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Mexico's ability to evade a 25% tariff on its exports to the United States reflects a concerted effort to create the image of a highly cooperative neighbor. This culminated in a decision not to retaliate immediately to President Trump's February 1 tariff threat, followed by a friendly and productive phone call between Presidents Sheinbaum and Trump two days later. The two presidents agreed to postpone the imposition of tariffs for a month to allow intensive bilateral negotiations to advance toward collaborative solutions on immigration, security and trade.

Simultaneously, Sheinbaum submitted secondary legislation to Congress to implement the energy reform, creating real investment opportunities in the electricity sector. She did this while dealing with discord in her legislative group, pointing to incipient but important weaknesses in her governing coalition.

Sheinbaum's Efforts to Placate Trump

From migration to security and trade, Sheinbaum's actions in January were guided by a central theme: demonstrate a real willingness to cooperate with the United States. On migration, Sheinbaum continued to aggressively deter migrants crossing through Mexico while publicizing the past successes of this policy: migrant flow fell by 68% over the past



year, reaching lows at the end of 2024 not seen since 2020 (based on U.S. Border Patrol numbers). She also agreed to welcome back all Mexicans expelled from the United States, accept some non-Mexicans, and comply with Trump’s decision to reinstate the “Remain in Mexico” program, which mandates that all asylum seekers wait in Mexico until their U.S. immigration court hearings.

On security, Sheinbaum made an important detour away from AMLO’s policy of not confronting organized crime, denying that fentanyl was produced in Mexico, and sharply limiting cooperation with the United States. There are now daily reports in Mexican media, and weekly announcements in Sheinbaum’s morning press conference, of drug-trafficking arrests and fentanyl lab raids partly based on intelligence cooperation with the United States. The flow of fentanyl into the United States, meanwhile, has significantly decreased since 2023. Finally, Sheinbaum’s security minister insisted that any government dialogue with organized crime always ends badly.

Even the announcement of Sheinbaum’s new investment strategy, Plan México, emphasized cooperation with the United States and the need to reduce economic reliance on China. In addition, the tone of the announcement and the government’s outreach to the private sector more broadly has been decidedly more supportive of business compared to her predecessor. The plan called for \$1.5 billion in incentives for investors over six years to encourage nearshoring. While ultimately not a huge number, it differentiates Sheinbaum from AMLO who refused to provide any incentives.

Tariffs Postponed

Early messages from Trump administration officials sent mixed signals regarding tariffs. Despite Trump’s promise to impose a 25% tariff on all Mexican (and Canadian) imports, public and private statements of incoming administration officials implied there was a way out: Mexico just needed to demonstrate that it was a trustworthy partner. There was also a “good” phone call between the two foreign ministers, and positive meetings between Mexican businessmen and incoming Trump Administration officials. In his comments at Davos, Trump slammed Canada but went out of his way to note that he believed relations with Mexico were very good. Simultaneously, however, incoming National Security Council (NSC) Chairman Mike Waltz noted that large portions of Mexico—including areas along the U.S. border—are under the control of organized crime, which is unacceptable to the United



States. Secretary of State Rubio also argued that China was using Mexican front companies to secretly export to the United States, and news reports referred to Rubio's previous accusations of ties between the AMLO administration and organized crime.

The February 1 announcement that the 25% tariff would take effect on February 4 relied on the International Emergency Economic Powers Act, an executive authority that permits the president to use economic means to respond to emergencies. In this case, the rationale is weak border security leading to a large and uncontrolled flow of migrants and fentanyl. The wording of the announcement said the tariffs will persist "until the crisis is alleviated" but offered no metrics to measure this. It further noted that organized crime has "an intolerable alliance with the government of Mexico," an argument that would be hard for Sheinbaum to disprove. The announcement also allowed for additional tariff increases should Mexico (or Canada) retaliate and included a 10% tariff on Chinese imports.

Sheinbaum "categorically" rejected the "slander" of suggesting Mexico has alliances with organized crime and argues that if any such alliance exists, it's in the United States and with the gun manufacturers. She also announced that Mexico would retaliate but postponed any action until Monday, February 3. Nationalist forces in her governing coalition were pressuring her to act more forcefully, but Colombia's recent experience after its president attempted to stand up to Trump militated against this response, as did Sheinbaum's cautious approach to Trump thus far. Sheinbaum also seems to have hoped that Trump's action would be relatively short-lived given his known preference for negotiating through coercion, the economic costs of the tariffs to the U.S. economy, and the U.S.'s strategic need to avoid weakening its southern neighbor.

This firm yet cautious strategy seems to have paid off. In a February 3 presidential phone call, President Trump agreed to delay tariffs for a month to allow for three high-level working groups to craft solutions to three shared issues: migration, security, and trade. The two presidents also agreed to keep talking during this process. Sheinbaum further agreed to send 10,000 National Guard troops to help police the border to block the flow of migrants and fentanyl. During Sheinbaum's morning news conference following the call, Economy Minister Ebrard noted that he was in contact with U.S. Commerce Secretary-designate Howard Lutnick, and they plan to meet soon after Lutnick receives Senate confirmation.

