



SPECIAL REPORT

# COVID-19

## Political and social implications of the pandemic in Mexico

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# POLITICAL AND SOCIAL IMPLICATIONS OF THE COVID-19 PANDEMIC IN MEXICO

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## INTRODUCTION

As of April 1, 1,378 cases and 37 deaths of COVID-19 had been confirmed in Mexico. Last Saturday, for the first time, the government made an urgent call for people to stay indoors. López Obrador's administration anticipates a peak in infections after April 18. Authorities estimate that more than 250,000 people could be infected, and 10,528 of them would require intensive care. If containment and social distancing measures are effective, the infection rate could stabilize within eight to 12 weeks.

The political and social impact of the pandemic could be extremely significant. After the epidemic has subsided, the negative effect on the economy will become evident, potentially involving hundreds of thousands of unemployed citizens, bankrupt businesses, an economic recession, and immeasurable loss of wealth. Furthermore, government approval may drop, governance and government leadership could be further weakened, and an environment of increased polarization will arise.

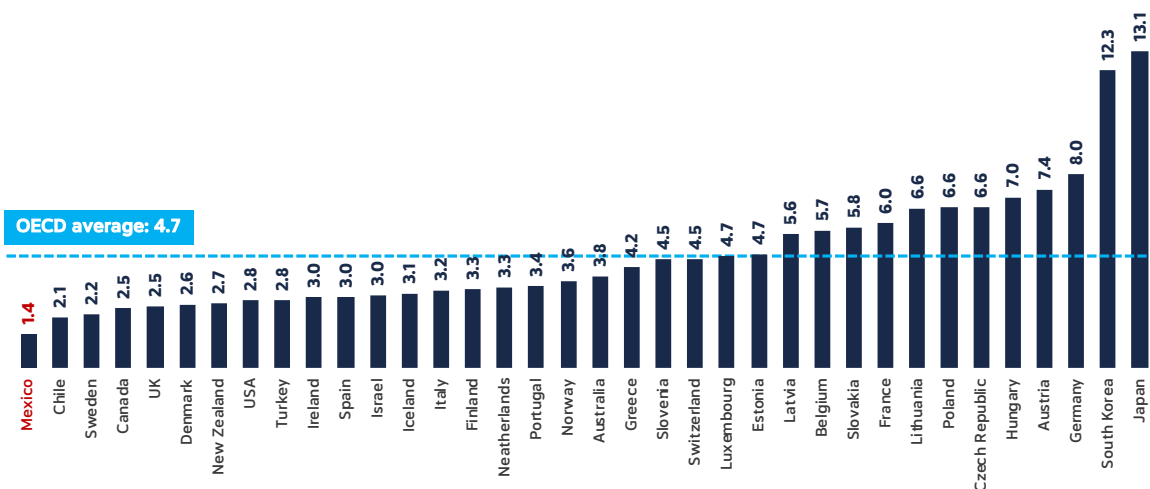
### 1. GOVERNMENT CAPACITY TO MANAGE THE CRISIS

#### a. The state of the health sector and public finances

Mexico faces the crisis with insufficient infrastructure: the number of public and private hospital beds in Mexico in 2015 was 184,112<sup>1</sup>, of which 4,291 were intensive care beds. That is, there are 1.4 beds per 1,000 inhabitants, while OECD countries have, on average, 4.7 beds.

#### GRAPH 1. Availability of hospital beds in OECD countries

Hospital beds available per 1,000 inhabitants (2017)

