

Mexican 2018 Election Outlook

After spending much of the past three months on the road, we think it's clear that the main concerns currently keeping investors nervous about holdings in Mexico are 1) what will happen to NAFTA ([which my colleague Brett House just wrote a great note addressing](#)), and 2) what will happen in the Mexican 2018 elections. To a lesser degree, there is uncertainty over the future course of monetary policy. It is not our role to say who we think would be the best option in the electoral contests. However, we do think it's important to address the concerns our clients have regarding the elections as well as what we think the path to victory could be for each contender. Given the PRI and the PAN are "known entities", and have been fairly consistent in macro-policy terms, the questions we have received regarding the elections are centered on the economic platform of Morena, and whether Andres Manuel Lopez Obrador ("AMLO") will indeed seek to overturn the 2013 structural reforms, as he has said he would.

Who are the contenders?

- What will the electoral contest look like? Our base case, which seems to be "fairly consensus" based on the discussions we've had, is that the main contenders will be:
 - ✓ Morena: represented by AMLO.
 - ✓ PAN-PRD-MC coalition: represented by Ricardo Anaya (although there is rising speculation it may be a more contested nomination—Romero Hicks, Moreno Valle, Mexico City Mayor Mancera as well as former Economy Minister Derbez are mentioned as potential contenders).
 - ✓ PRI—and its allies: The party has put its hopes in an "outsider" for the first time, picking Finance Minister Meade, who until now was not part of the party as its candidate. This marks the first time the party has gone with an outsider.
 - ✓ A true independent candidate contender looks unlikely, although Margarita Zavala and "El Bronco" are getting close to securing enough signatures to get a formal nomination.

What is the path to victory for the main contenders?

Most polls still suggest AMLO is the candidate to beat, but it's worth remembering this has often been the case early in electoral races since 2000. Polls still seem to bounce around a lot, but as would be expected, there seems to be some convergence in voter intentions among the three main players as we get closer to the July 1, 2018 election day. This is reasonable to expect, given that other parties are fielding candidates who have not been campaigning for 18 years, as AMLO has. Both the PAN and PRI are also parties with a much broader support at the national level. What do we expect to be the election scenarios for the main contenders?

- **PAN-PRD-MC ("The Frente"):** We think there are a few important elements for this coalition to consider, including:

