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Carlos Navarro

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Mexican Peso Rebounds Sharply After Slump at Start of 2017

by Carlos Navarro
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The Mexican peso took a beating in the days just before and after US President Donald Trump took office in January. Trump’s statements threatening to impose broad tariffs on imports of Mexican products and to leave the North American Free Trade Agreement (NAFTA) raised strong concerns about the fate of the Mexican economy over the next year (SourceMex, Jan. 11, 2017, Feb. 1, 2017, Feb. 22, 2017). The Mexican currency fell to record lows in January, surpassing 21 pesos per US$1.00. The currency gradually recovered to 19 pesos per US$1.00 by early May (SourceMex, May 10, 2017) and to about 17.90 per US$1.00 by early August.

As of the end of July, the peso had increased in value by almost 21% versus the dollar since the start of the year. This was the strongest performance for any currency at the global level, surpassing the positive performances recorded by Poland’s zloty and Sweden’s krona, according to a Bloomberg news service analysis.

US threats, but no action

Analysts attributed the peso’s rebound to a softening of Trump’s rhetoric, particularly a more conciliatory tone regarding NAFTA. Some of the proposals that the Trump government has floated ahead of a formal renegotiation of the agreement, scheduled to begin on Aug. 16, could help Mexico, including plans to boost local content for manufacturers and to protect intellectual property rights and labor rights. Those proposals were actually part of the Trans-Pacific Partnership (TPP) agreement, which the US abandoned earlier this year (SourceMex, April 26, 2017).

“There were initially a lot of fears when Trump won the presidency that trade relations with Mexico would deteriorate and the peso would see a decline in value,” said an IG Markets report published in the daily English-language newspaper The Yucatan Times. “However, none of those fears have been realized. This is largely because there are no signs that Trump is going to back out of NAFTA. This has assuaged a lot of doubts in the market and made the peso an appealing prospect for investors in emerging markets.”

And economist Luis Arcentales of Morgan Stanley in New York told Forbes.com, “I sense a shift among local investors who seemed much more constructive about Mexico after having been quite cautious because of a whole host of factors ranging from domestic politics to concerns about protectionism.”

Other threats made by Trump against Mexico during the presidential campaign and in the early months of his administration, including constant anti-immigrant rhetoric, have yet to become a reality. Trump’s threats to crack down on undocumented immigrants actually had the effect of increasing the amount of money that expatriates in the US have sent to Mexico in the last year to a record US$26.9 billion (SourceMex, Feb. 15, 2017). Remittances for January-June 2017 reached about US$14 billion. If the trend continues, the total amount of remittances by the end of the year would reach about US$28 billion.
And despite a crackdown on immigrants around the country, the rate of deportations remains below the totals reached during the administration of former US President Barack Obama (SourceMex, Jan. 22, 2014). According to statistics from the US Immigration and Customs Enforcement agency (ICE), the current administration deported about 58,000 undocumented immigrants between Jan. 20, 2017, when Trump took office, and April 29. That would amount to an average of 577 people deported daily. In contrast, the Obama government deported a total 2.7 million undocumented immigrants during eight years in office, which translates to an average of 923 deportations daily.

The relatively low rate in deportations under Trump has continued in recent months. In June 2017, slightly more than 14,000 undocumented immigrants were repatriated, which is the lowest number in the last nine months.

While the Trump government might yet make good on its threat of massive deportations, there is no sign that this will occur any time soon. A large influx of repatriated citizens to Mexico would put a strain on the country’s social services, which could boost government spending, said analysts.

**Repatriated capital boosts investment**

Another factor that has contributed greatly to the rebound of the Mexican peso is a program that President Enrique Peña Nieto’s administration launched earlier this year to encourage Mexican individuals and businesses to return undeclared capital from overseas locations to Mexico. The program was announced at the beginning of the year, amid strong concerns that the US would scrap NAFTA and enact new import taxes on Mexican products.