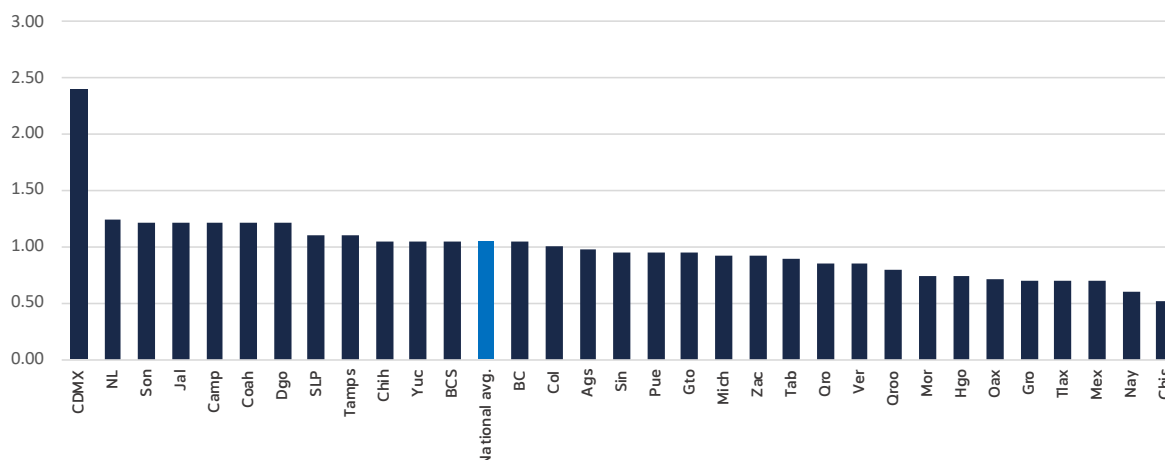


Source: OECD

<sup>1</sup> Coneval. Diagnostic Study of the Right to Health Services, 2018

## GRAPH 2. Availability of hospital beds at the state level

Hospital beds available per 1,000 inhabitants (2014)



Source: Secretariat of Health

Moreover, some states will face more challenging crisis, since they have a reduced amount of infrastructure: while Mexico City has almost 2.5 beds per 1,000 inhabitants, Puebla and the State of Mexico -states with a high number of positive cases- have less than one bed per 1,000 inhabitants. Although President López Obrador announced a three-month advance (from April to June) in the resources allocated to the Ministries of Health at the state level, it must be noted that the total budget is 3% lower in real terms than 2018.

### b. Government response to Covid-19

#### Prevention and health measures

- Suspension of classes for primary, middle, and higher education from March 20 to April 19 (later extended to April 30).
- From March 23 to April 30, implementation of social distancing policies: sick people, adults over 60 years old, and pregnant women must stay at home.
- As of March 26, suspension of non-essential work of the federal government.
- As of March 29, stay-at-home order for one month to reduce the rate of infection.
- Implementation of Plan DN-III of the Ministry of National Defense (Sedena) and Plan Marina, of the Mexican Navy, as a support plan for the civilian population. (See section 4).
- As of March 30, the government declared a health emergency, extending the period of social distancing until April 30.

#### Economic Recovery Plan

- Continue the government's landmark infrastructure projects to generate jobs: Felipe Ángeles airport, Dos Bocas refinery, Tren Maya, among others.
- Strengthening social programs: advance payment of pensions for the elderly and the disabled by one bimester.
- Delivering one million loans to small business (mainly in the informal economy), in addition to the almost 500,000 that are being delivered in the *Tandas para el Bienestar* (group savings pool), and another million loans of 25,000 pesos each for the formal economy.
- The president has assured that he will not exempt companies from taxes, nor will he request financing from the International Monetary Fund.



## 2. THE ECONOMIC IMPACT OF THE CRISIS

Both the coronavirus pandemic and the collapse in oil prices will severely impact an already vulnerable Mexican economy after a year of stagnation. Estimates of the magnitude of the economic contraction for 2020 range from -2% to -7% with a high level of uncertainty regarding the pace of recovery.

### a. The 2008 experience

While the current crisis presents distinct characteristics from the 2008 crisis –an initial supply crisis affecting supply chains and the labor force, followed by a severe demand shock with uncertain timelines–, that experience offers some references for the 2020 crisis. Table 1 illustrates the before, during, and after of the 2008 financial crisis, along with the current situation.

