Economic Analysis

NAIM survey and outcome: unnecessary self-inflicted damage

Confidence is damaged as the moderates within the upcoming government lost a key battle

Carlos Serrano / Javier Amador

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Outcome of the public consultation: only around 1% of registered voters participated. Within this minority, a large majority opted for the cancelation of the current project. The scope of the survey was limited: 1,073 voting polls in 538 municipalities, around one fifth of total, but representing 79% of the total population. The option of cancelling the current project and instead keeping the current one while expanding operations in Santa Lucia and Toluca won by a landslide: 70% opted for the cancelation, with only 29% voting for the continuation of the current project. Polls conducted before the exercise showed that results were leaning to the cancelation when asked the actual question in the survey, as opposed to the continuation of the project when asked a more neutral question. As the elected president and the majority who opted for the cancelation in the survey seem to believe that there was corruption surrounding the current project. We share their concerns, but, in our view, the solution was not cancelling it.

The elected president confirmed that the results of the consultation are binding and the new airport will be canceled. The decision to cancel the project involves direct costs and indirect costs. As to the former, if bond holders and counterparties in signed contracts require the government to repay the debt related to the canceled project (issued bonds, credit and a cancelation fee), the amount will be about USD 10bn at the current 20.0 exchange rate, or around 0.9% of GDP. Yet, in many ways, **the direct costs associated with the cancelation seem to be the lesser cost. The indirect costs are reflected already mainly in** higher interest rates and a weaker Peso. The Mexican peso (MXN) had been clearly underperforming and weakened sharply on the news on the outcome (3.5% to 20.0ppd). Long-term interest rates have risen to account for a higher sovereign risk premia but also pricing in a possible action by the Central Bank. With higher inflation risks, Banxico will now likely react to these new developments and risks with a fresh hike in November's meeting. In fact, we now think Banxico should hike not only to curtail inflation risks arising from the MXN sharp weakening but also to signal that policy mistakes entail a cost.

Markets, international and domestic investors were all giving the new president the benefit of the doubt. Before uncertainty began to mount, it was believed that the Texcoco airport would end up likely being constructed with possible modifications to lower costs, and likely accountability to curtail possible corruption. The upcoming government consulted technicians that expressed their opinion: the current project was the better option. The benign view regarding the new government was supported by appropriate cabinet appointments in the economic team and by sound macroeconomic messages. In our view, this self-inflicted damage was unnecessary. In our view, it is risky to send a signal that the approach to economic policies could be discretional. Going forward, there will likely be a period of damage control but confidence is damaged. **The outcome has put Mexico on the map at a delicate moment of rising foreign rates and hypersensitivity of the markets to the economic decisions of the countries.** Underperforming at any time is costly, during risk-aversion periods is more so.

Indirect costs represent the real damage. Is confidence going to be eroded? Will markets begin to view the upcoming government in a different light after this process and outcome? If they do, costs might prove high. All the uncertainty around NAFTA has kept private investment weak for the past three years. With a new trade deal signed and a benign outlook after the elections as sound economic policies were assumed, the view was that private investment was about to turn a corner and begin to overcome the weakness seen over the past few years. This outcome might be perceived as an additional bump in the road and represents an opportunity cost.

Besides, higher interest rates and a weaker Peso will translate into higher debt-servicing costs. This will limit the available money left to be spent on social programs. With a signal of a possible discretional approach to public policies, will markets continue pricing in that macroeconomic soundness will prevail throughout the government? The fact that this question arises is in our view the greater cost from all this. In a nutshell, markets know that the moderates lost a key battle and that they could continue to lose more battles on other fronts.