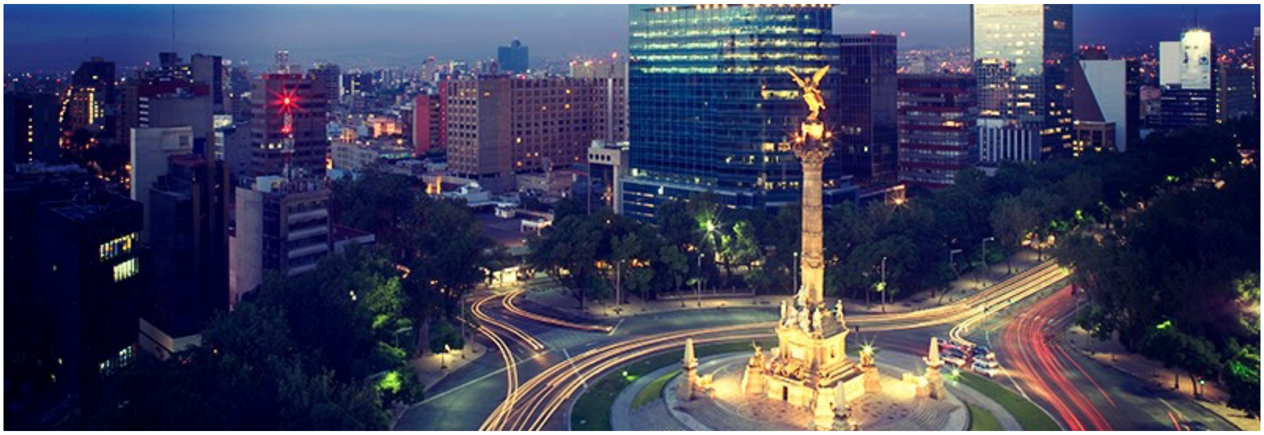

Monthly Report on Mexican Politics, the Economy, Energy, and U.S.-Mexico Relations

July 2026

Executive Summary

The United States refused to renew the USMCA, as we anticipated, and seems unlikely to move toward a quick resolution of outstanding differences. Despite Mexico's insistence that the agreement remains in force and should therefore provide investor confidence, the opposite is the case. This source of investor uncertainty is compounded by concerns over judicial independence and weak public investment in Mexico, both of which are undermining investment and limiting the country's growth potential. Indeed, a new survey indicates that Mexico-based firms are expanding their operations internationally instead of in Mexico.

U.S. efforts to compel Mexico to deepen security cooperation, including moving against politicians tied to organized crime, again filled Mexican headlines last month. In this context, a Mexican government report pointing to likely FBI involvement in the 2024 capture of a Mexican drug lord—something the Mexicans already believed to be true, but which the U.S. denies—incited a strong reaction from President Sheinbaum. Nevertheless, both sides seemed to intentionally pull their punches to preserve bilateral security cooperation. In a parallel development, the death of the 17th Mexican national at the hands of the U.S. Immigration and Customs Service (ICE) led Sheinbaum to announce legal action in the United States, raising the profile of this festering bilateral issue.

Simultaneously, Sheinbaum's ability to address Mexico's multiple policy challenges benefited from the continued consolidation of her presidential authority. Sheinbaum defeated a radical teachers' union, demonstrated more control over her Morena party, and preserved her electoral coalition. She also benefited from the formation of two new political parties, one of which is an ally and a second that will further divide the opposition.

On the energy front, June confirmed that Mexico is moving from policy design into implementation. The month's main developments point to a more structured and state-guided market, where private participation remains possible but is increasingly tied to public planning priorities, CFE-centered structures, interconnection feasibility and tighter regulatory oversight. For clients, the key issues are the transition of legacy self-supply and cogeneration arrangements, the potential cost impact of new transmission charges, the emergence of priority pathways for generation and storage, the execution risk behind CFE's 7.4 GW mixed investment pipeline, and the growing strategic role of natural gas and electricity storage in supporting reliability and industrial growth. Monarch's monthly *Mexico Energy Report* is available upon request to clients who are interested in a deeper analysis of these developments and what they mean for their exposure and opportunities across power generation, storage, natural gas, industrial supply, and infrastructure in Mexico.

