

Banks

AMLO v financial markets

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By: **Colby Smith**

For the second time in nearly as many weeks, incoming President Andrés Manuel López Obrador, also known as Amlo, has rattled investors.

First it was Mr López Obrador's decision at the end of October to uphold the “will” of the people (<https://www.ft.com/content/5728caea-dc5e-11e8-9f04-38d397e6661c>) and cancel the country's largest ongoing infrastructure project, a new airport in Mexico City. Now the banking sector has found itself in his party's crosshairs, leading many to worry about how much riskier Mexican assets could get after he takes office on December 1.

Late last week, the Senate leader of his Morena party announced plans to ban a range of fees that banks charge clients. The proposal, which could see up to 50 per cent of commissions eliminated, led the peso to weaken nearly 2 per cent against the dollar. Borrowing costs, as measured by yields on Mexico's government

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By: Thomas Hale

bonds, rose. And because the targeted fees contribute roughly 17 per cent of Mexican banks' net revenue, according to Moody's, the largest domestically-owned bank Banorte saw its share price [plunge \(https://www.ft.com/content/6951e01c-e37a-11e8-a6e5-792428919cee\)](https://www.ft.com/content/6951e01c-e37a-11e8-a6e5-792428919cee) as much as 12 per cent. Shares of Spain's BBVA, which generates about 40 per cent of its profits in Mexico, slid 6 per cent.

Calmness descended after Mr López Obrador [promised \(https://www.ft.com/content/520c68da-e45d-11e8-8e70-5e22a430c1ad\)](https://www.ft.com/content/520c68da-e45d-11e8-8e70-5e22a430c1ad) not to change the banking laws in the next three years, but broke again Monday when Morena lawmakers said they would [forge ahead \(https://www.bloomberg.com/news/articles/2018-11-12/mexican-stocks-drop-with-peso-after-senate-defies-lopez-obrador?srnd=markets-vp\)](https://www.bloomberg.com/news/articles/2018-11-12/mexican-stocks-drop-with-peso-after-senate-defies-lopez-obrador?srnd=markets-vp) with the plans regardless. Banorte fell nearly 9 per cent and Mexico's benchmark stock market lost over 2 per cent of its value.

Despite Mr López Obrador's pushback to these changes, investors have already priced in a higher risk premium for Mexican assets. Here's a chart from Sergio Luna, the chief economist for Citigroup's Mexico unit Citibanamex, showing the uptick at the longer end of the yield curve:



With financial markets seeking higher compensation for these elevated levels of risk,

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Eye-popping PayPal anecdote from Peter Thiel about Elon Musk's kinda prodigious risk appetite

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@matt_levine

PETER THIEL: I was thinking doing a back on PayPal... and [the chapter on Elon Musk] was going to be titled, "The man who knew nothing about risk"... We had decided to give a credit card to absolutely anyone who wanted them. You got up to \$10,000 credit limit. Elon had told the woman who was rolling the service out that he wanted 1 million people to be using the new credit card by the end of the year. Fortunately, it was about two weeks down from the front page, and so not that many people were able to discover this. Some people did. They wrote us back and said, "You know, this is fantastic! I haven't had credit for years. I can't believe you're offering me credit! I haven't even had a checking account in ten years!"... We ended up with something like a fifty percent charge back rate - the worst subprime companies are like four to six percent. And then, happily, we sort of rolled that product back very quickly.