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- ✓ Not fracturing: Many argue that a coalition between the right (PAN) and left (PRD) is not sustainable, and there has also been substantial friction in the candidate selection process, as each part of the coalition has a different view of what a “fair” selection process looks like. If factions within the Frente feel left out, or unfairly treated, we could see further fractures (such as former first lady Zavala’s departure), and our take is that these departures would be warmly welcomed by competing parties.
- ✓ Who to select as the Mexico City election candidate. For AMLO, Mexico City and its surrounding areas has traditionally been his “bastion of strength”. However, for the first time, the left seems ready to split entering the contest. Picking a strong candidate who can tap/regain the PRD’s traditional strengths, and unite them with the PAN’s strength in a narrower number of “Delegaciones” could make the coalition candidate quite competitive in the contest vs Morena’s Claudia Sheinbaum. For Morena, either a loss in Mexico City or a very tight result would be a big blow for its presidential aspirations, by eating into AMLO’s traditional voter base.
- ✓ Millennials: Mexico is a very young country, and close to six million of the voters in this election are new voters, who have never before cast a ballot in a Presidential election. It’s hard to get a sense of where these voters lean towards, but some political analysts we’ve spoken to think that many of them will vote for Morena—as a form of protest. However, it’s also hard to tell 1) whether they will vote, or have low turnout (as has been the case in other countries), and 2) whether a coalition candidate can tap the expected anti-establishment vote that many expect millennials to deliver. It’s also unclear if the anti-establishment vote will be for the same candidate in the different regions of the country. It may well be that the anti-establishment vote will favour the PAN-PRD-MC coalition in the north and the Bajío regions (traditionally a PAN strength), and Morena in the South-Centre (traditionally AMLO’s power base). Regarding the argument that millennials have tended to have low turnouts in recent elections, there is also a counter-argument that millennials proved to be both very organized and very active in the “citizen response” to the Mexico City earthquake this past September.
- **Morena:** Our sense is that for Morena there are several keys to victory:
 - ✓ Not losing support in Mexico City and its surrounding areas. Even though AMLO has very high voter recognition at the national level (being a permanent face in electoral contests since 2000 tends to help), he has not managed to get strong support outside of states to the south of Mexico City (including the CDMX). If the PAN-PRD-MC coalition manages to split the CDMX vote, it would be a serious blow for Morena.
 - ✓ A split “establishment vote”: if the PRI-PAN vote turns into an “anti-AMLO vote”, it would be tough to see a Morena candidate take the Presidency, as the combined bases of the two could top 50% of the vote nationally. Conversely, if the PRI and PAN end up on even footing, the establishment vote will be split and, under this scenario, polls suggest we have a very tight race in which any of the three parties can win—including Morena—and Morena may actually have a slight edge.
- **PRI:** A few months ago, the PRI was seen as having lost the 2018 elections because of the low approval rate of the Peña Nieto presidency (it fell to near 10% at one point). However, recent polls suggest Peña Nieto’s approval rate is now closer to 30%—which we think is at least in part due to the tougher stance the Mexican Government has taken towards the Trump Administration. How can the PRI win?
 - ✓ Distance the party’s candidate from the “punishment vote”: According to the latest Mitofsky poll, the PRI has by far the greatest rejection rate of any party (51.7%, vs 35.0% for the PAN, and 34.7% for Morena). There are many factors that could make this less “relevant” than it seems, such as these voters already being part of the Morena/PAN-PRD-MC voter base. However, it still suggests that to be a truly strong contender any PRI candidate has to manage to distance himself from the party’s dented brand name. How can this be achieved? Our take is that the easiest way to do this would be by selecting a candidate who is not seen as a PRLista which is the reason we believe Jose Antonio Meade got the nod. Or, even more effectively
 - ✓ Forming a coalition to dilute the PRI brand: Another way to dilute the PRI’s high rejection rate is to form a coalition with other parties. This can be a formal coalition that changes the brand name that the candidate represents or an informal

coalition where several parties or independents overtly back a PRI candidate—especially one not as clearly associated with the PRI. Who could that coalition include? In the past, the Green Party has often backed the PRI. Others also believe that given Meade’s close relationship with the Calderon administration (he was Finance Minister and Energy Minister under President Calderon), he could potentially form an alliance with Margarita Zavala and her supporters. Meade’s candidacy has already received a very warm welcome from senior members of the Calderon block ([see this link](#)).

- ✓ A fear we have heard is that, for traditional PRIistas, picking a PRI outsider could alienate some of the party’s voter-base. Our gut feeling on this one is that as long as President Peña Nieto has firm control of his party, which we think he does (as evidenced by his handling of the State of Mexico elections last summer, and being able to change the party statutes in the August meeting to allow outsider candidates, and yesterday—by the wide support for Meade’s candidacy), this should not be as meaningful.
- ✓ Meade is kicking off behind the other contenders in the polls but, given he has low recognition still, his upside is much higher than that of the other contenders. The main question is whether he can bridge the challenge posed by the PRI’s high voter rejection rate (around 50% in some polls). The key will be increasing brand recognition, while limiting the negatives. The second key will be being able to attract independent voters, and potentially the PAN vote—especially those that were alienated by the Frente (the coalition between PAN-PRD-MC).

Mexico: investor concerns and electoral scenarios:

Currently, polls suggest a relatively tight 3-way race between the PAN-PRD-MC alliance (the latest el Universal and Mitofsky polls puts voter intentions at 22% and 24.5%), Morena (AMLO’s party, for which the latest el Universal and Mitofsky polls show 27% and 20.6% voter intentions), and the PRI’s own coalition (for which the same polls suggest 26% and 21.1% voter intentions)—see table below for the comparison. Morena appears to either be steady, or modestly falling. The PAN-PRD-MC coalition seems to be losing strength on both surveys, while the PRI has been gaining ground. However, it’s worth noting that the polls are not directly comparable (some of the reasons are explained in the notes under the table), and we are still a long way from Election Day.

