Investment Institute Macroeconomics

Mexico's General Elections: Continuity likely but headwinds ahead

An overview of the main candidates, their policies and the challenges they face

Macroeconomic Research

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Key points

- Mexico's general elections have more than 20,000 positions up for grabs. Claudia Sheinbaum of the ruling Morena party leads the presidential race by a wide margin and could become the country's first female leader
- A Sheinbaum presidency will likely be a continuation of Andrés Manuel López Obrador's policies: higher social spending, fiscal rectitude, continued state support and control over Mexico's energy sector
- Although Sheinbaum's victory seems certain, she will face a series of challenges including a lack of supermajority in Congress, an ailing energy sector and the upcoming USMCA trade agreement review in 2026
- A Sheinbaum victory would also mean a continuation of AMLO's policies which would likely have several positive implications for investors

Big vote, big challenges

Anticipation is mounting for Mexico's general elections on 2 June as citizens will cast their votes for a new president and legislature, as well as for numerous local government officials. Despite high approval ratings, incumbent President Andrés Manuel López Obrador (better known as AMLO) cannot seek re-election under the country's rules limiting the head of state to one six-year term. The incoming president is scheduled to take office on December 1 and given current polling, we could see the election usher in Mexico's first female leader.

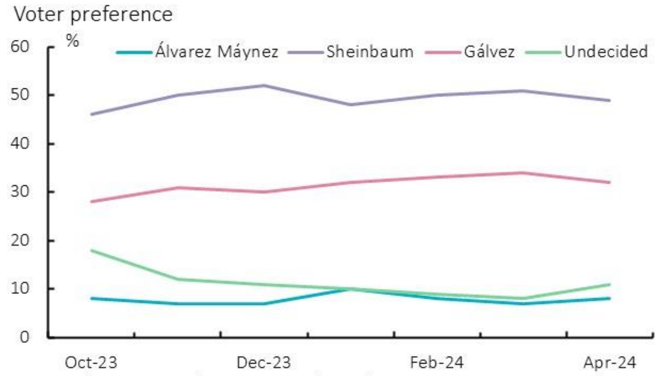
These elections will be nothing short of monumental, with over 20,000 positions up for grabs, including 628 seats in Congress including 128 senators and 500 federal deputies. Overall, it signals that there will be significant changes to Mexico's political landscape. Amid pressing issues such as the state of the energy sector, nearshoring, and the forthcoming United States-Mexico-Canada Agreement (USMCA) review in 2026, the outcome could hold profound implications. Additionally, with both the US and Mexican presidential elections coinciding for the first time in over a decade, the interplay between these two nations adds complexity to this crucial electoral cycle.

Adiós Presidente, hola Presidenta

Below we list the presidential election's main candidates and outline their key policies:

Claudia Sheinbaum, former Mayor of Mexico City (2018-2023) and candidate of the ruling Morena party, enjoys a comfortable lead in the race - 49% of support, according to an El Financiero newspaper poll (Exhibit 1). Sheinbaum's candidacy is buoyed by the Seguimos Haciendo Historia coalition she spearheads, which includes the Workers' Party and the Green Party. Sheinbaum's popularity is further bolstered by the enduring support of the incumbent President AMLO, Mexico's first left-wing leader, who maintains a strong public approval rating after nearly six years in office.

Exhibit 1: Two women lead the presidential race



Source: El Financiero and AXA IM Research, April 2024

Sheinbaum is running on a platform of continuity of AMLO's popular legacy. On the economic front, Sheinbaum wants to maintain fiscal discipline, uphold the central bank's autonomy and ensure public debt stability. Although she has not yet proposed tax reform, she has highlighted the need to fight tax evasion. Sheinbaum's pension system proposals aim to ensure retirees' financial security by advocating for current policies, such as increasing contributions, reducing eligibility requirements and supporting the creation of the 'Pension Fund for Wellbeing'. Additionally, Sheinbaum's energy policies emphasise continued support for state energy companies like Petróleos Mexicanos (Pemex) and Comisión Federal de Electricidad (CFE), with a focus on oil refining and renewable energy development.

