Mexico | Plan B: strengthen the domestic market and the rule of law

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30 Oct 2017

In recent days we have again seen that there is still a risk of the Trump administration's leaving the North American Free Trade Agreement (NAFTA). The exchange rate reflects this fear. Recent movements affecting the peso in relation to the dollar and other emerging currencies can be explained by the changing perception of NAFTA's future. In October, the peso was the most depreciated currency in the world.

I still feel that, if self-interest and economic rationality prevail, the US will not shelve the agreement as it has brought the country numerous benefits. Mexico is the US's third largest trading partner and its second biggest export market, with both figures increasing five-fold since NAFTA was signed. American companies have also built complex value chains that make them more competitive.

President Trump has, however, shown himself to be highly unpredictable. We therefore need to be prepared for a scenario in which the US decides to exit NAFTA. I feel that a Plan B should consider two essential strategies: strengthening the internal market and building a true rule of law. In fact, these should be the cornerstones of policy over the coming six-year period, whether or not the US remains within NAFTA.

We often hear that if the agreement is terminated, Mexico should diversify and look toward other markets - the Pacific Alliance, Asia, Europe, etc. This is all well and good, of course. However, why not first turn the domestic market around? It has over 120 million consumers - the eleventh largest country in the world. In order to strengthen the domestic market, mechanisms will need to be found to increase real wages. Mexico is one of the countries with the lowest proportion of national income paid in wages. To do this, I suggest two measures: (i) maintain and consolidate the independence of the Bank of Mexico to ensure that inflation remains low, with the positive effect that this has on real wages and (ii) continue to formalize employment, which will result in improved pay conditions.

NAFTA has brought three important benefits to Mexico: (i) it has allowed it to import better quality goods at a lower price, increasing competition to the advantage of consumers (ii) it has meant that Mexico has become a major exporter of manufactured goods, and (iii) it has allowed the country to attract direct foreign investment as NAFTA was set up within a framework that signposted the message that Mexico is a country that respects the rules of engagement and transmits certainty to foreign investors.

The first two of these benefits need not be lost even if the United States leaves NAFTA. In this case, trade will be governed by WTO rules, which will mean that the average weighted tariff applied to Mexican exports to the US would increase by around 3.5%. With the depreciation of the peso, Mexico would be more competitive that it was two years ago, albeit without NAFTA. This represents a significant paradox: Trump wants to leave NAFTA because he doesn't like the trade deficit that the US has with Mexico. If America leaves, this deficit will increase. As far as imports are concerned, Mexico could opt to maintain a zero tariff to ensure that the benefits to consumers continue.

Finally, in regard to the signposting mechanism designed to attract investment, the country need to strengthen the rule of law, Mexico's biggest unresolved issue. This means having a competent, independent judiciary. We should look to capitalise on the Trump situation to achieve this. The new US administration is a reflection of the importance of solid institutions, checks and balances and genuine accountability to a country.

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