USMCA Enters Annual Review Process

The United States announced on June 30, and confirmed in a July 1 trilateral video call among trade negotiators, its decision not to renew the USMCA. For now, this means the agreement remains in force while the current process of dual bilateral negotiations continues. Mexico and the United States will meet next in Mexico City beginning July 20 in an attempt to find a compromise between their positions. Bilateral U.S.-Canada talks have not yet begun.

The United States and Mexico agree on the need to reduce Chinese participation in North American supply chains but have not found the best way to set this up. Otherwise, the two sides continue to disagree. Mexico is calling for a sharp reduction in steel, aluminum, and auto tariffs, which the U.S. resists, and Mexico resists U.S. demands for tighter rules of origin combined with a high U.S. content requirement in the auto sector. The United States further insists on reducing its trade deficit with Mexico, whose trade surplus with the U.S. increased by 17.5% year over year in May and was 2.7% higher during the first five months of 2026, while bringing manufacturing investment back to the United States. Following the U.S. decision not to renew the USMCA, Toyota announced a $3.6 billion investment to move the production of its best-selling Tacoma pickup from Mexico to Texas. Trump's response on Truth Social was telling: "Tariffs at work!"

Meanwhile, the tomato dispute continues to make its way through the U.S. bureaucracy. The U.S. International Trade Commission ruled in late June that the United States could retain its 17.09% anti-dumping duty on Mexican tomatoes. The issue now goes to the Department of Commerce to calculate the margin of dumping and set the final duty accordingly. We expect the final decision later in July.

Monarch Analysis

The Mexican bottom line in the USMCA renewal talks remains achieving a lower tariff level than the rest of the world, doing so as quickly as possible to reduce the uncertainty that is slowing investment, and preventing bilateral security concerns from seeping into the trade conversation. President Trump's bottom line, however, is to bring manufacturing back to the United States while cutting the U.S. trade deficit with Mexico. There is also speculation that bilateral security tensions influenced the U.S. decision not to renew the USMCA, and there are indications that Trump will use the bilateral relationship as a political *piñata* during the midterm elections. As a result, Mexico's coveted quick resolution to the USMCA review remains unlikely.

Anemic Growth for the Foreseeable Future

The continued uncertainty caused by trade rules in limbo, combined with the fallout from last fall's judicial reform, undermined investment. Nor is a recent Supreme Court ruling against the Sheinbaum administration in a tax case affecting a major corporation likely to rebuild confidence in the Mexican judiciary. Not only is it a single case, but the justice positioned to be the next president of the court, Lenia Batres, voted to support the tax authorities' power to reopen settled cases. Reflecting all this, a recent HSBC poll found that 95% of Mexico-based firms are focused on expanding their operations internationally, with only 23% of U.S. companies saying they will expand in Mexico for the next two years.

While growth appears to have recovered following its early 2026 swoon (with the economy expanding 2.3% year over year in April, up 1.2% from March for its strongest monthly gain in five years) and inflation registered its lowest rate of the year in June, most economists estimate Mexico's potential rate of growth at just 2% due to weak public and private investment. Nor is a new leader at Mexico's development banks, Nacional Financiera and Bancomext, who has promised to focus on supporting investment, likely to be enough to change the investment climate.

Finally, the double-digit increase in exports during the first five months of the year that have contributed to Mexican growth appear to be unsustainable. In particular, a 10.9% increase in exports to the United States is likely driven by the stockpiling of inputs in the face of tariff uncertainty rather than a large increase in global demand.

Monarch Analysis

A return to growth, albeit anemic, with lower inflation is good news for Mexico, but it is unlikely to be followed by the robust growth required to create enough jobs or to significantly cut the government's fiscal deficit that caused Moody's to downgrade Mexican debt in May. Nor is last month's Petrobras-Pemex agreement for joint project development in deep water and mature fields likely to significantly reduce Pemex's drain on budgetary resources. Weak growth and a large fiscal deficit should thus remain persistent economic challenges for the Sheinbaum government.

