

# Economic Outlook for Mexico 2020

December 2019



# Introductory letter

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Managing partner



I am pleased to welcome you to the fourth edition of our analysis document “A changing Mexico: Perspectives 2020”.

Within the last publication we commented that 2019 would be a year in which several important changes and adjustments would be presented in both global and national scenarios. The effects of these changes have begun to have an impact on the world's economy; however, economic indicators do not necessarily show the depth of the changes.

Some of the proposed changes materialized during 2019 and others did not end up crystallizing. In this publication we will offer a brief account of the facts that in both, the global and domestic environment marked the course during this 2019. We also seek to contribute to the need for information and warn our clients and friends about the possible risks, scenarios and recommendations that the Salles Sainz - Grant Thornton team considers important for the next year 2020.

Moments of change such as those that are occurring, open opportunities and generate specific risks. At Salles Sainz - Grant Thornton, we hope to help our clients find a way to take advantage of the first and mitigate the second.

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**Mexico and the world will continue through a stage of great changes; being attentive to the events of Mexico will help to anticipate possible scenarios**

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# Executive summary

If 2019 were defined by an adjective, in both the world and national scenario, this would undoubtedly be: intense. 2019 cannot go by unnoticed and it represents the period in which the world has resisted falling into a recession.

In general terms, it can be observed that the world is in transition, moving from an economic model that tends to exhaust itself, toward new schemes that are gradually expected to provide stability and results.

This transition to a new economic era has been consistent with uncertainty, and it has had an impact on investment, industry and economic growth in general.

In the political field in Mexico, it is observed that the economy has been subject to politics, which has brought about imbalances. This has been exemplified by the majority in Congress and the so-called Republican Austerity that has led to the cancellation of long-term projects, such as the New International Airport of Mexico City (NAIM) and the reallocation of spending, primarily towards social components. At least on paper, it has moved toward policies in benefit of redistributing wealth, increasing transparency, reducing corruption, and improving social welfare.

Pursuant to the above mentioned, the structural problems persist: levels of poverty, insecurity, and low economic growth to name the most important. The foregoing has brought about low levels of employment, affected the internal market, and brought about a lack of trust, and uncertainty.

However, the year 2020 shapes up to be taking a clearer path. The reasons that underpin it are responsible public finances, adjusted interest rates, controlled inflation, a stable exchange rate, growing remittances, and expected private and public investments mainly in infrastructure. Moreover, after the Protocol of Amendment to the USMCA was signed on December 12, further ratification is expected, which substantially improves certainty for new investments.

The foreseeable promising context offers considerable possibilities for improvement in the business environment; therefore, it will be important for the different economic actors to be prepared, maintain financial order, fiscal discipline, and for them to think differently, consistently looking for opportunities arising on current and emerging markets, provided that the issues referred to above are addressed, primarily insecurity and uncertainty.



# Prior considerations

During 2018, it was observed that the world economy was edging toward a slowdown process. Growth rates went from 3.8% in 2017 down to 3.6% and growth along the lines of 3.0% was estimated for 2019.

Political changes continue to have a bearing on the economy. Societies continue to vote against migrations, corruption, and wealth disparity. Significant economic decisions have been postponed due to the interests of communities that seek a solution for that disparity.

Thus, attempts to protect economies are maintained based on fostering production and internal consumption. The trade war between the United States and China still has not taken a path that is conducive to a prompt solution.

In this scenario, the electoral period in the United States has to be incorporated with the intended reelection of the current president Donald Trump and the fierce political struggle that will ensue during the following year.

The downward trend in the different socioeconomic indicators has brought about “tiredness” in societies that demand changes of political regimes. Clear examples are Brexit in the United Kingdom, political discourses in the United States, and radical governments such as the Swedish government in Europe or the Brazilian government in Latin America.

The world is slowing down, but it defends itself so as not to fall into recession

It is estimated that Latin America will record growth barely above zero in 2019, and even the emerging countries of Asia, which had been growing above 6% annually, will not reach that rate this year. Even so, the world has resisted an economic crisis and, although it shows signs of frank slowdown, it presents its own peculiarities country by country.

The structural problems in the world continue to be the same with the distribution of wealth, migration fleeing poverty and persecution, violence and insecurity. This has encouraged societies to continue in the search for solutions, such as new social and economic models that are expected to provide giving relief to those most in need.

However, on the other hand, there exist large economic groups which, in a natural search for profitability for their capital, have maintained practices that are not always the most appropriate for the entire population.

The international environment aimed at seeking different solutions has come to Mexico. 2019 has been particularly complicated for our country. The uncertainty perceived in the environment arising from the change of government has often been pointed out and it has increased due to political definitions that prevail over economic reasoning. Thus, the lack of economic growth has been one of the results of such a change.

In the last federal elections in 2018, the presidential candidate for the National Regeneration Movement (Morena), Andres Manuel Lopez Obrador was the winner. In addition to that, candidates for senators and deputies for that party were elected, which resulted in a reconfiguration of the executive and legislative power.

The transition of the current government has brought about controversy in all areas, some arising from unilateral decisions and contrary to what was observed, and others due to the lack of trust that was conducive to the lack of clarity in the economic and political objectives of the new government.

The decision to cancel Mexico's New International Airport in Texcoco was the first of many decisions made by the Federal Administration that has given rise to a lack of confidence and stagnation of the economy.

The emphasis on social policy geared towards spending channeled to vulnerable groups through social support and assistance programs has been part of the new strategy. However, the importance of economic growth and development has been underestimated, which can lead to strong social pressures, mainly due to low job generation.

The 2019-2024 National Development Plan sets forth: “We have named this popular and social mandate the Fourth Transformation, because, just like it was up to our ancestors to build models of society to replace the colonial order, conservatism allied with foreign intervention and the Porfirio Diaz administration (Porfiriato), it is our turn to build what has continued after the neoliberal bankruptcy, which is not exclusive to Mexico, although it is more emphatic and evident in our country”.

The so-called Fourth Transformation is based on philosophical and political economy aspects defined mainly in the following points:

- To eradicate corruption
- To separate political power from economic power
- State focused on well-being, through attention to vulnerable groups, mainly through economic transfers
- To maintain healthy finances through republican austerity

Undoubtedly, the Fourth Transformation represents a watershed in the economic life of Mexico. Its beginning has shown moderate yields, although it would seem that the bases of significant changes, which are logically conducive to resistance, aversion and even strong movements against it, have been laid.

Of course, it is still too early to validate the new model, but in the light of the results in terms of economic growth, social development, infrastructure, public safety, health, diplomacy and international negotiation, it is clear that at least the start of the Administration has not been as successful as expected. Thus, it is necessary, more than ever, to be aware of every movement on the board.

On December 12, the Protocol of Amendment to the Agreement between the United States of America, the United Mexican States, and Canada<sup>1</sup>. Subsequently, the Mexican Senate has ratified the document, hoping to give a certain signal to the different economic actors and improve economic and political stability. The ratification in United States and Canada is missing, and the renegotiation and clarification of some points, mainly in labor matters, since United States, in an implementation text, establishes that sending personnel to embassies to verify trade agreements, which concerns negotiations, but not to the point of hindering the progress made.

We are living in a time of transition in the search for a new world economic order and Mexico is immersed in that process

Although trade may not be seriously compromised by the delay in ratification and entry into effect of that Agreement, there is a considerable number of projects that represent a significant amount of investments that are dependent upon the conclusion of this agreement to be implemented.

2019, then, has generally been a year of significant changes in the scenario and internal performance. This trend will continue and 2020 is awaited with a high degree of uncertainty due to the current process of world transition.