**TABLE 1. Key economic indicators before, during and after the economic crisis of 2008**

Variable	Before the crisis	During the crisis	After the crisis	2019
Growth	2.6% (II-2008)	-8.9% (II-2009)	4.5% (I-2010)	-0.5%
Primary activities	1.9%	-1.5%	-1.8%	1.7%
Secondary activities	0.6%	-10.6%	4.5%	-1.9%
Tertiary activities	3.7%	-8.1%	4.9%	0.0%
Aggregate demand	2.1%	-11.7%	6.9%	-1.5%
Private consumption	1.8%	-4.6%	-3.4%	1.0%
Public investment	14.9%	14.2%	-5.6%	-12.3%
Private Investment	7.5%	-15.5%	-8.5%	-3.4%
BS Exports	1.1%	-18.5%	20.2%	-2.7%
Unemployment rate	3.44%	6.15% (III-09)	5.29%	3.2%
Job creation	1.7% (%12 m, Sep-08)	-4.2% (Jun-09)	0% (Jan-10)	1.7% (%12 m)
Exports (monthly)	8.4% (Sep-08)	-35.7% (Apr-09)	27.2% (Jan-10)	-0.9%
Industrial activity	-0.5% (Aug-08)	-10.5% (Jun-09)	4.1% (Jan-10)	-0.9%
Inflation	3.7% (Jan-08)	6.53% (Dec-08)	4.46% (Jan-10)	2.8%
Debt (SHRFSP)	28.8% (2007)	32.9% (2008)	36% (2010)	44.7%
Budgetary income	10.7% (2008/07)	-5.8% (2009/08)	0.7% (2010/09)	1.6%
Oil income	31.80%	-34.40%	11.50%	-5.8%
VAT	7.50%	-14.70%	16.90%	-2.3%
ISR	14.30%	-9.20%	8%	-2.2%
Total expenditure	11.3% (08/07)	2.9% (09/08)	2% (10/09)	-0.1%

Current	8.30%	1.60%	1.70%	0.9%
Capital	26.40%	8.30%	3.00%	-2.5%
Exchange rate	10.11 (Aug-08)	14.67 (Mar-09)	12.80 (Jan-2010)	19.10
Banxico interest rate	7.5% (May-08)	8.25% (Dec-08)	4.5% (Jan-2010)	7.25%

Source: Integralia with information from INEGI, Banco de México and the SHCP

## b. The magnitude of the recession

The 2020 recession will be severe, and most likely shorter than that of 2008 —aggregate demand dropped five quarters in a row—, but all signs point to a deeper fall and a more subdued recovery, due to the following reasons:

- Double impact on supply and demand.
- At the time of the external impact, the economy was fragile as it accumulated four consecutive negative quarters, with the four components of aggregate demand having experienced weak performances.
- Low business confidence.
- Public finances are more fragile today than they were in 2008.
- Pemex is in a far worse situation than a decade ago.
- The economic team of the current government is less experienced.
- President López Obrador's economic vision is rigid and highly ideologized.
- Authorities' response has been slow and hesitant.

## c. Government reaction

To overcome the critical situation in the economy, decisions are required to minimize the damage during the economic downturn and, particularly, to encourage a swift recovery. The main obstacle is political: most of the measures required collide with the political vision of President López Obrador.

- The president believes that fiscal support for businesses is support for the rich.
- The president believes that supporting businesses would translate into another Fobaproa (a fund to rescue banks created in the 1990s.)
- The President believes that in the past, the poor paid the bill for the crises and therefore denies support to the production plant.
- The president believes that Pemex will be able to move forward without a total reassessment of the business plan of the company.
- The president believes that refining is necessary for energy self-sufficiency and, therefore, will not cancel the refinery (a project that today is even more unfeasible than a month ago).
- The president believes that debt is always a bad thing and is therefore reluctant to relax his view of the deficit.
- Lastly, the president believes that the recession will be brief, and therefore he does not see the need for extraordinary measures.

## d. How will the country emerge from this recession?

A V-shaped recovery (sharp drop with immediate rebound) is not likely. A U-shaped (drop with slow recovery) or even L-shaped (drop followed by stagnation) recovery is more likely, with expected median growth for 2021 of 1.7%, according to the Citibanamex Expectations Survey of March 20. While most of the effects will be temporary, three additional factors anticipate a

slow recovery: If the production plant is not supported, there is a risk of more severe damage and the destruction of relevant sources of employment. The Business Coordinating Council estimated a loss of 800,000 to 1 million jobs by 2020. The depreciation of the exchange rate could also affect indebted companies.

1. At a sectoral level, the effects of the economic slump will be varied:
  - Temporarily benefited: private health services, some retail and wholesale trade items due to anticipated purchases, the telecommunications sector due to extended stays in homes, and sectors whose income is mostly in dollars.
  - With more significant risks: the construction sector, manufacturing (at least temporarily due to the impact on supply chains), transport, financial services, real estate, entertainment, tourism, among others. We anticipate a substantial negative impact on public revenues, which could expose government suppliers to delays in payments and cancellation of contracts.
2. A further downgrade of Pemex's and sovereign credit ratings by Moody's remains highly likely. Standard & Poor's reduced Mexico's sovereign rating and Pemex's from BBB+ to BBB on Thursday 27th, placing both ratings within two levels of losing their investment grade.
3. As exemplified by the cancellation of the Constellation Brands brewery, the climate of legal uncertainty and business mistrust will persist.