Voter intentions for the 2018 Presidential Election, expected coalitions without candidates

	El Universal		Mitofsky	
	August 24 th	November 1 st	August ‘17	October ‘17
Morena-PT	32%	27%	19.2%	20.6%
PAN-PRD-MC	25%	22%	26.0%	24.5%
PRI-PVEM	23%–24%	26%	18.6%	21.1%
Independent	7%	4%	n.a.	9.9%

Notes: numbers in red in the second survey fell, numbers in green rose.
 In el Universal’s August survey, they only showed 1 independent (Jaime Rodriguez), rather than a grouping.
 For the August ‘17 Mitofsky survey, we added the independent voter intentions of individual parties expected to form a coalition.

What are the main concerns of investors heading into the 2018 elections? Outside of issues with corruption and security which, in most “real economy” investor surveys come out as the top concerns, we have perceived that the greatest unease among our clients relates to the potential for large changes in the “rules of the game”. Most see the PRI and PAN (along with their expected coalitions) as status quo (AMLO himself calls it the PRIAN). However, with respect to Morena, there is uncertainty over how much change could ensue in terms of policy...macro, and otherwise. In particular, some of the concerns that investors have raised were confirmed as part of the plan on November 20th when Morena presented its 50-point, [Basic Guidelines for the Alternative Nation Project 2018–2024](#). One question we get, which is not related to any party but rather a generalized concern over the next government, is what will be done to address corruption issues, as well as security. Regarding Morena’s platform, the issues we’ve been asked about are:

- Lack of clarity on his intentions with regard to the reform package. In his November 20th government plan presentation, Morena said it would put ALL reforms to consultation, not just the energy reform—AMLO actually said he personally leans to overturning all of them. How protected are reforms from being overturned?
 - ✓ Energy: our take is that overturning the reform would be nearly impossible for several reasons: 1) lack of a two-thirds majority in Congress—which no party seems to have a realistic shot at (not even close), 2) the Popular Consultation Law says referendums cannot be used for issues that affect public income and spending ([Article 11. IV](#)), 3) we think the public sector balance sheet does not have room to allow the sector to grow without private capital, hence any government that bars the private sector from participating would see it stall.
 - ✓ Fiscal reform: as above, there are several hurdles, including that he is unlikely to have majorities in either House, let alone both. In addition, the law of Popular Consultations (i.e. referendums) explicitly says: “popular consultations cannot be applied to IV. The revenues and spending of the Government” ([Article 11.IV](#)). This means this would be an extremely tough reform to overturn via both a legislative and referendum channel.
 - ✓ Education: it can be argued that the education reform is to a large degree a public spending reform, as it reallocated which level of government pays for education. From this perspective, the education reform is shielded by both the referendum law section we mentioned earlier, and also by the two-thirds majority in Congress that is needed to overturn it. The part of the reform that does not seem to be protected by the referendum law’s restrictions is the newly introduced teacher evaluation, which would still need a majority in Congress to overturn.
 - ✓ Competition and Telecoms: these areas are less clearly a public spending issue—so a referendum could work, but would still need a 2/3 majority to overturn through a legislative process. AMLO also said he would use CFE’s infrastructure to offer internet services nationally.
- Uncertainty over AMLO’s plans for the Mexico City Airport, which he has publicly threatened to cancel—and reiterated on November 20th when he launched his government plan (he said he’d add two runways to the Santa Lucia Air Force base and use that instead).
 - ✓ We see cancelling the airport as highly unlikely for several reasons: 1) as you can see in [this picture](#), the work has already begun, 2) there are already US\$6bn in bonds issued to finance the project—the bonds are collateralized by the TUA airport tariff—and it should be difficult to get investors to agree to any change in plans, and 3) AMLO’s plan is to build the airport at the Santa Lucia Air Force base, which would likely not be welcome news for Mexico’s armed forces—among the most popular institutions in the country.
- Uncertainty over whether a Morena government would undermine commitment to orderly public finances (which are already weakened due to the response to the 2009 crisis). These concerns emerged when AMLO met with investors in New York and London, as they saw a lot of planned extra spending, and no new taxes—which he reiterated in his November 20th program launch (new programs would be funded by fighting both corruption and wasteful expenses):
 - ✓ There are indeed material spending pledges, not only on the infrastructure front, for which some projects could attract private sector interest, but also on items he pledged such as: 1) doubling pensions, 2) promises to give a monthly stipend to post-secondary students nationally (not a massive income, but available to a lot of students—the payment would be roughly MXN30,000 per year, per student), as well as 3) promises to cut VAT on the border region, among others.
 - ✓ On this front, we think there are several aspects to consider: 1) no party is likely to have a majority in Congress (we’d even argue that 40% share in Congress looks like a tall order for any party that does not form a “Coalition Government” which, for the first time will be formally possible) meaning that approving the annual revenues law, economic assumptions, and spending decree will require consensus-building and compromise, 2) it’s also relevant to consider that in Mexico a very large share of spending is executed at the local level, which means the number of governors a party holds is crucial (Morena currently has none, out of 32, and a very narrow geographic support).

