



## Monarch News

August 2018



### CEO Executive Summary

Negotiations to update NAFTA gained a new momentum in July following the election of Andrés Manuel López Obrador (AMLO) to be the next president of Mexico. President Trump's initial warm reaction to AMLO's victory certainly helped, but Mexico's willingness to negotiate bilaterally with the U.S., with Canadian support, has been the main driver behind recent progress. It appears that the two sides are very close to resolving one of the main sticking points between them – issues related to auto rules of origin. While several more months of negotiations remains the most probable scenario, both the Americans and the Mexicans are talking about a resolution by the end of August. Nevertheless, we have our doubts that this apparent honeymoon in U.S.-Mexico relations will last. For starters, it is unclear if the U.S. is willing to make real concessions in the NAFTA talks that would get both Mexico and Canada on board, and then there is the open question of whether President Trump is truly prepared to make a deal with Mexico, giving up his favorite political “piñata” in advance of a bruising midterm election, for which he will want every available red meat issue to turn out his base. In addition, even as Mexico and the U.S. get closer on the economic issues raised in NAFTA, the two countries continue to hold conflicting policy preferences and national interests related to migration and security.

The post-election context in Mexico has been dominated by AMLO. Indeed, there is a sense that the country has two presidents – a nearly invisible incumbent and a hyperactive president-elect. AMLO uses his nearly daily press conferences to announce cabinet and sub-cabinet appointments when these have historically been made in November. He announced his legislative agenda for the fall despite not taking office until December 1. And he has already announced his austerity and anti-corruption platforms and presented some of his governing programs. These announcements have been met by near silence from a political opposition that was crushed in the July election, leaving it to civil society, the private sector, and the media to raise questions about the wisdom of some of AMLO’s personnel choices and policy promises.

In the economy, the election results overshadowed slow growth to push consumer confidence to its highest level in a decade. Markets also continued to express confidence in AMLO’s moderate post-election persona, driving the peso to highs not seen since before the election of Donald Trump. Still, investment banks and ratings agencies are flying a yellow flag, concerned about the future of economic reform and macroeconomic stability under an AMLO government. And concern persists about the security situation in a country that saw record high homicides during the first half of 2018.

## **I. NAFTA and U.S.-Mexico Relations**

It has been less than two months since the Mexican elections, but so far it appears the Trump Administration is welcoming the López Obrador victory despite past criticism by AMLO, including in a book he authored titled “Listen Up, Trump.” Rather than take it personally, Trump appears to see AMLO as a kindred soul, a renegade who won in a landslide vote, so much so, that [the U.S. president has purportedly dubbed AMLO as “Juan Trump” in private](#).

Two July developments reinforced this positive U.S. attitude about AMLO: (1) the cordial visit of a high-level U.S. delegation that traveled to Mexico City on July 13 (the earliest that such a delegation has met with the Mexican president-elect after his election) and (2) the ensuing exchange of letters between the two presidents. Both [the AMLO](#) and [the Trump](#) letters spoke of an opportunity for good relations and called for a quick resolution to the NAFTA talks. During the July 13 meeting, AMLO’s team included

his designated Ambassador to the United States, Martha Bárcena, a highly respected career foreign service officer. Her pairing with Marcelo Ebrard in the Foreign Ministry indicates that policy will continue to be made in Mexico City and implemented in Washington, D.C.

In the midst of this positive turn in the bilateral relationship, the United States initially continued to telegraph a hard line on trade. On July 16, the U.S. [launched challenges at the World Trade Organization to the retaliatory tariffs](#) imposed by Mexico, Canada, and the European Union in response to Trump's steel and aluminum tariffs. In addition, the U.S. [Commerce Department continued its investigation into the security implications of foreign auto imports](#) and the potential need for tariffs to protect the U.S. auto industry. And in his July 20 letter to AMLO, Trump apparently could not resist adding a threat to take a "different route" if NAFTA were not renegotiated quickly. But then things began to change.