### 3. SOCIAL UNREST

As the economic crisis deepens, social unrest will increase.

#### a. Social protest

In accordance with Integralia's measurements, social protest had already increased during 2019; nonetheless, the health crisis and its economic consequences will spread it on a differentiated basis.

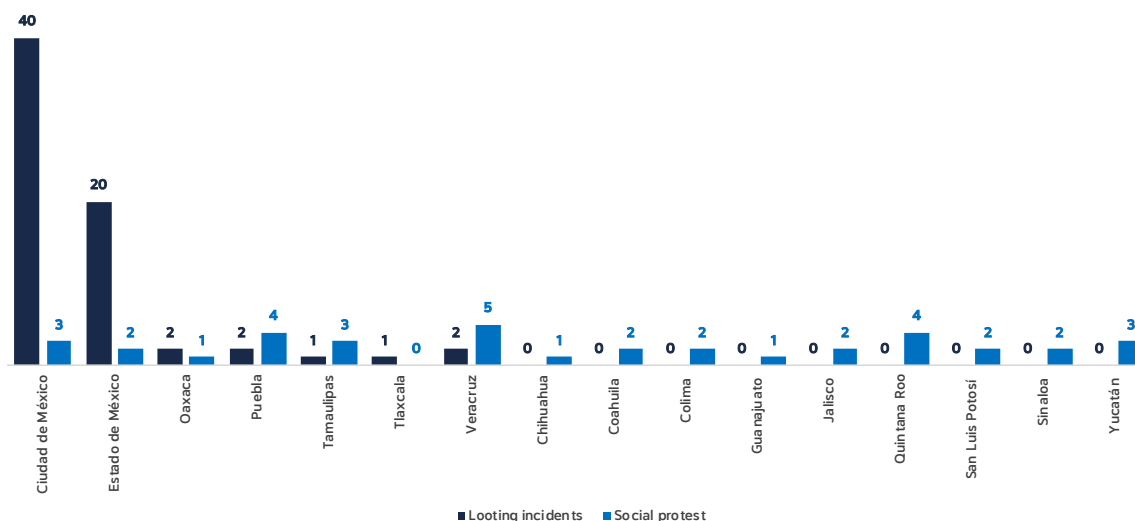
**TABLE 2. Types of protests related to health and economic crisis, 2020**

Type	Phase	Groups or social sectors	Regions
<b>Protests in the health sector:</b> More than 20 protests have taken place related to the sector in recent weeks, in various parts of the country. Should the deficiencies and shortages in the health sector continue, and as confirmed cases progress, protests will increase in various institutions, not only by doctors and nurses but also by patients' family members.	II	Medical personnel, patients and their families	Metropolitan areas of Mexico City, Monterrey, Guadalajara, Puebla, Querétaro, and capital cities
<b>Protests from groups directly affected by the contingency:</b> The sectors most affected by mobility restrictions and who do not have sufficient income to access basic goods could defy the call to avoid crowds and protest through blockades and street marches.	Phase II to Phase III	Vulnerable population in terms of income, population without access to medical services, and the population that works in the streets.	Mexico City Metropolitan Area, Oaxaca, Chiapas, Guerrero, Puebla, Tlaxcala, Michoacán, Veracruz, and Tabasco. <sup>2</sup>

<sup>2</sup> Selection criteria: organizations with high levels of informality and 2) states with social protest precedents.

### GRAPH 3. Social protests and looting incidents reported in the media

Period of analysis: March 23-28



Source: Prepared by the authors with newspaper data from March 23-28

#### b. Social polarization

The pandemic is polarizing the public conversation. Two conflicting narratives stand out:

- AMLO is an irresponsible leader who, through a combination of arrogance, ignorance, and ideology, has minimized the crisis.
- The president has been a responsible leader who has succeeded in balancing a measured and effective preventive response with an enormous social sensitivity for the poor.

However, as the crisis progresses, one side will systematically question official figures on contagion and deaths, while the other will insist that the crisis has been handled in an exemplary manner. Narratives will be generated in which the most radical pro-AMLO groups will accuse the opposition and the media of spreading "fake news" and call for censorship. Anti-corporate narratives can also be expected to increase as the economic crisis worsens and staff cuts become inevitable.