- In many ways, we think concerns over AMLO are focused on the wrong spots—reforms being overturned, public finances, the airport, etc. Rather, we think the areas we need more clarity on are: competition reform (i.e., the future of competition regulators, does AMLO favour “national champions”?, etc.), and the justice/corruption-fighting institutions. We’d also like some clarity on his stance regarding civil society institutions that have been formed in those areas—such as the IMCO, Mexico Unido Contra la Corrupcion y la Impunidad, etc.
- Which institutions will remain independent? Our take is that: 1) Congress will be split, and any candidate will need to negotiate strongly with the opposition to even pass an annual budget, 2) Banxico will remain independent and strong, 3) the armed forces are independent and very well respected by society, and 4) the Supreme Court will remain independent. We think any anti-establishment Constitutional Reform looks highly unlikely. To some degree, the more drastic changes in the 2018–2022 Presidential period are likely to be more administrative than legislative.

Perception of Corruption in Government Institutions

	Mexico	Brazil	Chile	Denmark	Spain
Political parties	91%	81%	76%	30%	83%
Legislative branch	83%	72%	68%	18%	67%
Army	42%	30%	36%	17%	19%
Police	90%	70%	53%	9%	37%
Judicial system	80%	50%	67%	5%	51%
Civil Servants	87%	46%	58%	11%	42%

Source: IMCO, from "Corruption Barometer", Transparency International.

Other factors to consider

- The World Cup: the 2018 FIFA World Cup is scheduled to take place from 14 June to 15 July 2018. Mexico is a passionate soccer country. Accordingly, if a key game (i.e., the National team) takes place on Election Day, it could affect voter turnout.
- Millennials are a big question mark. 1) will they turn out to vote?, 2) will they broadly vote “anti-establishment” (and what does that mean?), and 3) would the millennial vote in Mexico be uniform across geographic regions? (i.e., will the North vote for a different candidate than the south?).
- Mexico City may be less of a bastion for AMLO’s party than in any of the last four elections, especially if the PRD does not implode, and the PAN preserves its strength in specific parts of the city.
- NAFTA: will the free trade agreement negotiations affect the electoral outcome by fueling nationalist sentiment? It may very well do, but we’re not sure which way this goes. We think the recent rise of President Peña Nieto’s popularity is a result of his tougher stance vs President Trump’s demands. However, AMLO has also been trying to use nationalist sentiment in his favour.

Bottom line: The 2018 election is still up for grabs, and there are too many moving parts to properly “handicap” it. In addition, when evaluating how risky or positive each candidate can be, it’s important to analyze which institutions will remain independent, and what that means for how much a particular candidate can accomplish, and in which sectors.

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