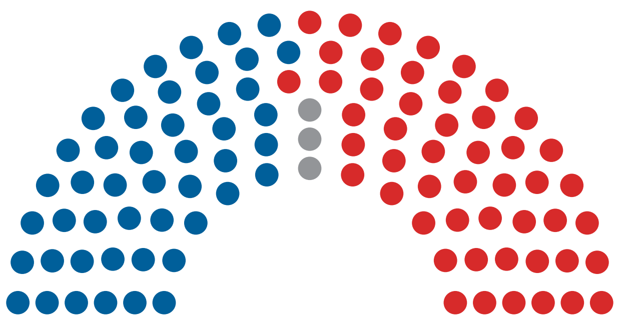
- Incumbent candidate
- He is facing low approval rates, mainly due to the state of the economy and concerns about his age (he would be 82 by the start of his second term).

Donald Trump

- While being the clear favorite among Republican presidential hopefuls, how some pending legal charges against him could weigh on his campaign remains unclear.

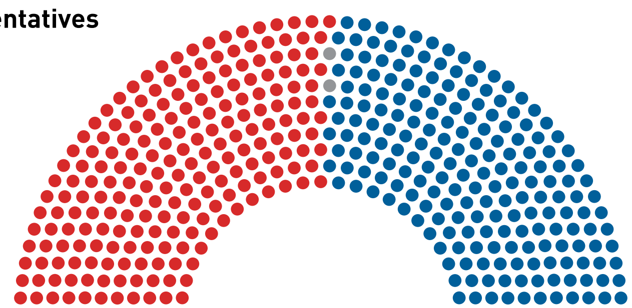
What else is at stake?

Senate
34/100 seats



Democrats
Republicans
Independent / Vacant seats

House of Representatives
435/435 seats



How would a Biden or Trump administration look for Mexico?

Biden's Second Take:

In our view, a Biden reelection could offer continuity to his current tenure. His stance regarding Mexico would likely be similar to what we have seen thus far: an economic policy that favors North America as a region and a willingness to negotiate, as has been the case with the USMCA disputes.

However, the possibility of a Republican-controlled Congress could further pressure the Biden administration to take a hands-on approach regarding said disputes, particularly those concerning energy and GM corn.

A Trump Return:

Furthermore, Trump's return to the White House could revolve around domestic issues and the U.S. external policy regarding China, Russia, and Israel. As for Mexico, the once-existing threat of exiting NAFTA was solved with the signing of the USMCA pact back in 2018. Hence, we deem it unlikely that Trump would aim for something similar again, especially under the current international trade context.

Nevertheless, a comeback of Trump's protectionist narrative could also put pressure on USMCA disputes going forward, particularly as the USMCA 2026 revision approaches.

2024 ELECTIONS IN THE UNITED STATES

Winds from the North can influence the Mexican party.

Mexico's economic indicators, deeply intertwined with the U.S. economy, tend to fluctuate substantially when the latter undergoes election cycles. Yet, other macroeconomic variables relevant for Mexico, including the GDP and its components, inflation, labor market, and public finance metrics, remain broadly unaffected amid political cycles in the United States compared to non-electoral periods.

Specifically:

- **In electoral years in the United States, foreign direct investment into Mexico usually grows at a more muted rate, on average, chiefly due to a slackening in new investments**. This situation could be attributed to the fact that the United States is Mexico's predominant investor, accounting for 43% of Mexico's total FDI in 1H23. The uncertainties inherent to U.S. elections further curb new investments in Mexico compared to non-electoral years in the United States.
- **Remittances to Mexico generally grow at a slower average rate in electoral years in the U.S.** Since the 2000 elections, the pandemic year has been the only exception. Given the economic challenges that both countries faced in that period, many Mexicans in the U.S. felt compelled to increase remittances to provide greater vital support to their relatives in Mexico.
- **The Mexican peso is more susceptible to episodes of sharp depreciation amid electoral cycles in the U.S., probably influenced by a heightened market risk aversion**. While the Mexican peso depreciates at an annualized rate of 2.1% in non-electoral years, on average, this rate escalates to 6.8% when the U.S. undergoes election periods.