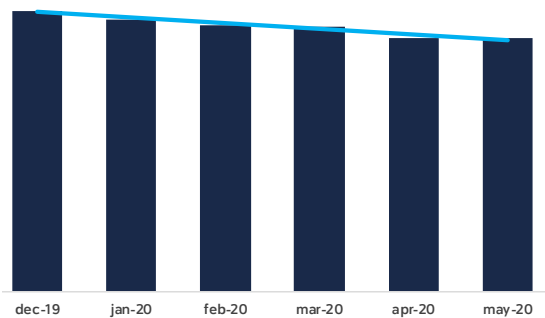
## 4. PUBLIC SECURITY

### a. Public security and territory control

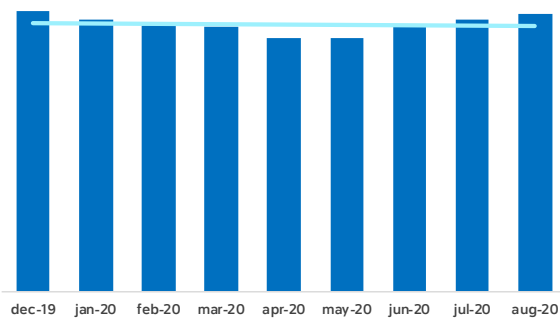
Social isolation means fewer opportunities to commit crimes, as there are fewer people on the streets, in shops, and in public transport. Thus, a reduction in crimes such as burglary and robbery on public transport is likely. In contrast, a relative increase in the number of cases of domestic violence and theft from businesses (as these will be left empty) will occur.<sup>3</sup> Nevertheless, these changes will be transitory and short-lived, and it is likely that the incidence of crime will return to its original levels once the contingency period is over, as occurred during the H1N1 influenza crisis in May 2009.

