

TOP RISKS FOR 2020

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Top 10 risks for 2020

Occurrence likelihood levels

Low  Medium  High  Very high 

1. Legislative activism by Morena

Risk type: **Legal Uncertainty**
 Probability 

This year, Morena is expected to push for legislative changes to complete its so-called "fourth transformation". Despite the fact that Lopez Obrador had claimed that constitutional and other fundamental changes would take place only during the second half of his six-year term, there are concerns inside the government that the election results of 2021 may limit the ability of Morena and its allies to amend the Constitution. For this reason, an ambitious legislative agenda is expected to be pursued, ranging from reforms to the Judicial Branch and to the electoral system, as well as regarding other items in Morena's agenda, such as the Amnesty Law, Cannabis regulation, eliminating the immunity from prosecution of public servants, along with reforms in certain sectors such as finance (with emphasis on the cap on bank commissions); and outsourcing; the Circular Economy Law, the Animal Welfare Law, and the reordering of the Mexican maritime sector, among others.

Three elements point to a complex panorama for Morena in the election to the Chamber of Deputies in 2021: a) the massive conflict within the party in virtually all entities of the country and in the national

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leadership; b) the bad public assessment of an important number of mayors as well as local authorities which might decrease the appeal of Morena in local elections; and c) the lack of federal resources available for members of Congress to manage inside their districts.

2. Increased scrutiny of corporate finances

Risk type: **Economical**

Probability 

During the past year, a number of legislative and regulatory changes were approved that will result in more stringent oversight of taxpayers, with a potential impact on administrative costs for companies. Such measures are explained by increasing pressure on the government to fulfill its budgetary objectives. For instance, a ruling amending various regulations on fake invoices and "ghost companies" was approved, classifying as organized crime tax fraud or its equivalent, and the issuance, sale or disposal of tax vouchers covering non-existent or false operations, or simulated legal acts. This will force high volume taxpayers to be extremely careful when filling out invoices. Furthermore, a measure providing for tax advisors to inform the Tax Administration Service (SAT) about schemes that generate some tax benefit was approved, which will increase the responsibilities of such advisors as they will have to issue an additional statement with this information, whereas the SAT will be able to determine the validity or legality of such schemes. Given this context, another constitutional amendment which prohibits tax exemptions and establishes the harmonization of local legislation in this area within a year was also approved.

It is important to highlight the presidential proposal of Raquel Buenrostro to become Head of the SAT. She was Chief Administrative Officer of the Secretariat of Finance and Public Credit (SHCP), as well as the public face of this government's strict austerity policy. Because of her background and closeness to the president, she is expected to advocate for more aggressive audit and oversight practices.

3. High insecurity levels continue

Risk type: **Economical**

Probability 

Between January and November 2019 (last available date) 31,688 intentional homicides were reported in Mexico, representing an increase of 2.71% over the same period last year. Locally, the states with the highest intentional homicide rates were Colima (79.50 per 100,000 inhabitants), Baja California (66.26), Chihuahua (52.87), Morelos (42.56) and Guanajuato (42.33). Moreover, in the same period, cases of extortion, kidnapping and business robbery also increased, by 31.29%, 8.51% and 5.43% correspondingly. With respect to high-impact crimes, there was a slight reduction of 4.96% in the number of robberies from transporters, which directly impact the distribution and commercialization chains, from 11,194 cases in the first 11 months of 2018 to 10,639 in the same period in 2019. Nevertheless, three states keep having rates of robbery to transporters significantly above the national average (9.42 per hundred thousand inhabitants): the State of Mexico (123.07), San Luis Potosí (57.51) and Tlaxcala (30.68).

It is worth noting that despite the shortcomings in the security strategy which became evident in 2019, following events such as the failed operation to capture Ovidio Guzmán in Sinaloa, the clashes between the military and drug traffickers in Michoacán, and the murder of members of the LeBarón family in Sonora,

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President López Obrador has not announced any change in the composition of the security cabinet. In addition, a lack of clarity persists regarding the policies for social reinsertion, crime prevention and reform of the justice system that the government intends to implement. Lastly, it is likely that states and municipalities will not have sufficient resources to strengthen their police forces and implement effective security strategies. Thus, incidence rates of crime are likely to remain high over the coming year.