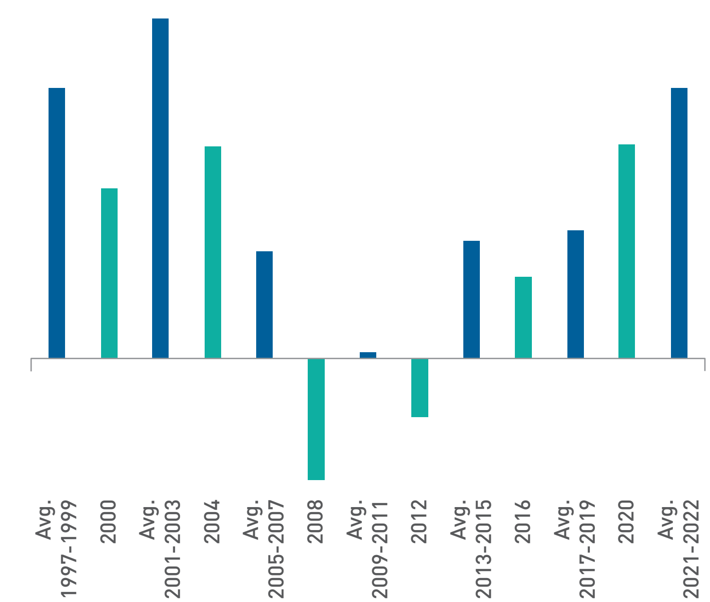
FDI to Mexico pause in electoral years in the U.S. due to less new investments.

-Avg. YOY %

	Electoral (%)	Non-Electoral (%)	Mean Difference (pp.)
Foreign Direct Investment	2.2	33.6	-31.5**
New	-0.3	52.5	-52.8**
Reinvest	20.3	-16.8	37.1
Intercompany	300.6	-4.7	305.2

Remittances usually slow down in election years in the U.S.

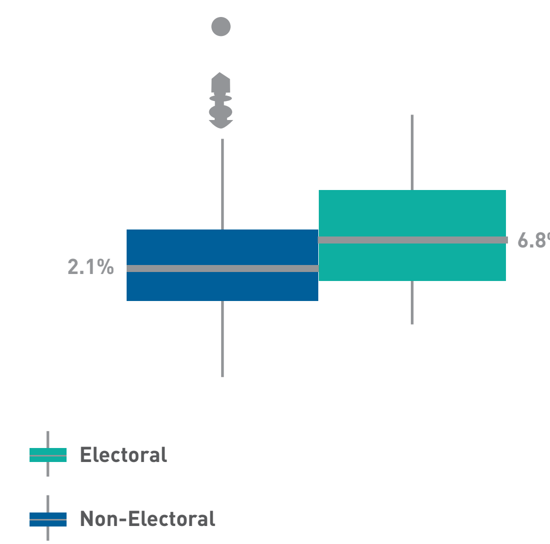
-Avg. YOY %



	Electoral (%)	Non-Electoral (%)	Mean Difference (pp.)
Remittances	8.07	12.6	-4.5***

The Mexican peso weakens in electoral years in the U.S.

–MXN depreciation, Avg. YOY %



	Electoral (%)	Non-Electoral (%)	Mean Difference (pp.)
Mexican Peso	6.8	2.1	4.7***

*Significance levels at confidence intervals (%): * at 90%; ** at 95%; *** at 99%*
Source: GBM estimates with data from Banxico, Bloomberg, and INEGI

GEOPOLITICAL CONFLICTS

While far away, an escalation of geopolitical conflicts around the world could pull the plug and end the party early by pressuring oil prices and supply chains again.

A year and a half after the Russian invasion of Ukraine, the Israel-Hamas war has come to remind us that geopolitical conflicts could quickly ruin the party, not only in Mexico but for the global economy as well. But even as the world has turned its head towards Israel and Palestine, Mexico's economy —particularly on the trade front— remains distant from the issue. Indeed, exports to Israel amounted to US$116.5 million in 8M23 (0.03% of total Mexican exports), while Israeli imports summed US$682.0 million (0.20% of total imports in the period).

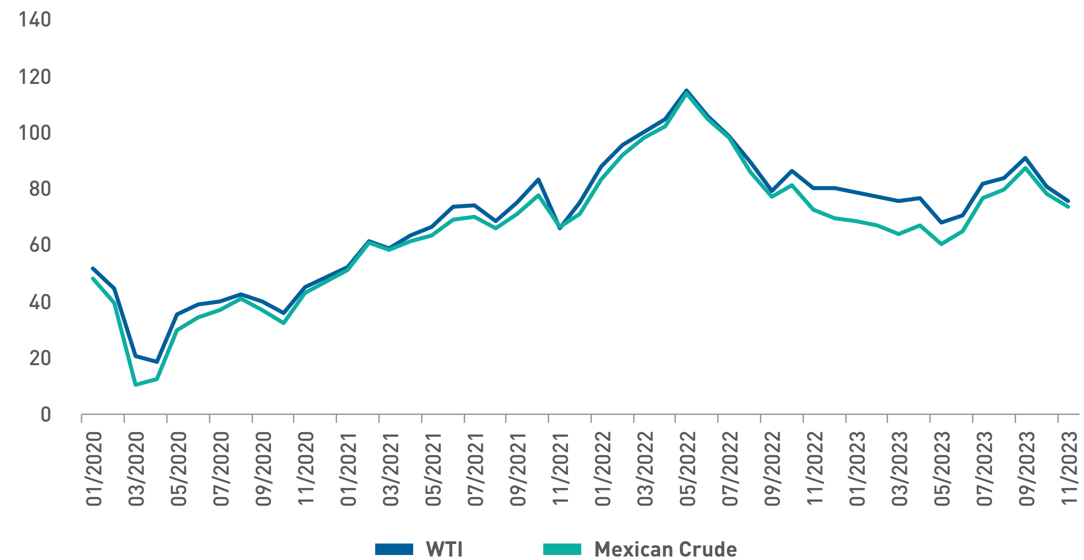
As the conflict unfolds, the biggest concerns revolve around oil. Even though neither Israel nor Palestine are relevant oil producers, the conflict in the Middle East has led to widespread nervousness in the markets. The biggest risk stems from the bleak prospect of Iran directly entering the conflict. That scenario would likely lead to a block in the Strait of Hormuz, the world's most important oil transit checkpoint, through which around a fifth of the global oil supply passes.

