



Monarch News

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CEO Executive Summary

The NAFTA negotiation “drama” remained as intense and, in some ways, mysterious as ever this past month. Indeed, both optimists and pessimists can point to many things that support their world view about the future of NAFTA. Yet the true state of play remains as elusive to pin down as ever, thanks largely to the unpredictability of the man who occupies 1600 Pennsylvania Avenue.

New challenges arose in the U.S.-Mexico relationship over the last month, with the cancelation of a planned meeting between Presidents Trump and Peña Nieto, followed by the resignation of the U.S. Ambassador to Mexico, and topped off by the White House announcement of a plan to impose stiff tariffs on steel and aluminum imports. Although the tariffs ultimately included an exemption for Canada and Mexico, they put a damper on seventh round of NAFTA negotiations in Mexico City. At the same time, important signs are emerging that the negotiations are making meaningful progress, with some—including the Canadians—expressing outright optimism about the state of affairs. All parties seem intensively focused on trying to conclude the negotiations before the Mexican presidential elections in July.

For at least a few more days, Mexican Presidential politics are in an interregnum between the primary season and the presidential campaign, which has thus far been dominated by corruption-related accusations levied against all three leading candidates. The most problematic have been the charges against the PAN/PRD candidate, Ricardo Anaya, not only because of the damage they can do to his campaign, but also because they appear to be orchestrated by the PRI-led government and to have improved Andrés Manuel López Obrador's ("AMLO") prospects. Meanwhile, the three alliances released their lists of proportional representation congressional candidates. The PRI list is dominated by party stalwarts, and the PAN/PRD list is balanced among the parties in the alliance. The candidates selected for the Morena-led alliance seem to confirm our belief that AMLO is constructing a big-tent coalition, not unlike the PRI of the past, to strengthen his electoral chances and his capacity to govern should he win. AMLO also reignited discussion about energy policy under his administration, which we increasingly believe will be nationalist but pragmatic, likely to slow and redirect the Energy Reform rather than reverse it.

In the Mexican economy, growth held steady, inflation continued to fall, and the debt-to-GDP ratio fell for the first time in a decade, but the trade deficit widened to a record high. Looking at specific sectors, the government approved legislation to regulate Financial Technology ("FinTech") in Mexico and stepped on the Energy Reform gas pedal. There were also three significant Telecommunications rulings. The Supreme Court decided in favor of Televisa, stating it is not a preponderant agent in the pay TV sector, and against América Móvil, requiring it to give its competitors access to its network and equipment. The Telecommunications Commission ruled that América Móvil must break up its fixed line telephone business.

I. U.S.-Mexico Relations

A sharp disagreement over funding for President Trump's border wall [derailed another planned White House meeting between Trump and Mexican President Enrique Peña Nieto](#). Peña Nieto insisted that Trump publicly admit that Mexico will not pay for the wall during the visit. Trump refused and became exasperated when Peña Nieto would not let the matter go. This scuttled a meeting intended to discuss other key issues in U.S.-Mexico relations, including security, trade, and immigration, and it threatened to reverse the warmer bilateral feelings that developed recently in the NAFTA negotiations.

A week later, one of the State Department's top diplomats and undisputed Mexico expert, Roberta Jacobson, [announced she would be stepping down as U.S. Ambassador](#) effective May 5. Ambassador Jacobson is exceedingly well-liked in Mexico and had become a master of smoothing out Mexican ruffled feathers in the wake of President Trump's undiplomatic tweets and public statements. Although she leaves behind a talented team of Embassy diplomats, her deft touch on bilateral affairs will be missed, and all of us at Monarch join the chorus of many in thanking Roberta for her incredible service to the country. It is reassuring that [Ed Whitacre is said to be Trump's selection to replace Jacobson](#). As a pro-NAFTA Texan and former executive at AT&T and General Motors, he should fully comprehend the central importance of Mexico to U.S. national interests. But as no formal nomination has been made, we will keep watching this space with great interest.

