



Monarch News

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CEO Executive Summary

The sixth round of the NAFTA negotiations made real progress, but the final outcome of this process remains *far from certain*. The round closed one chapter, generated productive discussion on two of the U.S. “poison pill” demands, and saw a much more positive overall tone to the talks, notwithstanding some tough talk from Amb. Lighthizer directed, this time, to the Canadians. Concerns that the U.S. will withdraw also receded somewhat. Still, none of the main differences between the U.S. and its NAFTA partners were resolved, suggesting that the talks will extend well beyond March, possibly into late 2018 or early 2019. Beyond NAFTA, U.S.-Mexico relations continued to feel the weight of President Trump’s persistent use of Mexico as a political piñata, including a new poll that shows a majority of Mexicans hold a negative opinion of the United States.

The Mexican economy recovered from its earthquake-induced weakness at the end of 2017, while inflation receded, and the peso strengthened during the first weeks of 2018. But the real economic news last month was the great success of the January 31 auction of production rights for a series of deep water petroleum fields. The auction generated 1.5 times more revenue for the government than all previous rounds combined.

On the political front, primary campaigning for the Mexican Presidential election is drawing to a close, and Andrés Manuel López Obrador continues to lead in the polls although his lead over Ricardo Anaya of the PAN/PRD alliance has been reduced significantly. Meanwhile, support for José Antonio Meade of the ruling PRI party plummeted to a distant third while the likely independent candidates continue to poll in the single digits.

I. NAFTA Negotiations

NAFTA negotiations again dominated U.S.-Mexico relations in January. We see two main takeaways from the sixth round of the negotiations that took place in Montreal from January 21 to 29: (1) concerns that the U.S. will withdraw from the agreement receded somewhat despite persistent tension between the United States and Canada, and (2) assuming the U.S. does not withdraw, the conclusion of the talks will likely extend well beyond the end of March target date—likely into late 2018 and potentially even into 2019. Given the domestic political calendars in the U.S. and Mexico, this adds a major element of risk and uncertainty for the discussions.

Negotiators in the sixth round of NAFTA talks closed the anti-corruption chapter, made progress on several other chapters, and advanced on two of the “poison pill” demands made by the U.S. government—the sunset clause and the investor-state dispute resolution mechanism.

More importantly, [negotiators reported a better atmosphere for the talks](#). The tone shifted from recriminations and loud hints that the U.S. might be forced to withdraw to a willingness to consider Canadian proposals addressing two core U.S. demands. On auto rules of origin, however, U.S. Trade Representative Robert Lighthizer, in his closing comments at the end of the round, rejected the Canadian proposal as completely unworkable. [Lighthizer also strongly criticized the Canadians](#) for bringing a case against the United States in the World Trade Organization that challenges how the Trump administration has used tariffs in response to what it sees as unfair competition. Trade conflicts between the United States and Canada still clearly pose a real and direct threat to the success of the NAFTA negotiations. That said, [Lighthizer noted that “some real headway” was made in the round](#), albeit at a much slower pace than he had hoped for. This recognition attenuated fears that the U.S. is on the verge of walking away from the

negotiations, but it also transforms the upcoming seventh round of talks in Mexico City, February 26-March 6, into another important round.

Make no mistake, none of the major differences between the United States and its NAFTA partners have been resolved. No progress was made on the U.S. desire to eliminate the Chapter 19 dispute resolution mechanism and to dramatically change government procurement rules—demands that continue to be unacceptable for both Mexico and Canada—and only 3 of an estimated 30 chapters have been closed. This means there is far too much work remaining for the three parties to reach an agreement by the end of March, even if they make sufficient progress in Mexico City to again avert a U.S. withdrawal.

Ultimately, as well as things went in Montreal, there is still a very long way to go. We remain concerned that the Trump Administration may believe that a formal withdrawal from NAFTA will put pressure on Mexico and Canada when it is much more likely to motivate them to walk away from the talks. Unlike 25 years ago, [Mexico and Canada now have trading options beyond the United States](#), from the European Union and the Pacific Alliance to the TPP-11, which [agreed on a final pact to be signed on March 8](#) without the United States. These markets are not complete substitutes for the U.S. domestic market, the largest in the world, but they significantly soften the blow Mexico and Canada might otherwise face were NAFTA to implode.

On balance, our assessment is that raw politics, not sound economics, has driven the U.S. side of the negotiations since day one and will continue to do so. If President Trump's political or economic problems increase, such as a worsening crisis with the Russia investigation, a stock market crash, or the materialization of a democratic wave election, political motivations are apt to guide his behavior to feed his base. And Mexico has always been his favorite political piñata. In this context, the absence of real progress on the hard issues is troubling.

