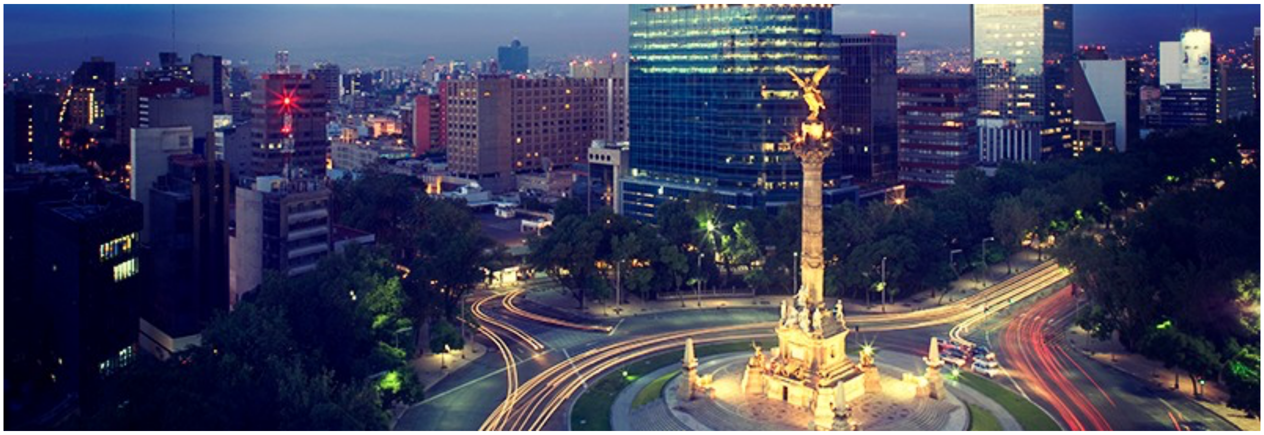

Monthly Report on Mexican Politics, the Economy, Energy, and U.S.-Mexico Relations

August 2026

Executive Summary

Trade talks and tariffs dominated headlines in July, including another productive round of bilateral USMCA review talks. The main takeaway, however, continues to be the low probability of a successful USMCA review during the remainder of the Trump administration. Not only are the parties far apart on the linchpin of the trade agreement—rules of origin in the auto sector—but we were reminded last month of the tie between U.S. satisfaction with Mexican security cooperation and its willingness to ink a trade pact. U.S.-Canadian tensions were again evident, this time in the U.S. decision to raise the pressure on Canada by announcing a 50% tariff on a list of its exports without exempting USMCA-compliant goods. And of course, there were the Section 301 tariffs on 60 economies for insufficiently policing the use of forced labor in their export supply chains—the latest demonstration of the centrality of unilateral tariffs in U.S. foreign policy under President Trump.

Security affairs continued to be a point of bilateral tension. Despite the successful bust of the largest fuel smuggling operation in Mexico thus far, harsh U.S. rhetoric persisted. This reflected Trump's pressure tactics, but it was also reinforced by the murders of ten businessmen and public officials in the state of Zacatecas at the hands of organized crime. Good news about investment, growth, and price stability in the Mexican economy included a record trade surplus in June. Unfortunately, this is unlikely to contribute to a successful USMCA review since eliminating the U.S. trade deficit with Mexico is one of President Trump's goals.

In Mexican domestic politics, a political scandal involving the governor of Baja California highlights the lack of unity in President Sheinbaum's political coalition. These splits are apt to become more visible in the coming weeks with the late summer selection of 17 gubernatorial candidates, threatening to weaken Sheinbaum's governing authority.

On the energy front, July was less about new policy announcements and more about execution. The Ministry of Energy (SENER) signaled that Mexico's priority is now strengthening transmission and distribution rather than adding generation capacity, while the first group of Mixed Investment projects moved past the award stage into commercial negotiations and project structuring, where maturity, permitting and financing capability will determine those that advance to construction. Federal officials continued to affirm a role for private investment aligned with national planning objectives and CFE's expansion strategy, even as Pemex's financial and operational pressures weighed on sovereign risk perceptions and investment sentiment.

USMCA Round Three Produced No Agreements

The third round of bilateral USMCA review talks took place in Mexico City during the week of July 20. The U.S. demands, which Mexican Economy Minister Marcelo Ebrard said have been reduced from 54 to a list of 14, continue to focus on stricter rules of origin to move manufacturing to the United States and close loopholes that allow Chinese inputs to enter North American supply chains.