<sup>1</sup> It can be consulted on: [https://www.gob.mx/cms/uploads/attachment/file/516595/Protocolo\\_Esp\\_BIS\\_COTEJO\\_SE\\_SRE.pdf](https://www.gob.mx/cms/uploads/attachment/file/516595/Protocolo_Esp_BIS_COTEJO_SE_SRE.pdf)

# 2019, a year of great intensity, the world pushes back

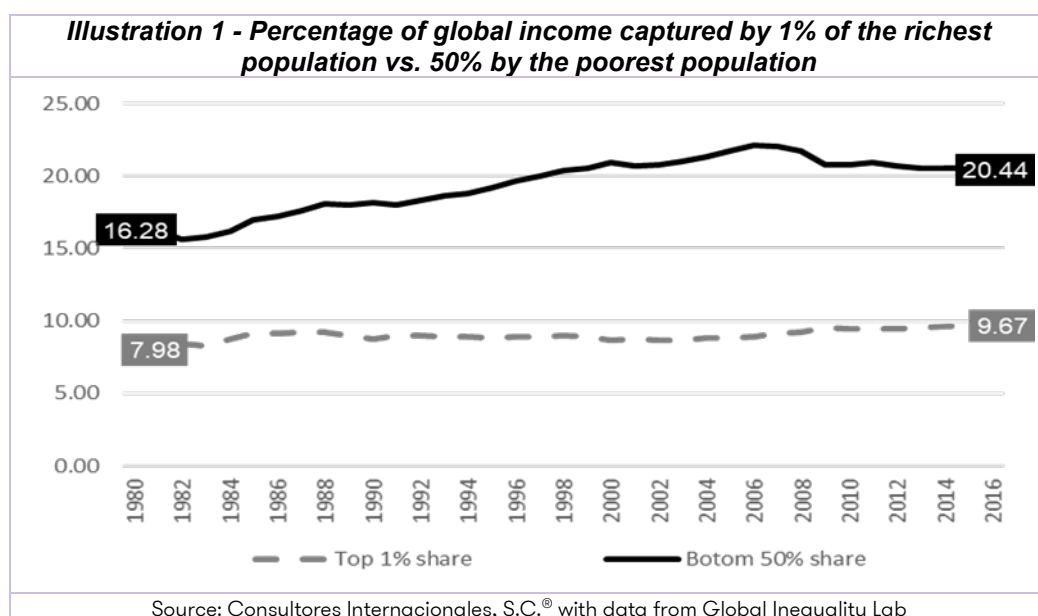
2019 will go down in history as a year of uncertainty, trade tensions, and low economic growth. In general, there is resistance shown, which despite the slowdown, has not yet broken out into a worldwide economic crisis.

## World scenario

Over these last decades, the concept of globalization and the global economic integration paradigm were almost generalized reason for optimism. World trade, the free flow of financial assets and investments mainly from the developed countries to those which are in that process, the transfer of technologies and knowledge have been variables that were conducive to a global development process. The truth is that within countries, even in those already developed, gaps and inequality have increased significantly.

The International Monetary Fund (2019) argues that “on average, lagging regions have worse health outcomes, lower labor productivity and a higher proportion of employment in the agricultural and industrial sectors than other regions within the same country. Moreover, the adjustment in lagging regions is slower, with adverse shocks having more extended negative effects on economic performance”.

*In general terms, the foregoing has brought on strong pressures within these lagging regions, with consequences that have manifested themselves in different ways, from results in electoral polls, protests, and from reemergence of old social movements to massive migrations, families seeking better opportunities or even fleeing from violence and persecution.*

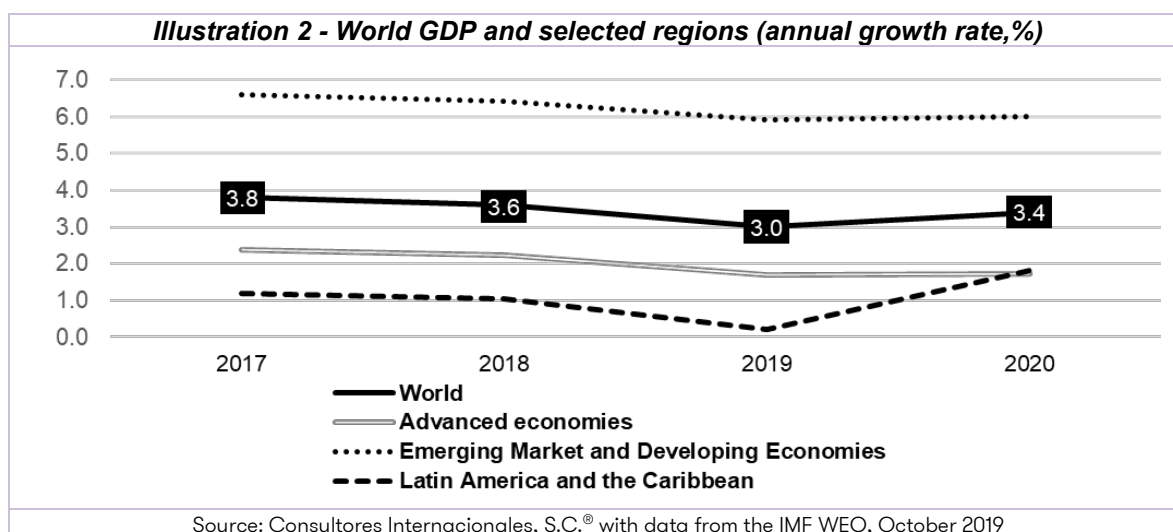


### The world is torn between open trade and protectionism

This discrepancy continues in the world between fostering trade opening, driven mainly by heavily exporting Asian countries, being China the most significant of them. On the other hand, countries such as the United States and the United Kingdom, which used to promote globalization vigorously, lead those protectionist tendencies.

The political effervescence has continued in the world throughout 2019. Social problems have evolved, but they have not been solved and there is virtually no clarity anywhere nor in the problems brought on such as poverty, migration, violence, among several other things.

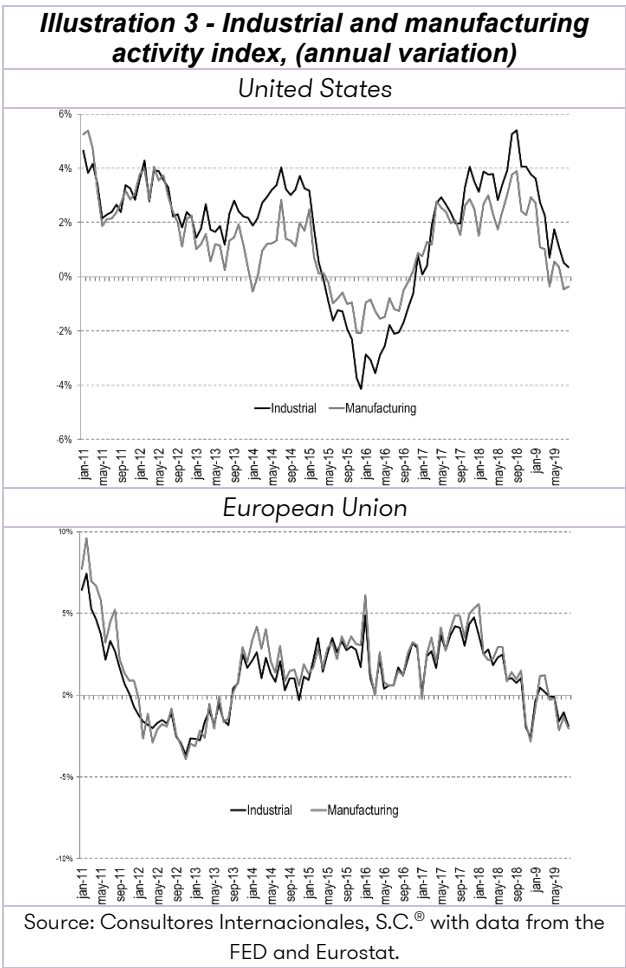
In general, it can be concluded that global economic growth lost dynamism during 2019, pressured by lower rates of both advanced and emerging economies in Asia. Uncertainty and trade tensions have paralyzed investments, thereby slowing down growth.





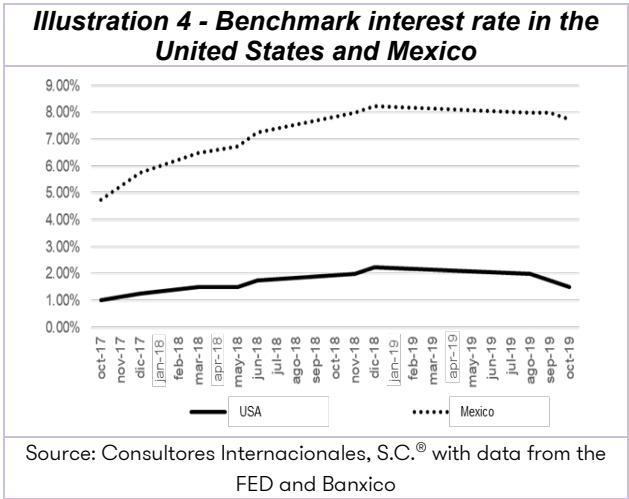
In the Latin American region, considering the strong political and economic changes in countries such as Argentina, Peru, Ecuador, Brazil and, of course, the low dynamics of the Mexican economy, the IMF barely sees positive growth of 0.2% in 2019. In this regard, the Latin American Alliance of Economic Consulting (LAECO) estimates a drop along the lines of -0.1% at 2019 year-end and 2.0% for 2020.

Two references that show the economic slowdown lie in the industrial and manufacturing activities. By way of example, they are clearly exposed in the casualties recently recorded in the United States and in the European Union. Concurrently, between 2015 and 2018, investment flows have decreased in economies such as the United States, Canada, Russia, India, Chile and, of course, Mexico.