Former senator **Xóchitl Gálvez** is Sheinbaum's primary challenger, commanding 32% of the vote according to polls. She leads the Fuerza y Corazón coalition, which brings together historical adversaries: the National Action Party (PAN), the Institutional Revolutionary Party (PRI), and the Party of the Democratic Revolution (PRD). In the 2018 presidential election, these parties failed to unite, ultimately contributing to AMLO's presidential victory.

In terms of policy, Gálvez advocates for a decentralised economic model where the private sector plays a key role in investment. She proposes tax reforms to ease the burden on small and medium-sized enterprises and emphasises protecting autonomous regulatory bodies. She also wants to boost infrastructure investment through public-private partnerships and streamline permits for energy production, particularly in renewables. She pledges to uphold existing social welfare programmes while bolstering support for vulnerable populations by proposing a lower retirement age and improved healthcare access. However, she has not specified how this pension reform would be financed.

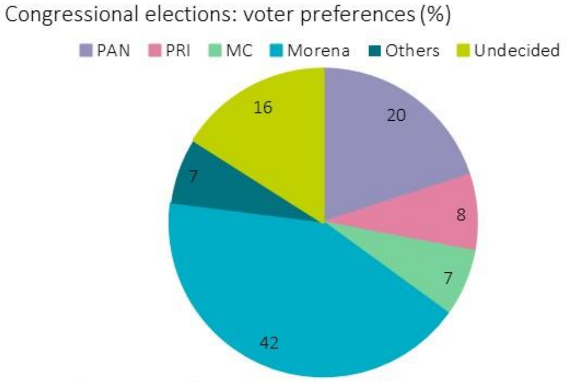
Jorge Álvarez Máynez, currently serving his second term in Mexico's Chambers of Deputies, entered the presidential race in January after his party's initial candidate, Nuevo León governor Samuel García, withdrew. Positioned as a potential 'third way' option, Álvarez Máynez is targeting anti-establishment voters with promises of political reform. However, according to polls, he is in third position and quite some way behind Sheinbaum and Gálvez, and the outcome of his candidacy may chiefly be to bolster his party's visibility and up its representation in Congress. He advocates for increased public investment to improve infrastructure, to transform state-owned energy companies to promote renewable energy and also supports decriminalising drugs to boost revenue. Additionally, his 'National Pacification Plan' focuses on creating more police academies and ending militarisation.

Winning the crown, missing the court

As it stands in the polls, barring a significant electoral upset, Sheinbaum's victory seems almost inevitable. Her triumph would signify a historic milestone as Mexico's first female leader and would further solidify Morena's hold over the country. The ruling party currently holds a simple majority in both chambers of Congress and controls most governorships, yet attaining a supermajority seems improbable in the legislative elections.

Despite AMLO's strong 70% approval rating, his efforts to enact constitutional reforms have been hampered by Morena's (and its allies) shortfall in Congress. With all lower house seats and 128 upper house seats up for grabs, June's elections take on added significance. Polls show 42% support for Morena, 20% for PAN, 8% for PRI (Exhibit 2), 7% for Movimiento Ciudadano and 7% for all other parties. However, a significant 16% of voters remain undecided. With this level of support, Morena will again likely lack the supermajority needed for constitutional reforms. As such, a Sheinbaum administration may encounter similar legislative obstacles to AMLO's presidency.

Exhibit 2: A bittersweet congressional victory?



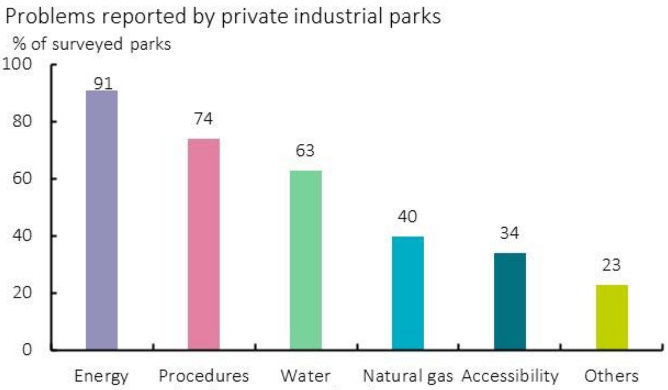
Source: El Financiero and AXA IM Research, April 2024

