Mexico after the US elections

The Trump victory: Mexico absorbs the aftershocks

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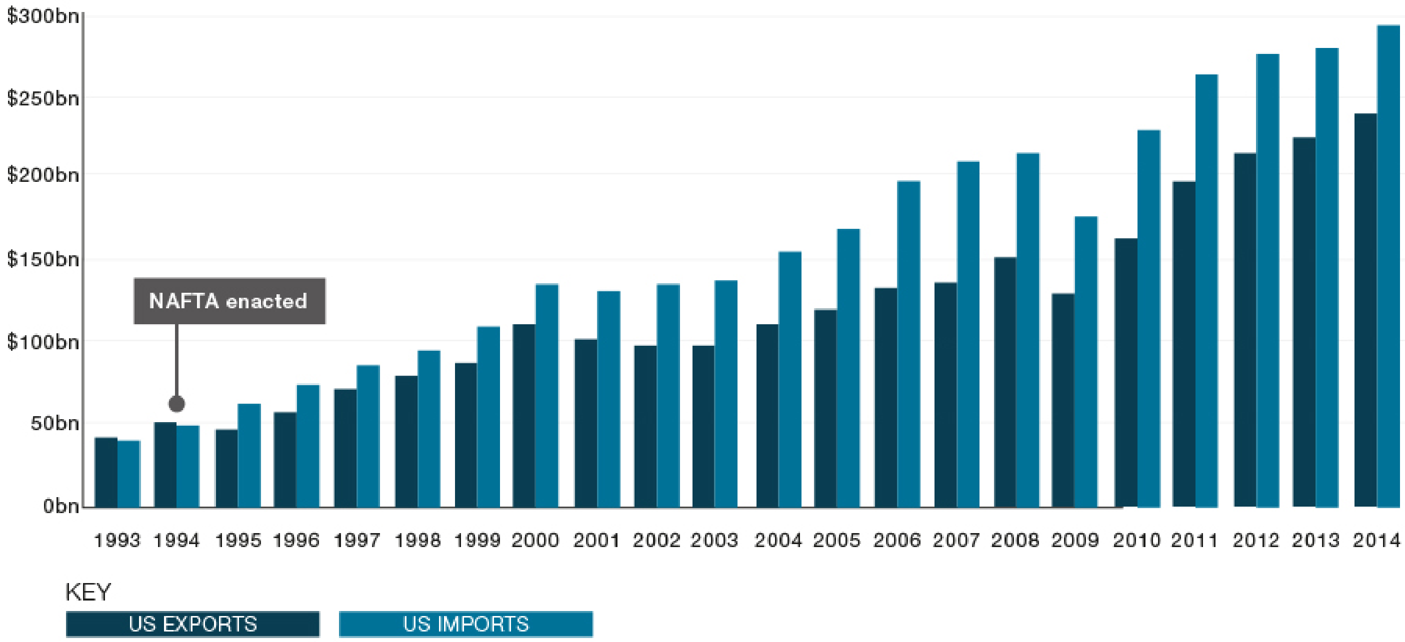
The repeated chants of ‘Build the wall! Build the wall!’ at US President Donald Trump’s rallies were a headline-grabbing feature of the presidential campaign. Never before in modern history did Mexico play such a prominent role in a US presidential campaign. As well as his proposals to build a border wall – and threats to make Mexico pay for it – Trump promised to deport 11m illegal migrants from the US, of which 5.7m were estimated to be Mexican. Trump also committed to renegotiate or even pull out of the North American Free Trade Agreement (NAFTA), which binds Mexico, the US and Canada, calling it ‘the worst free-trade agreement in history’. In addition, he threatened tariffs of up to 35% on goods manufactured in Mexico by US companies.

Trade fears

The combined effect of all this attention has been deeply unsettling for Mexico, but nothing comes close to the concern elicited by the threat to NAFTA. Mexican exports to the US have risen by almost 500% since the treaty took effect in 1994, to a total of USD 294bn in 2016. Almost 80% of Mexican exports head north of the border. North American economic integration has been at the heart of Mexico’s export-led development model for the past 22 years.

US-MEXICO TRADE ($BN), 1993-2014



Source: US Census Bureau, Foreign Trade Division

So it is not surprising that following the election the peso depreciated more than 15% and while the peso has regained territory in this respect and has almost recovered from its Election Day plunge, it remains vulnerable to Trump’s anti-trade and anti-immigration rhetoric. - Meanwhile, Mexican GDP growth for 2017 has been revised downwards three times by the International Monetary Fund (IMF) from 2.9% to 2.35% to 1.7%.