The [reported Presidential promotion of Peter Navarro](#), Director of the National Trade Council, to become "Assistant to the President" and the [resignation of Gary Cohn](#), director of the National Economic Council, marks the ascendance of the trade skeptics within the Trump Administration. The resulting shift in the balance of trade policy power in the Administration helped inform the President's March 1 announcement that he would slap a 25% tariff on steel imports and a 10% levy on aluminum imports. This was justified on purported national security grounds and without making an exception for U.S. allies. [Mexico loudly hinted](#) and [Canada openly vowed to retaliate](#) (as did the EU creating the risk of a broader trade war) if last minute efforts to create a carve-out for our NAFTA partners did not succeed. The [President's ensuing tweet that "Tariffs on Steel and Aluminum will only come off if new & fair NAFTA agreement is signed"](#), seemed to signal little chance for a carve out.

But as often happens with the Trump White House, things soon began to change. On March 7, Jared Kushner made an unexpected trip to Mexico City where he met with Foreign Minister Luis Videgaray and President Enrique Peña Nieto (surprisingly, without the U.S. Ambassador present) [in a reported effort to mend fences](#). The next day the President formally proclaimed the initiation in 15 days of steel and aluminum tariffs, but [with an exemption for Mexico and Canada "to see if we can make the deal \[on NAFTA\]"](#).

Coming in the middle of the seventh round of the NAFTA negotiations taking place in Mexico City, February 25 to March 5, the steel tariff announcement cast a pall over the talks. This round of talks was expected to be difficult as the three nations took on the highly contentious issue of auto rules of origin. But a decision to call the chief U.S. [rules of origin negotiator back to Washington](#) to attend talks with auto industry representatives effectively took the issue off the table. Overall, the lead negotiators for Mexico and Canada reported good progress on non-controversial chapters in the round, including the closing of three chapters: on good regulatory practices, sanitary and phytosanitary measures, and publication and administration. But little progress was made on the main obstacles to agreement, a fact that outweighed the [surprisingly cordial interplay among the three lead trade negotiators](#) at the end of the round. Round 8 is now expected for the second week of April in the Washington area after a [potential intersessional to discuss rules of origin](#). *As we go to press, Amb. Lighthizer is concluding his testimony to the House Ways & Means Committee, where he is indicating that, with respect to the Auto ROO issues, the parties are “finally starting to converge.”* Even so, Lighthizer’s testimony reveals that on other key issues, including ISDS, the parties may well still be far apart. The drama and the mystery continues...

While a conclusion of the negotiations by the end of April seems out of reach, the [Mexicans remain hopeful that the talks can be successfully completed before July](#), especially after the [Canadian Prime Minister agreed to a picked up pace for the negotiations](#) following a phone conversation with President Trump in which he expressed the U.S. desire to complete the negotiations this spring.

Mexico, meanwhile, moved forward with its “Plan B” to expand trading and investment relations with the rest of the world. On March 7, it joined Canada and nine other Asia-Pacific countries to [sign the revised and renamed Comprehensive and Progressive Agreement for Trans-Pacific Partnership](#).

II. Mexican Politics

The Mexican Presidential election is in the midst of the six-week period between the February 11 end of the primary season and the initiation of the presidential campaign on March 30. During this interregnum campaigning is prohibited, although reporting on the candidates and their activities is permitted. This included the [speeches the top three candidates gave during the Banking Association meeting](#) March 9-10. At this event, José Antonio Meade of the PRI received a standing ovation for a speech emphasizing economic policy continuity and improved rule of law. Ricardo Anaya of the PAN/PRD alliance represented himself as the anti-corruption candidate focused on the future, clearly implying that AMLO was the candidate of the past. AMLO spoke last and promised no expropriations and no reversal of economic reform, but pointedly made no promise not to revise the reforms.

During the pause in campaigning, the National Electoral Institute announced that flaws in the signature gathering efforts of Jaime “El Bronco” Rodríguez and Armando Ríos Piter disqualified them from standing for President. There will thus be only one independent candidate on the ballot – Margarita Zavala. This outcome is expected to hurt Ricardo Anaya’s presidential aspirations as Zavala is more likely to draw votes from Anaya than from Meade or AMLO.