4. AMLO strengthens his influence over the Judicial branch and autonomous agencies

Risk type: **Power Concentration:**
Probability 

AMLO will have decisive influence in the appointments to renew members of a variety of bodies: the president of the Federal Institute of Telecommunications (IFT), a commissioner of the Federal Economic Competition Commission (COFECE), two vacant positions in the National Commission of Hydrocarbons (CNH), one more in the Energy Regulatory Commission (CRE), two positions in the National Institute of Transparency, Access to Information and Protection of Personal Data (INAI), as well as three judges of specialized chambers in anti-corruption matters — currently pending in the Senate. The designation of profiles that do not meet legal requirements and/or that have political or ideological kinship with the government is expected to continue, which might lead to a further reduction in the technical capacity of these bodies.

Regarding the Supreme Court, with the appointment of Margarita Ríos Farjat AMLO will have already proposed three of the 11 ministers who compose the plenary, besides being close to Minister President Arturo Zaldívar. The Court will rule on far-reaching issues over the next few months, which means that its composition could be decisive. It is worth remembering that decisions on the unconstitutionality of a law require at least eight votes in the SCJN Plenary. Additionally, Congress may approve a constitutional reform to modify the integration and powers of the Judicial Branch (especially that of the Federal Judiciary Council), something that could reduce its autonomy vis-à-vis the Executive.

5. The dismantling of the Energy Reform continues

Risk type: **Legal Uncertainty**
Probability 

2019 closed with new governmental decisions that confirm that AMLO will not reverse its plan to dismantle the energy reform. Both Pemex and CFE have formally requested the Energy Regulatory Commission to revert several of the guidelines previously issued to generate more competition in the sector. This implies continued impediment to private sector participation in all strategic areas of the hydrocarbons and electricity industry. Consequently, after a year in office, the nationalist vision of natural resources of the President and his main collaborators in the energy area remains firm. As we have said before, the pragmatism prevailing in other public policy issues will not reach the energy sector during 2020.

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6. The Electoral Reform undermines the autonomy of the INE and reduces funding for political parties

Type of risk: **Power Concentration:**

Probability 

During 2019, a number of proposals were submitted to modify Article 41 of the Federal Constitution with the aim of reducing the public financing of political parties. While one of the proposals was rejected in the Chamber of Deputies, president López Obrador announced that a new one will be presented in the session beginning in February. Reducing party funding would convey a signal that the parties are congruent and adjust to the austerity promoted by AMLO's administration; nevertheless, the opposition claims it would jeopardize the equity of electoral races in the context of newfound presidential hegemony.

Meanwhile, in February the Chamber of Deputies will issue a call for candidacies to substitute the four electoral councilors who will conclude their term in April (this designation falls under the exclusive purview of the Lower House). There is a high likelihood that Morena will appoint profiles who are ideologically and politically close to it, since such appointments require a simple majority, and Morena and their supporters can achieve this without the support of the opposition. Lastly, a bill could also be voted on for the presidency of the INE's General Council to alternate every three years and be elected by the Lower House. Such an initiative could imply the early termination of Lorenzo Cordova's presidency and the emergence of a new president from one of the four new councilors (this is however unlikely because a constitutional reform is required). Finally, it is anticipated that President López Obrador will present a reform to the secondary legislation on electoral matters (apparently in February, of a preferential type), of whose content Integralia will offer an analysis in due course.

7. Increasing social conflictivity

Risk type: **Economical**

Probability 

In 2019, the Social Conflict Index prepared by Integralia showed an upward trend. In 2020, that trend will continue as a result of the following factors: in recent years, during the first quarter, there has been a tendency for social conflictivity to increase in response to collective contract negotiations, often resulting in demonstrations, strikes and even labor strikes, such as those that occurred in Matamoros early last year. Second, it is anticipated that political polarization will persist or even increase, mostly due to a presidential rhetoric that tends to emphasize a division between supporters and opponents. Third, the federal and Mexico City governments have shown themselves unwilling to resolve disputes by enforcing the law, encouraging various social groups to lead violent protests which have resulted in the interruption of logistical distribution routes and therefore in significant economic losses. Fourth, the deteriorating capacity to generate their own revenues and the general decline in federal transfers to states may undermine local government capacities to prevent and resolve conflicts.

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8. AMLO strengthens his influence over the Bank of Mexico

Risk type: **Economical**
 Probability 

During the last sessions of the Governing Board of the Central Bank, it has become clear the existence of conflicting views on several topics. The potential inflationary and employment impact of the 20% increase in the minimum wage has been the most recent topic of controversy. During all 2019, two of the members of the Board —Gerardo Esquivel and Jonathan Heath (designated by AMLO)— adopted a "softer" stance with respect to the ideal level of the Bank's reference interest rate, while the other three members —Alejandro Díaz de León, Irene Espinoza and Javier Guzmán— adopted a more "restrictive" stance. By the end of 2020, the latter will complete his term as deputy governor and President López Obrador will therefore be able to count on a third member of the Board. The implications of this are twofold: a more cautious Central Bank in 2020, and, from 2021, more closely aligned with the government.