Much has been written and discussed concerning the possibility of a world recession. However, the world has resisted and shown strong economic fundamentals, by maintaining growth rates, though lower, that do not stop being positive.

It is also true that there are fewer inflationary pressures in practically the entire world, with exceptions and, therefore, benchmark interest rates show a downward trend.



There is generally a number of external factors that directly affect the world's economies, from trade disputes between the United States and China, to geopolitical disputes in Latin America and, of course, the presidential elections in the United States, which will inevitably distort the confidence of international investors.

Despite of the uncertain outlook, attention is drawn to a 2020 that will give rise to opportunities for emerging economies, including Mexico.



## Domestic scenario

It has been a complex year due to the passivity and paralysis in which the different economic actors have fallen into in view of an uncertain.

The country's economy has been subject to political interests, particularly the executive branch, due to actions executed or to be executed that are decided from a political approach in detriment to the resulting technical and economic feasibility.

The use of popular referendums and even voting by a show of hands to assess government actions has been a characteristic of this Administration, which has gained high levels of popularity, but also detractors.

### Political matters

This Administration began with great expectations and a clear majority in Congress, which in principle implied a smoother transition and attaining goals more likely to be reached.

Thus far this year, the legislative agenda has been most intense. Among the laws enacted fast track are the Federal Labor Act, National Guard Act, National Domain Extinction Act, and General Education Act and secondary laws.

The so-called Fourth Transformation implied a series of significant changes in the economic model and political order, starting with the cancellation of the New International Airport of Mexico as a watershed of republican austerity; that is, a new vision that resulted in a public spending policy that shifted a good part of the resources toward social spending and the financial forecast of future spending. With the argument of republican austerity, investment in tourism promotion was cancelled, as laid out by the disappearance of entities such as ProMexico and the Mexico Tourism Promotion Board.

Giving preference to politics over the economy has brought on imbalances in 2019

From January to September 2019, a decrease has been observed in real terms at a rate of 2.1% in programmable spending, arising from decreases in personal services (-4.2%), materials and supplies (-7.5%), and physical investment (-14.4%).

With regard to social development, spending on environmental protection, housing and community services, health, education, recreation, culture and other social manifestations has been reduced in the amount of 9.424 billion pesos in this period, compared to what was exercised in the same period of 2018. In contrast more than 36.6 billion additional pesos have been exercised in social protection and other social matters.

This spending policy has already shown effects in the different productive sectors of the Country, mainly in the construction sector, which has been showing negative growth rates for almost a year and is in an outright technical crisis.

Even with the political power and the electoral strength held by the president and his political party, there are strong pressures against which they will surely add up, mainly due to security and economic growth mistakes.

The great efforts that have been carried out to reduce excessive spending throughout public administration are identifiable, although it is due to reduce inequality and generate development for the most vulnerable groups, the social spending approach will hardly solve the serious existing problems and, on the other hand, it will not generate a multiplier effect on the real economy, that is, those chain expenses that are generated before public investment<sup>2</sup>.

<sup>2</sup>Consider, for example, government purchases from Mexican companies, the increase in sales would occur throughout the associated value chain, from design, assembly, distribution and even after-sales services. For further information, consulting the Kido and Kido document is suggested (2018), available in the bibliography of this document.



## Social matters

The poverty measurement data conducted by the National Social Policy Evaluation Council were presented in August 2019 (CONEVAL, 2019). By 2018, there were 52.4 million people in poverty in Mexico, of which 9.3 million (7.4% of the total population) are in conditions of extreme poverty<sup>3</sup>.

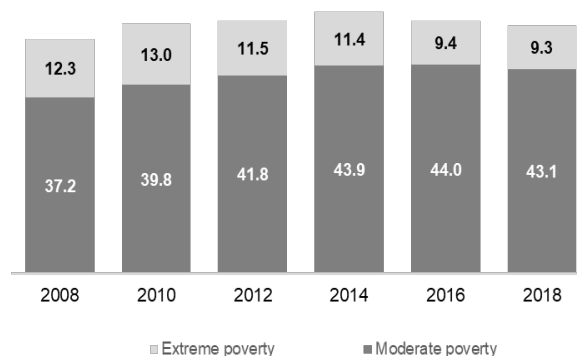
The new orientation of social policy aims to place vulnerable groups as top priority

This meant that during the past six-year period, the number of poor people in Mexico was reduced by 0.9 million. That is, in terms of percentages with respect to the total population, it went from 45.5% to 41.9%. Specifically, in the fight against extreme poverty, 2.2 million people moved out of this situation and joined the group of moderate poverty.

As a social problem, security is undoubtedly one of the most relevant throughout the country. According to data from the National Urban Public Security Survey (ENSU)<sup>4</sup>, the perception of insecurity has remained between 71% and 75% so far this year. As part of the methodology of this survey, respondents are asked to respond if living in their city is safe or unsafe, in terms of violence and crimes. The latest version published corresponds to data of September (INEGI, 2019).

It is important to note that there could be a greater perception of insecurity, at least temporarily, derived from the events in Michoacan (police ambush in Aguililla) and Sinaloa (confrontation in an urban area against members of organized crime) in October 2019, widely disseminated in social media and networks.

**Illustration 5 - Mexico: Evolution of poverty (millions of persons)**



Source: Consultores Internacionales, S.C.<sup>®</sup> with data from CONEVAL

<sup>3</sup> According to CONEVAL's definition, "a person is in a situation of poverty when he has at least one social deprivation (in the six indicators of educational lag, access to health services, access to social security, quality and housing spaces, basic services in housing and access to food) and their income is insufficient to acquire the goods and services that are required to meet their food and non-food needs". (CONEVAL, 2019).

<sup>4</sup> The ENSU estimates the perception of public safety of persons more than 18 years of age in urban areas. (INEGI, 2019).

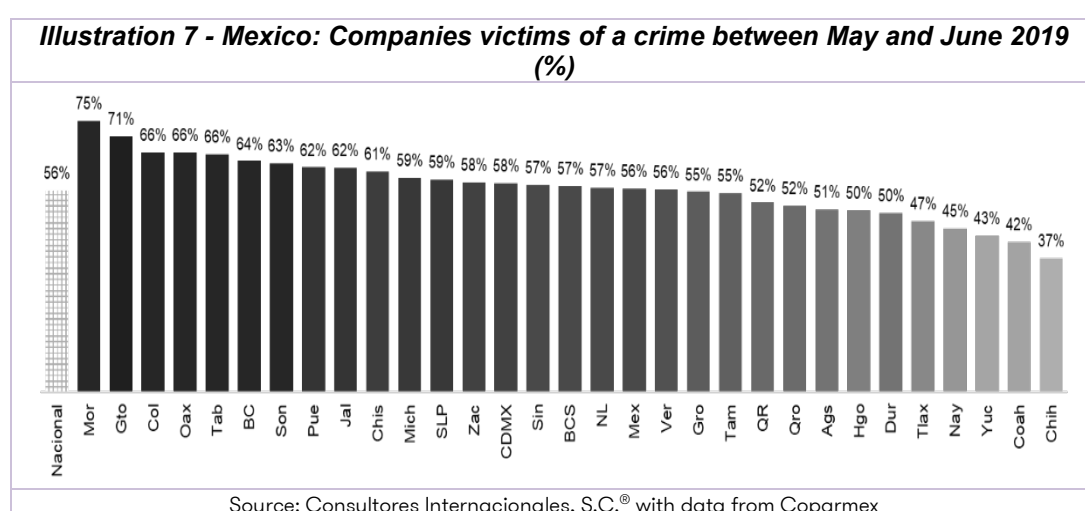


Of course, in addition to the effect that this has implied for society, it has become a burden on the business community. According to data from Data Coparmex, between May and June 2019, 55.7% of companies have been victims of a crime in the last year. (COPARMEX, 2019).

The data is even more alarming if it is reviewed in detail in each of the states. Morelos and Colima exceed the average by more than 15 percentage points.

The business climate is further aggravated by blockages and demonstrations on roads, robberies and vandalism of means of transport, mainly motor transport and railroad.

It is even noteworthy that the insecure environment was one of the elements that led to falling two places in the competitiveness ranking of the World Economic Forum. (WEF, 2019).





In this year, the Rule of Law Index was also published (World Justice Project, 2019), where Mexico placed 99 out of 126 (26 of 30 if only the Latin American region is considered), that is, it lost two places with regard to the 2017-2018 publication. The worst qualified elements were corruption (place 117 out of 126), order and security (117 out of 126), civil justice (113 out of 126), and criminal justice (115 out of 126).

The increase in crime and insecurity has had an adverse effect on the decisions of economic agents

In general terms, there is a period of physical insecurity and a complex business climate aggravated by uncertainty and economic insecurity and the lack of the Rule of Law.