Continued U.S. Pressure Begets Another Sheinbaum Retort

As expected, the United States kept the pressure on Mexico to deepen security cooperation, including moving against politicians linked to organized crime. In mid-June at the end of the G7 Summit, President Trump repeated his contention that "the drug cartels are totally running Mexico" and that President Sheinbaum is a "very scared woman." The same day, Vice President JD Vance softened the message by arguing that the United States wants "to work with Mexico to help Mexico fight the cartels" but added that the United States reserves the right to use military force in Mexico to protect its national interests. This repetition of by now standard U.S. rhetoric, however, provoked a nationalist response from an increasingly prickly Mexico. A key Morena powerbroker, Ricardo Monreal, retorted that "Vance does not know Mexico," where "the threat of military action is inadmissible."

During the final six days of June, the United States turned up the heat again. In his June 25 congressional testimony, Secretary of Homeland Security Markwayne Mullin argued that Mexico's cartels control every inch of the U.S.-Mexico border, directly threatening U.S. security. Two days later, *The New York Times* published an article based on leaks from U.S. government officials noting that "at least a dozen elected officials in Mexico, including governors and members of Congress, many from the governing party, have reached out" to U.S. authorities to inform on fellow politicians in response to a private DEA outreach effort.

On the last day of the month, the U.S. Treasury Department announced sanctions on individuals and entities associated with a Jalisco New Generation Cartel (CJNG) fuel smuggling operation. The statement specifically noted that any financial institution associated with the sanctioned actors could be sanctioned as well, a not-so-subtle reminder of Treasury's power to threaten the Mexican financial system. Finally, the statement highlighted the cartel's use of its proceeds from this operation, explicitly pointing to "cash payments to Mexican political campaigns and media outlets to help elect corrupt Mexican politicians."

Sheinbaum emphatically criticized the repeated insinuations that Mexican politicians are tied to organized crime without providing accompanying evidence on which the Mexican justice system might act.

Simultaneously, the news outlet "Pie de Nota" exploited its access to U.S. government sources to report that the FBI was involved in the July 2024 capture of Ismael "El Mayo" Zambada, one of the leaders of the Sinaloa cartel. As if concurring with this report, the FBI announced that the plane used in the operation would be displayed in an FBI museum as a tribute to its counternarcotics operations. In response, Sheinbaum released her government's report on the El Mayo operation, which raises questions about the Biden administration's insistence that it was not involved. And to make sure the message was clear, in her morning press conference, Sheinbaum noted that "someone lied" and pointedly reminded listeners of Mexico's constitutional and legal prohibitions against foreign operations on Mexican soil.

Another point of bilateral contention, the death of Mexican nationals at the hands of the U.S. Immigration and Customs Service (ICE), aroused Mexican ire following the 17th such death on July 7 under disputed circumstances. President Sheinbaum demanded accountability and announced the Mexico would move beyond diplomacy and initiate legal action in the United States to protect the rights of its citizens.

Monarch Analysis

As expected, the U.S. government furthered its pressure campaign to force the Sheinbaum government to increase security cooperation, based on the belief that only coercion will produce the results the Trump administration demands. Unsurprisingly, given the Mexican government's increasingly nationalist stance, President Sheinbaum took advantage of the opportunity to shoot back, reminding the United States of Mexico's red lines in its security cooperation. Mexico's newly activist approach to its relations with the United States was also evident in its reaction to the most recent Mexican death at the hands of ICE. Both sides, however, continue to pull their punches: JD Vance insisted that the U.S. wants to work with Mexico, and Sheinbaum sharply criticized the Biden administration instead of President Trump.

Consolidating Presidential Authority Amidst Warning Signs

The past month brought further evidence of Sheinbaum's gradual consolidation of presidential authority.

Months of coercive tactics by the National Coordinator of Educational Workers (CNTE), Mexico's smaller but more radical teachers' union, reached a peak in the days preceding the start of the World Cup. They demanded that the government take over their private retirement accounts despite this being fiscally impossible. To press their demand, they called a national strike, occupied Mexico City's central square (where the city's main World Cup Fan Fest was scheduled to take place), and threatened to block access to the Azteca Stadium and the World Cup's inaugural match on June 11. Sheinbaum refused to budge but also refused to use force to dislodge the protesters, effectively challenging them to embarrass a government ultimately sympathetic to their demands. At the last minute, the

CNTE leadership backed down, leaving behind a rump band of protesters who could be controlled by the police. Sheinbaum emerged victorious and the World Cup went forward without a serious hitch.