For the first time in these talks, Mexico brought its own list of 13 concerns focused on six priorities: prevent the unilateral application of trade measures, resolve the tariffs on steel, preserve the Mexican auto industry's competitiveness, advance economic security frameworks, generate greater investor certainty, and address other pending bilateral issues.

In the talks, U.S. negotiators continued to insist on unilateral Mexican concessions to meet their demands. While both sides reported progress in this round, a key sticking point continues to be rules of origin, especially in the auto sector. Mexico has said it could accept high North American content, but only if there is no minimum U.S. content requirement and there are limits on the U.S. ability to alter USMCA tariff rates in the future.

Don't Expect a Successful USMCA Review Under Trump

On the eve of the round three talks, U.S. Trade Representative Jamieson Greer acknowledged in congressional testimony that there are bilateral sticking points but indicated there could be an "interim agreement" before the end of the year, while continuing talks on more contentious matters into next year. Ebrard implicitly built on the "interim agreement" idea, suggesting that round four, to be held in Washington, D.C., during the first week of September, could close several agreements.

If this were to happen, however, it would not indicate that a successful review that extends the USMCA for another 16 years is on the horizon. Quite to the contrary. As Greer noted, this would leave unresolved the most important issue, rules of origin for the auto sector, as well as contentious labor and environmental regulations. We thus continue to believe that the review process will remain unresolved through the remainder of the Trump presidency. Indeed, recent events have reinforced this position.

In his Congressional testimony, Greer also noted that the United States needed to have Mexican cooperation in all areas, including security and water, to get a USMCA deal. This is one of the clearest administration statements that security cooperation is a prerequisite to trade cooperation. But achieving full security cooperation is proving elusive for Mexico in part because the U.S. continually redefines what cooperation must include.

Nor is the situation likely to change if Trump loses control of the House of Representatives in the November midterm elections. In a July 17 statement, the members of the Democratic House Trade Working Group said they would push for stronger labor and environmental standards, tougher rules of origin, improved enforcement mechanisms, and protections against offshoring as the USMCA negotiations move forward.

Finally, Trump unilaterally imposed two new tariffs in July that again demonstrate his devotion to tariffs to achieve geostrategic goals as well as to alter trading behavior.

Mining U.S. Trade Law for New Tariff Tools

On July 23, USTR announced the imposition of a 10% or 12.5% tariff on 60 economies accounting for 99.4% of U.S. imports. The justification was a failure to prevent products produced with forced labor from entering their supply chains and thus their exports to the United States. In fact, the tariffs were designed to sustain the United States' revenue-generating tariff wall due to the imminent expiration of the 10% global U.S. tariff implemented last February under Section 122 of U.S. trade law. These new tariffs, applied under Section 301 of the trade code, are of indefinite duration and can be raised or eliminated at the discretion of the president.

They had no impact on Mexico, at least for now. The USTR finding exempted all USMCA-compliant exports, the 10% tariff on non-compliant exports is identical to the Section 122 tariff it replaced, and it left Section 232 tariffs on steel, aluminum, and autos unchanged. This new tariff, however, was stacked on top of a preexisting 301 tariff on Brazil. This suggests that future 301 tariffs could also stack for all countries, potentially increasing the tariff rate for non-USMCA-compliant Mexican exports to the United States. Currently, several 301 investigations are underway. The most advanced investigation covers 16 economies, including Mexico, and focuses on structural excess capacity in exporting countries' manufacturing sectors.

Also relevant to the USMCA review is Trump's July 20 issuance of three proclamations imposing 50% tariffs on a range of Canadian exports to offset the "disadvantage" that U.S. exporters suffer due to discrimination against U.S. auto, alcohol, and dairy exports. To do this, the Trump administration unearthed Section 338 of the 1930 tariff law, becoming the first president to use it. The law permits the president to unilaterally impose tariffs for an undetermined period. Significantly, the proclamations exempt goods already subject to Section 232 tariffs, but they do not exempt USMCA-compliant goods.

The tariffs do not go into effect until August 19, giving both sides time to negotiate. Tellingly, Prime Minister Mark Carney said Canada would not retaliate by imposing tariffs or quotas on raw material exports and expressed a willingness to talk. He also noted that the U.S. imposed similarly high tariffs on Canadian exports during the 2018 USMCA negotiation to force Canada into talks. Success, however, could be more difficult this time.

