



Monarch News

October 2017



CEO Executive Summary

As we enter the month of October, we are excited to announce an important new addition to the Monarch team: Giselle Fernandez, a five-time Emmy Award winning broadcast journalist, has joined Monarch Global Strategies as a Senior Advisor in our Los Angeles office. Giselle will be advising clients on strategic communications, brand development and management, capital formation, and marketing strategies, with an emphasis on accessing multicultural markets. We are thrilled to welcome Giselle and look forward to introducing her to clients who would benefit from her vast experience in multi-cultural communications and cross-border business development. Our press release announcing Giselle's addition to our team, along with her bio, can be found [here](#).

On a more difficult front, we are saddened to share the news, now well known, about the disastrous earthquakes that struck Mexico in September. Our hearts are with the Mexican people, and as a company doing business in Mexico, we are determined to help Mexico recover from this terrible tragedy. As has been widely reported, on September 7 and 19 Mexico was hit by two massive earthquakes. Damage from the first was concentrated in the isolated Tehuantepec isthmus region of Oaxaca

state, while damage from the second was concentrated in Mexico City generating economic and political consequences in addition to the loss of lives, livelihoods, and homes. The loss of life was a painful consequence of the quakes, but it could have been much worse given the magnitude of the quakes, 8.2 and 7.1, respectively. Earthquake resistant building codes helped keep the loss of life to less than 500 people. The economic impact of the quake is expected to be limited, slightly reducing growth in the third quarter and increasing it a bit in the fourth, with reconstruction unlikely to break the federal government's budget. Politically the impact looks to be much greater, although it remains unclear who the winners and losers will be. What is clear is that public tolerance for politicians and the government waste and corruption they perpetuate has reached a new low.

Meanwhile round three of the NAFTA negotiations took place in Ottawa, September 23-27. Contrary to expectations, the United States did not formally present text for the most controversial issues. This made the round workman-like, making progress on non-controversial chapters but raising doubts about the negotiators' ability to finish the talks before the end of 2017.

I. The Earthquakes

[Southern Mexico was hit on September 7 by the strongest measured earthquake ever to hit Mexican territory](#), an 8.2 tremor that was followed [twelve days later by a 7.1 quake centered in the Mexico City region](#). The September 19 quake eerily struck 32 years to the day after a 1985 quake measuring 8.1 on the Richter scale that leveled large portions of the capital and killed an estimated 10,000. This time dozens of buildings collapsed killing less than 400 people, far fewer than in 1985, despite the [land accelerating in places at a rate that exceeded the 1985 tremor](#). The more limited loss of life owes much to improved seismic building standards imposed in the aftermath of the 1985 quake and to an impressive rescue effort led by self-organized groups of citizens reinforced by a rapid and effective government response.

These earthquakes were not just natural disasters with profound human consequences, however. The quakes, the rescue effort, and reconstruction will also have economic, societal, and political implications, as Mexican civil society demands that public resources be better and more effectively allocated to efforts to rebuild Mexico and

provide the assistance that is so desperately needed. As we touch on below, this is already sending political tremors throughout the Mexican political establishment.

II. Mexican Economy

With [over 2,200 properties damaged by the earthquake in Mexico's economic heartland, Citibanamex lowered its estimate for Mexico's 2017 GDP growth to 1.9% from 2.0%.](#) This corresponds with the analysis of [independent economists who argue the economic impact of the quake will be marginal,](#) generating a small drop in growth during the third quarter and a small uptick in the fourth. A greater impact on economic growth comes from [the slowing of domestic consumption and the inability of exports to make up the difference,](#) as seen in the National Statistics Institute's (INEGI) 1.3% preliminary estimate for July's annual growth rate, the lowest monthly number since April 2016.

Nor is the earthquake expected to have a significant impact on inflation, which [decreased a bit in the first half of September to 6.53% annualized,](#) reinforcing Bank of Mexico President [Agustín Carstens' conviction that inflation has hit its peak.](#) Reflecting that estimate, the Bank's board voted unanimously to [hold interest rates steady at 7%](#) in its late September meeting. The peso had a largely uneventful month, oscillating between 17.6 and 17.9 pesos per dollar for most of the month on the back of [higher oil prices](#) and uneventful NAFTA news. However, a rise in the U.S. dollar due to [expectations of tighter U.S. monetary policy following the Federal Reserve's September policy meeting](#) pushed the exchange rate to 18.2 pesos per dollar during the final trading days of the month, the first time it has surpassed 18 since early July.