Furthermore, in the face of a drop-off in global demand, another oil supply cut from leading players, like Saudi Arabia and Russia, cannot be ruled out. The mere prospect of a restricted global oil supply could pressure oil prices again. Recall that oil prices are a key variable for Mexico's inflation and public revenues, where higher oil prices could pressure the former but benefit the latter.

Half of the world's top ten producers export crude oil through the Strait of Hormuz, controlled by Iran.
–Selected Oil-Producing Countries in the Middle East

Sources: Banxico, Bloomberg, International Energy Agency (IEA), World Bank

Geopolitical conflicts have pressured international oil prices, and upside risks are still present heading into 2024.
–WTI Crude Oil Price (USD/barrel); Mexican Crude Oil Price (USD/barrel)



The World Bank's worst-case scenario for 2024 estimates oil prices could reach US$150 per barrel.
–World Bank Oil Estimates for 2024

Middle East Scenario	Estimated Oil Supply Cut	Estimated Oil Price	Comparable Scenario
Small disruption	0.5-2.0 MMbpd	US$93-102 per barrel	2011 Libyan Civil War
Medium disruption	3.0-5.0 MMbpd	US$109-121 per barrel	2003 Iraq War
Large disruption	6.0-8.0 MMbpd	US$140-157 per barrel	1973 Arab Oil Embargo

MAIN RISKS AHEAD FOR OUR ECONOMIC OUTLOOK

ON THE UPSIDE[1]

GDP:

- Expansionary fiscal policy that further boosts consumption
- A milder economic slowdown in the United States
- A more rapid materialization of nearshoring investments
- A better performance of remittances

CPI:

- Further inflationary pressures stemming from the positive output gap, particularly on the core component
- Price pressures derived from a minimum wage increase
- Higher oil prices affected by supply cuts and geopolitical conflicts

MONETARY POLICY RATE:

- Higher-than-expected pressures on CPI, particularly its core component
- A more cautious Banxico that opts to keep rates higher for longer
- A more restrictive stance by the U.S. Federal Reserve

MXN:

- A faster-than-expected reduction of the interest rate spread
- More volatility derived from elections in Mexico and the US
- Higher risk aversion for emerging economy currencies, such as the MXN.
- An unfavorable resolution for Mexico related to the USMCA dispute settlements on energy or GM corn

ON THE DOWNSIDE[2]

GDP:

- A weakening in the labor market, affecting private consumption
- A slower-than-expected economic growth in the US
- Lower remittances due to uncertainties revolving around the US economy
- A resolution of the USMCA dispute settlement process that leads to new tariffs imposed on Mexico

CPI:

- An easing trend on merchandise and services prices that lowers inflationary pressures
- A wider output gap
- A more hawkish stance by Mexico's Central Bank

MONETARY POLICITY RATE:

- A faster deceleration of core CPI
- A less restrictive stance by the Federal Reserve or an earlier start of the easing cycle

MXN:

- A more restrictive monetary policy stance by Mexico's Central Bank
- An electoral surprise particularly in Mexico´s presidential contest, bringing relief to the market

[1] Upside risk refers to the prospect of an increase in the level of a given variable.
[2] Downside risk is the opposite, the prospect for a variable to decrease its level.

APPENDIX. 2023 SNAPSHOT

Before we say farewell, let us reminisce about the past year.

JANUARY

- Justice Norma Lucía Piña Hernández was elected Chair of the Supreme Court of Justice (SCJN) until 2026, becoming the first woman to preside over the highest court in Mexico.
- The North American Leaders Summit was held in Mexico City, where Presidents Andrés Manuel López Obrador and Joe Biden, along with Canadian Prime Minister Justin Trudeau delivered a joint press conference and agreed to strengthen the region.
- An arbitration panel ruled in favor of Mexico and Canada in a trade dispute with the United States over the interpretation of automotive rules of origin under the USMCA.
- Omar Mejía Castelazo was unexpectedly appointed as Deputy Central Governor following the exit of Gerardo Esquivel.

