All lime and salt, no tequila: questioning the impact of Trumpian uncertainty on Mexico's economy

***Abstract*:**

This essay revolves around the policy uncertainty created by Trump's election. More specifically, it examines the possible effects on the state of the Mexican economy, both short and long term. First, this paper illustrates how the uncertainty has taken a toll on the economy, using government expectations of inflation and the state of domestic financial markets. Discussion then ensues on supposed impact of potential policies: (1) the imposition of tariffs on Mexican goods; (2) the crackdown on immigration from Mexico. Furthermore, we will evaluate the likelihood of success of these policies and consider more closely the response (or lack thereof) by the Mexican economy. Considering Mexico's financial markets and other aspects of the economy, such as total factor productivity (TFP), social inclusion and inequality, and the impact of previous structural reforms, it seems reasonable to question assumptions on Mexico's socioeconomic vulnerability. The data will be chiefly drawn from Banxico, WEF, IMF and OECD, as well as from reliable news articles. We will argue that while Trump's rhetoric and media reaction appear to impact the Mexican economy, the evidence shows that the influence of his policies will be modest and may not affect the economy in a highly significant manner.

Key Words: Uncertainty, Mexico, Trump, Financial System

Introduction:

Though much attention has been given to the fluctuations of the Mexican economy, and to Trump's unpredictable behaviour, both topics have largely been examined in isolation. Links have certainly been spotted and drawn between the two phenomena, but few have been closely analysed, and even fewer have been used as a platform for prediction. Perhaps this is due to the recency of Trump's rise, the fact that the absurd saga of back-and-forths is still unfolding, or, maybe, that most secretly wish Trump's Mexico-bashing rhetoric (visible in his impulsive Tweets and 'bad hombres'-type derisions) is just a string of metaphors, a bad dream of no actual consequence. Into this vacuum, then, steps this paper. By and large, dialogue on the specifics of the matter has not reached beyond the confines of the journalistic world; our academic lens stands in contrast to this. Ultimately, we find that, though *some* economic damage has always ensued after Trump's most biting words against Mexico, the sting was fleeting, the stock market dip a mere blip. We refer to various metrics to debunk reigning views of Trump as slayer of the Mexican economy, pointing out that Trump has not, does not and will not *truly* hurt Mexico. When one considers that Trump must operate within a tight system of checks and balances, one can see clear forces - stubborn Mexican leadership, a robust Mexican economy, Congressional pressures, budgetary constraints, among others - stacked against his odds of success. It seems reasonable, then, to want to revise initial forecasts of Trump's repercussions on Mexico.

Contextualising uncertainty:

Uncertainty runs to the very core of the way Trump conducts himself a politician; it is intrinsic to his character. Taking Trump-induced uncertainty as a starting point, then, ideas abound as to the ways it has manifested itself. One such indicator is the glaring discrepancy between the Mexican Central Bank's surveys of inflation and the actual inflation. We posit that, while a degree of discrepancy is natural as some factors are impossible to predict, the November Survey conducted by the bank defies such normalcy, being remarkably different from the observed inflation. For this reason, in January, the bank had to revise its inflation predictions and increase its predicted maximum annual inflation implicit in monthly inflation by approximately 37% (see Appendix A). Another, equally telling, indicator, we find, is the high level of volatility in domestic financial markets that followed the election (Banco de Mexico, 2017). Inflation is one of the several worrying indicators put forward by this paper as evidence that the Mexican economy stands to lose somewhat from the fears and scaremongering surrounding Trump.

Whether his contradictory discourse and inconsistent persona constitute a *serious* and *sustained* threat to Mexico, however, is a separate question - in this, we argue that the Mexican economy is sufficiently resilient, and Trump's whims sufficiently self-undermining and in-check, to dispel the thought. We substantiate this claim on two fronts, analysing two pledged policies, whose enactment, as yet, seems dubious: first, Trump's confused mudslinging against NAFTA, and second, the unconstitutional - and thus unlikely - implementation of racist immigration and deportation policies. All are avenues through which Trump might theoretically deliver concrete blows against the Mexican economy. Though Trump's famed Wall has attracted much speculation, we chose to bypass it on the following basis: first, it is doubtful that this grandiose, unfunded project will ever take off, and, even if it does, it will probably take a starkly different form to thes one originally imagined (there is talk of turning the wall into a solar energy venture). Equally, the Wall is unlikely to have a noteworthy impact given that net migration, since 2009, has actually flowed from the US to Mexico (Pew, 2015).

