Energy Client Monthly Report

December 2024

November developments were a reminder of the internal and external constraints on the Sheinbaum presidency, but these were punctuated by renewed evidence of her political strength and her pragmatic approach to governing. During the month, four different issues provided a consistent reminder of the constraints placed on Sheinbaum by AMLO and his acolytes: the rushed effort to eliminate seven autonomous institutions, the continuing challenge of implementing the judicial reform, evidence of the huge budget deficit facing the country, and the very public pressure for Sheinbaum to select AMLO's candidate to run the human rights commission. The election of Donald Trump has significantly complicated U.S.-Mexico relations, imposing an additional, external constraint on Sheinbaum's freedom of action. Popular support for the new president and an opposition in disarray, however, have helped strengthen Sheinbaum's presidential authority. In this context, she forced a change in the legislation eliminating independent institutions to prevent it from violating the USMCA, and her team developed a potentially feasible, albeit optimistic, way to reduce significantly the 2025 budget deficit. We suspect that governing Mexico in the coming months will resemble November's challenges.

The Reform Agenda

The government moved forward with the elimination of seven autonomous institutions, but with a delay to modify the reform bill to prevent it from violating the USMCA. Five institutions, including CRE and CNH, were eliminated and their responsibilities absorbed by the relevant cabinet ministry. The Federal Telecommunications Institute (IFT) and the Federal Competition Commission (COFECE), however, received special treatment. The competition responsibilities of the IFT and COFECE were merged to create an independent organ of the Economy Ministry, giving the new agency sufficient independence to meet USMCA requirements. How much autonomy it will have in practice, however, depends on the implementing legislation to determine its ability to reach independent decisions and the minimum qualifications of its members. More broadly, the relative independence of all the new dependencies will be determined by who is selected to lead them. In the case of the new competition authority, Monarch has learned that the father of COFECE president, Andrea Marvan, who is close to AMLO and Sheinbaum, is advising the government. His council is apt to be reasonable and trusted, which bodes well for the agency's future operations.

There has been no such compromise on the judicial reform front. While Sheinbaum sent to Congress the secondary legislation governing the judiciary and the judicial profession, it lacked the long-promised changes that would "fix" the reform by increasing qualifications for judicial candidates. Equally troubling, after falling short for weeks, the registration of judicial candidates suddenly produced thousands of new registrants during the final 48 hours of the process to provide multiple candidates for the positions up for election. The administration clearly applied political pressure to the states to achieve this outcome, which generates concern that similar pressure could be applied in advance of the June election to ensure victories for the government's favored judicial candidates.

An Optimistic 2025 Budget

To meet Sheinbaum's commitment to slash her inherited 6% budget deficit, the 2025 budget relies on selective large spending cuts coupled with an optimistic growth estimate to bring the deficit down to 3.9%. Presented to Congress in mid-November, the budget is built around a 2-3% growth estimate while business economists polled by the Bank of Mexico expect growth closer to 1.2%. The government correctly argues that the experts have been

wrong before, most recently in 2023 due to a surprisingly robust U.S. economy. But the Finance Ministry may have overestimated the likelihood of nearshoring investment to drive growth in the wake of a problematic judicial reform and the election of Donald Trump. Indeed, the most recent foreign direct investment numbers presented by the Bank of Mexico, for the third quarter 2024, show that while investment increased 4% over last year, it still registered the second lowest amount of investment for a third quarter in fifteen years (excluding COVID). Further, greenfield investment fell 36.5% to the lowest level in ten years. Finally, total FDI was 30% lower than the Economy Ministry's initial estimate based on planned investments that apparently never materialized. This suggests a lot of investment is remaining on the sidelines waiting to see how the judicial reform and the Trump presidency play out.

These numbers suggest that the budget will have to be adjusted next year, likely opening the door for a fiscal reform. Spending in several essential categories was slashed by over a third, including health and security, making further cuts difficult to imagine. In addition, the largest categories of social spending and interest payments on the debt cannot be cut, so the solution will have to come from increased revenues. But the budget already includes an estimated 3% increase in tax collections. In this context, Morena legislators have called for a progressive tax reform while Sheinbaum repeated her stance that there is no need for a fiscal reform, but with the important addition of two words: "for now".

AMLO's Influence Continues, But Over a Stronger Sheinbaum

The Senate's selection of the new president of Mexico's Human Rights Commission (CNDH) demonstrated AMLO's continuing influence in national politics. It chose Rosario Piedra, the least well rated of the candidates for the position and apparently not Sheinbaum's preferred option, but she was AMLO's favorite. This decision followed an aggressive, last minute pressure campaign by Morena's senate leader and very close AMLO ally, Adan Agusto Lopez. This development does not mean that AMLO is calling the shots for Sheinbaum, but it does suggest that when something really matters to him—protecting his political allies or preventing a violation of the core foundations of his Fourth Transformation, for example—he will exercise his self-anointed "right to dissent" further limiting Sheinbaum's freedom of action.