This campaign pause also turned out to be the perfect time for dueling corruption charges to be leveled against the three leading candidates. AMLO has been sharply criticized for associating with corrupt union leaders such as the former head of the teachers’ union, Elba Esther Gordillo, and the PRI-exiled former leader of the miners’ union, Napoleón Gómez Urrutia. As the former Secretary for Social Development, PRI candidate Meade has been tarred by corruption charges leveled against his predecessor in the post, Rosario Robles, and as former Finance Minister, he has been implicitly tied to the political use of federal transfers to state governments by his successor. And PAN/PRD candidate [Ricardo Anaya has been accused by the Federal Attorney General of corruption and money laundering](#) in a real estate deal in Queretaro.

The corruption charge against Anaya is the most significant. True or false, it is apt to tarnish the image of a politician who has campaigned as a squeaky clean candidate. It also appears to involve the political use of the Attorney General’s office to attack the

second-place candidate and thereby create an opening for the flagging campaign of the President's preferred candidate, Meade. The manner in which these accusations have echoed through the Mexican media has raised serious questions about bias in the coverage of the candidates. And according to [the first post-accusation poll](#), this strategy has benefited AMLO, by creating disgust at the political exploitation of the Attorney General's office. His advantage over Anaya is now 14 points as Meade falls further behind.

In other election news, in late February [Meade announced additions to his campaign team](#) designed to solidify support among PRI voters. The list includes three politicians with substantial support networks within the party: former Interior Minister Miguel Ángel Osorio Chong, and two people who each are former presidents of the PRI and former governors, Manlio Fabio Beltrones and Beatriz Paredes. At the same time, by bringing on board such prominent *PRIístas*, Meade also deepened his ties to [a party for which 47% of Mexicans say they will never vote](#).

On other fronts, the [PRI](#), and the [PAN/PRD and Morena-led alliances announced their lists of candidates](#) for proportional representation seats in the Mexican Senate. The PRI list is dominated by party stalwarts, making room for only three close collaborators of presidential candidate Meade, one for the Senate and two for the Chamber of Deputies. The latter two candidate lists were drawn up to solidify the political alliance backing the presidential aspirations of Ricardo Anaya and AMLO, respectively. In the case of AMLO, the list includes two prominent exiles from the PAN, Germán Martínez and Gabriela Cuevas, the banished PRI union boss, Napoleón Gómez Urrutia, and one of the founders of the PRD, Ifigenia Martínez. It is a list designed to build a PRI-style big tent coalition that can ensure AMLO's election and his ensuing capacity to govern.

Finally, confusing signals emerged from AMLO's camp with regard to the front-runner's energy policy. The [candidate stated that he would try to prevent the country's oil from falling into foreign hands and repeated his promise to review the oil contracts](#) recently signed with private firms. But a key [economic adviser tried to soften the impact of these statements and reassure investors](#) by noting that AMLO had reviewed the contracts and found no problems. AMLO's proposed energy minister also restated the [candidate's plan to build two new refineries in Mexico](#) with the aim of generating gasoline self-sufficiency, [in spite of industry doubts about the efficiency of this strategy](#). Our take:

AMLO is a pragmatic nationalist who is likely to slow and redirect the energy reform rather than reverse it.

III. Mexican Economy

Despite uncertainty surrounding the 2018 Presidential election and the NAFTA negotiations, the [Bank of Mexico held its growth estimates for 2018 and 2019 steady](#) at 2-3% and 2.2-3.2%, respectively. In part this reflects [foreign direct investment of \\$29.7 billion in 2017](#), an 11% jump compared with 2016, [a trend which continued into early 2018](#). But this good news came in conjunction with a rapidly widening [trade deficit in January, to the worst on record](#) for the first month of the year.