Despite the actions that have been implemented such as the new security strategy based on the creation of the National Guard and various changes in the way of attacking the problem of insecurity and organized crime, they still fail to have positive results.

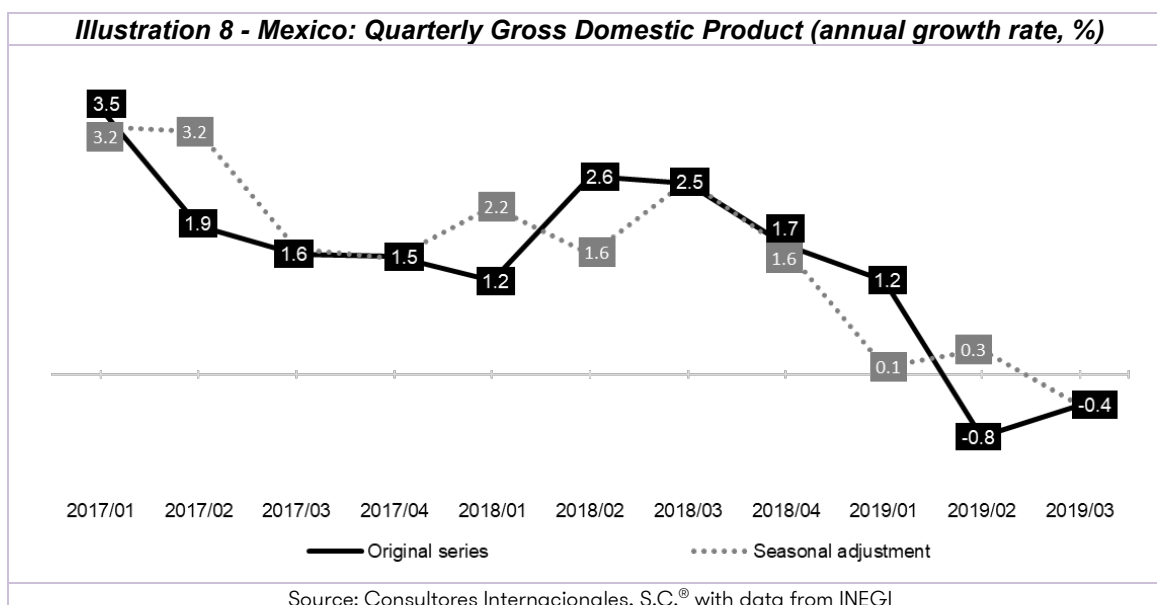
It does not appear that environmental conditions and safety actions are enough to significantly reduce these events in 2020.

This is why it is observed that the climate of uncertainty will continue with the known effects not only on the mood of society, but also on the economic scenario and on the flow of investments.

## Economic matters

2019 will be the year with the lowest economic growth in 10 years. In the first quarter, the annual variation of the GDP was 1.2%, -0.8% in the second quarter, and -0.4% in the third. Although there are not enough elements to consider it a recession (given that by seasonally adjusting the original data, it records negative growth only in the third quarter), it is possible to distinguish a slowdown, which is important to bring to light, since it seems to have started in the last quarter of 2018. Even by recording 1% growth in the last quarter of the year, total growth of the year would be approximately 0.3%, which does not seem possible.

In accordance with various institutions that estimate the growth of Mexico's GDP ranging from 0.2% to 0.6% for 2019, Consultores Internacionales, S.C.® estimates growth of 0.3 percent.



**Table 1 Mexico's GDP growth estimates per institution, 2019-2020**

Institution	2019 Estimate	2020	Month of publication
IMF	0.4%	1.3%	October
Banxico (survey of specialists)	0.5%	1.4%	October
Citibanamex	0.2%	1.2%	October
Moody's	0.2%	1.3%	October
OCED	0.5%	1.5%	September
Consultores Internacionales, S.C.	0.2%	1.2%	November

Source: Consultores Internacionales, S.C.® with data from different institutions, 2019

In the IMF's global economic perspectives (2019) it is argued that "growth slowed sharply in the first semester of the year due to strong uncertainty concerning policies, insufficient budget execution, and certain transitional factors".

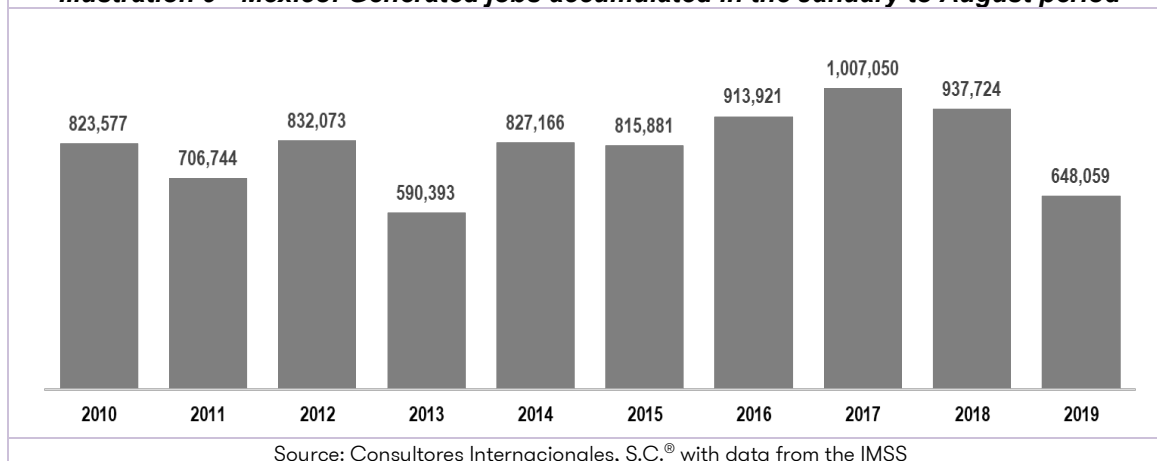
Mexico does not grow and employment levels are reduced

Inevitably, the performance of the economy has already had an impact on tax collection and job creation.

In the first case, it is observed that according to data of Secretaría de Hacienda y Crédito Público (SHCP), total revenues of the public sector from January to September 2019 have been 1% higher (in real terms) compared to the same period of 2018. A -4.6% decrease is observed in oil revenues, and decreases of -0.6% and -2.6% in the collection of Income Tax (ISR-Spanish acronym) and Value Added Tax (VAT).

With regard to jobs, 648,059 new formal jobs were created from January to October 2019, according to data from the Mexican Institute of Social Security (IMSS-Spanish acronym).

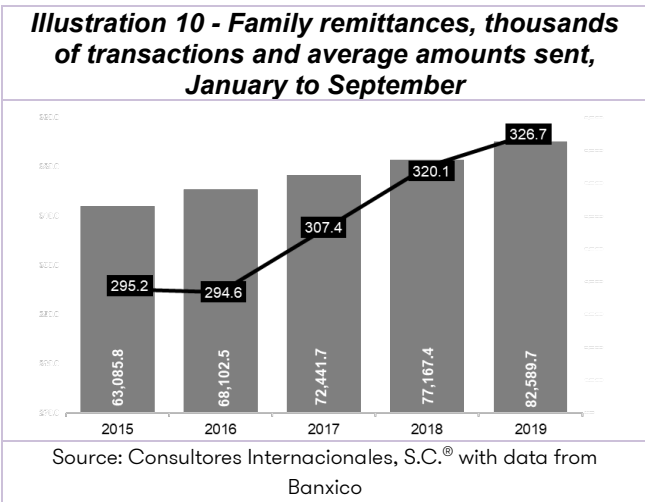
**Illustration 9 - Mexico: Generated jobs accumulated in the January to August period**



Coincidentally, there has been a slowdown in the private consumption indicator in the last year, growing on an average annual rate of 1%, while it did so at the rate of 3.3% and 2.1% in 2017 and 2018.

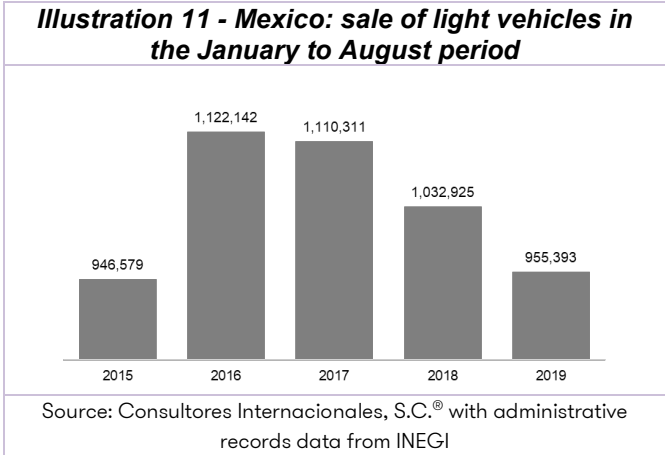
One of the arguments associated with this variable has been that it does not include the 900,000 trainee students of the Young People Building the Future program (STPS, 2019). It was even a cause for disagreement by the Presidency of the Republic regarding the figures reported by the IMSS.