9. Pemex remains at risk of credit downgrade

Risk type: **Economical**
 Probability 

In 2019, Pemex managed to obtain a series of measures that granted it a temporary lifeline. Firstly, it achieved a recapitalization by the federal government, along with a reduction in its tax levels. In addition, the company succeeded in refinancing a significant portion of its short-term debt (but at a higher cost for medium- and long-terms). Lastly, production levels remained relatively stable, while falling short of original budget projections. Nevertheless, to date the company has not been able to fully convince investors its strategy will be sustainable and therefore in 2020 will be under scrutiny by rating agencies and financial markets. In Integralia's view, the forecast for oil production looks overly optimistic and the financial indicators of the company suggest a further deterioration in its balance sheet, which underlines the probability of a credit downgrade.

10. Threats against Mexico within the context of the electoral process in the United States

Risk type: **Economical**
 Probability 

Attacks against Mexico were a key component for the success of Donald Trump's campaign for the presidency in 2016. His nationalistic and nativistic discourse, which highlighted the alleged dangers of migration and narcotics smuggling from Mexico for the well-being of Americans —including the consequent need to build a wall on the southern border— resonated strongly with the voter base of the Republican Party. In his role as president, AMLO has maintained a position of appeasement vis-à-vis Trump, as demonstrated by his flexibility in dispatching the National Guard to the southern border and in accepting changes to the T-MEC on labor and environmental oversight provisions. However, during the

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2020 presidential campaign, Trump will likely reinforce the criticism of Mexico, and the call to expedite the wall's construction, to bolster his chances of electoral success.

The possibility that Trump will again threaten to impose tariffs on Mexican products on the grounds of insufficient cooperation on migration or security issues cannot be ruled out (especially if there is another case of violence against U.S. citizens, as happened to the LeBarón family in Sonora in November). There is also a possibility that the threat of declaring Mexican cartels as terrorist organizations will resurface, affecting the image of Mexico and potentially causing delays in border crossings, a decline in tourism flows, as well as financial sanctions for companies or individuals with links to criminal organizations. Furthermore, it is important to highlight the probable participation of Mexico as a non-permanent member of the UN Security Council, something which could further put stress on the bilateral relationship, given that such a position would force Mexico to take a stand on various international security issues involving the United States.

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Other Trends and Events to Monitor in 2020