Canadian public opinion is much more strongly anti-Trump now than it was in 2018, limiting Carney's negotiating room. And on the other side, the Trump team seems more frustrated with Canada now than eight years ago. It is thus easy to see how this strategy could fail, with the tariffs going into effect and the two sides finding themselves further apart, continuing to delay the start of formal USMCA review talks between the United States and Canada.

Monarch Analysis

Despite seemingly productive USMCA review talks between the United States and Mexico, a successful review of the agreement remains highly unlikely. Not only are the United States and Mexico far apart on the central issue of auto sector rules of origin, but there is no indication that President Trump would be willing to have his tariff imposition authority constrained by a successful review. To the contrary, last month's decisions to reinforce the global U.S. tariff wall and to announce 50% tariffs against Canadian exports were reminders of the centrality of this tool in Trump administration foreign policy, one he is unlikely to surrender.

Nor are the Democrats proposing a significantly less demanding USMCA negotiating stance. And the tariffs on Canada are a reminder of the obstacles hindering the U.S.-Canada side of the USMCA review process. All told, tariff uncertainty is the most likely future scenario for North America.

Broader Bilateral Cooperation Still Punctuated by Conflict

Despite continued challenges in the USMCA talks, the United States agreed to allow Mexican sugar and cattle back into the U.S. market. The U.S. Embassy's celebration of the 250th anniversary of U.S. independence, meanwhile, attended by the Mexican foreign minister, military leaders, other government officials, and private sector leaders, showcased and symbolized bilateral cooperation. Yet, tension in the bilateral security dialogue persists.

In mid-July, the U.S. government declared two more Mexican organized crime groups to be foreign terrorist organizations. Five days later, the former head of the Sinaloa Cartel, Ismael "El Mayo" Zambada, was sentenced to life in U.S. prison. Following his sentencing, DEA head Terry Cole stated, "this is just the start" and that the U.S. was going after "every corrupt official" in Mexico.

White House Deputy Chief of Staff for Policy Stephen Miller then implied that Mexico was unable to cooperate with U.S. security demands when he argued that the control of Mexican territory by terrorist networks prevents Mexico's judicial, political, and legal systems from functioning. And on August 3, President Trump posted a Bill O'Reilly comment from March stating that "Mexico is not a friend to the United States" because its "socialist" president will not permit joint military operations against organized crime in Mexico. Events in Mexico seem to have fed this perception.

Organized Crime Sends a Message

On July 18, ten men—among them businessmen, a former mayor, and municipal officials from Fresnillo—were murdered in the state of Zacatecas, and five of their bodies were hung from an overpass. A faction of the Sinaloa Cartel claimed responsibility for this crime, sending the message that whoever breaks with Sinaloa will end up the same way. The government is working on the assumption that the murdered individuals either missed an extortion payment or were dealing with a rival cartel, either of their own volition or under pressure.

Monarch Analysis

The murders are a reminder of the enormous security challenge facing the Sheinbaum government despite its real success in lowering the murder rate. Their visibility in the U.S. media also likely reinforced U.S. government attitudes about Mexican security such as those expressed by Stephen Miller, further complicating bilateral security relations and thereby the USMCA review.

Mexican Domestic Politics: Arrests and Secret Recordings

Mexico's Federal Attorney General's Office arrested former Baja California governor Ernesto Ruffo as the presumed leader of the country's largest fuel smuggling ring uncovered thus far. Ruffo was Mexico's first opposition governor (1989–1995), representing the National Action Party (PAN), and is now an adviser to one of Mexico's newest political parties, *Somos México*.

Simultaneously, a political scandal involving the current governor of Baja California hit the headlines. Leaked secret recordings of Governor Marina del Pilar's conversations with supposed U.S. government intermediaries revealed her willingness to turn over confidential information in exchange for the return of her U.S. visa. The likely source of the recordings is her predecessor as governor and sworn political enemy, Jaime Bonilla, a fellow Fourth Transformation politician whose vows to destroy del Pilar are on the record.

Monarch Analysis

The Ruffo arrest and the unrelated bust of an illegal refinery in Tamaulipas state show the seriousness with which the Sheinbaum administration is dealing with a crime that has become one of the largest revenue sources for the cartels. At the same time, they raise questions about the impartiality of justice in Mexico. Government opponents note that while investigations into Morena politicians' purported ties to organized crime seem to have bogged down, this investigation into an opposition figure progressed much more efficiently.