But, borrowing insights from Trump's shaky assurances and impulsive language, the uncertainty whipped up by Trump's lofty, unreachable promises does not neatly spell the demise of Mexico's economy. If anything, initial downbeat expectations have been, and deserve to be, revised since last November.

Literature Review:

Since Trump became president there has been much discussion of his potential policies. His trade policy has received a lot of scrutiny, especially concerning whether he will or will not be able to deliver on a withdrawal from free trade agreements. Presentations by Jon R. Johnson (2017) in C.D. Howe Institute and Marcus Noland et al (2016) in PIIE address the possible legal stumbling blocks in the way of Trump's desire to withdraw from NAFTA. Some authors like Isabel Altamirano-Jimenez (2017) highlighted how Trump's idea of pulling out of NAFTA could create a conflict with Indigenous People along the border. Interestingly, regarding NAFTA, commentators like Greg Mastel (2016) have challenged the seemingly-conventional wisdom that Trump is far from mainstream. Instead he says that Trump's positions, such as 'the system is broken', are widely shared among mainstream economists and social scientists.

So are the shock factor, rumours and uncertainties of Trump's stances exaggerated? Though this paper certainly thinks so, the journalistic consensus so far has, generally, leant the other way. Indeed, in the wake of Trump's election, mainstream media reported with gusto on the potential threat that Trump posed to Mexico. The Washington Post stated that 'With Trump's victory, Mexico's worst fears are realized', stating that few US presidents have been as openly hostile to Mexico as Trump. The New York Times highlighted how 'Mexico braces for the fallout of a Trump presidency', reporting that Trump's potential upending of decades-old trade deals promises Mexico a turbulent financial future. Another New York Times article reported on the behind the scenes chaos over the possibility of mass deportations of Mexicans living in the US. CBS News outlined how 'Trump's election put Mexico on edge', with Trump's gesturing to tear up NAFTA putting millions of jobs at risk.

Methodology:

This essay will draw on data collected by the International Monetary Fund (IMF), Organisation for Economic Co-operation and Development (OECD), World Economic Forum (WEF), the Bank of Mexico (Banxico) and Trading Economics - in short, a host of online platforms that provide reliable economic data. While this study integrates a multitude of data from inflation predictions of the central bank to FDI inflows to inclusive development level, there are, inevitably, limits as to the information we selected: clearly, the financial field was largely omitted - banking and stock market statistics, for instance, were largely absent; yet in acknowledging this, we invite future studies to build on our socio-economically-oriented findings in a financial direction. Further challenges arise insofar as the study must rely on data as reported in the news media, which is itself prone to various spins and biases. These are limitations that must be contended with.

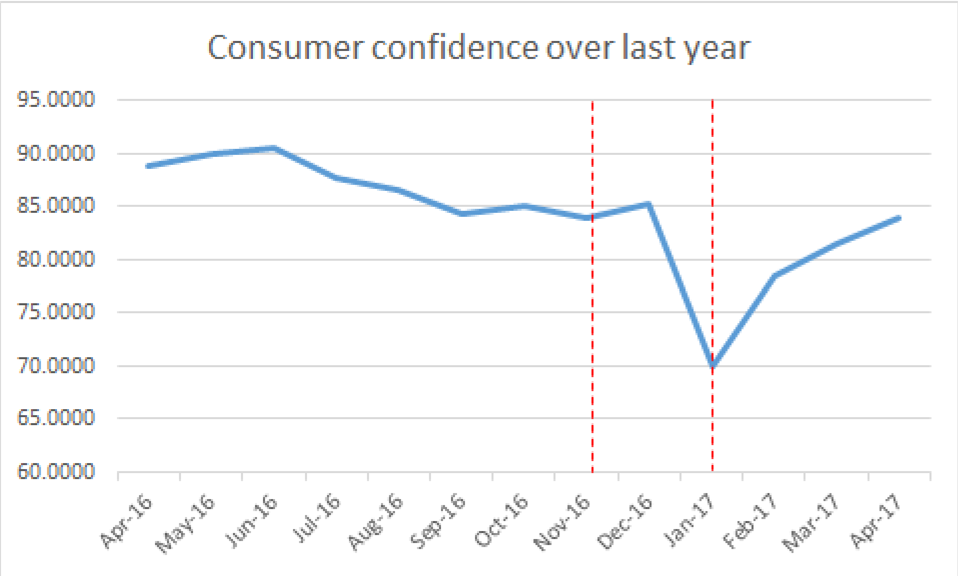
Still, by choosing to focus mainly on economic indicators, we look to usefully particularise the scope of the essay. The accompanying discussions of broader aspects, such as social capital and the legal system, imbues this essay with a balanced, well-rounded outlook. A further preoccupation is that Trump has only been president since January and has, perhaps, not had enough time to conclusively illustrate the full range and complexity of the 'Trump effect'. The elusive nature of his impact on Mexico's economy is difficult to extricate from other possible factors, too, as noted by the deliberations of the Federal Reserve.