- Performance of state and municipal public finances.** Between January and November 2019, federal transfers to states and municipalities registered a 5% drop in real terms with respect to the same period in 2018. The main reason for this was a reduction in the resources earmarked to the Budget's "Branch 23" (support to states). As a consequence, and in order to increase local tax collection, more than 20 entities have included in their revenue laws for 2020 the possibility of collecting new taxes or increasing the collection of some local taxes.
- Development of AMLO's large projects and infrastructure.** According to figures as of September 2019, the progress of the main infrastructure works of the federal government (Santa Lucía International Airport, Dos Bocas Refinery, Tren Maya and Corredor Transistmico) show divergent progress. While the new airport required 100% of the resources budgeted for that year and made 3% physical progress, the other three projects spent virtually no resources in the first nine months of 2019 and made no significant physical progress. Significant delays in the construction works are to be expected, placing strong pressure on public finances and continuing to generate social unrest.
- Dynamics inside Morena.** Last November, the national leadership must have been renewed; however, because of internal conflicts, no consensus has been reached by the party to carry it out. Integralia considers that the process could start in the second half of 2020 or possibly even after the 2021 mid-term elections. Conflicts might affect the dynamics inside the congressional benches of the party about the possibility of reelecting legislators (it is uncertain whether the party will allow them to run for re-election or whether it will opt for new candidates).
- Creation of new political parties.** The General Council of the INE will approve in June the formation of new political parties which will compete for the first time in the 2021 elections. Four organizations are expected to obtain registration: Redes Sociales Progresistas of unión leader Elba Esther Gordillo; Encuentro Solidario, formerly Partido Encuentro Social; Grupo Social Promotor de México, formerly Partido Nueva Alianza; and Libertad y Responsabilidad Democrática —México Libre—, of former president Felipe Calderón and former presidential candidate Margarita Zavala. The establishment of these parties is significant due to their potential impact on the party system and electoral dynamics in 2021. While Redes Sociales Progresistas has expressed its support for AMLO's project, it is likely to gradually assume positions contrary to Morena and become more critical of the government as the 2024 election approaches. It cannot be ruled out that Grupo Social Promotor de México and Encuentro Solidario also might endorse the government; rather, it is expected that México Libre will be an unyielding opponent of AMLO's administration.
- Attempts to strengthen the opposition: PAN/Business organizations/civil society.** Opposition parties will attempt to diminish the president's and Morena's popularity, and to begin positioning themselves with a view to the start of the electoral process in September and candidate selections at the end of the year. In this regard, establishing a proactive (not just critical) position with respect to the president, and profiling more solid leaderships will be fundamental. Given this context, it is predictable that the main opposition role will continue to be undertaken by the PAN, which would seek to be the leading force in confronting AMLO, and will therefore seek to establish links with civil society groups—including organizations such as "Futuro 21" (close to the weakened PRD)— and business bodies such as Coparmex. Organizations with a growing regional profile (such as MC) and new parties, such as México Libre, should also be monitored.
- Labor Reform implementation.** Pursuant to the transitional regime of the labor reform enacted in 2019, unions have until May 2, 2020 to adjust their consultation procedures (to obtain the Certificate of Representativeness and to have the content of their collective bargaining agreements verified by the authority). This time limit might lead to disputes within trade union associations to define the rules in their statutes for what will be the first campaign for collective labor contract ownership. Consequently, the collective bargaining that started in 2019 will continue and new leaderships may emerge. Similarly, the major trade union organizations that existed in the past might experience a migration of members and divisions, thereby increasing the number of trade unions. In turn, companies may confront more than one union internally, which would increase the complexity of contract negotiations.

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- **Ratification of the USMCA.** The United States Senate is expected to approve the trade agreement early this year, however, the start of the impeachment process against Donald Trump could delay the vote. The approval would be held up in Canada, where the parliament resumes its duties until January 27. This agreement would enter into force within three months of its ratification by the three countries. As a result of the recent changes that have been negotiated in the addendum to the agreement, monitoring the implementation of the agreement in Mexico, especially on labor issues, will be of utmost importance.
- **Increased use of referenda to define investment projects.** The use of popular consultations to define investment projects is likely to continue and even increase. This, because last December the reform to Article 35 of the Federal Constitution came into force, redefining the issues of consultation and its implementation process. Even though this reform allows for the consultation of topics "of national and regional importance", establishing a day for their execution (the first Sunday of August of each year), it is foreseeable that these mechanism will be used to promote public policy priorities of the federal and local administrations. Having said this, the possibility that the President may resort to popular consultations outside the legal framework cannot be ruled out, as he has done often in recent months to advance his public policy priorities.
- **Launch of the 2021 electoral process organization.** The electoral process will officially begin in September 2020, and internal political negotiations within the parties to define candidates will begin at the end of the year. The 2021 election will be the largest in the history of the country: the Chamber of Deputies, 15 governorships, 29 local congresses and almost two thousand town halls will be renewed. There will be elections for the first time in all 32 states, and the potential voters will number 96 million.
- **Private sector and federal government relationship.** 2019 closed with a better business outlook. Entrepreneurs trust that 2020 will be a more agile year for public spending and greater legal certainty for investment. Yet investment shows no signs of recovery and business confidence indicators continue to reflect skepticism. Should this trend continue, the smooth relationship between AMLO and entrepreneurs could become strained at various times.
- **Implementation of the INSABI.** According to available information, the National Institute of Health for Welfare (INSABI) has failed to provide universal health coverage, as promised by the federal government. Instead, people who had the Seguro Popular for the care of high specialty diseases have been faced with a significant increase in their fees or the lack of delivery of medicines essential for their care. That could generate discomfort in the citizenry and social unrest.

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IMPORTANT DATES

- January 13:
 - INEGI publishes the Monthly Indicator of Gross Fixed Capital Formation and Monthly Indicator of Private Consumption in the Internal Market for October 2019
 - The call for the new University of Medicine and Nursing in Mexico City will be released.
- January 14:
 - INEGI issues the Urban Passenger Transport Statistics for November 2019.
 - A meeting between the National Conference of Governors and the President of the Republic will take place to discuss security issues.
- January 16: INEGI releases the National Survey of Urban Public Safety during the fourth quarter of 2019.