The Baja California scandal threatens President Sheinbaum's ability to preserve the Fourth Transformation's legislative and gubernatorial dominance in next year's midterm elections, and the governing authority this generates, in three ways.

First, it appears hypocritical to accuse the opposition governor of Chihuahua of betraying Mexico for authorizing illegal joint security operations with the CIA while backing a Morena politician willing to provide confidential information to the U.S. government.

Second, this scandal indicates that many Morena politicians would be willing to sell out the movement to save their own skins just as the U.S. Drug Enforcement Administration is pressuring Mexican politicians to provide incriminating evidence against their colleagues. To the extent that this DEA strategy is successful, it will dramatically undermine trust and unity in the Fourth Transformation coalition and thus Sheinbaum's ability to govern the country.

Third, if the culprit behind these leaks is indeed Jaime Bonilla, it is further evidence of the challenge Sheinbaum faces in sustaining unity in the movement in advance of the 2027 midterm elections. Baja California is not the only state with this kind of internal division, making the late August/early September determination of the gubernatorial candidates a critical moment for the President and her governing authority.

Positive Economic News, but with a Caveat

Second-quarter growth in Mexico exceeded expectations, registering quarter-over-quarter growth of 1.5%—the highest since 2020—and year-over-year growth of 2.1%. At the same time, inflation in the first half of July registered just 3.1%, the lowest rate in six years and lower than the U.S. inflation rate. This was accompanied by announcements of two large investments: a US$649 million investment by Kia to build the electric EV3 model at its existing Nuevo León plant, and Talos' acquisition of a 50% stake in an oil field off the coast of Tabasco, deepening the presence of an experienced offshore producer in the country. Mexico also registered another record trade surplus in June, which likely reflects expansion of the trade surplus with Mexico's largest trading partner, the United States.

Monarch Analysis

While all this is good news for Mexican growth and price stability, the trade surplus is likely to reinforce tensions in the USMCA talks since a core U.S. demand is to cut its trade deficit with Mexico.

Energy: From Policy to Execution

July was less about new policy announcements and more about execution. The government's attention shifted toward implementing the electricity framework introduced earlier this year, providing greater visibility into where investment opportunities are likely to emerge over the coming months.

One of the clearest messages came from SENER, which emphasized that Mexico's immediate challenge is no longer a lack of generation capacity, but rather the need to strengthen the transmission and distribution network. As industrial demand continues to grow, driven by nearshoring and new investments, expanding the grid has become a national priority. Aside from CFE's own transmission infrastructure plans, this reinforces the strategic importance of private storage solutions and other technologies that could help improve system flexibility and reliability.

The first group of Mixed Investment projects also entered a new phase during the month. With the contract awards now behind them, developers and CFE have begun commercial negotiations, project structuring and execution planning. This marks an important transition for the market. Success will increasingly depend on project maturity, financing capability, permitting status and the ability to reach financial close, rather than simply securing a place in the government's selection process.

Early market feedback also suggests that not all awarded projects are equally positioned to advance. We understand that several are encountering challenges in meeting international financing standards, primarily because they lack a clear and bankable interconnection pathway or because the sponsors have strong EPC capabilities but limited experience as project developers and operators. As a result, some are expected to rely on domestic financing rather than international lenders, which could affect project timelines and execution.

At the policy level, federal officials continued to reiterate that private investment remains an important component of Mexico's electricity sector, provided that projects align with national planning objectives and CFE's expansion strategy. While this represents a different model from the liberalized market of previous years, it also provides greater clarity regarding the sector's future direction. For investors, understanding how projects fit within government priorities is becoming just as important as their technical and commercial fundamentals.

Outside the electricity sector, Pemex's structural challenges continued to weigh on the broader energy landscape. Ongoing financial support from the federal government, efforts to reduce supplier debt, and persistent operational pressures remain important variables for companies with exposure to hydrocarbons or public-sector counterparties. While these issues are largely separate from the government's electricity expansion plans, they continue to influence sovereign risk perceptions and investment sentiment.

Monarch Analysis

Overall, July reinforced that Mexico's energy sector has entered a new stage. The debate is no longer centered on regulatory reform, but on execution. The policy framework is largely in place, and the market is now being shaped by commercial negotiations, infrastructure development and project delivery. For investors and operators, competitive advantage will increasingly belong to those capable of developing technically mature, financially robust projects that align with the government's long-term planning objectives and can be executed successfully.

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