Even if Sheinbaum secures a supermajority - contrary to current poll predictions - and consolidates her party's control, there will be no room for complacency. Mexico needs to leverage global geopolitical tensions to increase its appeal for nearshoring activities if it wants to boost its relatively low potential GDP growth. In this context, the upcoming USMCA review in 2026 will be crucial, though its outcome remains uncertain, particularly if Donald Trump were to be re-elected as US president. In addition, Mexico also needs to revitalise its ageing energy sector to ensure affordable energy provision to its large industrial sector, making it more attractive for foreign companies to invest in the country. In the following sections, we delve deeper into these themes, highlighting the challenges awaiting Mexico's next president.

Another kind of power struggle

Years of infrastructure investment neglect have exacerbated the challenges Mexico's industrial sector faces, with energy emerging as a critical concern. A 2023 survey revealed that over 90% of private industrial parks encountered issues with reliable electricity (Exhibit 3), reflecting the repercussions of the sector's heavy reliance on oil, which accounts for approximately 43% of primary energy consumption.

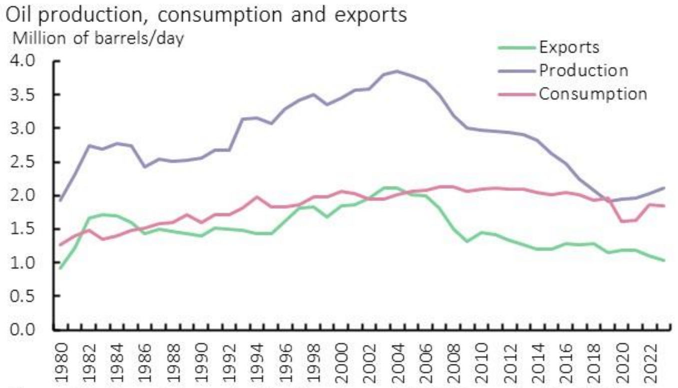
Exhibit 3: Issues faced by the industrial sector



Source: BBVA Research and AXA IM Research, July 2023

The oil industry has historically been a very important sector in Mexico. From 1979 to 2002 Mexico was among the top five global oil producers and until a few years ago, oil-related revenues represented around one-third of total public revenue. However, oil output began to fall in 2004 as the country's largest oil field started to deplete (Exhibit 4).

Exhibit 4: Dwindling oil industry



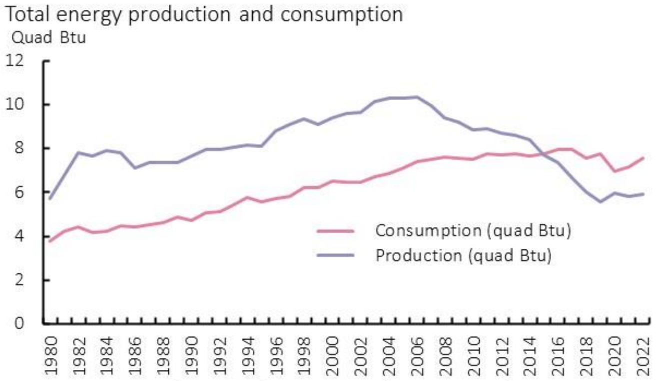
Source: U.S. Energy Information Administration and AXA IM Research, May 2024

To revitalise the ailing industry, the previous administration approved an ambitious energy reform in 2014, allowing private investment in both the oil and electricity sectors, while putting an end to the 75-year-old monopolies held by the two state-owned giants, oil company Pemex and utility company CFE.