Furthermore,this paper conducts a discourse analysis on Trump's rhetoric, and the implications that this rhetoric has for the Mexican economy.

Also this paper shall conduct analysis of two major policies which Trump campaigned on, NAFTA and Immigration, and will assess their potential impact and feasibility.

Trump's impact so far:

The discourse surrounding Trump has had a significant impact on market expectations, and consequently on market outcomes. Thus, statements on building a wall, deporting "bad hombres" and tearing apart NAFTA have all sent jitters down the Mexican economy, and have had tangible impacts on key economic indicators. For example, the Consumer Confidence Index, the valuation of the Peso and growth expectations all fell negatively in light of such statements initially. However, while isolationist rhetoric, coupled with a zero-sum view of the world set the tone for Trump's foreign policy (in particular with Mexico), data shows that markets have adjusted and are thereby affected to a much lesser degree by Trump's brash ideas and statements. The two dotted lines correspond with Trump's election and inauguration:



Source: Banco de Mexico, TradingEconomics.com

This swing in the credibility of Trump can be attributed to several factors. Firstly, governmental checks and balances (such as the judicial roadblock to his Muslim Ban, or funding issues with regard to The Wall) have tempered expectations and shown that Trump is still, in most situations, bounded by institutional realities. This has consequently eased market expectations and lessened the impact of Trump's rhetoric. Secondly, Trump himself has rolled back on his promises (talks of erecting a wall have turned into talks of building a fence, for example), which has given rise to the view that his rhetoric might have solely been for the domain of the election period.

Lastly, and perhaps most interestingly, it could be posited that markets have already adjusted to the "Trump Effect", and thus, have stopped taking his words at face value. This can be attributed to his often absurd (and sometimes indecipherable – *covfefe*) statements, which can seem to put his seriousness as a character into question. Moreover, Trump's gaffes at foreign policy events, such as the NATO summit of 2017, have been extensively covered, ridiculed and hence have contributed to a falling credibility as well. All this means that markets no longer associate the same level of urgency and extremity with Trump's words.

Spillovers from Trump's Policy in the US:

By and large, the data shows that Trump's policy in the United States is having a significant impact on Mexico's economy. More specifically, his pro-business and deregulatory stance has led to improved confidence in US markets and has led to an upward trend in valuations. This has consequently, via interdependence, spilled over into a more optimistic mood for markets in Canada and Mexico. At least in the foreseeable short run, this is likely to improve economic conditions in Mexico.

The state of the Mexican economy:

In order to assess the potency of Trump's impact on the Mexican economy, it is necessary to evaluate how it has been performing recently. Generally, there has been a consistent downgrading of Mexican GDP growth: World Bank's report (2017) downgraded GDP growth rate relative to a June 2016 report by 1% for 2017 and by 0.5% for 2018. Such weakening of growth prospects can be partially attributed to a policy of uncertainty due to the new American administration. Furthermore, this decrease in growth can have a negative impact on financial markets as well since lower growth would mean more non-performing loans on Bank and corporate balance sheets (International Monetary Fund, 2016), thus increasing the cost of borrowing for the public. This could be exacerbated by the fact that there is significant growth disparity in Mexico; that is, while the North and Centre of Mexico have been growing rapidly, the South has still stuck with traditional economic practices (Organisation for Co-Operation and Economic Development, 2017). Consequently, higher growth may have little impact on the level of social capital and inclusion.