**GRAPH 4. Potential evolution of the number of intentional homicides registered**

Scenario 1. Slight downwards trend in the following months

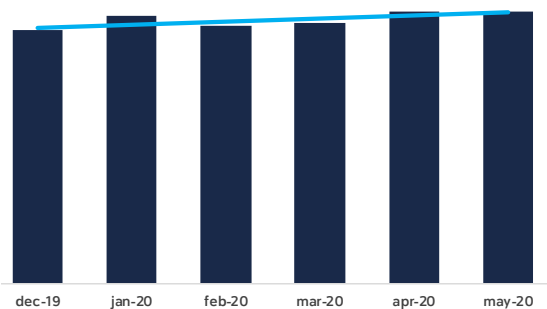


Scenario 2. Trend becomes stable once the contingency is over

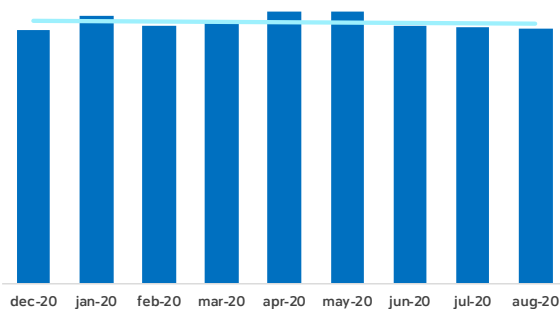


**GRAPH 5. Potential evolution of the number of registered thefts to business**

Scenario 1. Slight upwards trend in the following months



Scenario 2. Trend becomes stable once the contingency is over

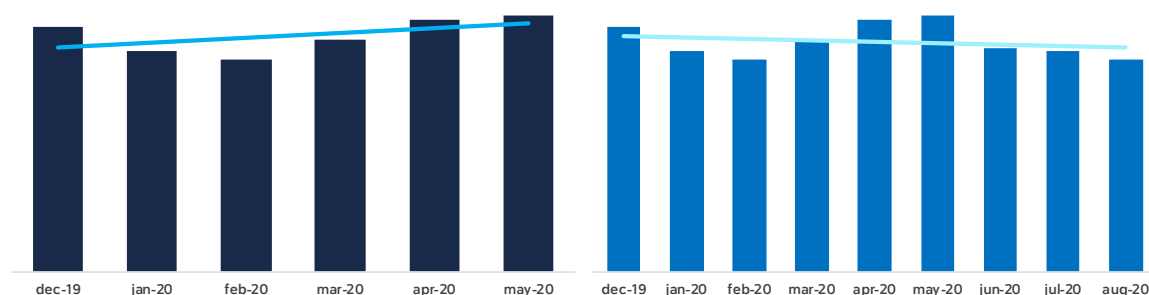


<sup>3</sup> Examples of this are the lootings that have already been taking place in the State of Mexico. Until March 24th, the Attorney General's Office of the State of Mexico investigated 20 groups on Facebook and social networks that called for looting stores amid the health crisis, in municipalities such as Tultitlán, Ecatepec, Nicolas Romero, Chalco, Tlalnepantla, Zumpango and Cuautitlán Izcalli.

## GRAPH 6. Potential evolution of the number of registered thefts to cargo

Scenario 1. Upwards trend in the following months

Scenario 2. Trend becomes stable once the contingency is over



Source: Prepared by the authors based on data from the Executive Secretariat of the National Public Security System

The coronavirus crisis poses both demand and supply challenges for organized crime. On the one hand, the closing of restaurants, bars, and nightclubs in the United States and Europe will reduce the demand for narcotics. Moreover, the strengthening of security and health controls on the U.S.-Mexico border will make it more difficult to transport drugs. On the other hand, measures imposed by the Chinese government to deal with the contingency have caused a reduction in the availability of the chemical precursors to produce fentanyl and methamphetamine; according to journalistic sources, this has caused the price of a kilo of fentanyl to rise from just over eight hundred thousand to one million pesos in two months (a 15% increase). Nevertheless, traditional drug trafficking chains will be re-established once the contingency ends, and, as a result, criminal organizations will be able to normalize their activities.

During this period, it is possible that some cartels or criminal gangs will impose extraordinary measures in the territories where they exercise greater control, and where the presence of the Armed Forces will be reduced as a result of their relocation to other locations more affected by the contingency. For example, in some favelas in Brazil, criminal groups have already imposed a "curfew" to try to prevent the spread of the virus among the inhabitants. This implies the risk that criminal groups will absorb powers that correspond exclusively to the State. It is likely that there will be riots and even escapes in some prisons, as happened in Italy, because of the insufficient budgetary resources for their adequate management during the contingency and the condition of "self-government" that prevails in many of them.

### b. The role of the Armed Forces

The implementation of the DN-III-E Plan in its preventive phase implies the direct participation of the Army and the Navy to stop the spread of the virus and to assist the affected population. It's important to note that the only experience the Armed Forces have in health emergencies is the handling of H1N1 influenza in 2009. However, their participation was much more limited at the time, as they were mainly focused in aiding the distribution efforts of medical supplies (such as masks and anti-bacterial gel) and the coordination of some health centers.

Currently, the government's plan involves the Armed Forces making their entire medical infrastructure available to the civilian population (including 36 hospitals, 272 clinics, and 79 facilities for treating severe cases), and makes them responsible for the purchase and distribution of specialized medicines. This represents an enormous and unprecedented logistical and budgetary challenge.

The contingency offers an opportunity to restore the image of the Armed Forces, which has been undermined in recent years. Nonetheless, it is too early to ascertain that they can effectively and orderly fulfill all the new responsibilities assigned to them; moreover, it is likely that even more resources will be required than the 4.5 billion pesos that the Ministry of Finance assigned to Sedena and Semar this week.

## 5. LEGAL CERTAINTY

Although the measures announced by the government have taken place within the existing legal framework, some aspects lack clarity and legal certainty; which in turn ends up holding the private sector – perhaps excessively – responsible for mitigating many aspects of the crisis. The declaration of a “health emergency due to extraordinary circumstances” is not clear enough as to what it will mean regarding labor matters – specifically the payment of wages during the crisis. This has already generated criticism.

The government intends to restrict mobility without affecting workers’ wages; for this reason, it avoided decreeing a “health contingency” that would have allowed employers to pay a minimum wage for the duration of the contingency. This matter will be controversial; whilst the government relies on “social commitment” to comply with the announced measures, it didn’t announce any additional policies to support the production plant (particularly small businesses). Additionally, there is no clarity as to what the next steps are should the health crisis last beyond April 30.

It remains to be seen whether when declaring “phase 3” of the contingency, the government moves from recommendations to more severe and mandatory measures.