Although Economy Minister Ildefonso Guajardo said at Davos [he believes the negotiations could be concluded as late as November](#), after the U.S. mid-term elections, this is far from an ideal outcome. Should Andrés Manuel López Obrador (“AMLO”) lose the July presidential election, a successful negotiation before the end of 2018 becomes less urgent and negotiations could extend into 2019, albeit with the added risk of the

Democrats winning a congressional majority in the 2018 U.S. midterm elections. But if AMLO wins the presidency, finishing up by November will become more urgent. In that case, everyone involved in the talks would want the Mexican Senate to approve the agreement before Mexico's December 1 inauguration day. This would limit AMLO's freedom of action on economic policy by locking in Mexico's trade-based growth model and its energy reform in an international treaty, which, according to the Mexican constitution, takes precedence over national law.

So, while the chances for an updated NAFTA look better than they did last month, those who are fighting for its survival are far from out of the woods, especially given the [12% growth in Mexico's trade surplus with the United States in 2017](#).

II. U.S.-Mexico Relations

Beyond NAFTA, [President Trump again claimed that Mexico would eventually pay for the border wall "indirectly through NAFTA."](#) Unsurprisingly, this elicited [an immediate censure from Mexican government officials](#) and all three leading presidential candidates. Nor are Mexicans keen on the Administration's new immigration proposal, although most politicians have chosen not to comment publicly on what is formally an internal U.S. matter. The proposal calls for full funding for the wall, expedited removal of undocumented immigrants, and an end to most family migration in exchange for legal recognition and a path to citizenship for 1.8 million dreamers. The fate of the Dreamers, however, remains tragically uncertain, as Congress appears (at the time of this writing) to be reaching for a budget deal that leaves them behind and with no clear path forward.

Mexicans continue to show their discontent with the United States. [Mexican tourism to the United States fell 8.5% last year](#), while [Ford saw an 18% decline in its Mexican sales](#), partly due to a boycott of their products in retribution for the canceling of its planned San Luis Potosi plant in an apparent attempt to please Trump. And the January release of a survey of Mexican public opinion showed that [for the first time in 20 years a majority of Mexicans hold a negative opinion of the United States](#).

This was the difficult climate that greeted Secretary of State Rex Tillerson on his February 1 visit to Mexico, and Secretary of Homeland Security Kirstjen Nielsen on her February 6 visit. Secretary Tillerson did little to improve the situation when, the day before the trip,

he publicly warned of Chinese imperialism in Latin America and made the diplomatic mistake of [suggesting that the Monroe Doctrine, the foundation for decades of U.S. intervention, had been a success in Latin America](#). Even so, his associated comments about NAFTA—noting its great importance for the United States—struck a much more positive tone, as did his acknowledgement of close U.S.-Mexico cooperation in the drug war and [shared U.S. responsibility for the drug trade](#). Like clockwork, however, President Trump undermined his Secretary of State. On February 2, he [implied that Mexico was among a group of countries accepting U.S. assistance to fight drug trafficking but not taking action to prevent drugs from reaching the U.S.](#), and he suggested the aid could be cut off.

As a final note, the Mexican and Canadian foreign ministers met bilaterally just before Secretary Tillerson's arrival in Mexico. Their meeting was the latest in a series of Mexico-Canada bilateral meetings—in the context of the NAFTA negotiations and on the sidelines of Davos and the TPP-11—that reflect a clear decision to work together to advance a shared North American agenda.

III. Mexican Economy

The Mexican economy recovered in the fourth quarter of 2017 from the third quarter's natural disaster-induced slump. Growth looked particularly impressive when compared with the third quarter, marking a 4% annualized increase. When compared with the fourth quarter of 2016, however, [growth was a more moderate 1.8%, bringing total growth for 2017 to just 2.1%](#). This is well below 2016's 2.9% figure but in line with [Mexico's expected 2018 growth of 1.9%-2.3%](#). That said, [employment growth in the formal sector for the year was over 800,000 jobs](#), the third largest on record and a full 9.5% greater than in 2016.

The peso had another volatile month influenced by changing expectations about the NAFTA negotiations. But it finished the month on an upswing driven by [a three-year high in oil prices](#) and [statements by U.S. Treasury Secretary Steven Mnuchin suggesting a U.S. preference for a weaker U.S. dollar](#). The peso also benefited from two late January announcements: [Mexico's lowest trade deficit in three years](#) and [a 6.6% increase in annual remittances bringing the 2017 total to \\$28.8 billion](#). The peso closed January at

18.65 pesos per U.S. dollar, [a 5.13% gain for the month making it the best performing emerging market currency in January.](#)

[Inflation decelerated in January, falling to just 5.5% in the month](#), down from 6.8% in December. Nevertheless, the Bank of Mexico still raised the benchmark interest rate a quarter point on February 8 in [an attempt to ward off market uncertainties](#) created by the NAFTA negotiations and Mexico's upcoming July 1 Presidential election. The bank also welcomed its [first female board member](#) in January.