However, despite all these shortcomings there are good reasons to be optimistic about the state of Mexican economy. While Mexico's growth rate has been partly impacted by a global economic slowdown, it has still performed above expert predictions. That is, in spite of Trump's threats of withdrawing from NAFTA, the growth rate for the first quarter of 2017 has been revised from 0.5% to 0.6%. IMF checks have shown that the financial system is resilient and liquidity tests indicate that its major banks can withstand severe financial shocks (International Monetary Fund, 2016). This high level of liquidity can help significantly. For commercial banks that make up almost half of the financial sector, liquid assets made up 35% of short-term liabilities while foreign exchange risks are low since foreign currency lending accounts only for 13% of total loans; development banks were well-capitalised and liquid (International Monetary Fund, 2016). The system has been strengthened by reforms that introduced better financial oversight. At the same time structural reforms since 2012 have also increased productivity especially in energy, financial and telecom sectors (Organisation for Co-Operation and Economic Development, 2017, Appendix B). While export-led growth is important domestic demand remains the principal factor contributing to growth (Organisation for Co-Operation and Economic Development, 2017) and it is expected that private consumption will increase as a result of structural reforms of the financial sector, increase in real wages and strong remittance inflows (World Bank, 2017).

NAFTA:

Trump's candidacy platform has mentioned multiple times its intentions to change North American Free Trade Agreement (NAFTA) up to the point of terminating the deal calling NAFTA "the worst trade deal in history". This is going to have a significant effect on Mexico as it has benefited significantly from NAFTA: the free trade agreement allowed Mexico to shift its production away from oil (see Appendix C). Nafta has made Mexico highly reliant on exports to the US: the most recent data for 2016 indicates a similar rate of approximately 81% (Instituto Nacional de Estadistica y Geografia, 2017). In terms of investment almost half of Mexico's Foreign Direct investment (FDI) comes from the US (World Bank, 2017) and these investments account for approximately 8% of the GDP. Large amount of trade and investment seems to indicate as to how reliant Mexico has become and break up of NAFTA would significantly disturb the trade as the rule-based system would be eliminated, leading to substantial decrease in FDI as investor would become uncertain of future prospects of Mexican production. The is the case since NAFTA has created a special union of developed and developing states where trade is promoted by relocating production which leads to export-led growth for the emerging economy (Palley, 2011).

Moreover, despite hostile rhetoric it is unlikely that Trump could unilaterally abolish NAFTA. This is because of the fact that NAFTA came into force after a Congressional Act called H.R.3450 - North American Free Trade Agreement Implementation Act (North American Free Trade Agreement Implementation Act 1993). NAFTA's trade agreement does not specify the precise exit process (Johnson, 2017) which seems to imply that each 'Party' of the agreement should decide the legal way of exiting in the respective legal system. In the US case, since the Congress has passed a law to ratify the agreement Congress' approval is necessary to withdraw from NAFTA- it is a joint Congressional/Executive Agreement (Johnson, 2017). Thus, even if Trump would intend to abolish the agreement, he cannot unilaterally do so. While it is possible that a Republican controlled Congress may approve such a bill there are reasonable grounds to doubt that. Firstly, in the House of Representatives each member represents his/her district and abolishing NAFTA would hurt the Republican controlled Southern Districts the most. For this reason, it is highly likely that Republican Representatives would rebel against repealing Implementation Act. Secondly, withdrawing from NAFTA would hamper trade with Canada which together with MExico makes up for 30% of the US exports and 26% of imports (AJG Simoes, CA Hidalgo, 2011). This might have a significant negative impact on the US economy which is why it is unlikely that the repeal would pass the Senate.

In case of renegotiation there are many positive ways in which NAFTA can be changed to Mexico's advantage and the impacts are not as severe as expected. Mexico relies heavily on American's imports, especially the core market with 98% of its corn imported from the US. (Webber, 2017) It would be difficult for Mexico to find cheap supplies of corn in the short term if the renegotiation is not in Mexico's best interests and a possible rise in corn prices. In response to that, the President of Mexico has decided to start the possible collaboration with Asian and other Latin American countries. Moreover, it might be a good news for the small corn farmers in Mexico as they could compete against those heavily subsidised American farmers in terms of prices. By looking at the automotive industry, Mexico was the leading supplier of automotive goods for the US in 2016, accounting for 30% of total U.S motor vehicle and auto parts imports. (CRS report, 2017). Ford has decided to withdraw the $1.6bn investment plan in Mexico and instead investing in the factory in Michigan(BBC News 2017) after Donald Trump criticised Ford's investment plan in Mexico on his tweets. However, other giant automotive companies, for example Toyota and BMW would still conduct its investment plan despite receiving the threat of a possible 35% tariffs on imported cars from Mexico to the U.S from Donald Trump.