A buffer in terms of internal consumption has undoubtedly been the family remittances sent primarily from the United States. According to data from Banxico, 26.98 billion dollars have been received between January and August 2019, which is 9.2% more than the same period of 2018. More remittances are being made and more money is being sent. Up to September 2019, 82.6 million remittances have been made, averaging \$ 327 each one. Between 36 billion dollars and 38 billion dollars for family remittances are expected to be received by year end.



An indicator associated with the domestic market is the sale of light cars on the Mexican market. In general terms, it offers an approximation to medium-term expectations and the perception of expected payment capacity.

7.5% fewer light cars were sold on the Mexican market in the period January to September 2019, compared to the same period in 2018.

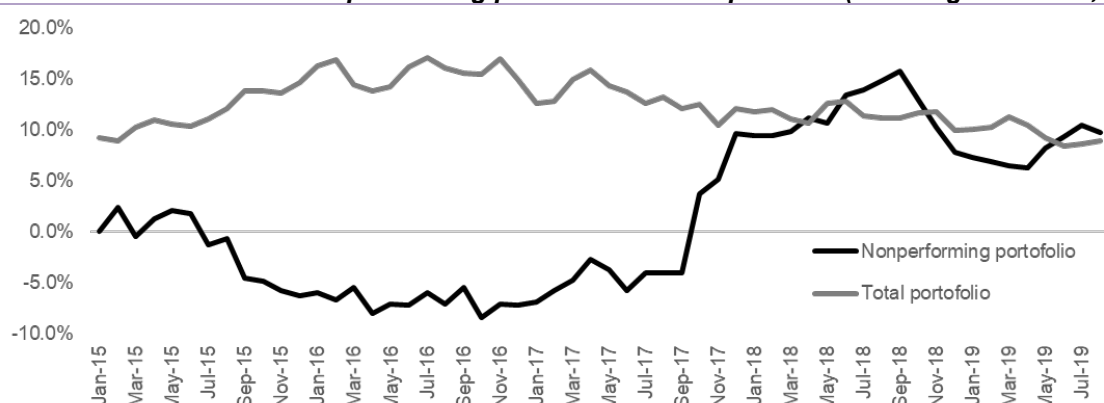


By the same token, the evolution of the construction sector is another significant indicator of the economy due to the high added value and employment that it generates. According to data from the Industrial Activity Index published by INEGI, in all months from November 2018 up to August 2019, except for January, annual variations have been negative, with the most severe in May, June and July, - 8.7% -6.0% and -8.8%, respectively.

Another highly relevant indicator to consider in the analysis of the domestic market is the total and nonperforming loan portfolio. It is observed that the non-performing loan index grew quickly from 87 billion pesos in September 2017 up to 101.5 billion pesos in August 2019<sup>5</sup>. In this same period, the placement of loans has slowed down and the non-performing loan index (the proportion of the nonperforming portfolio with respect to the total portfolio) has been maintained at an average rate of 2.2%.

<sup>5</sup> Both figures stated at 2018 prices, deflated by the CPI.

**Illustration 12 - Mexico: Nonperforming portfolio and total portfolio (annual growth rate, %)**



Source: Consultores Internacionales, S.C.® with data from Banxico

A positive element in handling the economy has undoubtedly been the responsible and disciplined management of the country's public finances. Proper management of financial variables has enabled inflation, interest rates, and exchange rate levels to be controlled.

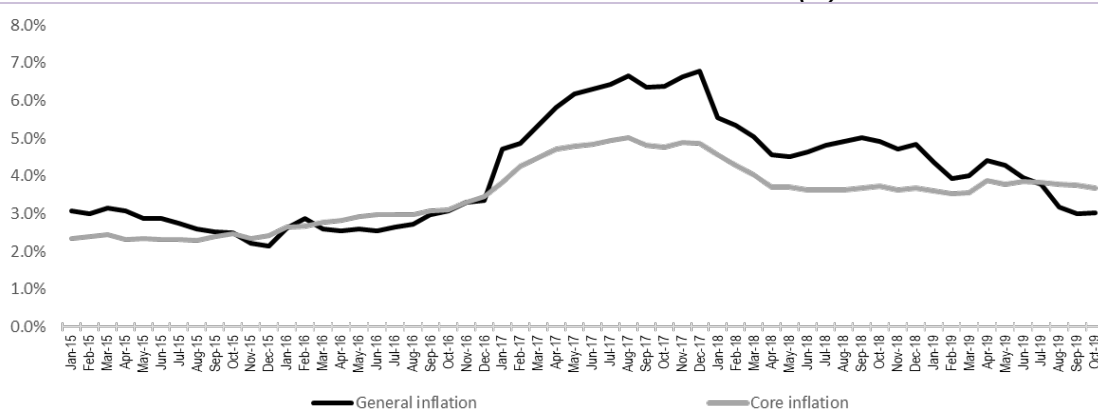
Therefore, it is not surprising that a general downward trend is observed in inflation. INEGI data indicates that inflation is placed at 3.0% as of October 2019. However, there is one element that should be considered guardedly in this regard: core inflation<sup>6</sup>. The latter indicator is often lower than general inflation. However, there are three consecutive monthly records that are above the general index, indicating that the prices of goods and services normally are increasing without any volatility. The foregoing implies that the drop in price levels responds more to economic stagnation that hinders prices from going up than to structural reasons.

In consideration of the behavior of inflation, the Board of Governors of the Bank of Mexico decided to reduce the interbank interest rate by 50 basis points overnight to a level of 7.5% (November 14, 2019).

Mexico has maintained discipline and responsibility in managing public finances despite low levels of growth

The statement of September 26 (Banxico, 2019) sets forth that this adjustment was decided accordingly, given the breadth of the GDP, the behavior of inflation, and by following the previous movement by the Fed. However, the dynamic of the core inflation is estimated to be a moderate risk, which Banxico will monitor permanently and, if applicable, act accordingly with downward or upward trends.

**Illustration 13 - Mexico: Annual inflation (%)**

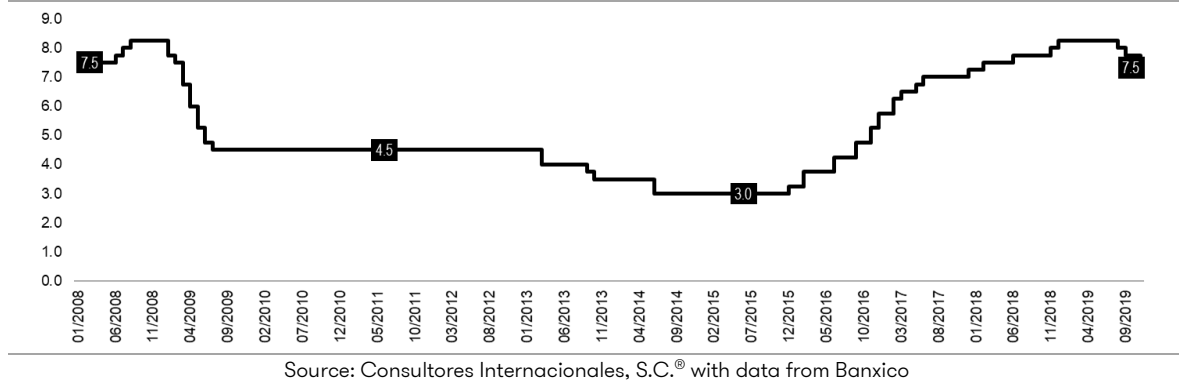


Source: Consultores Internacionales, S.C.® with data from INEGI

<sup>6</sup>Core inflation is particularly a very useful classification for making economic policy decisions and for preparing forecasts on inflation, insofar as the goods and services that make up the basket that is used to measure such inflation are not subject to administrative decisions, marked seasonality or high volatility. The Core Inflation Index seeks to capture the trend of price movements. Due to this, generics that have highly volatile prices are excluded therefrom, namely, agricultural products, energy, and government authorized tariffs". (Banxico, 2019)- Proof of domicile



**Illustration 14 - Mexico: Interbank Interest Rate target (%)**



The Federal Reserve cut the interest rate by 25 basis points to a range of 1.5% - 1.75% on October 30. This cut is already anticipated and no more changes are expected for the rest of the year.

