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# Hasenstab: How AMLO and Mexico Can Avoid a Populist Fate

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Markets had largely expected Andrés Manuel López Obrador to emerge victorious in Mexico's presidential election on July 1, but only now are the longer-term implications of the new political mandate beginning to take shape as he awaits inauguration on December 1. Dr. Michael Hasenstab, CIO of Templeton Global Macro, offers his analysis of what may lie ahead for Mexico and explains why he thinks the new president should be wary of repeating the populist agenda of other Latin American leaders in recent history.

Andrés Manuel López Obrador's (AMLO) populist ousting of the PRI (Institutional Revolutionary Party) government creates some political uncertainties. However, we believe AMLO's team has done a sufficient job of reassuring investors that it will transition the government in an orderly manner, "to maintain economic and financial stability." That's a good start from the incoming government, in our view.

## Financial Discipline vs Populist Impulses

History offers us a number of examples of populists in Latin America that abandoned market-friendly policies to the detriment of their countries, notably including Dilma Rousseff in Brazil, or the Kirchners in Argentina.

While AMLO has shown some populist impulses, such as expanding pension benefits or broadly handing out scholarships, his team appears aware of the pitfalls that often await governments that disrupt confidence in their country's financial markets.

Over the last few weeks, AMLO's team has vowed to uphold fiscal discipline and maintain the independence of the central bank. AMLO has also indicated he would not reverse a number of critical reforms carried out by his predecessor, such as the privatization of the energy sector.

Certainly a lot of actual policy remains to be seen, but the team's initial attentiveness to capital markets and the business sector is an encouraging sign. Additionally, AMLO did run relatively responsible fiscal policy during his tenure as mayor of Mexico City.

## How Well Will AMLO's Political Alliances Hold?

Nonetheless, there are some concerns for the incoming government. The left-wing Morena party, which AMLO founded in 2014, contains a number of unknown newcomers that lack previous political experience, including activists and celebrities. His governing coalition in Congress, Juntos Haremos Historia, enjoys a majority in the Chamber of Deputies, controlling 62% of the seats, but is composed of politically contrasting allegiances between the Labor Party (PT) and the social conservative PES party.

AMLO's popularity appears to be the glue binding these disparate political factions together, but it remains to be seen how those alliances will hold together on actual policies, particularly if AMLO's popularity wanes.

Even the Morena party itself, which now has the highest number of seats in both chambers of Congress, has little experience whipping votes. We believe it will be important for the government to uphold recent reforms and to also pursue new reforms if Mexico wants to expand its economy and continue attracting investment.

## A Largely Positive Response From Markets So Far

But despite some of the longer-term political uncertainties following the election, markets have largely reacted positively in recent weeks. Much of that can be attributed to the central bank (Bank of Mexico) continuing to run orthodox policy in the background of the election. Notably it raised its policy rate 25 basis points (bps) on June 21 to 7.75%, while indicating that it intends to further support the peso and keep inflation expectations anchored.

The Mexican peso has responded by strengthening 10% against the US dollar from June 14 to July 15, while markets have priced in another 25 bps rate hike at the August 2 meeting.

On the whole, a number of questions linger for the incoming Morena-led government, but we don't expect major disruptions to the institutional strength of the country, or its economy.

Investors should recall that the Mexican government has run appropriate fiscal policy for the last two decades, while protecting the independence of its central bank, and maintaining a free-floating exchange rate. We don't see those institutional constructs being disrupted.

## Our Outlook for Mexico Remains Positive

Additionally, Mexico's economy has remained largely resilient—the country has one of the most open economies in the world, benefitting from free trade agreements with the United States, Canada, Japan, Central America and the European Union. It also significantly benefits from upswings in the US business cycle.

Renegotiations of the North America Free Trade Agreement (NAFTA) remain an ongoing concern, but are not likely to derail the extensive systems of trade between Mexico and the United States, in our view.

Overall, we continue to have a positive outlook for the country. We remain focused on investment opportunities in Mexico's local-currency market, as the peso remains undervalued while yields in the front-end of the curve remain highly compelling at more than 7.5%.

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