FEBRUARY

- The Mexican Senate ratified Rodrigo Alcázar Silva and Giovanni Tapia Lezama as Commissioners of the National Antitrust Authority (Cofece), completing Cofece's Governing Board.
- President López Obrador amended the decree that banned GM corn imports, clarifying it still can be used in animal feed and industrial processes, only prohibiting GM grains for direct human consumption.
- After nationalizing lithium deposits in April 2022, President López Obrador signed a decree handing over the management of lithium reserves to the Ministry of Energy.

MARCH

INE
Instituto Nacional Electoral

- In a unanimous decision, the Mexican Senate ratified Andrea Marván Saltiel as Chair of the National Antitrust Authority (Cofece) for a four-year term.
- Mexico's Chamber of Deputies elected Guadalupe Taddei Zavala as the new Chair of the National Electoral Institute (INE) after the term of Lorenzo Córdova ended.

APRIL

Suprema Corte
de Justicia de la Nación

- The Ministry of Finance (MoF) revised its macroeconomic and fiscal targets for 2023 (GDP growth estimate of 2.2-3.0% and a primary balance of -0.1% of GDP).
- Mexico's Supreme Court of Justice resolved the first part of the bill to amend secondary electoral laws —known as "Plan B"— was unconstitutional after opposition parties filed an action of unconstitutionality and the National Electoral Institute (INE) submitted a constitutional controversy against it
- President López Obrador submitted a proposal to Congress granting the public administration the power to review, amend, annul, and revoke administrative actions, concessions, permits, or authorizations. This was followed by a proposed amendment to the Mining, Water, and Environmental Protection Laws.
- Mexico's Supreme Court of Justice ruled that the National Guard cannot remain under the control of the Ministry of Defense.

MAY

- HR Ratings affirmed Mexico's sovereign credit rating at 'BBB+' with a stable outlook.

JUNE

- MORENA and its allies won gubernatorial elections in the State of Mexico, while the opposition coalition (PAN-PRI-PRD) emerged victorious in Coahuila.
- Mexico's Ministry of Finance issued a decree offering tax incentives to companies that settle in the Interoceanic Corridor of the Isthmus of Tehuantepec.
- Chancellor Marcelo Ebrard resigned from the Mexican Ministry of Foreign Affairs, being followed by Mexico City Mayor Claudia Sheinbaum, Senator Ricardo Monreal, and Minister of the Interior Adán Augusto López to pursue the MORENA presidential nomination. Alicia Bárcena took over as Minister of Foreign Affairs and Luisa María Alcalde Luján as Minister of the Interior.
- President López Obrador met with Ursula von der Leyen, President of the European Commission, and agreed to expedite the signing of the free trade agreement between Mexico and the European Union.

APPENDIX. 2023 SNAPSHOT

Before we say farewell, let us reminisce about the past year.

JULY

- Fitch Ratings downgraded Pemex from 'BB-' to 'B+' with a high speculative grade and a negative outlook.
- Moody's downgraded Pemex's outlook from stable to negative and maintained its 'B1' rating.

AUGUST

- The Mexican Economy Ministry issued a decree that introduced tariffs of 5-25% on the imports of steel and textiles, among other products, for nations without trade deals with Mexico until July 2025.
- The United States and Canada requested a dispute settlement panel under the USMCA over Mexico's GM corn imports ban. The verdict should be announced in 2024.

SEPTEMBER

- The Ministry of Finance presented the 2024 Budget Bill, which deviated from this administration's previous conservative fiscal approach. The proposal expects to reach a primary deficit of -1.2% of GDP.
- MORENA elected Claudia Sheinbaum as its presidential candidate, while the opposition coalition designated Xóchitl Gálvez.
- The Mexican Exchange Commission decided to gradually reduce the Bank of Mexico's currency hedging program due to the improved conditions in the local exchange market and post-pandemic stability.
- The Federal Aviation Administration (FAA) restored Mexico's Category 1 aviation safety rating two years after downgrading it.
- President López Obrador inaugurated the interurban train connecting Mexico City to Toluca, called "The Insurgent".

OCTOBER

- President López Obrador appointed Miguel Ángel Maciel Torres as Energy Minister after the resignation of Rocío Nahle.

NOVEMBER

- The Mexican Congress approved the 2024 Budget Bill. While no major changes were made to the original proposal, Pemex's profit-sharing duty (DUC in Spanish) was reduced from 40 to 30%.
- Supreme Court Justice Arturo Zaldívar announced his resignation after 14 years in office.
- MORENA and its allies revealed their list of candidates for the 2024 gubernatorial elections in nine states. Despite conducting electoral preference surveys, the party had to abide by the gender parity requirement imposed by the INE, mandating at least five female nominees.

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