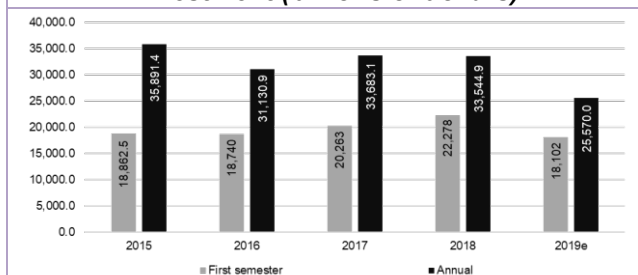
Interest rates have been cut in Mexico, with the perspective of continuing to go down

In general terms, it has been observed that the investment has shown a downward trend. The analysis of the Gross Fixed Investment Index shows that since November 2018, there was a positive annual growth rate of the indicator only in January. Thereafter, the drops have been accelerating practically in its two main components that parallel each other, namely, construction and machinery and equipment.

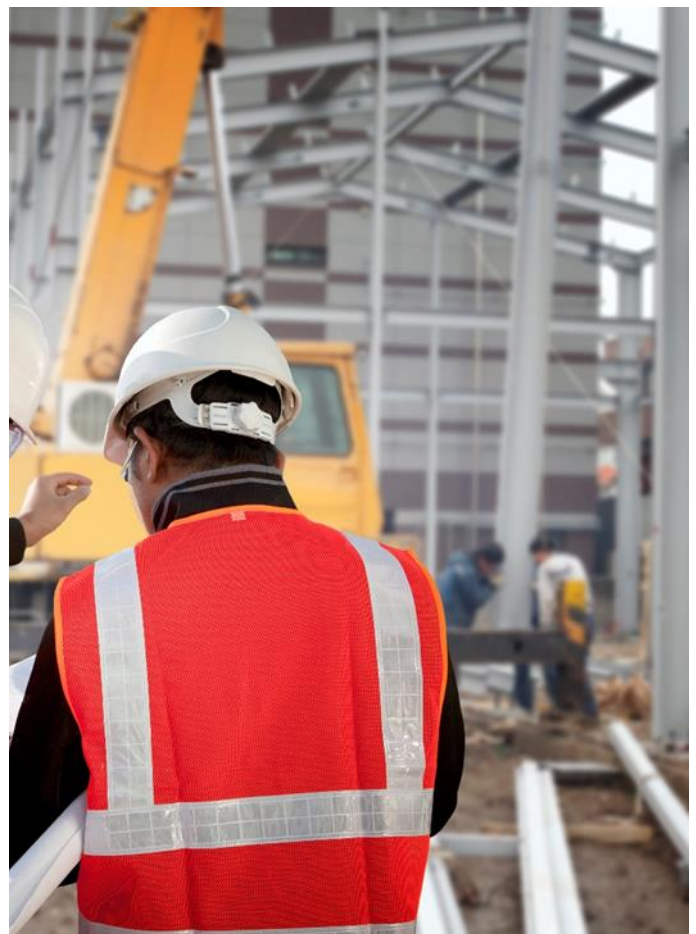
In spite of the environment of downward interest rates and controlled inflation in the world, Mexico needs to maintain a positive real interest rate in order to retain investment flows and in so doing, keep the exchange rate at appropriate levels.

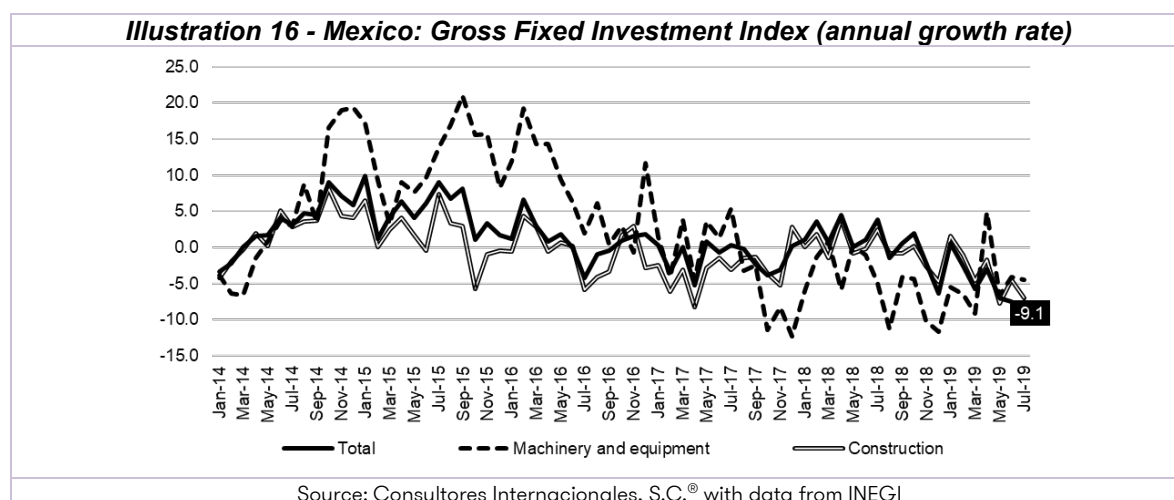
Indeed, all of the foregoing has brought on a climate of uncertainty among investors, and 2019 has not been a year of good figures with regard to Foreign Direct Investment (FDI). The data available as of the second quarter indicate that 11% and 19% less have been attracted during this year, respectively, with respect to the same period of 2017 and 2018. At 2019 year end, it is estimated that investments attracted could amount to 25.6 billion dollars.

**Illustration 15 - Mexico: Direct Foreign Investment (billions of dollars)**



Fuente: Consultores Internacionales, S.C.® con datos de Banxico y estimaciones propias





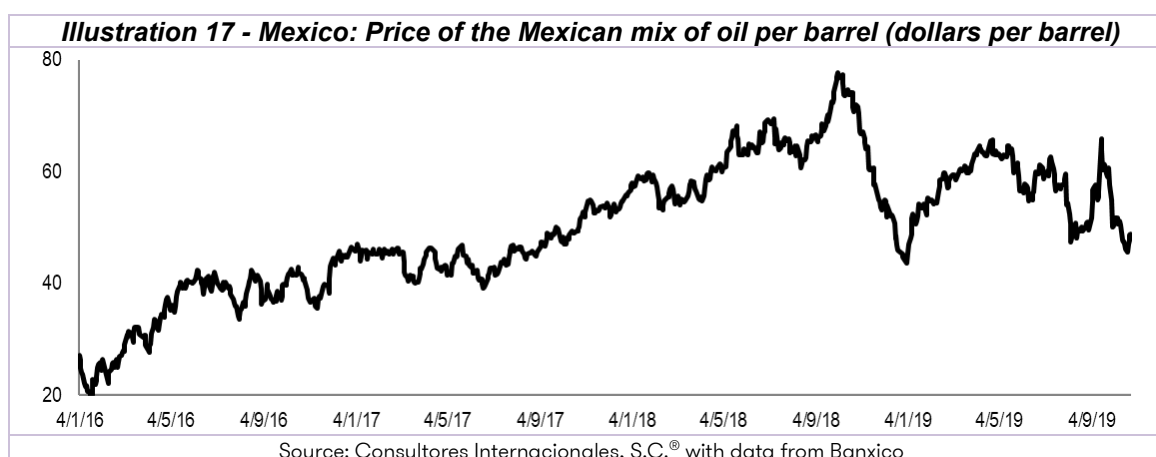
The 2020 PNI will trigger economic growth

The price and oil production are expected to be stable

The National Infrastructure Plan (PNI-Spanish acronym) 2020 will be presented providing greater certainty, and it could be an element that will boost economic growth next year.

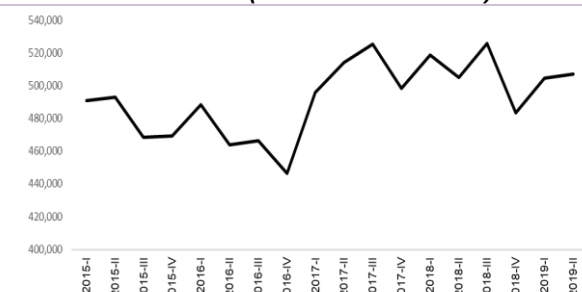
Oil prices are expected to be stable in the following months, which will allow greater flexibility, together with the increase in expected oil production, public finances, and the exposure of Pemex's financial risks.

As stated by the SHCP, the PNI will contemplate three stages: the first stage entails considering private investment works, 15 projects for 158 billion pesos that would be highway concessions, development of port areas, concessions granted for airports; the second stage entails joint investment projects between private initiative and public sector; and finally works that are only for public investment. Of course, resources are expected to be released and obstacles overcome to start the mega projects of this administration; we refer to Santa Lucia, Dos Bocas and Tren Maya.



On the other hand, the liabilities of the investment portfolio<sup>7</sup> have also shown a downward behavior. Zero growth was observed in the first quarter of 2019 [latest available data], compared to the same period of 2018.