Immigration:

As indicated previously, Mexico's prosperity is to some extent dependent on remittances. Every year $25bn in remittances flows into the Mexican economy from the US, much of it from undocumented migrants. Hence, the tougher immigration stance that Trump has advocated during his campaign could cause sizeable problems for Mexican economy. Trump infamously said that Mexico was sending 'drug dealers, criminals and rapists' to the US. During his republican primary campaign he stated that the US is a dumping ground for Mexico and that if illegal immigrants continue to enter the US, 'we have no country'. In Trump's first town hall meeting he vowed 'if I win, Day 1 of my presidency, they're getting out and getting out fast' (CBC News, 2015). In his first major speech on immigration in August 2016, Trump outlined his radical proposals in greater detail. He said there would be no amnesty and vowed to deport millions of undocumented people (Guardian, 2016). Anybody who entered the US illegally would be subject to deportation. Trump promised to create a deportation force for this purpose. This according to the Guardian (2016) defied expectations that he would soften his stance on immigration. This rhetoric created huge uncertainty for the 11 million undocumented Mexican immigrants living in the US, as well as their family in Mexico who often rely on income earned in the US, in addition to the Mexican government who could face considerable cost re-integrating the large number of deported citizens.

Since Trump's election it is true that immigration laws have been hardened, for example those who've committed minor offences can now be deported (NY Times, 2017). However, there have been signs of Trump moderating his radical rhetoric on illegal immigration. This was partly because of complaints from many pundits such as Bill O'Reilly who highlighted the legal impossibility of deporting so many people so quickly since these people were protected by the Constitution and would be able to challenge immigration repression in court. In late February this year, Homeland Security Secretary John F. Kelly, on a visit to Mexico, said that there will be no mass deportations of people living in the U.S. illegally, representing a climbdown from what

Trump argued for at the height of his campaign. In addition, he has outlined how he would consider granting legal status to undocumented immigrants who haven't committed serious crimes, a move which NBC (2017) called a massive shift in policy. The Trump administration has focused on deporting the 2 million with alleged criminal records, rather than those who have not committed a crime, which TIME magazine (2016) calls an embrace of the status quo, given it is essentially the same policy as that of his presidential predecessors. Given the economic contribution of illegal immigrants to the US and the infeasibility of finding and deporting all undocumented migrants, Trump no longer advocates the harshest of his rhetoric on immigration. This is another example of how economic and institutional realities have limited the delivery of Trump's rhetoric. Whilst Trump has generated considerable uncertainty, for undocumented citizens with criminal records for example, he has not been as destructive as previously expected. Thus, Trump will not be able to drastically harm the Mexican economy by slashing immigration.

Conclusion:

This paper argues that while Trump, initially at least, had a sizeable impact on the state of the Mexican economy, the paranoia in markets was short lived due to two reasons.

Firstly, institutional checks and balances can temper most of Trump's policies and consequently prevent him from enacting highly radical policies. For example, scraping NAFTA, as analysed earlier, would be a highly complex process both in accordance to domestic and international law. Moreover, even renegotiating NAFTA, according to our analysis, can potentially lead to several structural advantages for Mexico in terms of newly developing trade sectors. It is also, furthermore, important to consider that Trump’s flailing credibility is likely to temper fluctuations caused by irresponsible statements.

Secondly, the structural resilience of the Mexican economy, and its improving indicators show that it can absorb minor potential shocks from a turbulent USA, which undermines the impact that Trump, in his limited capacity, can play. Even then, Trump’s pro-business and deregulatory stance has shown to heighten the mood in US markets, which has translated into higher market valuations for Mexico as well. Thus, in the foreseeable future, Trump may actually benefit markets in Mexico.

Ultimately, though it first appeared that Donald Trump would play an increasingly strong role in moulding the Mexican economy, the data shows that his hands might not be as large as his words.

