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British Vote to Leave European Union Has Small Impact on Mexico

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The decision by voters in the United Kingdom (UK) on June 23 to leave the European Union (EU) had economic repercussions across the globe, including in Mexico, where the immediate impact was to put significant pressure on the peso, bringing the Mexican currency to its weakest level ever against the US dollar, according to the Wall Street Journal. On June 24, the Mexican currency fell to 19.52 pesos per US$1.00, but recovered gradually in subsequent days. On July 6, the exchange rate was 18.76 pesos per US$1.00

A weak currency generally makes Mexican products cheaper for overseas buyers, resulting in an increase in exports. Even before the British vote, commonly known as Brexit, the peso had been falling gradually. According to economists, the Mexican currency had declined by 24% against the US dollar since late 2014. The health of the US economy is key for exports, since the northern neighbor accounts for 80% of Mexico’s sales to overseas customers.

Although the weak peso failed to increase exports to the US over the past year, the Mexican currency is expected to remain weak for the foreseeable future, which could eventually boost exports to the US. However, economists point out that the flip side of a weak peso is the potential for higher inflation. “The peso remains highly volatile and has depreciated in relation to levels that prevailed before Brexit,” said Bank of America Merrill Lynch. “Because of the increased weakness of the peso, we see the potential for us to increase the inflation forecasts for 2016 and 2017.”

Interest rates cut

The Brexit vote prompted Mexico’s central bank (Banco de México, B de M) to cut interest rates in the ensuing days. In making the move, the bank explained that global economic conditions could impact prices in Mexico.

“The central bank is acknowledging that the external environment is more complex, that it may drive the peso weaker, and we have to respond to it. Growth considerations are very secondary,” Alonso Cervera, a managing director in the Emerging Markets Economics Research group at Credit Suisse, said in an interview with the Bloomberg news service.

The central bank pointed to concerns about the negative impact of global markets on the US economy, which could have a ripple effect on Mexico. The Mexican economy is projected to grow by about 2% to 3% in 2016, with economic expansion limited by a stagnant industrial sector and continued low oil prices.

“With this action, the board looks to keep the drop in the peso in recent months and the adjustments in some relative prices from translating into an uprooting of expectations for inflation in our country,” central bank officials said in a statement announcing the decision.
Still, analysts agree that the fundamentals for the Mexican economy remain solid, partly because of recent austerity measures enacted by President Enrique Peña Nieto’s administration (SourceMex, Feb. 10, 2016).

According to analysts, the austerity measures should continue this year and through much of 2017 to compensate for the weak global oil market and help narrow Mexico’s budget deficit.

On the day after the Brexit vote, Finance Secretary Luis Videgaray announced an additional austerity move, saying the government would reduce spending by another US$1.7 billion. At the same time, the finance secretary offered assurances that Mexico has already covered all of its foreign financing needs with the recent issuance of bonds in Japanese yen.

**UK vote has marginal impact on trade**

The recent Brexit vote is expected to have little or no impact on Mexican exports to Britain. This is because trade between the two countries is already very small. In 2015, Mexico exports to Britain amounted to slightly more than US$1.9 billion, or roughly 0.5% of Mexico’s total exports for the year. Exports in the first four months of 2016 stood at slightly more than US$1 billion, or about 1% of Mexico’s total exports for the year.

While Britain alone represents only a small portion of Mexico’s export market, the EU is the second-largest destination for Mexican goods, thanks to an economic cooperation agreement that the two sides negotiated in 1997 (SourceMex, Dec. 17, 1997, and July 19, 2000). In 2015, Mexico exported 19.3 billion euros (US$21.4 billion) in goods to EU countries and imported 33.7 billion euros (US$37.4 billion) from members of the European bloc, according to the European Commission.

Britain’s exit from the EU is expected to have an impact on the price of commodities in Latin America. This is likely to cause significant problems for countries that depend heavily on commodities for export income, including Venezuela, Ecuador, Peru, Chile, and Colombia. This is less of an issue for Mexico and Central America, which depend less on exports of raw materials than their South American counterparts.

The UK’s move could set a precedent for countries to trend away from economic integration agreements. This could have an impact on agreements like the Trans-Pacific Partnership (TPP), which Mexico, Peru, and Chile signed with nine other Pacific Rim countries in an effort to become less dependent on China (SourceMex, Oct. 28, 2015).

“Just as Latin American politics are taking a more pragmatic turn and are less focused on ideology —right when they are coming over to the pragmatism party ... they are afraid that everyone else is swinging away from it,” Ben Raderstorf, an analyst with the Inter-American Dialogue, told the online news site Law.com.

“Brexit will hurt investments in Latin America,” columnist Andrés Oppenheimer wrote in The Miami Herald. “Britain’s vote to leave the EU has brought about anxiety among investors, dragging down stock markets worldwide. And in times of uncertainty, investors flock to places they consider safe, such as the US, and tend to avoid putting their money in emerging markets.”

Coincidentally, the Brexit vote occurred while Peña Nieto was in Canada to attend a summit with Canadian Prime Minister Justin Trudeau and US President Barack Obama. At the summit,
the Mexican president called for the three member countries of the North American Free Trade Agreement (NAFTA) to expand integration efforts.

“The purpose of this visit is to renew our bilateral relationship, to give it new life, to find ways to advance the prosperity and competitiveness of North America,” Peña Nieto said.

In response to questions about the so-called Brexit decision, he added, “I think what is happening elsewhere in the world invites us to strengthen our strategic alliance and especially to be much more inclusive.”

The Brexit decision also had a negative impact on individual entrepreneurs, causing economic losses in the global stock markets. One of the biggest losers was Mexican billionaire Carlos Slim Helú, owner of Grupo Carso and telecommunications entities Telmex and América Móvil. Slim lost about US$2.7 billion in the wake of the vote. He was one of 400 wealthy individuals around the globe who lost a collective US$127 billion as a result of the vote, according to the Bloomberg news service.

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