**Illustration 18 - Mexico: Investment in portfolio, liabilities (millions of dollars)**

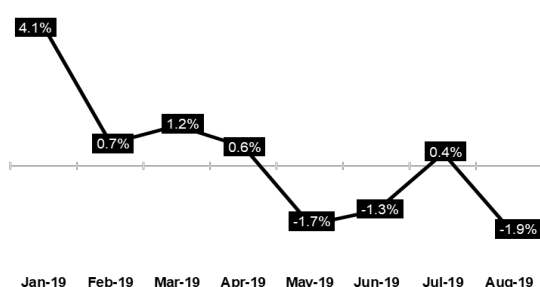


Source: Consultores Internacionales, S.C.<sup>®</sup> with data from Banxico

The U.S. Manufacturing sector has slowed down

With regard to the external sector, the dynamics of the US manufacturing sector are observed with some concern. Between January and August, a stagnation is observed in the monthly value of new purchase orders and there is even a downward trend if we consider annual growth rates for each month.

**Illustration 19 - United States: new purchase orders of the manufacturing sector (annual growth rate)**

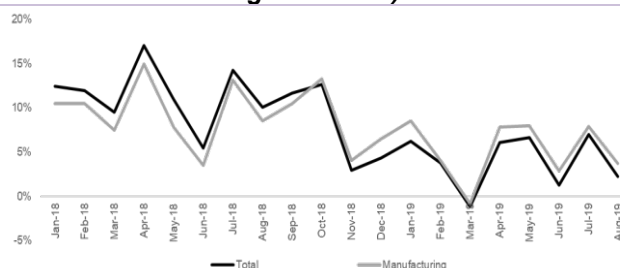


Source: Consultores Internacionales, S.C.<sup>®</sup> with data from the U.S. Census Bureau

This has generated an impact on the Mexican export sector, which has also been decreasing its trade dynamics; whereas in 2018, the growth was an average of 10% each month, it has been around 4% in 2019. If only manufacturing exports are considered, the values are 9% versus 5%.

The foregoing concurs with our estimates; thereby placing exports between 461 and 470 billion dollars by year end. This will mean a growth between 2% and 4%, compared to 2018 and around 8% by 2020.

**Illustration 20 - Mexico: Value of exports (annual growth rate)**



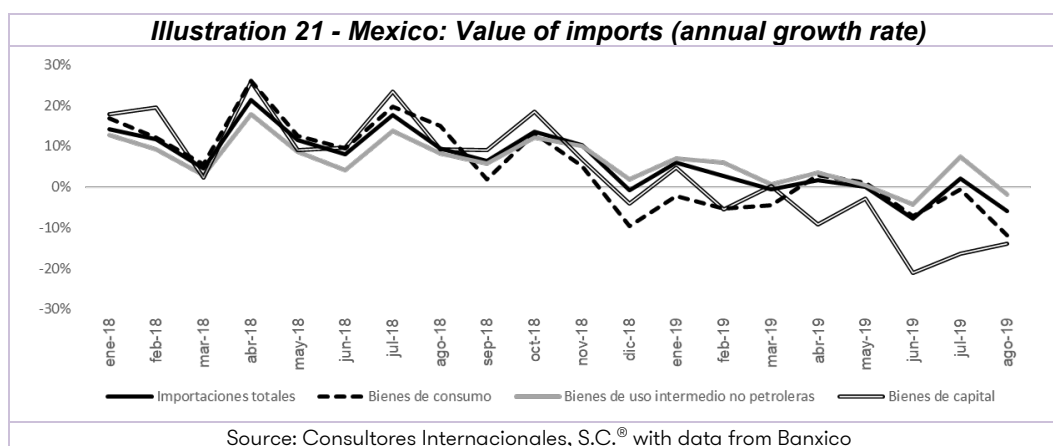
Source: Consultores Internacionales, S.C.<sup>®</sup> with data from Banxico

Purchasing power has decreased

The analysis is also complex with regard to imports. In general terms, total imports are decreasing compared to the values recorded last year and the decrease seems to accelerate.

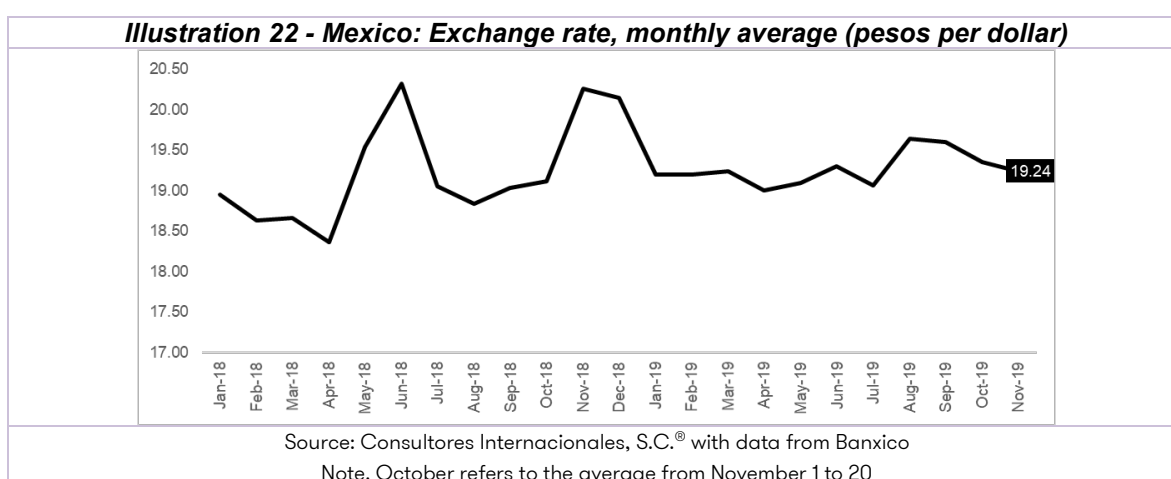
In principle, as noted above, the dynamics of the Mexican market have been decreasing, which has impacted the demand for imported consumer goods. The same trend is also observed in non-oil inputs and capital goods, which indicates that the manufacturing sector is losing purchasing power.

<sup>7</sup> It refers to payments made by residents to nonresidents for the portfolio holdings that nonresidents hold of stocks, bonds, promissory notes, and money market instruments issued by residents.



Finally, a variable strictly associated with foreign trade is the exchange rate. It is understood that a strong currency has high purchasing power. Otherwise, a weak currency makes the prices of its merchandise attractive. In the case of Mexico, the balance is an element that has been sought in recent decades, which is intended to maintain purchasing and selling power.

It is a variable that also offers an approximation of the perception of short-term markets. Since August, the exchange rate has been under pressure, due to the preference of actors for dollars in view of worldwide uncertainty. However, it has been more stable than in prior years.



# 2020, What can we expect?

Toward 2020, the only thing completely certain is that uncertainty will remain, and that is the great challenge for the different economies of the world: managing it and preventing paralysis from continuing.

For Mexico, external factors will be transcendental, such as the ratification of the USMCA in the United States Congress, which seems to be subject to having the labor reform applied in Mexico, an issue that has been explicitly important, above all, for the Democrats. The unions in the United States have already joined the equation, which seek to postpone the ratification of the Agreement.

The ratification of the USMCA will trigger investments

The probability of the ratification of the USMCA is high and, therefore, a climate of greater security will be expected to be generated for investments, which will begin to flow to Mexico, giving rise to positive effects on the economy.

We have to be mindful and not let the unfolding electoral process of our northern partner go unnoticed. Campaigns may entail distracting and disruptive elements. In addition, there will be other factors such as the seemingly solved trade war with China.

The threats of a global recession and especially in the United States do not seem so close. It is true that the slowdown will continue, but so will economic growth. According to the most recent IMF estimate, 2.1% growth is expected in the United States in 2020 and 1.6% by 2024, which has a direct impact on our exports.

Other elements that should be considered are those that can affect energy prices directly or indirectly. If the geopolitical crisis, primarily in the Middle East, intensifies and gives rise to new attacks on oil fields, detention of ships or others, there will surely be a shortage and, in so doing, price increases. In the meantime, there are no technical reasons that significantly change the level of oil prices in 2020. It is estimated that the price per barrel ranges from 55 to 61 dollars, which does not show significant differences from data observed.





Likewise, the economic and political environment throughout Latin America could become even worse, mainly in countries like Bolivia, Peru, Ecuador, Argentina and, of course, Venezuela. This could also have adverse effects, especially with regard to the risk perceived in the region in general. We must indeed be watchful of the dynamics in migration flows.