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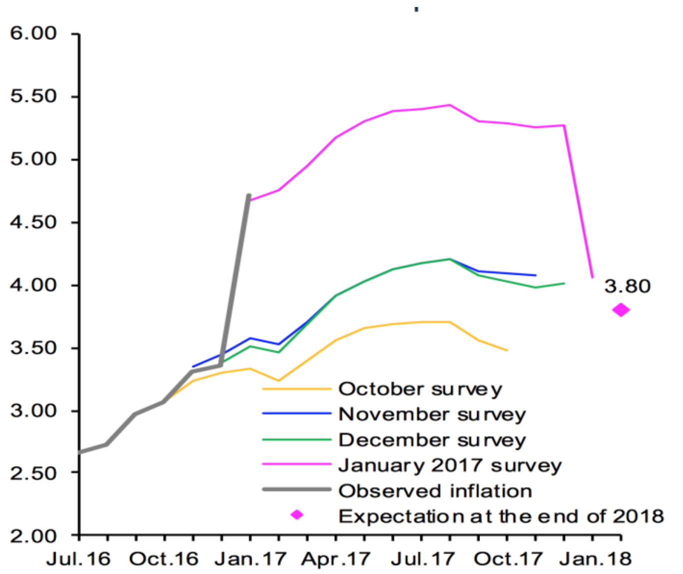
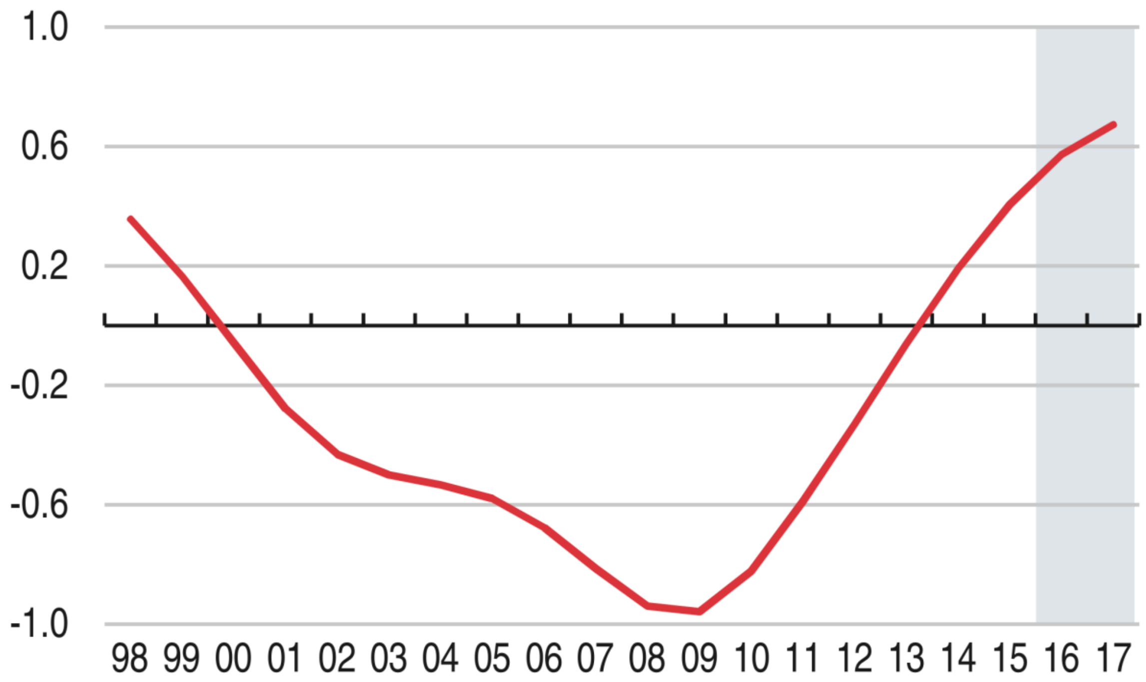
Data Appendixes:

Appendix A. Predicted inflation in November Survey and the actual inflation Source: Banco de Mexico Quarterly report October-December 2016)



Appendix B: contribution of total factor productivity to potential GDP per capita growth, %

Source: OECD (2016a), Ollivaud, P., Y. Guillemette and D. Turner (2016), "Links between weak investment and the slowdown in productivity and potential output growth across the OECD", OECD Economics Department Working Papers, No. 1304, OECD Publishing, Paris., OECD (January 2017)



Appendix C: Oil production as a share of GDP. Source: Organisation for Co-Operation and Economic Development, 2017