On September 8, Finance Minister José Antonio Meade [delivered to Congress the Administration's budget for 2018,](#) which is built on forecasts for economic growth of 2-3%, an average peso to dollar exchange rate of 18.1, an average oil sales price of \$46 per barrel, and a decline in inflation to 3% by the end of the year. The [proposal calls for spending cuts of about \\$5 billion](#) (90 billion pesos) to balance the 2018 budget. This budget is expected to be modified significantly by the legislature to make room for earthquake reconstruction, which is [estimated to cost as much as \\$10 billion.](#) Insured losses are expected to be just \$1.2 billion since [less than 10% of Mexican home owners have earthquake insurance.](#)

Late September also marked the [inauguration of three Special Economic Zones](#) to promote investment and development in southern Mexico.

Sector Focus: Energy

The earthquakes have [shut down Mexico's Salina Cruz refinery](#) until late October in a country where [fuel production had already fallen by 26.7% in five years](#). They also [stopped wind generation](#) in the Tehuantepec region of Oaxaca, and [temporarily knocked out 19 power generators](#) in central Mexico. Hurricane Harvey, meanwhile, laid bare Mexico's heavy reliance on natural gas imports from the United States. Pemex was forced to ask clients to cut gas consumption by 20% due to a drop-off in imports from the U.S.

In petroleum news, the government announced it will [auction off 35 shallow-water blocks next March in the country's third round of hydrocarbon bidding](#). This is on top of [the 70 contracts it has already awarded](#) under the energy reform. Meanwhile, [Shell opened its first gas station in Mexico](#), adding to an avalanche of permits for gas stations approved by the Energy Regulatory Commission (CRE). In the two years since Pemex lost its monopoly, [privately branded gas stations have grown to represent 23% of all stations in Mexico](#).

In the electricity sector, Mexico's electricity transmission system operator, CENACE, will [announce the winners of the third long-term electricity auction on November 22](#), for which the government has received 14% more sale proposals than in the second auction. The Ministry of Energy (SENER) announced the [first tender for bids to build new transmission lines will also be held in November](#). Meanwhile, [construction of the nation's largest solar farm got underway in Queretaro](#), while [Yucatan took receipt of turbines for the state's first wind farm](#).

III. Mexican Politics

A controversy over who would be Mexico's first independent attorney general dominated politics in early September. President Peña Nieto favors his current attorney general, Raul Cervantes. But [citizen organizations and private sector groups are encouraging the president to reconsider this position](#). They argue that Cervantes is too close to the president to be truly independent. To support this effort, the PAN party

leadership blocked the formation of the *Mesa Directiva* in the chamber of deputies. Without this key committee, the lower house could not conduct business just a week before the administration was scheduled to present its 2018 budget blueprint. To avoid this legislative crisis, [the President's PRI party operatives agreed to this opposition demand](#), but they also [called for another constitutional reform to improve the effectiveness of the new office](#). Since the PRI is unlikely to build the two-thirds majority needed to approve a constitutional reform in today's divided congress, this demand is most likely a delaying tactic that will postpone naming a new attorney general, and thus the effective start of the anti-corruption system, until after the 2018 presidential election.

Following the earthquakes on September 7 and 19, the political agenda changed dramatically. The quakes pushed aside disputes over the anti-corruption system and replaced them with competitive calls from Mexico's main political parties to rewrite election rules and the 2018 budget to transfer money benefiting politicians and political parties to reconstruction efforts. While the ultimate political implications of the earthquake remain unclear, it is apparent that society has become much more demanding and much less tolerant of Mexico's political class. After playing a central role in the rescue efforts in the immediate aftermath of the earthquake, Mexicans, especially those from Mexico City, feel more united and powerful than they have in decades. If this sentiment lasts, it will change the political context of the 2018 presidential election and change the calculus of Mexican politicians and parties.

IV. U.S.-Mexico Relations / NAFTA Round 3

U.S.-Mexico relations were again dominated by the NAFTA modernization talks, and specifically the third negotiating round held in Ottawa, September 23-27. This was supposed to have been the round in which the U.S. formally presented text for three of the most contentious issues in the talks – rules of origin, dispute resolution, and investor-state dispute settlement mechanisms. These issues were discussed, rules of origin extensively so, but no text was tabled. Rules of origin in the auto sector, according to [an op-ed penned by U.S. Commerce Secretary Wilbur Ross](#), are the key to reducing the U.S. trade deficit and are shaping up to be a decisive issue in the negotiations. The [U.S. wants a 35-50% U.S. domestic content provision](#), which Mexico and Canada oppose.

The United States did table text to ease the process for issuing trade complaints for seasonal produce, and it [floated the idea of a sunset provision](#) for NAFTA which would terminate the agreement after five years unless all three parties agreed to extend it. This provision is designed to allow the U.S. to unilaterally abrogate the revised agreement should it fail to reduce the U.S. trade deficit with its North American partners. [Canada and Mexico immediately rejected this provision](#) as did [key U.S. Congressmen and members of the business community who prefer greater certainty that NAFTA will be in effect before making long-term investments](#). The United States also presented text covering questions of government procurement, intellectual property, investment, and labor. The labor text was immediately rejected by unions and some of their democratic allies in Congress as insufficiently tough on Mexico.