On July 18, Mexican Economy Minister Ildefonso Guajardo [announced he would travel to Washington](#) the following week to hold bilateral trade talks with the United States. On July 23, President Trump said that he [expected to work something out on NAFTA](#) with Mexico's incoming president and tweeted that [AMLO is "a terrific person"](#) with whom the U.S. is negotiating "to do something very dramatic." On July 25, the [United States and the European Union declared a truce in their trade spat](#), and in congressional testimony the next day, U.S. Trade Representative Robert Lighthizer [described NAFTA talks](#) as being in their final phase, moving at an unprecedented speed, and apt to be concluded shortly. Both the outgoing and incoming Mexican governments are [keen to conclude negotiations by the end of August](#), a date that will allow President Peña Nieto to sign the pact before he leaves office on December 1.

This set the stage for the last week of July. U.S. Commerce Secretary Wilbur Ross [started the week by declaring the bilateral talks "near completion,"](#) members of the Mexican technical team, in a meeting with Monarch, then described the talks as 90% done, and media reports suggested that the two sides were [getting near an agreement on the trickiest bilateral issue – auto rules of origin](#). Progress was palpable, even though many of [the most difficult trilateral issues – such as a sunset clause and investor dispute settlement mechanisms – remained unaddressed](#).

But the apparent advances in these bilateral talks, coming after [repeated suggestions by Trump that the United States might negotiate a treaty first with Mexico and later with Canada](#), led some to wonder if Mexico was angling for a bilateral accord to meet their self-imposed late-August deadline. Such concerns were raised despite a [July 25 visit by Canadian Foreign Minister Chrystia Freeland to Mexico](#) during which both the current government and AMLO's team [assured Freeland that any agreement would be trilateral](#). This message was reinforced on August 3, [according to Inside U.S. Trade](#) (*subscription only*), by AMLO's trade representative, Jesús Seade (an old friend of Lighthizer), who stated it was time to bring Canada back into the mix to take on the sunset clause. To be clear, we see no plausible scenario for two bilateral agreements, and we are confident this position is firmly held by both Mexico and Canada.

Trump's attitude toward AMLO and the advances in the NAFTA negotiations could suggest a honeymoon in U.S.-Mexico relations, were it not for lingering questions about the willingness of the United States to make the real concessions needed to seal a deal in the NAFTA talks. In addition, there are the persistently prickly issues of migration and security, and President Trump's [apparent inability to stop bashing Mexicans](#) at the campaign-style rallies he so enjoys.

## II. Mexican Politics and Security

The post-election political context in Mexico has been dominated by the President-elect in a way that has never happened before. In the past, victors have tended to lay low in the weeks following the election and to wait until late November to announce their cabinet. **Not Andrés Manuel López Obrador**. AMLO has so dominated the political scene that [Mexico seems to have two presidents](#) – the nearly invisible incumbent and the hyperactive victor. In near daily press conferences, AMLO has already announced the core of his cabinet and his policy agenda. He announced his [50 austerity and anti-corruption proposals](#), which include a controversial decision to dramatically [cut the size](#) as well as [the wages and benefits](#) of the high-level bureaucracy, and he announced the [12 pieces of legislation](#) that he would like the Congress to approve in the fall session beginning September 1. This legislative wish list even includes two items – [recreating a security ministry and eliminating prosecutorial immunity for all politicians](#) – to be introduced as preferential legislation, an exclusive purview of the sitting president, not the president-elect. AMLO has also introduced his [energy plan](#), announced his [priority](#)

[infrastructure projects](#), and detailed his [plan to decentralize the Mexican government](#) while [centralizing government procurement](#).

In this process, AMLO has benefited from his overwhelming July 1 victory, which will give him large majorities in the federal legislature ([which will have gender equity for the first time in history](#)) and in the majority of state legislatures, and which [weakened](#) or [eliminated](#) opposition parties in Mexico. AMLO will not face an effective political opposition for some time. This does not mean, however, that there will be no pushback to his proposals.

The union representing government workers worries that AMLO's plan to decentralize the government would force its unionized members to move out of Mexico City against their will. The private sector expressed concern over AMLO's energy plan and energy team (more on this below), civil society organizations have expressed deep reservations about AMLO's [anti-corruption plan](#), and intellectuals and columnists have used their access to the media to question AMLO's governing style and many of his proposed policies.

At the same time, [expectations for an AMLO government are extraordinarily high](#). Meeting these expectations will be difficult, which is one of the reasons AMLO insists on carrying out a series of policy promises that are of questionable efficiency but powerful symbolically. This includes: living in his modest apartment and turning the presidential home, Los Pinos, into a public museum, selling the presidential plane and traveling on commercial flights, cutting his salary in half, reducing the president's security detail, and eliminating presidential immunity for prosecution for electoral crimes or corruption.

