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Mexico's transformation

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In Latin America, this looks to be the year of Brazil — thanks to the impending World Cup and presidential elections. But with another lackluster year looming in emerging markets, fans of transformation, growth and investment potential should instead look to Mexico. Brazil's president, Dilma Rousseff, is expected to win a second term this year, and its soccer team stands a good shot at victory. But growth has slowed considerably. In the world's seventh largest economy, reforms are stagnating and the country faces a possible ratings downgrade.

Mexico, by contrast, is in the throes of serious reforms. It will likely lead Latin America with at least 4 percent growth this year and an improving investment outlook. Standard & Poor's recently boosted Mexico's credit ratings because of energy reforms that the rating company trumpeted last month as a "watershed moment" for the country.

After years of stagnation and violence, a new reform government is positioning Mexico for significant growth. Jobs are increasing, inflation is lower, growth is higher and the returns on Mexican equities are multiples of what they have been in Brazil. "Mexico may quickly swing from the region's worst to best performer," emerging markets economist David Rees from Capital Economics wrote in a research late last year.

Enter Enrique Peña Nieto, a telegenic Mexican state governor who won the presidency in 2012, bringing the Institutional Revolutionary Party (PRI) back to power for the first time since its 70-year reign ended with the 2000 elections.

Peña Nieto, 47, crossed party lines and enlisted the opposition in a "Pact for Mexico." He has driven changes many thought were not possible.

His most significant reform revised Mexico's constitution, opening the energy industry to private investment. Another key reform allows legislators and mayors to run for consecutive terms, which had been banned since the early 1920s.

That will provide more accountability in a country with a history of authoritarian rule (by the PRI). The possibility of re-election should, in theory, be an incentive for better governance.

Peña Nieto's fiscal reform is designed to increase government revenue while redistributing the tax burden — raising rates on the wealthiest, taxing capital gains and dividends, homogenizing the value added tax rate and putting new levies on sugary beverages and junk food. He is also creating unemployment insurance and universal pension for people 65 years or older.

Meanwhile, the economic data is encouraging — if clearly not all the government's doing. Mexico's manufacturing sector is now competitive and its economy is not as reliant on commodities as other Latin American countries are. Its retail sales and manufacturing sectors are hitting highs not seen in almost a year.

In the short-term, however, domestic risks abound in how the government will implement these reforms. "Secondary" bills, for example, are needed to flesh out the details of the energy reform implementation. That will determine whether the investment conditions are attractive enough to lure foreign oil companies.

Passage of reform bills is not enough, however. The president will need to show the benefits to Mexicans. Indeed, some measures could cause problems. For example, roughly 45 percent of the population is poor, so new VATs and levies would further erode their purchasing power.

Another remaining challenge is to reduce violence between drug gangs and other criminals. While murders fell slightly last year, kidnapping and extortion increased.

Jorge Castañeda, former Mexican foreign minister and foe of the PRI, touched on these improvements in his recent essay, "Mexico's Second Revolution."

"Mexico, a stagnant and violence-plagued country in recent years," Castañeda writes, "finally began to overcome its malaise in 2013, thanks to an activist president and a coalition of political parties determined to move the country forward."

Yet careful management will be necessary, so that visible benefits can buy his government public patience for the continued transformation.