Real advances in the round were limited to [what the Canadian foreign minister referred to as “bread and butter issues”](#) for which the parties are in substantial agreement. These include effectively concluding the chapter on small and medium enterprises, nearly concluding the competition chapter, and making significant progress on chapters covering digital, telecom, regulatory, customs clearing and trade facilitation, state-owned enterprises, and food safety and plant and health measures. In a [joint statement](#) at the end of the round, all three countries committed themselves to the rapid conclusion of the negotiations.

The problem is that postponing the presentation of formal text for the most contentious issues is apt to delay the conclusion of the negotiations. Mexican Economy Minister Ildefonso Guajardo recognized this when he [stated that the negotiations might have to extend into 2018](#) rather than be completed by the end of the year. U.S. Trade Representative Robert Lighthizer echoed this sentiment when he said that [concluding the talks by the end of 2017 is “very, very optimistic”](#) and blamed delays in presenting formal chapter text on the U.S. interagency approval process and congressional concerns. He said that the U.S. should have this text ready for the fourth round to be held in the Washington, D.C., area October 11-15. The atmosphere for this round could be particularly tense given the U.S. decision to [propose a 220% tariff on Canadian-made Bombardier airplanes](#) in order to compensate Boeing for illegal subsidies the firm is alleged to have received from the Canadian government.

An emerging dynamic in the NAFTA talks also concerns what appears to be a breakdown in consensus, if there ever was any, in the U.S. government interagency process. It seems that USTR has moved forward with advancing positions in the discussions that face opposition in the interagency, some key parts of Congress, and especially in the private sector. ***This dynamic causes us to question whether the Trump political team is driving a negotiation that is intended to fail, giving the President what he wants: the ability to withdraw from NAFTA by blaming the other parties for failing to reach agreement, even when the demands sought lack support from within the U.S. government and at home in the private sector.*** We are watching this closely...

Beyond NAFTA, four developments reinforced tension in the bilateral relationship. On September 5, the Trump Administration announced that [the DACA program to shield the undocumented children of immigrants from deportation would end in six months](#) if Congress did not pass a law to replace it. Later in the month, contractors [began to construct eight prototypes for the border wall](#) in the Otay Mesa border region in Southern California. Trump's chief of staff, [General John F. Kelly, allegedly justified the need for a border wall by arguing in an Oval Office meeting that Mexico was on the verge of collapse](#). And Mexico [withdrew its offer of assistance to Hurricane Harvey victims](#) after feeling snubbed by a Trump administration that took more than a week to accept the offer and then made no public statement about the first of two devastating earthquakes in Mexico. Following the second massive earthquake, however, the [arrival of U.S. search and rescue teams was warmly welcomed](#).

V. Monarch Events, Speeches, Publications

September 5: MGS Chairman Ambassador James R. Jones spoke with [Politico Pro](#) about the latest in NAFTA talks after round two of renegotiations. *Subscription required.*

September 6: MGS President & CEO Michael Camuñez discussed the current state of NAFTA renegotiations with [Forbes](#) following the completion of round two of talks.

September 8: Michael Camuñez briefed the California Chamber of Commerce's board of directors and International Trade Committee on the [status of the NAFTA negotiations](#).

September 11: Michael Camuñez, as Chair of the Pacific Council's Mexico Initiative, hosted a private dinner for Council members with Mexican Foreign Minister Luis Videgaray in Los Angeles to receive a briefing on the status of the NAFTA negotiations and the latest developments in the bi-national relationship.

September 11: Ambassador Jones and Michael Camuñez provided [North American Shale Magazine](#) with their insights on what NAFTA means to the U.S. oil and gas industry and energy infrastructure.

September 19: Ambassador Jones and Senior Director Pedro Niembro commented on post-flood reconstruction efforts in Peru in the Inter-American Dialogue's [Latin America Advisor](#).

September 22: MGS Senior Advisor Pamela K. Starr discussed Mexico's 2018 presidential election at a National Intelligence Council/State Department Bureau of Intelligence and Research co-sponsored event on Mexico held in Washington, D.C.

September 22: Monarch published [NAFTA News – Volume 4](#), a periodic newsletter from Monarch, Manatt, Phelps & Phillips, and TACTIX, jointly offering information and insight on NAFTA renegotiations from experts in the three NAFTA national capitals.

September 22: MGS Director Begoña Sanchez spoke at INDEX Nuevo Leon on changes to the Mexican Trade Regulations.

October 3: MGS Managing Partner Luis Ricardo Rodríguez spoke at the University of Monterrey on proposed changes to NAFTA after the third round of negotiations.