Regarding security, as Mexico's murder rate reached [a new record high during the first half of 2018](#), the president-elect continued to search for a security strategy to deal with this challenge. AMLO announced that he will [replace Mexico's national intelligence entity, CISEN, with a new National Intelligence Agency](#), and his designated head of what will soon be the country's recreated Ministry of Public Security (SSP), Alfonso Durazo, suggested that [Mexico might create a border patrol](#) for the first time in its history.

AMLO [tasked his Attorney General-designate](#), Olga Sánchez Cordero, with considering all options to deal with the country's drug problem, including an amnesty for low level offenders, as the president-elect proposed during the campaign, and the decriminalization of marijuana. But before delineating the content of his security plan, AMLO will undertake a [series of consultations with residents of communities with security challenges](#).

### **III. Mexican Economy and Trade Policy**

The Mexican [economy grew 2.7% in the second quarter](#), a slight drop from its first quarter pace. The [IMF still estimates](#) that the economy will finish the year with 2.3% growth, but lowered its 2019 forecast by 0.3 points to 2.7%. Meanwhile, President-elect [López Obrador continues to promise 4% growth](#) during his six-year term in office.

Driven by high expectations for the performance of the coming AMLO government, [consumer confidence registered a record jump in July](#), reaching its highest level since 2008. Markets continued to express confidence in AMLO and his economic team, reacting well to [promises to respect the autonomy of the central bank](#), maintain the floating exchange rate, and [not immediately fulfill his campaign promise to raise the minimum wage](#), but to do so in consultation with the central bank.

Driven as well by good NAFTA news, [the peso hit a three-month high](#) in late July and closed at 18.4 pesos per U.S. dollar on August 6. The peso also benefited from the announcement of [another record month for remittances in June](#) and from downward pressure on the U.S. dollar generated by President Trump's threats to slap higher tariffs on Chinese goods.

In this context, and despite [early July's higher than expected inflation](#), driven largely by energy prices, the Bank of Mexico [held its reference interest rate steady at 7.75%](#) in their early August meeting. But Banxico also signaled the possibility that it could increase rates again in the fall.

In the midst of this good economic news, however, [investment banks](#) and [ratings agencies](#) issued warnings owing to concerns about the future of Mexico's economic reforms and its macroeconomic stability under the incoming López Obrador administration. In addition, prior to the more recent progress in NAFTA negotiations,

Standard & Poor's [warned that Mexico's debt rating could be downgraded](#) if talks were unsuccessful.

In trade policy, [Mexico met with fellow members of the Pacific Alliance in late July](#) and together presented a united front in support of freer trade. This included a promise to eliminate tariffs on the small percentage of goods still subject to taxation among Alliance members and to explore new areas of cooperation with Mercosur, the South American trade group. Meanwhile, [Reuters reported](#) a 38% drop in the value of Mexican wheat imports from the United States as Mexico continues its search for alternative markets, and [AMLO met with the Chinese Ambassador to consider investment, trade, and development projects](#) with an eye to reducing Mexico's large trade deficit.

### **Sector Focus: Energy**

AMLO's energy proposals dominated news for the sector in July. While his economic team continued to insist there would be [no change to the energy reform](#) and that [current contracts would be honored as long as they are free of corruption](#), AMLO's selection of [a highly nationalist energy policy team](#) with almost no experience in the sector generated anxiety in the industry.

AMLO also announced [\\$8.6 billion over three years in refining investments](#) with the aim of [eliminating gasoline imports](#) and [lowering fuel prices after three years](#). These and other plans for the hydrocarbons sector led [Moody's to issue a warning about Pemex's credit risk](#).

The National Hydrocarbons Commission announced that [auctions scheduled for late 2018 would be postponed until February 2019](#), and potentially longer depending on the will of the new administration. This [decision was not well-received by the industry](#), creating concern about the future of energy reform. At the same time, however, the Italian oil company [Eni announced plans to invest \\$1.8 billion in offshore fields](#) over the next 20 years.

