


MEXICO

Downgrading short- and long-term trajectories due to reduced judicial independence and higher structural fiscal spending


Short-term trajectory:

Negative Neutral Positive

A horizontal bar chart with three segments: a red segment on the left labeled 'Negative', a yellow segment in the middle labeled 'Neutral', and a light green segment on the right labeled 'Positive'. The red segment is currently filled, indicating a 'Negative' trajectory.

Long-term trajectory:

Negative Neutral Positive

A horizontal bar chart with three segments: a red segment on the left labeled 'Negative', a yellow segment in the middle labeled 'Neutral', and a light green segment on the right labeled 'Positive'. The red segment is currently filled, indicating a 'Negative' trajectory.

- Eurasia Group is downgrading Mexico's short- and long-term trajectories from neutral to negative due to reduced judicial independence and higher fiscal risks.
- On 10 June, President-elect Claudia Sheinbaum met with President Andres Manuel Lopez Obrador to discuss the transition and legislative agenda.
- After the meeting, Sheinbaum stated that overhauling the judiciary, which will likely undermine its independence, will be a priority and added new initiatives that will increase spending structurally.

Lopez Obrador and Sheinbaum met to discuss the transition and legislative priorities before the new legislative session begins on 1 September. Sheinbaum campaigned to conclude Lopez Obrador's agenda and consolidate his legacy.

After the 2 June elections, it became clear that the ruling coalition would have constitutional majorities in the lower house and should be able to obtain them in the Senate. Since then, the possibility that the 18 constitutional initiatives that the president presented in February 2024 but could not approve during the last legislative period of his term would dominate the agenda became more likely. Not surprisingly, the market reacted negatively. The main reason is the judicial overhaul, in which justices and magistrates would be elected in national elections, among other changes that would politicize the judiciary and reduce its independence. This will erode limits to the executive branch's ability to change the rules of the game and undermine what has been a major source of protection for investors under Lopez Obrador.

Though Sheinbaum has always been in favor of these

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reforms, she tried to send signals of moderation since her election to calm the negative market reaction. She announced that Rogelio Ramirez de la O would stay as Finance Minister indefinitely, that Juan Ramon de la Fuente would lead her transition team, and that she expected reforms to be widely discussed. But Lopez Obrador said last Friday that judicial changes should be above market stability and that he could return to public life if he disagreed with the agenda, a clear signal that he did not like Sheinbaum's vagueness. Today, Lopez Obrador convinced Sheinbaum that the judicial overhaul must be approved quickly, ideally before he leaves.

In return, he agreed to allow an open discussion of the initiative, but one that will take place over the summer, not during the legislative period, and likely be meaningless. Sheinbaum also pushed to add her own initiatives. The problem is that they are all negative for investors since they will add fiscal spending in structural terms, undermining her efforts to signal fiscal prudence. The first program would create a pension for women aged 60-64, to be given before they can receive the subsidies to the elderly established by Lopez Obrador. A second will establish a universal scholarship for children, something Sheinbaum did in Mexico City. Details of these proposals will be presented in the coming weeks (Sheinbaum also said she will announce her cabinet next week, a key signpost of her intentions). Ramirez de la O is unlikely to be happy with these initiatives but will likely stay.

Sheinbaum also said there will be a reform to the Institute of Social Security and Social Services for State Workers (ISSTE) to quell concerns from the teachers' union, likely empowering them and providing additional benefits. Finally, a law to ban reelection in congress will also be discussed. These initiatives will likely be approved swiftly, given Morena's comfortable majorities. Other constitutional changes come later.

Due to these initiatives, we are downgrading Mexico's short—and long-term trajectories from neutral to negative. The judicial overhaul will be highly contentious, undermine investor confidence, and generate conflict with middle-class voters, the private sector, and other key players. It will erode the country's checks and balances and reduce investor protection. There is a chance that its scope will be reduced once opposition begins to be felt, but most likely, it will be closer to Lopez Obrador's desires.

Lopez Obrador is leaving the country's fiscal accounts in much worse shape than he inherited them. The fiscal deficit is expected to exceed 5% of GDP this year, the rainy-day funds are gone, and the president's infrastructure projects will demand more spending. While Ramirez de la O claimed last week that the deficit would decline to 3% of GDP and debt dynamics would stabilize, adding social programs is far from a positive signal and will make this hard to achieve, especially as Sheinbaum looks to consolidate her power.

Two of the main pillars that have sustained investor confidence in Mexico, judicial independence and fiscal stability, are taking a hit just a week after the election and will look worse in the future. The president-elect has shown sensitivity to market tensions, so some calibration and corrections could be made, but none of these initiatives are likely to be fundamentally changed. The judicial overhaul is something Lopez Obrador wants to make sure gets done before he leaves, and the social programs are the way for Sheinbaum to try to make her name and boost her popularity. This means the business environment will deteriorate in the coming two years.

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Positive: Political factors in the country are anticipated to have a positive impact on the macro business environment

Neutral: Political factors in the country are anticipated to have a neutral or negligible impact on the macro business environment

Negative: Political factors in the country are anticipated to have a negative impact on the macro business environment

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