For now, crisis averted. Yet it is unlikely that this will be the last Trump-generated challenge for Mexico. To the contrary, we expect more in the coming weeks and months. Stay tuned.

Energy Legislation

As anticipated, President Sheinbaum submitted to Congress a package of 8 legislative initiatives known as the “secondary energy legislation” on February 4. The package contains:

- 1) Law of Planning and Energy Transition
- 2) Law of the State Public Enterprise CFE
- 3) Law of the Electricity Sector (*Ley del Sector Eléctrico-LESE*)
- 4) Law of the State Public Enterprise PEMEX
- 5) Law of the Hydrocarbons Sector
- 6) Law of the National Energy Commission (*Ley de la Comisión Nacional de Energía-LCNE*)
- 7) Law of Biofuels
- 8) Law of Geothermal Energy

Since the Monarch team was able to gain access to the *LESE and LCNE* drafts prior to their presentation to Congress, we will focus on them. We are very excited by what we read. In essence, nothing changes operationally from the laws that governed the industry since the Peña Nieto Energy Reform, and in fact, the legislation opens the door to new opportunities to invest in the sector. The main weakness we see was expected, which is the 54-46% split in favor of CFE to give it generation prevalence. The new figures created by the Law, such as Long-term Producers and Public-Private Partnerships, should, however, provide an attractive and healthy space for the development of private generation. It also introduces the concepts of energy storage, cogeneration, and electromobility infrastructure. In a welcome surprise, and despite CFE’s efforts to reabsorb it, the grid operator CENACE maintains its status as a separate agency that will operate the market with technical independence under the purview of SENER.

Key elements for the operation of the sector were respected, such as the Wholesale Electricity Market and – very important for private renewable energy generators – the dispatch order based on economic merit. While the dispatch order contains some confusing wording, our team confirmed through a key government decision-maker that it will be strictly based on price, while maintaining reliability as a priority. Private investors can participate in generation through six main avenues, with the latter three prioritizing renewable sources:



- 1) Distributed Generation (up to 0.7 MW, exempt from Generation Permit)
- 2) Isolated Self-supply (+0.7 up to 20 MW, fast-tracked permitting, on site)
- 3) Interconnected Self-supply (+0.7 MW, with ability to sell excess energy to CFE, ideal for supply to industrial activities in separate locations)
- 4) Long-term Generator (we believe through an auction system, exclusively supplied to CFE)
- 5) Mixed Investment (CFE will own 54% through PPPs)
- 6) Market Generator (requires an interconnection contract)

The Law of the National Energy Commission unites the regulators of the hydrocarbons and electricity sectors into one agency, an administrative decentralized body of the Energy Ministry with technical independence. It will be led by a Director General, and its decisions will be made through a Technical Committee. The agency will have separate units for hydrocarbons and electricity. Its attributes in the power sector will be granting permits for generation, commercialization, and cogeneration. It will set the tariffs for basic supply, transmission, and distribution, oversee the operation of the Wholesale Electricity Market, and provide technical support to SENER.

Just one word of caution: the remaining key element we still need to analyze is the Law of Planning and Energy Transition, which could still contain an unwelcome surprise. The risk, however, seems to be low based on the LESE. The Sheinbaum administration has shown us they understand the needs of the electric sector without losing their nationalistic views (particularly evident in the hydrocarbons sector legislation), and they are willing to learn and listen from their private stakeholders to attract the 6 to 9 GW in private generation they expect.

Divisions in Sheinbaum's Governing Coalition

While dealing with the crisis in bilateral relations, Sheinbaum has faced continued signs of division in her governing coalition. While her legislative leaders have buried the hatchet, the driver of their dispute—battling for influence in Morena to position themselves to be the next president—will persist. At the same time, new problems arose. The new Morena governors of Morelos and Veracruz are investigating their predecessors, fellow Morena politicians closely allied with AMLO, for corruption. In Tabasco and Sinaloa, meanwhile, huge increases in crime and violence associated with reported ties with organized crime are undermining



support for the current Morena governors, also associated with AMLO. This puts Sheinbaum in a difficult position—she must either protect problematic politicians and thereby fulfill an informal agreement with AMLO, who still exercises enormous influence over Morena, or tolerate Morena’s loss of legitimacy and potential U.S. dissatisfaction due to its association with these unpopular politicians.

At the end of the month, one of Morena’s small legislative allies, the Labor Party, expressed its deep displeasure with a central element of Sheinbaum’s election reform—the elimination of proportional representation congressional seats. Designed to increase representation for small parties, their elimination would have enormous political costs for the Labor Party. Its leader in the Chamber of Deputies laid out the party’s position: Sheinbaum’s overwhelming legislative majority depends on Morena’s alliance with the Labor Party, and if this element of the reform is not eliminated, the party will have to rethink this alliance.



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