With regard to internal factors, managing the 2020 Economic Package and its impact merit our attention. The recently approved annual temporary tax regulations have brought on positive expectations of tax collection capacity. Although it will be necessary to wait to see its impact on the business climate, legislative enactments should also be considered that equate tax fraud with organized crime. In any case, pursuant to the Domain Extinction Law, the authority could dispose of the defendant's assets preventively.

Apparently, practically all the obstacles that prevented the Santa Lucia airport from being started have been overcome. In fact, the construction was officially inaugurated on October 17. The real comparison of costs between one project and another will be practically impossible. However, among other costs and compensations, it can be considered that there was an economic paralysis for at least one year, arising from the associated uncertainty.

It will be necessary to think differently to identify business opportunities in 2020

Construction of the Mayan Train, the great infrastructure project of this Administration, will apparently be ready to begin in 2020. This project could involve strong financial and social complications in the Region, mainly because it has traditionally been a difficult and even explosive area. A very similar case is that of the Interoceanic Corridor of the Isthmus of Tehuantepec. Social groups, mainly indigenous, which explicitly oppose its development, have already appeared.

Although the flagship infrastructure projects of the current government can be released and started in 2020, the financial position of PEMEX is still complicated and has a high impact on the country's public treasury. Despite the great efforts to balance their finances, the plans presented have not been persuasive. The loss of the investment rating due to PEMEX's debt is considered to be highly probable, which will make it necessary to take measures to protect and mitigate that rating, so as not to impact sovereign bonds.

The spending policy will remain focused on social development, primarily through direct transfers to vulnerable groups which, as explained, do not have a multiplier effect, which is not significant in the least.

It is foreseeable that the budgetary restriction may be even more limited if the dynamics of the internal market do not rebound, since this depends directly on collection capacity.

Fiscal changes for 2020 can be a double-edged sword in terms of collection and investment certainty

Mexico continues to be a country with a low level of collection with regard to the Gross Domestic Product among the OECD countries. A large informal economy, evasion mechanisms and deficient tax administration and legislation have been the causes thereof. In this line of ideas, the Federal Revenue Act for 2020 contemplates significant tax modifications intended to improve collection. However, they have raised a sense of distrust in taxpayers, since the measures are perceived as intimidating, and even inquisitorial. With amendments to the Law, they could be conducive to certain arbitrariness by the part of the authority.

If this were the case, social tensions could be stronger with direct consequences for the economic stability and political capital of the current Administration, as well as the political party to which it belongs.

Austerity and prudence in spending will continue to be the foundation of the federal budget

Even so, the internal and external communication structures in the Government of the Republic would be expected to be aligned in 2020, and there will be a significant improvement in the flow of information. In that sense, the essential elements of the so-called Fourth Transformation will have to be clear in practically all relevant persons involved, thus avoiding confusion, or even statements or errors that must be corrected thereafter.

Next year, we will see moderate growth of the economy of around 1.0% to 1.3%, spurred by improved investment levels, the potential ratification of the USMCA, and the resources allocated to the infrastructure, through its expansive industries.



Banco de Mexico could lower the interest rate target somewhat more, depending mainly on two factors, namely, the decisions of the FED and the behavior of inflation in Mexico. As already noted, special attention will be paid to core inflation.

In this line of ideas, it is very probable that inflation in Mexico will continue its downward trend and place below 3% in 2020, due to low growth and a scenario of low interest rates.

Likewise, it is observed that managing public finances responsibly will enable exchange rate volatility to be contained. In the proposed scenario, the ratification of the USMCA will be a stabilizing element of this indicator. Of course, the exchange rate may experience volatile moments. However, we believe that these will be temporary.

2020 would be expected to be financially stable

Table 2 2019 -2020 Forecast

	2018	2019	2020
GDP (var. %)	2.0	0.3	1.0 - 1.3
Formal jobs (New workers registered with the IMSS)	660,910	426,434	508,500
Foreign investment (millions of dollars)	31,604	25,570	28,949
Oil price (dollars per barrel)	61.8	55.8	53.9
General inflation (%)	4.83	3.19	2.82
Underlying inflation (%)	3.68	3.49	2.96
Exchange rate (peso per dollar at year end)	19.65	19.59	20.18
Cetes 28 days (end of the period, %)	8.17	7.68	7.36

However, we must bear in mind that the conditions of the world environment, not only from the economic point of view, but also in social and political issues, pose significant risks which, together with the challenges and changes that are experienced within the country, require constant vigilance to be able to steer the decisions and paths of organizations. Among them, we consider that the most representative are the following:

### External

- Ratification of the USMCA
- Elections in the United States
- Trade disputes, especially between the United States and China
- Slowdown of the American economy
- Economic and business climate impairment in the Latin American region
- Migrations
- Production and, therefore, oil prices

### Internal

- Overreaction of the economic agents in dealing with the reduction of PEMEX's rating
- Increased levels of crime and insecurity in Mexico that affect economic decisions
- Greater deterioration of risk ratings that impair the business environment and slow investment
- Continued decrease in investment in infrastructure and deterioration of the construction sector
- Domain Extinction Law: threat to private property

- Lack of balance of powers and greater centralization of duties. Greater pressure on energy bodies and competitiveness regulators

On the other hand, we also see strengths, mainly associated with macroeconomic fundamentals that show strength and stability.

- Stable, downward inflation
- Competitive interest rates
- Attracting infrastructure investments
- Growing remittances
- Prudent public finances
- Good negotiating capacity shown with the United States

With this overview, we must think differently, in the understanding that we are already immersed in the transition to a new era characterized by a new world economic order where innovation and sustainable development should be what guide business decisions.





# Recommendations

## Investment opportunities

Upon triggering the Infrastructure Plan, 2020 will be a year in which there will be great investment opportunities mainly in this sector and those related to it.

- Companies should pay attention to large infrastructure projects and all those that will comprise the PNI 2020
- We suggest that strategic alliances be developed, which allow for expanding the spectrum of products and services offered, reducing costs, and improving profitability levels
- We believe that it is highly important to develop studies and undertake analyses that facilitate decision-making and show the viability of actions

## Tax Alert

The tax landscape could be complex for companies in 2020, associated with the approved annual temporary tax regulations and regulatory changes.

- We suggest that companies redouble their efforts in accounting matters, in order to maintain their taxes in order
- Rely on experts in the field, who offer trust, expeditious, objective opinions and immediate solutions

## Taking advantages of Interest rates

Toward 2020, interest rates are expected to continue with downward adjustments; therefore, we suggest that companies:

- Perform benchmarking exercises (comparative analyses) of bank credits, in order to reduce costs and offer the best credit options
- Strive for leveraging with suppliers, thereby preventing financial tensions from arising for the rest of the companies that make up the value chain

## Cash flows

Considering expected market conditions in 2020, we consider it to be of utmost importance for companies to maintain discipline in managing and disposing of resources and making good decisions to guarantee liquidity in dealing with business opportunities that are going to come forth.

- Companies should expedite and increase cash inflows, as well as delay and reduce cash outflows

## Uncertainty and adaptation

Uncertainty is the constant in the nearby future, in both the international and national scenario. Fast-paced changes do not seem to be expected. However, it is not prudent to expect everything to remain on hold and for economic participants to maintain passive behavior for a considerably longer time. As the months go by, the same uncertainty will be more manageable. Companies, consumers and governments will have more experience and, in doing so, adaptive capacity.

- Companies should find internal mechanisms for quick decision-making, without impairing the quality of their actions. Planning and definition times should be indispensable minimums
- The technification of monitoring and reporting of information will be fundamental. Filtering and addressing such information intelligently, accurately, and on a timely basis will make great differences, not only in the first circle of the companies or groups of investors, but also on middle and operational levels
- Flexible structures, available for rapid changes, will provide companies with strong advantages over others that continue to be rigid and resistant
- Ongoing training will be one of the most significant elements. Keeping staff on the cutting edge is a fundamental strategy that will also be conducive to retaining talent and reducing staff turnover, which is something that can make the difference between success and failure

## Innovation

Innovation, even when repeated to excess, will continue to be the engine of business growth, whether it is observed in goods and services for end or intermediate use for customers. Innovation must also be considered in all processes throughout the production chain.

- Companies that offer innovative, proven and differentiated options will have a better probability of keeping or improving their market share
- Identify business opportunities before the competition will be key in a complex and less dynamic business environment

## Sustainable development

The regulations and the very needs of consumers, companies and value chains are moving towards production and consumption schemes focused on the environment. More than ever, companies face challenges that can put their permanence on the market into play very quickly.

- Companies must incorporate the concepts of circular economy into their processes; that is, reduce the entry of virgin materials and waste production, in both the industrial and service sectors. Those that do not join this trend will be left behind quickly
- Although these are processes that go beyond a simple fashion, the truth is that they will also provide an incentive in market segments where care for the environment is one of the elements in the decision to purchase or invest



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