In January, the federal tax agency (Servicio de Administración Tributaria, SAT) announced that taxes would be reduced for any individuals or businesses that repatriated capital to Mexico. According to the decree, individuals or businesses repatriating capital would be subject to only an 8% income tax (impuesto sobre la renta, ISR), without penalties for past unpaid taxes. Under the law, the current ISR is 30%.

Under the scheme, the 8% tax must be paid 15 days after money is transferred to Mexico. Repatriated funds must then be invested in industrial plants, technology research and development, or financial mechanisms to increase overall investment in productive assets.

By all accounts, the program has been widely successful. Between January and July, a total of 102.4 billion pesos (US$5.7 billion) were returned to Mexico by the government-set deadline of July 31. The success of the program prompted three important financial organizations—the Asociación de Bancos de México (ABM), the Asociación Mexicana de Instituciones Bursátiles (AMIB), and the Asociación Mexicana de Instituciones de Seguros (AMIS)—to ask the government to extend the deadline to repatriate capital under the favorable tax rates through mid- to late October.

“By extending the deadline, a larger amount of money will be returned to the country, which will have the effect of boosting investments in strategic areas and promote employment in our country,” the three associations said in a joint statement.

The Peña Nieto government quickly embraced the request and announced the extension to Oct. 19. “The favorable response to this initiative is additional indication of confidence in our country,” the president said in a speech in July.
Guillermo Aboumrad, director of strategy at Finamex Casa de Bolsa, told the online financial news site Expansión, that the deadline extension made sense. “The repatriation of capital has favored the peso, and it was a good move to extend the deadline another three months,” he said.

There was some resistance to the proposal from non-business entities. In an interview with Expansión, constitutional lawyer Luis Pérez de Acha suggested that the tax-reduction plan is intrinsically unjust for the segment of the population that has to pay the normal ISR rate. Conversely, de Acha acknowledged that charging an 8% ISR for repatriated capital was preferable to obtaining zero tax revenues from this same money if it had remained overseas.

The recovery in the peso has helped boost optimism about Mexico’s economic growth. Mexico’s GDP grew by 0.6% in the second quarter of 2017 from the rate recorded in January-March. The growth rate for the first quarter was 0.7% relative to October-December 2016.

The finance ministry (Secretaría de Hacienda y Crédito Público, SHCP) has increased its forecast for GDP growth for the entire year. The new projection is a growth rate ranging between 1.5% and 2.5%, compared with an earlier estimate of 1.3% to 2.3%. The growth rate in the second quarter was up 3% from April-June of 2016, according to the government’s statistics agency (Instituto Nacional de Estadística y Geografía, INEGI).

Private analysts are less optimistic, given the strong uncertainty about how a renegotiation of NAFTA would affect Mexico. Grupo Financiero Banorte raised its estimate for 2017 to 1.9%, compared with an earlier projection of 1.6%. In an analysis released in late July, Banorte cited strong growth in the manufacturing sector and increased domestic retail spending. This optimism was moderated by the continuing uncertainty about the fate of NAFTA.

Others had similar projections. In an interview with the daily business newspaper El Economista, analyst Carlos Capistrán of Bank of America Merrill Lynch (BofA) said he anticipated a growth rate of 1.8% in 2017 and 1.3% in 2018.

According to Capistrán, the Mexican presidential elections next year, which are expected to be very competitive, add another element of uncertainty to the Mexican economy. “Projections indicate a close presidential election in 2018, which could keep uncertainty at a high level,” he said.

Conversely, Capistrán said the change at the top of the central bank (Banco de México, BANXICO) is expected to add a measure of stability to the Mexican economy, as the three names most often mentioned to replace the retiring Agustín Carstens generate a strong sense of confidence. The three potential replacements are Finance Secretary José Antonio Meade, deputy finance secretary Miguel Messmacher, and Alejandro Díaz de León, who currently serves on the board of governors of BANXICO. Carstens announced last December that he was leaving BANXICO for a position with the Bank for International Settlements (BIS) (SourceMex, Dec. 7, 2016). He was originally planning to step down in July, but decided to extend his stay at BANXICO by a few months.

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