

Mexican Politics Beyond the Headlines

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- A Fox presidential victory marks a significant historical change in Mexican politics, a departure that over the long term should bode well for the development of Mexican political and economic institutions. Markets will likely continue to rally on this news.
- Key to a successful Fox presidency in our view will be his ability to forge alliances with opposition parties, who themselves are undergoing a process of soul searching and upheaval.
- But the tumult occurring in the opposition parties could afford significant tactical opportunities to Mr. Fox, whose political skills are well honed from his tenure as governor of Guanajuato state.

Local currency and equity markets rallied over the July 4 holiday in the United States. The peso opened this morning at MXN9.47 per U.S. dollar, compared to MXN9.83 per U.S. dollar on the eve of the elections. In our view, support for Mexican asset prices should continue and intensify this week as global financial markets resume business. We expect a sustained rally in Mexico asset prices during the next two-and-a-half to three months.

Given Vicente Fox's landslide presidential victory, in the context of a well-supervised election, we expect a significant diminution in country risk perception in the short term. In our view, major potential headline news in the coming three to four months such as cabinet announcements, should be market friendly or market neutral. More importantly, the long-term outlook for Mexico has probably improved as a result of the alternance of power from the PRI to the PAN. A Fox win marks a significant historical change in Mexican politics, a departure that over the long term should bode well for the creation of autonomous and transparent political and legal institutions. Such developments should enhance the checks and balances on the executive branch, reduce corruption, and lead to less volatile economic outcomes in the future. However, in between the euphoria in the short-term and the potential for structural improvements in the long-term, important risks and obstacles in the medium-term should not be ignored.

Although the PAN made significant gains in both legislative chambers, Vicente Fox will face a split congress. In the Lower House, the more powerful of the two chambers, the PAN will be the leading party with 224 seats, but it will not hold a majority. The PRI will hold 208 seats, and the Alliance for Mexico (the PRD and its coalition partners) will hold 68 seats. In order for Mr. Fox to get legislation through congress, he will need to build coalitions with members of the PRI or PRD. In the Senate the PRI narrowly retains the upper hand with 58 seats; the PAN has 53 and the PRD has 17. Because no dominant party has emerged in either congressional chamber, the PRD may have earned a critical kingmaking role.

The upshot of the new distribution of legislative power relative to the executive branch is divided government. In this context, we believe the following recent developments and issues merit close consideration.

1. A shakeup of the PRI is in the offing. Top PRI officials, including Francisco Labastida, Roberto Madrazo, Manuel Bartlett and other members of the 'old guard' met on Monday to discuss a range of issues, including the party's leadership, opposition strategy and a possible restructuring of the party. We expect a fair amount of intra-party conflict and bloodletting in the days and weeks to come. Noteworthy in our view was a party official's admonition that the PRI rid itself of technocrats, a *fait accompli* as of several months ago, in our view. Nevertheless, we believe this type of populist rhetoric could be a harbinger of the PRI's policy stance in the congress.
2. Until July 2, the PRI was held together by the power of the presidency, specifically the president's ability to reward loyal followers and punish dissenters. With the loss of the executive branch, the PRI has lost the glue which kept the party together. Recall that the PRI is comprised of members with wide ranging interests. Differences exist along regional and ideological lines. In order to legislate, Mr. Fox may be confronted with the difficult task of negotiating with a disparate group of regional interests, as opposed to a unified PRI leadership with a disciplined party structure. A regionalization of the PRI may make coalition building with the PRI difficult for Mr. Fox.
3. In a recent interview, Cuauhtemoc Cardenas flatly denied the possibility of joining a Fox cabinet. Furthermore, Mr. Cardenas expressed his hope that the Alliance for Mexico (the PRD-led coalition) continue as a counterbalance to the Fox administration. Indeed, as is the case with the PRI, intra-PRD grumbling appears to be on the rise, with party aspirants similarly seeking changes in leadership and structure. What will be the emerging policy stance of the PRD with respect to critical second-generation reforms, which include fiscal and judicial reform, and which ostensibly jibe with the reformist aspirations historically associated with the PRD? Recall the PRD's newly important role in Congress as a potential kingmaker. Will the Mexican left adopt a 'Third Way' orientation willing to cooperate and reach compromises with the Fox government, or will they merely be obstructionist?
4. Vicente Fox, who through the campaign had a difficult relationship with his party, has been closing ranks with top PAN officials. This is not surprising in our view given the uncertain and possibly unfriendly stance of the legislature. Mr. Fox will need to have the firms support of his party, which he did not have during the campaign.

Bottom line: As we mentioned at the outset, a Fox presidential victory marks a watershed event in Mexican politics, which over the long term should bode well for Mexico's political and economic institutions. Markets should continue to rally on this news. Nevertheless the absence of significant headline risks in the near-term could obscure the importance of new patterns of political behavior which could potentially complicate the approval of important second generation economic and political reforms. Key to a successful Fox presidency in our view will be his ability to forge alliances with opposition parties, who themselves are undergoing a process of soul searching and upheaval.