Two new polls and an even weaker opposition, meanwhile, highlight the current reach of President Sheinbaum's political authority. Both polls show strong popular support for Sheinbaum. One, published last week in the El Universal newspaper and undertaken by one of Mexico's best polling firms, shows a sharp rise in her support and an optimistic sense that the country is going in the right direction under her leadership. Not only is her approval at 74%, but this includes 56% of the self-described opposition. An important caveat is that this approval is based on support for all things AMLO—support for the vulnerable, pensions and other transfers, and "continuing the work of AMLO." This is unlikely to limit Sheinbaum's freedom of action significantly, however, since she strongly backs all these policies.

Developments in the opposition also helped to expand presidential authority. The PAN party selected a new president, an establishment, Mexico City politician facing corruption accusations, Jorge Romero. Sheinbaum exploited this decision to further tarnish the PAN's reputation in public opinion. In her morning news conference, she read a passage from the memoirs of former President Felipe Calderon accusing his fellow PAN member of corruption. This selection also obviates any hope of a restructuring of the PAN to make it more effective and a more appealing option for voters. At the same time, the electoral institute announced that the PAN could lose its party registration since its membership is just 16,000 above the minimum required by law. The capacity of the PAN to lead an effective opposition is thus in doubt, but nor are the PRI or *Movimiento Ciudadano* (MC) in any condition to lead. The PRI continues to show signs of becoming a new junior partner of Morena especially given the government's threat to eliminate its party leader's congressional immunity in the face of corruption charges. MC, meanwhile, continues to be sharply divided internally between its Nuevo Leon and Jalisco factions with the election of a new party president scheduled for December 5.

More Bilateral Fireworks

Donald Trump's election victory significantly complicated bilateral relations and produced a three-pronged Mexican response: (a) attempts to calm the markets by arguing that Trump was unlikely to follow through with his tariff threats due to their high cost to the U.S. economy, (b) efforts to proactively smooth over potential disagreements with a Trump Administration, and (c) threats to respond in kind if Trump were to impose tariffs on Mexican exports. After her call to congratulate the U.S. president-elect, President Sheinbaum argued that Trump was unlikely to impose tariffs and that she would personally make Trump

understand how the USMCA benefits everyone. Economy minister Marcelo Ebrard initially took a nationalist line arguing that Mexico would retaliate against U.S. tariffs, but he also reassured investors that this was unlikely to happen because of the impact on U.S. companies operating in Mexico. He then issued a reminder to the United States that Mexico was its most loyal ally. The foreign minister, Juan Ramon de la Fuente, further argued that Mexico is already cooperating extensively with the United States on migration noting that irregular migration through Mexico has declined 76% since December of last year.

Meanwhile, two conservative Canadian provincial premiers threw Mexico under the USMCA bus saying that if Mexico did not match U.S. and Canadian tariffs on Chinese goods, Canada should pursue a bilateral treaty with the United States. Even Prime Minister Trudeau expressed his concerns at the G-20 summit about the level of Chinese trade and investment in Mexico, clarifying the following week that this applies to Chinese inputs to products "made in Mexico." If this cannot be resolved at the USMCA review, he suggested that it may be necessary to drop Mexico from the agreement. Uncoincidentally, the next morning President Sheinbaum announced "Plan Mexico," a program designed to produce in Mexico or North America many of the production inputs Mexico currently imports from China.

The following week, on November 25, Trump announced that he would impose a 25% tariff on Mexico and Canada, and a 10% tariff on China, on his first day in office if these countries did not fully cooperate on reducing the flow of migrants and fentanyl into the United States. Sheinbaum responded the next morning by reading aloud a letter that she said the foreign ministry would send to Trump the following day. While repeatedly calling for discussions as the only way to resolve mutual problems, the letter took a lecturing tone suggesting that Trump "may not be aware" of Mexico's migration cooperation, reminding him that Mexico does not consume fentanyl and the criminals get their guns from the United States, and warning that Mexico will respond in kind to any tariff. That message neatly played to a domestic audience, but it might not have been the best approach to the U.S. president-elect. Smartly, Sheinbaum spoke directly with Trump the same day generating positive readouts from both sides. Trump called the conversation "wonderful," and Sheinbaum referred to it as "very productive," yet in their ensuing comments they differed on its content. While Trump insisted that Mexico would help close the border, Sheinbaum insisted that Mexico would not close borders but instead build bridges. On fentanyl, Sheinbaum said on December 3 that Trump had offered U.S. assistance which Sheinbaum rejected, emphasizing the ability of Mexican forces to deal with the problem. But she welcomed U.S. intelligence and broader

cooperation on the issue. That said, Mexico's limited capacity to constrain organized crime suggests that guaranteeing effective Mexican security cooperation to an extent that satisfies Trump is likely to be difficult.

Finally, the make-up of the Trump cabinet points to two additional sources of bilateral tension. First, it makes abundantly clear that Trump intends to fulfill his campaign promise to aggressively deport undocumented migrants, likely to Mexico regardless of their nationality. How Sheinbaum will respond is unclear, but the decision will be crucial. Second, Mexico announced the arrival of 199 Cuban doctors to work in remote rural hospitals, the continuation of an agreement penned under AMLO. Given the deeply felt anti-Cuba sentiments of the U.S. Secretary of State-designate, Marco Rubio, this is unlikely to go unnoticed. 2025 is apt to be a rough ride in U.S.-Mexico relations.

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