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Jamie Powell

@ajb_powell

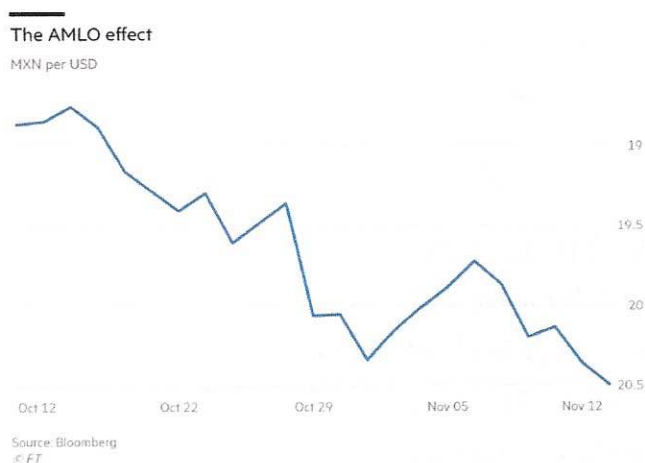
the new muse album art could not be more muse if it tried, i've now stared at it for five minutes in sheer disbelief.

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Luna says the central bank is likely to heed to these pressures when it meets on Thursday. Citi expects Banxico to raise rates by 25 basis points (to 8 per cent from its current level of 7.75 per cent), and to toe a more hawkish line through at least next year.

The reason for this shift boils down to Mr López Obrador. While at the previous central bank meeting in October the Monetary Policy Committee (MPC) left rates unchanged, they vowed to “remain vigilant” when it comes to “the potential pass-through from shocks to non-core inflation as well as other factors that could impact core inflation.”

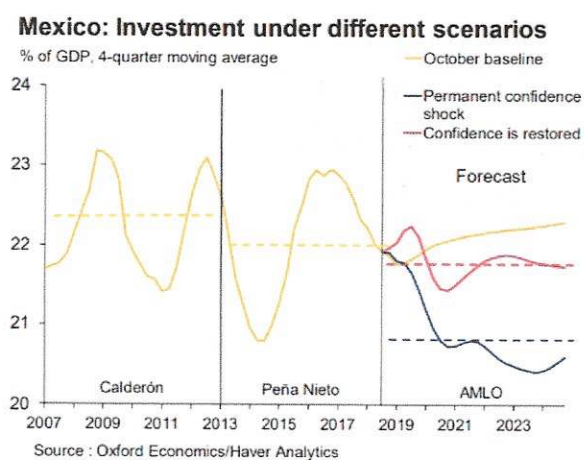
Specifically, the MPC was referring to fluctuations in the exchange rate that could potentially disrupt the central bank's ability to hit its 3 per cent inflation target. Here's how the peso has fared against the dollar in the last month:



From the central bank's point of view, then, it's clear why they'll need to raise rates tomorrow. As Alberto Ramos of Goldman Sachs points out, the upside risks to inflation that the MPC have been most worried about have materialised, thanks to the incoming administration's penchant for the unconventional.

In fact, Marcos Casarin and Fernando Murillo at Oxford Economics believe the economic damage could soon become far worse. Even if Mr López Obrador is able to restore the investor confidence lost from cancelling the airport and spooking the banking sector, Casarin and Murillo reckon that a weakened currency, higher interest rates and the subsequent increase in public debt could cap next year's growth at 2 per cent. Should the administration further vex investors and deter even more investment, GDP growth could fall below 1 per cent.

Here's their projection for GDP through 2024 under three scenarios:



Casarin and Murillo warn that if the worst comes to pass and Mr López Obrador fails to win back investor confidence, public debt could rise to more than 60 per cent of GDP and potentially jeopardise Mexico's investment-grade credit rating.

Fitch has already [downgraded \(https://www.ft.com/content/bbfbo3a-dd2d-11e8-8f50-cbae5495d92b\)](https://www.ft.com/content/bbfbo3a-dd2d-11e8-8f50-cbae5495d92b) its outlook for Mexico's sovereign debt to “negative.” And while the rating agency maintained its BBB+ rating for now, it's at Mr López Obrador's discretion if Mexican assets can hold on to it.

The incoming president has shown little sign of changing tact. This week he also announced a public referendum on the future of the Mayan Train, an infrastructure project designed to connect the various tourist sites across the Yucatan peninsula.

At pixel, the peso sits near a five-month low.

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