POTENTIAL MEASURES TO BE TAKEN BY AUTHORITIES	
<ul style="list-style-type: none"> <li>• Migration control</li> <li>• Restricting access to public meeting places</li> <li>• Forced isolation and curfew</li> <li>• Temporary requisition of hospitals and private clinics</li> </ul>	<ul style="list-style-type: none"> <li>• Partial and temporary border closures</li> <li>• Suspension of work</li> <li>• Reduction of salaries for public servants</li> <li>• Use of public transport to transport patients</li> <li>• Price controls</li> </ul>

Furthermore, there is a pause in the implementation of justice, since the judicial powers (federal and local) have determined that there will be no sessions, hearings or procedural deadlines during the health crisis, except in cases of emergency and in criminal matters where the constitutional deadlines cannot be extended. In other areas such as administrative, civil, commercial, and labor matters, lawsuits that are started now or that were started before the measures to suspend work will be resolved with a considerable delay.

## 6. POLITICAL CONSEQUENCES

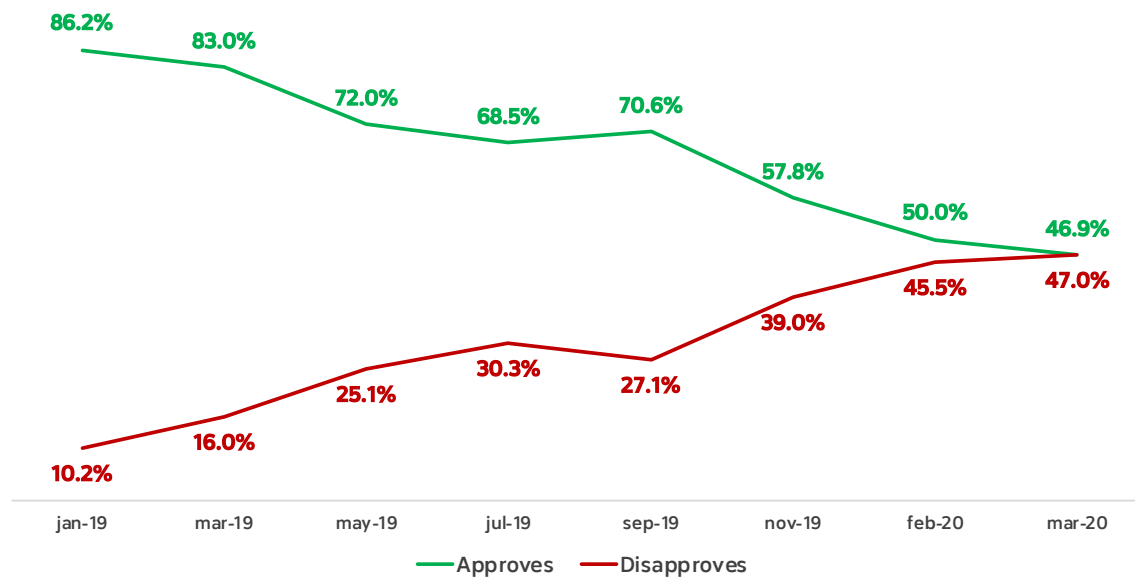
Once the health crisis is over, the economic consequences will be more evident, such as the effect on unemployment, the economic recession, and the impact on the exchange rate. At the same time, political costs will arise for various actors and institutions.

### a. Drop in the president's approval ratings

Recent polls show a drop in the president's approval, as a result of the government's response to the health crisis, which for many has been negligent. Should there be noticeable deficiencies in patient care during the coming weeks, combined with a passive attitude adopted by the government to lessen the economic crisis, AMLO's approval ratings could drop, taking the numbers to the low 40's, something similar to former President Enrique Peña Nieto's approval at the end of his second year. Nevertheless, should the government succeed in providing timely health care whilst the president positions himself as a social leader concerned with the most vulnerable, his approval ratings could remain at similar levels, and even see a moderate increase.