[Inflation continued to slow in February](#) to 5.45%, but it is still well above the Bank of Mexico's 3% target rate. As a result of still high inflation in Mexico, expectations for rate increases by the U.S. Federal Reserve Bank, and the uncertainty surrounding the future of NAFTA, [analysts anticipate that Banxico will raise the benchmark rate another quarter point to 7.5% during the second quarter this year](#).

The country registered the [first reduction in its debt-to-GDP ratio in ten years](#) in 2017, news of which helped steady the peso despite election and trade uncertainties. The Mexican currency lost less than 1% of its value in February, closing the month at 18.8 pesos per U.S. dollar. Overall, we agree with those who are concerned that [markets still have not priced in a potential AMLO victory in July](#).

Sector Focus: FinTech

The [President promulgated legislation that will regulate Mexico's financial technology sector](#). The legislation regulates FinTech services, organization, and operation, and is designed to encourage financial stability and prevent money laundering in this fast-growing sector of the Mexican financial system. Stay tuned for further analysis on this important sector from us in the near future.

Sector Focus: Energy

For the first year since 1990, [Mexican oil and gas output fell below two million barrels of oil equivalent per day in 2017](#). Since hitting a 3.4 million BOE per day peak between 2003 and 2005, production has suffered a steady decline. It was thus reassuring to hear that the Energy Ministry has decided to [keep its foot on the energy reform gas pedal for the rest of the Peña Nieto Administration](#), regardless of the outcome of the July presidential election. This will include the [first ever auction of shale blocks in September](#) containing massive but thus far unrealized production potential. Officials hope that the third time is a charm since this effort follows two failed attempts to hold an auction for unconventional resources.

Sector Focus: Telecom

The Mexican [Supreme Court overturned a ruling by the Mexican telecommunications regulator](#) (IFT) that had identified Televisa as a “preponderant” actor in the pay TV sector. Under Mexican telecommunications law, the ruling exempts Televisa from the operational limitations that apply to dominant actors possessing the power to set prices.

Following this pro-business decision, the [Supreme Court ruled in favor of the 2014 telecom law in a case involving Telcel](#). The court ruled that requiring América Móvil to give its competitors access to its network and infrastructure does not violate the firm’s rights. The court argued there are “certain obligations” that accrue to “the preponderant economic agent, which will expire once there are conditions of real competition in the market”. This will benefit [AT&T, which leads its Mexican competitors in the growth of wireless users](#).

And on March 5, the [IFT narrowly approved a plan requiring América Móvil to transform its Telmex and Telnor units into separate, independent corporate entities](#) over the next two years. The company announced that it will begin the separation process even as it challenges the IFT’s order in court.

IV. Monarch Events, Speeches, Publications

February 13: MGS Chairman Ambassador James R. Jones commented in the Inter-American Dialogue's [Latin American Advisor](#) on the likelihood of the NAFTA negotiations being successfully completed in 2018.

February 20: Monarch published [NAFTA News – Volume 6](#), a periodic newsletter from MGS, Manatt, Phelps & Phillips, and TACTIX, jointly offering information and insight on NAFTA renegotiations from experts in the three NAFTA national capitals.

February 22: MGS Senior Advisor Pamela Starr discussed the impact an AMLO victory could have on Mexico's capital markets, economy, energy reforms, and NAFTA in the Inter-American Dialogue's [Latin American Advisor](#).

March 2: Pamela Starr commented on the resignation of the U.S. Ambassador to Mexico in [The Wall Street Journal](#).

March 5: MGS President and CEO Michael Camuñez spoke to [The New York Times](#) about the growing troubles facing the renegotiation of NAFTA.

March 6: Pamela Starr published an op-ed analyzing the impact of the resignation of the U.S. Ambassador to Mexico on the bilateral relationship in [The Conversation](#).

March 6: Ambassador Jones joined CNBC's [Squawk Box](#) to discuss the importance of NAFTA not just to the U.S. economy but also to its national security and influence in the world.

March 12: MGS Managing Partner Luis Ricardo Rodríguez commented on the regional impact of Trump's steel tariffs in the Inter-American Dialogue's [Latin American Advisor](#).