However, since taking office, AMLO has consistently worked to dismantle this reform, claiming the country's dependence on large imports of refined oil products like gasoline and diesel is the result of a so-called energy sovereignty crisis. The government has cancelled oil field auctions, renegotiated pipeline contracts and imposed barriers to entry to new renewable energy providers. Likewise, it has tried for years to grant full control of the electricity sector to CFE. Should these trends - aimed at bolstering the state's hold over the energy sector - persist under a Sheinbaum administration, they would likely prove detrimental to Mexico's long-term energy requirements and could deter foreign companies from investing if they lack access to affordable energy. Indeed, Mexico is already a net energy importer, consuming more energy than it produces (Exhibit 5). According to the International Monetary Fund, the country's energy demands are unlikely to be met without private sector investment and expertise, particularly given the substantial debts of state-owned enterprises.

Meanwhile Sheinbaum's energy plans are somewhat contradictory. While her 2024-2030 roadmap calls for the rapid decarbonisation of the energy matrix, the same document indicates that her government would uphold AMLO's energy policy of striving for energy self-sufficiency by bolstering Pemex and acquiring more refineries, without mentioning a commitment to achieving net zero emissions. Sheinbaum has also stated intentions to invest over US$13bn (0.7% of GDP) through 2030 in renewable energy.

Exhibit 5: Energy deficit



Source: U.S. Energy Information Administration and AXA IM Research, May 2024

USMCA review in 2026

The certainty provided by USMCA's rules and the persistent efforts of the US, Mexico and Canada to implement the agreement effectively since its July 2020 start have been important in North America's impressive trade growth of over 36% since the trade agreement's inception. However, the agreement's upcoming review in 2026 introduces uncertainty for business communities in all three countries. If the parties do not extend the deal at the first joint review in 2026, there will be a review each year for the remainder of the agreement's term (until 2036). In these subsequent joint reviews, the parties may reaffirm their wish to extend the agreement for another 16 years. However, failure to extend the agreement during any of the reviews would result in the end of the trade deal in 2036.

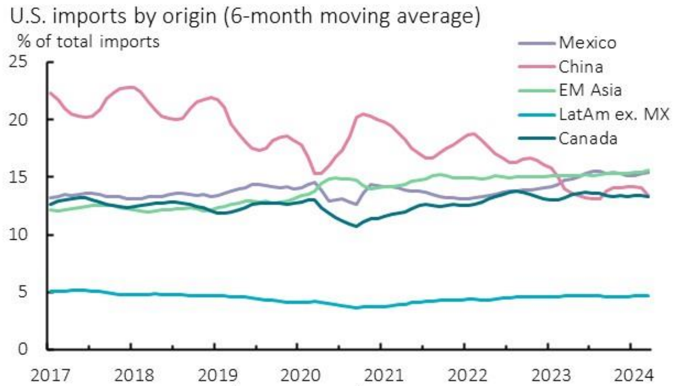
Presidential elections in Mexico and, more notably, in the US, could potentially shape the agreement's future, introducing additional uncertainty. Despite occasional nationalist rhetoric, AMLO's actions reflect his government's continued commitment to upholding US interests in Mexico. Sheinbaum will likely adopt a similar stance and advocate for the continuation of the USMCA, especially given Mexico's heavy reliance on the US market for its exports. However, it is important to acknowledge that under a Sheinbaum administration, the range of contentious issues related to the agreement is likely to be more extensive compared to one led by Gálvez, potentially complicating negotiations and implementation.

Proximity = Prosperity?

The continued success of the USMCA will be pivotal in advancing nearshoring efforts in Mexico. In a previous note, we outlined key drivers behind the shift of supply chains to Mexico, such as trade redirection from China amid the US-China trade war, amplified by USMCA's duty-free access. Additionally, pandemic-era disruptions have spurred demand for resilient supply chains, prompting a focus on production in proximity to the end consumer. Moreover, US President Joe Biden's administration has echoed the importance of making supply chains more resilient, highlighting Mexico and Canada's significant roles in this endeavour. Mexico's competitive advantages, including low wages and transportation costs due to its proximity to the US, further solidify its appeal as a manufacturing destination.

Since 2018, amid escalating trade tensions between the US and China, Mexico has seen an uptick in its share of US imports to 15.6% in 2024 from 13% in 2018. Meanwhile China's share has decreased to 13.5% from 22.8% over the same period (Exhibit 6). However, these figures highlight that Mexico has not fully seized the opportunity presented by China's reduced share, as other Asian countries emerge as formidable competitors in the reshoring landscape. Specifically, as a region, emerging markets in Asia have expanded their share from 11% to 15.7% since 2018. Nevertheless, it's worth noting that Mexico remains the primary individual country of import origin for the US, after it surpassed China in early 2023.