Sheinbaum's new Morena party leadership, meanwhile, overcame months of tensions with its two small party allies, the Labor and Green parties, to reestablish their coalition for the 2027 midterm elections. They agreed to form a united slate of candidates in every state except San Luis Potosí, where the Green Party demanded to field the current governor's wife as its candidate. Morena refused to support this position because Sheinbaum imposed an anti-nepotism rule for party candidates, but it did not allow this disagreement to block the broader alliance, which is essential to the government's effort to retain its two-thirds majority in the Chamber of Deputies.

Sheinbaum was also victorious relative to two party powerbrokers who hoped for a familial succession in Zacatecas and Guerrero states in violation of Morena's anti-nepotism statute. Ricardo Monreal bowed to the President's wishes earlier this year, preventing his brother Raúl from succeeding another brother as Governor of Zacatecas. In Guerrero, Félix Salgado insisted until the last minute on succeeding his daughter as governor but ultimately accepted the party's refusal to register him as a Morena pre-candidate.

Finally, the Mexican electoral authorities registered two new political parties for the 2027 election. The first, *Construyendo Sociedades de Pa*z, a.k.a. PAZ, is a socially conservative party led by a current Morena politician, Hugo Eric Flores. The second, *Somos México*, is a liberal, pro-democratic party led by a long-time politician and Morena opponent, Guadalupe Acosta Naranjo. Both benefit Sheinbaum. PAZ will be another small party ally of Morena and *Somos México* will compete for the anti-Morena vote, further dividing the opposition.

Monarch Analysis

These four events, within and beyond Sheinbaum's political coalition, point to a strengthening of presidential authority without sacrificing the party and coalition unity essential to governing Mexico and to winning the 2027 midterm elections. Although Sheinbaum's power over her party, her broader political movement, and the country will never match that of her predecessor, she is consolidating her political authority and governing capacity to an extent many doubted early in her presidency.

Energy: Regulation Moves Into Practice

June marked an important implementation phase for Mexico's energy sector. Several regulatory and market developments showed that the government's new policy framework is moving from design into execution, with private participation still present but increasingly tied to public planning priorities, CFE-centered structures, interconnection feasibility and tighter regulatory oversight. For companies active in generation, storage, natural gas, industrial supply or infrastructure, the operating environment is becoming more demanding. The transition of legacy self-supply and cogeneration arrangements, together with new transmission charge methodology, makes it necessary for industrial users, generators and investors to reassess contract exposure, delivered cost risk and asset economics.

At the same time, Mexico's new project pipeline is beginning to take shape through priority procedures for generation, storage and interconnection, as well as CFE's mixed investment projects. The reported 7.4 GW renewable portfolio signals continued space for private capital, but execution will depend on contracts, guarantees, PPAs, financing, permitting, interconnection and construction. Storage is also emerging as a strategic infrastructure category, while natural gas remains central to reliability, industrial competitiveness and energy security. Overall, the market is not closed, but it is more controlled. The opportunity is real, particularly in generation, storage, gas infrastructure, grid modernization and structured partnerships with CFE, but success will depend on regulatory alignment, timing, execution discipline and the ability to distinguish announced capacity from projects that can actually be delivered.

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The Monarch Global Strategies Team

Michael C. Camuñez
President & CEO
mcamunez@monarch-global.com
Los Angeles

Luis Ricardo Rodríguez
Managing Partner
lrodriguez@monarch-global.com
Monterrey

Geoffrey G. Jones
CFO & SVP Development
gjones@monarch-global.com
Washington, D.C.

Pamela K. Starr
Senior Advisor
pstarr@monarch-global.com
Los Angeles

Juan Pablo López Rojas
Senior Analyst
jplopez@monarch-global.com
Washington, D.C.

Pedro Niembro
Senior Advisor
pniembro@monarch-global.com
Mexico City

Juan Casillas
Senior Advisor
jcasillas@monarch-global.com
Mexico City

Gerardo de la Peña
Senior Advisor
gdelapena@monarch-global.com
Mexico City

Begoña Sánchez
Senior Director
bsanchez@monarch-global.com
Monterrey

Patricio M. Martínez
Senior Associate
pmartinez@monarch-global.com
Monterrey

Gabriel Cavazos
Senior Advisor
gcavazos@monarch-global.com
Monterrey / Mexico City