Sector Focus: Energy

Potentially more significant for the future of the Mexican economy than recent growth, inflation, and peso valuation was the January 31 auction for rights to develop 29 deep water petroleum blocks. This auction was by far the most successful to date, with contracts awarded for 19 of the 29 blocks on offer. According to Aldo Flores, the Energy Ministry's Undersecretary for Hydrocarbons, [the auction secured \\$93 billion for the Mexican government](#), 1.5 times the total investment of the nine previous auction rounds. And according to Juan Carlos Zepeda, the head of the National Hydrocarbons Commission, if the blocks are successfully developed [they should almost double Mexico's current level of oil production](#). Government coffers will also benefit handsomely, with 63%-67% of the profits accruing to the Mexican government in the form of royalty payments.

Prior to the January 31 auction, the Energy Ministry announced a July 25 auction for 37 onshore oil and natural gas fields covering an area larger than Delaware, which would follow a March 27 auction for 35 shallow water areas. [Bloomberg estimates](#) that these three 2018 auctions will offer more than 100 drilling permits to private oil companies, in a country that until just five years ago had a complete government monopoly on oil production. The country's hydrocarbons regulator indicated that [Mexico also aims to hold its first auction for shale oil fields before the end of 2018.](#)

IV. Mexican Politics

As the February 11 closing date to the primary campaign for the Mexican presidential election approaches, the [newspaper El Universal released the first poll taken during the primary season](#). Andrés Manuel López Obrador continues to lead with 32% of voter preferences, but otherwise the poll was full of surprises. José Antonio Meade of the PRI plummeted to a distant third at 16% while Ricardo Anaya of the PAN/PRD alliance has pulled to within six points of AMLO. Margarita Zavala and Jaime “El Bronco” Rodríguez are polling in the single digits with 20% still undecided. But a full 54% of respondents said they were unsure of their decision, leaving a lot of room for additional changes before election day. [Ensuing polls show a similar trend](#), albeit with a wider margin between AMLO and Anaya.

Regarding independent candidates, both Zavala and Rodríguez [appear to have surpassed the total number of signatures needed to appear on the Presidential ballot](#), with PRD Senator Armando Ríos Piter on the verge of reaching this goal. But none have yet fulfilled the second requirement: to obtain signatures from 1% of voters in at least 17 states. They have until February 19 to fulfill this final requirement.

As the primary campaign has progressed, three developments encapsulate the leading candidates’ status: Ricardo Anaya insisted that he will [demand a relationship of mutual respect from the United States](#); José Antonio Meade presented [a five-point anti-crime agenda](#) that felt more like a technocratic “to-do” list than an appealing call to arms; and Andrés Manuel López Obrador’s designated Economy Minister stated that [Mexico will remain in NAFTA in an AMLO administration](#).

As a final note on the presidential election, [U.S. government concerns that Russia may interfere in the Mexican election were first reported in January](#) and repeated by Secretary Tillerson in response to a specific question at his February 2 press conference in Mexico City. This did not play very well in an increasingly anti-American context deeply concerned about the likely election impact of the words and deeds of the Trump administration.

Finally, the Mexican Congress opened its spring session on February 1, although it seems unlikely that legislators who are in full campaign mode will make progress on important initiatives, such as the remaining elements of the Anti-Corruption System.

V. Monarch Events, Speeches, Publications

January 7: MGS Chairman Ambassador James R. Jones [commented for Politico](#) on the potential impact of an AMLO election victory.

January 17: MGS Senior Adviser Pamela K. Starr was quoted extensively in the Latinex article ["Mexico: The AMLO Threat"](#).

January 31: MGS President and CEO, Michael Camuñez [spoke to The Washington Post](#) about the current relationship between the U.S. and Mexican governments in advance of Rex Tillerson's visit to Mexico City.

February 1: MGS Chairman, Ambassador James R. Jones, participated in a panel discussion on NAFTA negotiations and their impact on the North American energy sector at the [Colorado Energy and Water Institute](#) in Steamboat Springs, Colorado.

February 1: MGS President and CEO, Michael Camuñez, spoke on NAFTA and the Mexican energy reform at [Energy Mexico 2018](#) in Mexico City.