Exhibit 6: Share in US imports

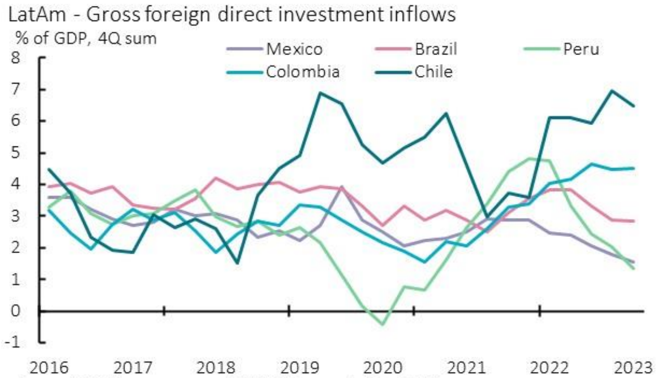


Source: LSEG Datastream and AXA IM Research, May 2024

Likewise, another potential bellwether for nearshoring activities are foreign direct investment (FDI) inflows. These investments often precede the establishment of manufacturing operations in a country, indicating longer-term commitment from companies seeking to relocate production. However, if anything, gross FDI inflows to Mexico have been losing steam since mid-2022 and currently amount to only 2% of GDP. Meanwhile, FDI inflows have picked up in other Latin American countries (Exhibit 7).

Sheinbaum holds a favourable stance on nearshoring, emphasising that investments should be in harmony with the nation's energy policy, provide high-quality employment opportunities, uphold local community interests, and adhere to rigorous decarbonisation criteria. She prioritises sectors such as semiconductors, electronics, electromobility, medical devices and agro-industry, aiming to capitalise on the distinctive strengths of various regions across Mexico and organise them into industrial corridors. Nonetheless, while Sheinbaum advocates for nearshoring, her efforts might be hindered by Morena's occasional nationalist and anti-business rhetoric, along with the party's failure to address the energy sector's issues. In contrast, Gálvez's more pro-business stance suggests potential for stronger nearshoring under her administration.

Exhibit 7: FDI inflows losing steam in recent years



Source: LSEG Datastream and AXA IM Research, May 2024

A slowing growth outlook

Mexico's forthcoming general elections are expected to maintain continuity within the political landscape, with the likely election of Claudia Sheinbaum from the ruling Morena party. However, challenges lie ahead as Sheinbaum may lack a supermajority in Congress, potentially hindering significant constitutional reforms. Nevertheless, these elections also present an opportunity to address pressing economic issues such as revitalising the energy sector, strategic leveraging of nearshoring opportunities, and the upcoming review of the USMCA. Moreover, the outcome of the US elections could add another layer of complexity to the political landscape.

If Claudia Sheinbaum is successful in the presidential race, her administration's continuation of AMLO’s policies is likely to have several positive implications for investors. Her commitment to fiscal discipline and public debt stability could provide a stable economic environment, appealing to bond investors. Additionally, her focus on renewable energy investment may present significant opportunities in the green energy sector, attracting investors interested in sustainable and environmentally friendly projects.

Regarding Mexico’s growth outlook, we expect GDP growth to slow to 2.2% in 2024, from 3.0% last year, despite increased public spending ahead of June’s elections. Already, growth has dipped to 1.6% year-on-year in the first quarter (Q1), the slowest since Q1 2021. Looking ahead, significant headwinds loom, including from high interest rates and a decline in remittances in pesos, reflecting the local currency's strength. Nevertheless, there are bright spots as well, such as stable credit flows, a resilient job market, and easing inflation. As we look towards 2025, growth should further ease to 2.1%. However, this figure remains contingent upon several factors, notably the next president's capacity to attract foreign investment, which in part relies on effective collaboration with the US government ahead of the 2026 USMCA review.

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