Mexico's President Keeps Score by the Peso as Economy Nosedives

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Andres Manuel Lopez Obrador Photographer: Alejandro Cegarra/Bloomberg

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Before stepping into his daily crack-of-dawn news conference, Andres Manuel Lopez Obrador tends to ask advisers for an update on how the peso is doing.

Pretty well, has been the answer lately. But Mexico's currency is just about the only indicator that's delivering good economic news to its president.

About halfway through Lopez Obrador's first year in office, Mexico is perilously close to recession. It may be there already. The economy contracted in the first quarter, and April-to-June figures are due next week. Economists surveyed by Bloomberg are split almost evenly on whether it will shrink again.

Either way, for an emerging market like Mexico, an economy expanding in line with the population hardly counts as growth at all. Worse, analysts can't see where relief will come from. None of the engines are firing.

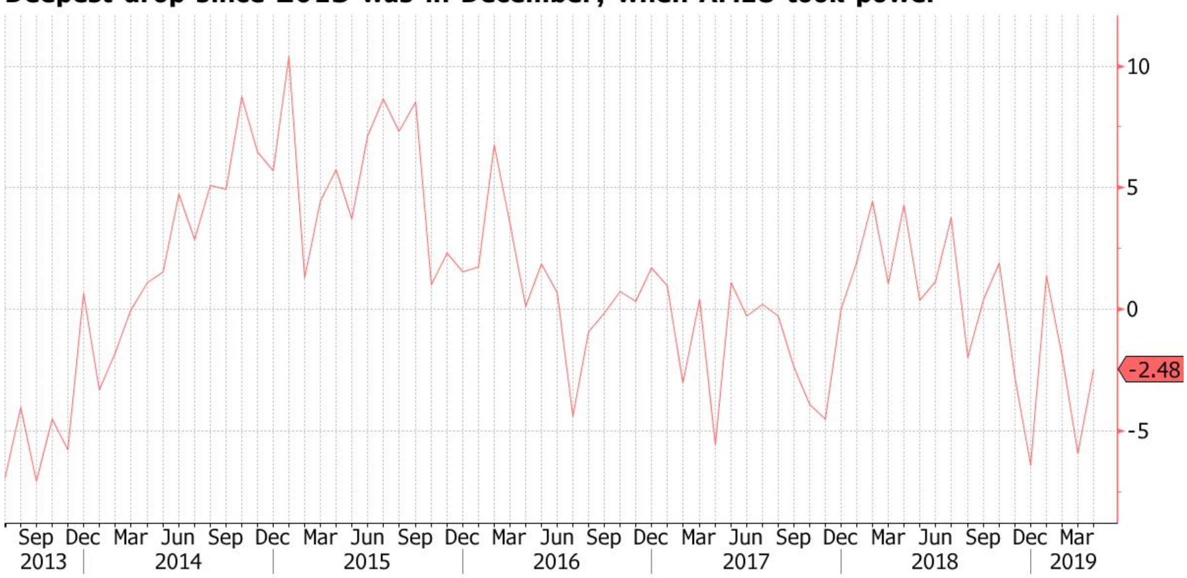
Government spending has plunged as Lopez Obrador imposed his version of austerity. Companies have put investment on hold, disturbed by trade-war risks and the president's decision to scrap a $13 billion airport. Industrial output has collapsed amid meager oil output, and consumer spending has weakened as shoppers worry about all of the above.

“We don’t expect any of these four factors to go away soon,” said Bank of America’s Carlos Capistran. “We believe economic growth will continue to be weak.”

A hawkish central bank isn’t helping. Banxico has kept its key interest rate at the highest in a decade. That’s bolstering the peso, one of the world’s strongest currencies this year, but it’s holding back economic growth. (Two of the rate-setting board’s five members now see room to ease.)

The economy received at least one bit of good news on Thursday when retail sales rose 2.8% annually in May, more than all economists had forecast. It may not be enough to ease concerns about a recession.

Gross Fixed Investment Contracted in 5 Out of 6 Months
Deepest drop since 2013 was in December, when AMLO took power



Source: Bloomberg

Lopez Obrador, who campaigned on a pledge to kick-start the economy after decades of sub-par growth, remains popular. Most Mexicans probably didn’t expect him to turn things around right away. And some of the drags on Mexico’s economy, like the constant threat of U.S. tariffs under President Donald Trump, are beyond his control.

Still, some business groups say the president’s policies are the reason so many investment plans are on ice.

Enoch Castellanos, who heads Mexico’s manufacturing industry chamber, refers to “uncertainty generated by the federal government changing the rules of the game.”

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Even before he took office, Lopez Obrador scrapped the Mexico City airport project that was well underway. Capital spending has been on the slide pretty much ever since.

The energy industry has been particularly hard-hit.

Lopez Obrador froze private companies out of oil auctions. He's promising instead to pump public money into state oil company Pemex, recently downgraded to junk by Fitch Ratings.

The government is also threatening to sue operators of natural-gas pipelines for billions of dollars, over contracts that AMLO has called abusive.

That dispute was the last straw for Carlos Urzua. The longtime AMLO ally quit as finance minister this month, saying he disagreed with various policies –- a move that heightened investor concerns.

Despite the big plans for Pemex, overall government spending was down 5.1% in the five months through May, compared with a year earlier. That number doesn't tell the whole story, because the previous administration had loosened the purse-strings in 2018, an election year.

AMLO Austerity in Mexico

Biggest drop in new government spending since Tequila Crisis

Note: Percent change in spending in first five months of the first year for each administration in real terms

Source: Secretaría de Hacienda y Crédito Público

Still, Lopez Obrador –- who promised to improve Mexico's dismal record of public investment –- should be doing so right now, instead of cutting the budget, according to Jose Luis de la Cruz.

"The first step is to recognize that Mexico is in a very acute deceleration," said de La Cruz, director of the Industrial Development and Economic Growth Institute in Mexico City. "There's no real understanding of this."

The economy contracted 0.1% in the second quarter from three months earlier, according to the median estimate in a Bloomberg survey of economists. While it would technically put Mexico in a recession defined by two consecutive quarterly contractions, it's closer to a toss-up.

"We're no longer going to use growth as the only parameter," said AMLO, who's betting his refinery and train projects will bring jobs to the impoverished south. "Growth generates wealth, but growth could mean wealth accumulation just for the few."

Solutions, ‘That Goal’

De La Cruz’s preferred solution would include spending more, especially to revive construction, and lending more via development banks.

How AMLO’s Plans to Transform Mexico Ran Into Reality: QuickTake

Wall Street economists, by contrast, would like to see AMLO halt his proposed investment in Pemex refineries, and let private companies back into the oil industry.

Those steps would breach campaign promises, and AMLO has ruled them out for now. But he’s also refrained from the go-for-growth policies some supporters would like to see.

Mexico is caught in a vicious cycle caused by the president’s “Draconian austerity,” said Citibanamex economist Sergio Luna, who forecasts 0.2% growth for the entire year, the lowest since the 2009 recession. “Less growth leads to lower tax collection and difficulty reaching fiscal balance. But the president is committed to that goal, so you need to keep cutting spending.”

— *With assistance by Rafael Gayol, and Catarina Saraiva*

(Updates with retail sales in eighth paragraph.)