In the electricity sector, AMLO announced that he would [forgive the \\$2.3 billion of past-due accounts owed by consumers to the state-owned](#) electricity company (CFE). He also announced the selection of Manuel Bartlett to head the CFE, which created a firestorm in public opinion. [Barclays warned](#) that Bartlett's lack of experience in the

power sector and historic opposition to energy reform sent the wrong signal to investors. More broadly, most Mexicans were incensed by the selection of a prominent ex-PRI politician responsible for a wide range of questionable acts during the 1980s and 1990s. In response to this wave of criticism, Bartlett announced that he [is not interested in reversing the energy reform because “it is working.”](#)

### **Sector Focus: Infrastructure**

After days of contradictory statements from the López Obrador team about the future of the new international airport (NAIM), [AMLO announced he will make a decision following an evaluation of the project](#) by his engineering team, which will be reviewed by members of Mexico’s engineering associations. He promised to share the conclusion of this evaluation with the public prior to [a mid-October “consulta.”](#) As AMLO promised during the campaign, he will present three options to the Mexican people, likely via a public opinion poll – cancel the project, continue it as is, or transform it into a private sector concession. We continue to believe the project will go forward, most likely as a private sector concession.

Beyond the airport, AMLO announced [seven priority infrastructure projects](#) including a 300 kilometer rail corridor cutting across the Isthmus of Tehuantepec that would facilitate transport of shipping containers between the Atlantic and Pacific oceans, a passenger train connecting key tourist sites in Southern Mexico, construction of 300 rural roads, and expanding the internet to cover every Mexican.



#### IV. Monarch Events, Speeches, Publications

*July 3:* Monarch Chairman Ambassador James R. Jones participated in the Inter-American Dialogue's [Latin America Advisor](#) discussion about the changes that can be expected as a result of AMLO's historic victory in Mexico's presidential election.

*July 5:* Monarch President & CEO Michael C. Camuñez discussed the outcome of the Mexican election and its consequences for the U.S. with Fox 11 Los Angeles's [Good Day LA](#).

*July 7:* Amb. Jones was interviewed by [CNN](#) about AMLO's victory and the need for him and President Trump to have a face-to-face meeting soon.

*July 9:* Amb. Jones spoke to [Reuters](#) about the role of AMLO's chief of staff, Alfonso "Poncho" Romo, in gaining the support of business leaders in Mexico.

*July 17:* [The David and Lucile Packard Foundation](#) announced that Michael C. Camuñez has joined its Board of Trustees.

*July 20:* Monarch released the complimentary first issue of the [AMLO Transition Report](#), a limited-run, subscription-only newsletter that will go in depth on the AMLO transition by highlighting the keys players and issues and what they could mean for policy decisions over the next six years.

*July 23:* Michael Camuñez was profiled and named one of [Hispanic Executive's](#) Top Ten Líderes for 2018.

*August 1:* Amb. Jones commented in the Inter-American Dialogue's [Latin America Advisor](#) on how to improve the security situation in Mexico.

*August 1:* Michael Camuñez was interviewed on National Public Radio's [All Things Considered](#) about the dangers of President Trump escalating his trade war with China.

*August 2:* Michael Camuñez was interviewed on CNBC's [Squawk Box](#) about recent flexibility from the U.S. negotiating team and the increased chances for an updated NAFTA agreement.



*August 2:* Michael Camuñez was interviewed on [CNN en Español](#) about recent progress toward an updated NAFTA agreement.

*August 2:* Michael Camuñez spoke to [The Associated Press](#) about the importance of the United States improving relations with Mexico and Canada before taking on China.

*August 3:* Michael Camuñez was quoted in [The New York Times](#) on recent progress toward a renegotiated NAFTA agreement, cautioning that it's hard to get too excited until President Trump gives his approval.

*August 5:* Monarch released the second issue of the **AMLO Transition Report** to clients and subscribers. This edition focuses on AMLO's political journey and the way he governed as mayor of Mexico City, and it includes biographies of his top cabinet officials and lead NAFTA negotiator. Since in politics, as in life, the past is often prologue, we felt it was important to see what AMLO's story can tell us about his future as president. To subscribe to the report and participate in monthly conference calls with Monarch's top management during the transition, [please provide the information requested here](#), and we will follow up to get you on board. Our third issue will be out soon as well.