

## **Economic update**

Foreign direct investment (FDI) into Mexico totalled US\$22.57 billion in 2014 – which represents a 35% decrease from 2013. It should be noted that 2013 was a particularly strong year due to the acquisition of Grupo Modelo (of Corona fame) by Ab InBev. Of the total FDI amount for 2014, US\$12.87 billion were invested in the manufacturing industry, US\$5.56 in financial services, US\$2.22 billion in mining, US\$1.95 billion in trade, and US\$0.87 billion in construction. Regarding the country of origin, 28.9% of FDI came from the U.S., 18.1% from Spain, 10.7% from Canada, 6.9% from Germany, and the remainder from 81 other countries.

On a more positive note, the Mexican government's revenue office (SAT) informed that tax revenues increased by 6.2 per cent and that the number of taxpayers reached 46.3 million in 2014. The figure was the result of a larger number of contributors than in 2013; 92,423 more companies and 4.5 million more individuals. The gain is encouraging, since Mexico's government relies heavily on oil revenue and informality has been a longstanding obstacle to productivity.

Finally, Fitch Ratings maintained Mexico's BBB+ rating. The agency highlighted the government's macroeconomic policy and pointed out that if the reforms passed under President Enrique Peña Nieto's administration are implemented correctly, they will improve competitiveness and growth in the medium term. However, it also highlighted that recent corruption scandals have made a dent on domestic confidence and that violence in certain regions of the country will continue to impose costs on the economy.

## **New anticorruption system and mid-term elections**

Since late October 2014, the issue of corruption has dominated Mexico's political conversation. A succession of different events –ranging from the disappearance of 43 students at the hands of organized crime groups in collusion with a local politician to accusations of conflict of interests directed at high ranking officials- shifted the country's narrative from the opening of its energy sector to one that has long-hampered Mexico's political maturity and economic growth.

However this week the country appears to have seen the first glimmers of a positive turn of events in this regard. After weeks of what seemed to be a legislative dead-end, the Chamber of Deputies (Mexico's lower House of Congress) approved the reform that could result in the creation of the National Anticorruption System. The reform's final success will depend on whether the Senate also approves the new legislation.

If approved, the reform would be highly significant, not only due to its contents –which are substantial- but because of what it says about Mexico’s changing political landscape.

The reform is underpinned by two main changes. The first concerns increasing transparency within government. Although public officials are currently required to declare their assets, they will now have to declare their potential conflicts of interests as well. The policy will likely complicate things for public officials who use their office as a way to benefit friends or companies that are also their paymasters.

It is perhaps a sign of the times that Pemex published its newly written Code of Conduct as discussions in the Chamber of Deputies were taking place, which makes an explicit mention regarding conflicts of interest within the organization. As a result of this, one of its board members stepped down last week due to his close relation to Grupo Bal, a Mexican company that recently launched its exploration and production division.

The second major change contemplated in the reform is the creation of various institutions that curb the executive power’s influence over the handling of corruption within the government. Firstly, the designation of the Secretary for Public Office –in charge of sanctioning misconduct by federal public officials- will no longer depend solely on the President but on the Senate’s ratification.

Moreover, the Federal Auditor –a body of the Lower Chamber of Deputies in charge of scrutinizing spending across the federal, legislative and judicial powers- will gain more teeth by being able to carry out audits in real time and being granted more powers to carry out deeper audits to state level spending. Some of the most notorious corruption scandals in recent years have been related to state governments.

Finally, the Anticorruption System will also entail the creation of a Specialized Attorney Office with a specific mandate to fight graft. More importantly, said office will be autonomous and will not depend on the Executive Power. This will be coupled with a new Tribunal in charge of processing corruption cases that will also remain autonomous.

Although the reform has yet to pass through the Upper Chamber, there are reasons for optimism regarding its final prospects, reasons that were also likely to have been a driving force behind its first step forward.

The reform had initially encountered resistance from the Institutional Revolutionary Party (PRI) that threatened to stop the legislation in its tracks. However, on Wednesday the party made a sharp turn that allowed the legislation to further crystalize.

It should be noted that Mexico will hold mid-term elections on the 7<sup>th</sup> of June, during which the new Chamber of Deputies, 16 local congresses and nine governors will be chosen. Furthermore, as mentioned above, the issue of

corruption has taken centre stage in the public debate, among other reasons because several of the PRI's most prominent members faced allegations of conflicts of interest.

In this context, the PRI saw a drop in preference polls from 42 per cent in November to 30 per cent in February. Although it still holds a relative majority, the rate of its fall in popularity is a warning sign not only to the ruling party but to its competitors –many of which have also recently faced accusations of their own- that the issue of corruption will hold significant sway over the upcoming elections.

Another relevant factor is the emergence of Morena, a new left-wing party led by Andres Manuel Lopez Obrador, a former mayor of Mexico City whose twice ended as the runner-up in the presidential elections and has expressed his intention to do so again in 2018. Mr. Lopez Obrador regularly decries corruption –although several of his close associates were caught red-handed exchanging political favours for cash- and has gained notoriety for his frugal lifestyle, particularly among the working class. However he also tends to alienate middle-class voters due to his populist rhetoric.

Morena's popularity increased from 4 per cent to 9 per cent during the past four months and is already close on the heels of the more mainstream left-wing party, the PRD. The PRD is the third largest political force, yet in disarray due to infighting.

In this sense, the federal government had already started to send out signals that it is escalating the issue within its own list of priorities. Last week a group of close collaborators and relatives of Angel Aguirre, the former governor of Guerrero –a state on Mexico's southern Pacific coastline- were arrested and are under investigation for funnelling large amounts of the state's funds.

The arrest is telling of the government's hardened discipline, given that although Aguirre won the governorship under PRD he was a longstanding member of the PRI and very close to President Peña Nieto. Moreover, in a recent interview with the Financial Times, Secretary of Finance Luis Videgaray acknowledged that the government needed to make "determined efforts" to build the public's confidence and gain its trust. Indeed, a poll carried out by GEA in December found that only 7 per cent of respondents trusted political parties.

If approved the reform would be as crucial as the eleven structural reforms that President Enrique Peña Nieto swept through Congress during the first year of his administration. Notwithstanding that it still has tortuous way to go, in light of the attention this issue has received, in addition to looming mid-term elections and the new dynamics in Mexico's politics, its odds are on the road to improvement.