#### GRAPH 7. AMLO's approval ratings

*Do you approve or disapprove of the way López Obrador is handling his job as president?*



Source: Prepared by the authors with data from the Gabinete de Comunicación Estratégica

### b. Impact on the financial sustainability of the Fourth Transformation's political project

The dual external impact on the Mexican economy will have significant consequences for public finances, including (i) lower tax revenues and (ii) lower oil revenues due to the collapse of international oil prices, as well as a lower production than what was originally estimated. Despite the adverse conditions, social programs and emblematic infrastructure projects are a priority for the federal government, so they will seek to make up for the shortfall in revenue

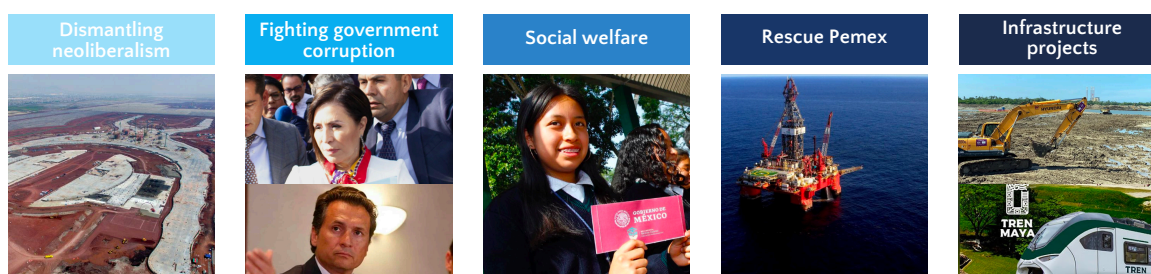


through the use of nearly 220 billion pesos of stabilization funds, significant cuts to operational expenditure, as well as spending on physical investment. However, those funds will be insufficient, jeopardizing the promise of fiscal balance; even forcing the government to break it before the 2021 electoral process.

### c. Weakening of the credibility of the government's project

The government will have less leeway and fewer political resources to push its transformative agenda. Of the five guiding principles of the so-called Fourth Transformation (see Figure 3), the expansion of public welfare through more resources allocated for social programs is the best-evaluated aspect of the government. Nevertheless, the results of the other four principles are limited and might be bound by the upcoming health and economic crisis; especially the rescue of Pemex and López Obrador's emblematic infrastructure projects. Even though the president says said projects will go ahead, it seems unfeasible. The pace of construction will be reduced, and they will not be completed in the promised timeframe. The most significant setback will be in the government's plans to rescue Pemex: in the coming weeks, the company will lose its investment grade, subjecting Pemex to an unprecedented amount of pressure to make significant adjustments.

**FIGURE 3. Five guiding principles of the government's project**



### d. Distancing and eventual rupture in the relation between the business sector and the government

A delay in the announcement the infrastructure plan for the energy sector (due to the government's refusal to reopen oil rounds and farmouts) and the "political" cancellation of the Constellation Brands brewery in Mexicali have already created a feeling of disenchantment and greater distance between the Business Coordinating Council and other associations, and the government. The administration's lack of interest to provide support during the crisis to the production plant and the more anti-business discourse that will arise when the president blames companies for lack of investment and unemployment, could create the conditions for an eventual distancing between private investment and the government.

## 7. SHORT- AND MEDIUM-TERM POLITICAL RISK SCENARIOS

Integralia has identified and tracked six factors that determine the level of political risk in Mexico: concentration of power, legal uncertainty, public insecurity, social conflict, government inefficiency, and economic deterioration. The risk level of most of them increased throughout 2019, mainly as a result of the uncertainty generated by the arrival to power of a new government and the decisions it has taken since then.

Integralia estimates that, except for the factors of concentration of power and public insecurity, the risk level of the other four will increase towards the end of 2020. The health emergency and the lack of specific countercyclical policies will result in a drastic drop in the economic activity in Mexico. The government's response capabilities will be put to the test, which in many cases will be outweighed by the crisis, most notably in terms of public health. Both of these circumstances will increase social conflict and polarization, translating into a more significant number of protests, acts of vandalism and looting. Society will become more divided into two extremes, not only as a result of the crisis itself, but also because of the statements made by relevant actors, including the President himself.

Higher political risk in 2021 foretells a more complex and challenging business environment for companies.

### Political Risk Scenarios 2018-2020

RISK FACTORS	Risk level recorded in 2018	Risk level recorded in 2019	Risk level by the end of 2020 (prospective)
Power Concentration	Low	Medium	Medium
Legal Uncertainty	Low	Medium	High
Public Insecurity	High	High	High
Social Unrest	Medium	Medium	High
Government Inefficiency	Medium	High	Very high
Economic Deterioration	Low	Medium	High