While the US administration has stopped speaking of a 35% tariff on all goods imported from Mexico, a more general tariff on imports from all countries is being debated as a part of a sweeping tax reform package. And other topics have been left out of the NAFTA agenda, such as agriculture, especially since US exports of agricultural products to Mexico have increased nearly fivefold since NAFTA was signed. This is why the new administration has indicated instead that it will merely seek concessions on key elements of the free trade accord in negotiations set to commence around this summer.

The US will likely focus on a few key areas. Among them are winning revisions to rules governing components manufactured outside the three-nation trade bloc and on reforming Chapter 10 of the agreement to limit Mexican and Canadian goods considered compliant with US ‘buy American’ laws. The US will additionally seek to restrict bidding for government contracts within NAFTA, and to streamline the treaty’s supra-national dispute resolution system. This last move would provide the US with greater leverage and the ability to resort to punitive tariffs. Similarly, it is likely to propose new requirements for labour and environmental standards in Mexico over issues which it deems to be ‘unfair competition.’Those issues include the country’s minimum wage in the manufacturing and agricultural sectors. Finally, the US will propose punitive tariffs in case Mexico does not follow the suggested standards.

That said, Trump's critics note that the US would face dangers from a ruptured NAFTA: Mexico is the second biggest consumer of US exports, and the most important market for California, Texas and Arizona. According to the US Chamber of Commerce, 6m jobs in the US depend on trade with Mexico. Additionally, Mexico has leverage to retaliate in any resulting trade war, especially concerning its tariffs on US products, which could be risen to its bound rates of 35%, while they currently average around 4%.

Rhetoric and reality

So the key question - for 2017 continues to be: will the new administration deliver on the rhetoric or will these continue to be toned down as the realities of mutual economic dependence sink in? As discussed, early signals indicate a willingness to moderate the scope of campaign commitments. Statements on deportations, for example, are now focusing mainly on convicted felons while the president has accepted that fences could be used instead of a wall along the border. Whatever the design of the complex physical barrier could be, this has also become an uncertainty since US budget talks got underway.

That said, the Trump administration will try to at least partly implement all the proposals relating to Mexico, given their centrality to the campaign and resonance with Trump's electorate. This could affect the business environment in Mexico in two main ways:

- **Trade**: US tariff rises and/or a protracted renegotiation of NAFTA will hamper investment plans. This is particularly the case in sectors such as manufacturing and automotive production, because they are largely focused on exports to the US market. In turn, any retaliatory trade measures by Mexico would increase the cost of imports needed for these industries to operate. A deceleration of economic growth would lower tax collection and lead to additional budget cuts that hamper reform efforts.

- **Security**: A disorderly influx of deportees could serve to bolster the ranks of organised criminal groups along the northern border. Tighter border security would disrupt routes for drug and human smuggling, leading to a spike in infighting among cartels. In a closely related matter, bilateral co-operation between intelligence and security agencies is likely to suffer under the new administration, reducing the significant progress achieved in this respect since the 2008 signing of the Merida Initiative, a bilateral security initiative through which the US provides financial and intelligence support.

Mexico's response

To confront this scenario, Mexico will try to accelerate the implementation of reforms to strengthen the domestic market. These measures will include telecoms and energy reform, as well as the special economic zones (SEZs) approved at the beginning of the year, which include tax incentives for investors in the ten poorest states (the first SEZ should start operations by the end of 2017).

Deterioration of the terms of trade with the US could finally unite the political class behind the reforms necessary to drive long-needed measures to improve the security environment to foster foreign investment. However, a worsening of relations with the US also threatens to unsettle Mexico's domestic politics. An economic downturn and a rise in anti-US sentiment would strengthen populist candidates in the 2018 presidential election. Watch closely left-wing candidate Andrés Manuel López Obrador, who was runner-up in the previous two elections and is staunchly opposed to energy reform. A surprise victory by López Obrador could see this reform threatened, further undermining Mexico's attractiveness to investors.

Publicly, the Mexican government has adopted an optimistic tone. Privately, it is hoping for the best while expecting the worst. Throughout 2017, Mexico will continue to do all in its power to manage relations with the new administration and avoid a major rupture. It should be noted that a renegotiation of the treaty is likely to take at least a year to finalise. In the meanwhile, Mexico will try to strengthen trade links with other countries, such as China, and countries in Europe and Latin America, in an effort to achieve a diversification of trade and investment flows away from US sources.

Image accreditation: Press Association - Protest against Donald Trump on his visit to Mexico City, Aug 2016.