
# NAFTA Renegotiation Quietly Underway

28 August 2017
By **Thomas Hughes**
Senior Editor of Global Investor Spotlight

It's not that President Trump doesn't like Mexico or Mexicans, it's that he doesn't like illegal border crossing and unfair trade practices. That being said sentiments expresses at a recent political rally, only a week into the NAFTA negotiations, might make you think otherwise. The President pledged to shut down the government if he couldn't get funding for his wall, and went on to say that he might just go ahead and pull the US out of NAFTA. He says we've taken advantage of too long, the deals in place too good for our counter-parties, the effect on the American worker too great.

Despite this public display of emotions the negotiations are underway and by all accounts have gotten off to an amicable start. If there is one thing that all three parties are aware of is that if NAFTA is scrapped it would disrupt the economies of all three nations, it is our mutual favor to complete the process as quickly as possible. Further, due to the amount of time that has elapsed since the deal was first penned a renegotiation will likely result in benefits for all.

• US/Canada/Mexico trade has rose more than 400% between the time it was implemented in 1994 and 2016.

The first of 7 rounds of talks began mid-August. The time line calls for the process to be completed by early next year. The US Trade Representative Robert Lighthizer, in statements to the press he made it clear that President Trump was looking for more than "a mere tweaking" of provisions, he wants a new deal fair for all sides and for the American worker in particular. The goal "We need to assure that the huge deficits do not continue, and we have balance and reciprocity... NAFTA has fundamentally failed many, many Americans and needs major improvement."

Areas of focus include how products are classified under NAFTA and the amount of non-NAFTA originated parts allowed in final construction. Also on the list are labor provisions, reforms targeted at preventing currency manipulation, third-party dumping and other trade distorting practices. The first round concluded with all sides agreeing to an "accelerated and comprehensive negotiation process" aimed at modernizing the deal.

Jaime Serra, a former trade minister who led the initial NAFTA negotiations for Mexico, had this to say in an interview earlier this summer. "If we integrate further and make Mexico more competitive versus China... even if our exports rise, U.S. jobs will rise, because when we

export (to the U.S.), they're exporting too (via U.S. Content),"

## Mexico By The Numbers

The Mexican economy has been churning out GDP growth in the range of 2.5% since the end of the Global Financial Crisis. According to World Bank and IMF estimates this is expected to continue into the coming years with expansion to near 3%. This is being driven externally by improving global economics and internally by reforms put in place by President Nieto. The combination has resulted in robust growth in Mexican manufacturing and its establishment as an export economy. The country has active trade agreements with Canada and the US but also with the EU, China and the major economies of South American which will help sustain it in the absence of successful NAFTA renegotiation.

In terms of revenue and earnings 2nd quarter growth was robust to say the least. Revenue and EBITDA grew by 12.0% and 12.6% respectively. The gains were driven by what managers at The Mexico Fund call "solid domestic consumption" and income derived from exports. Export income had the added boost of currency tailwinds as the peso gains against the dollar. Earnings growth is expected to moderate in the coming quarters but remain strong nonetheless in the high single to low double digits as global economies continue to improve.

Looking to Mexico's neighbors there is a direct correlation between strength in the US and strength in Mexico. The US economy is plodding along at a steady 2% with an expectation for expanding growth later in the year and next year. Two major indicators, the KC Fed's Labor Market Condition Index and the Index of Leading Indicators, confirm this outlook. The Labor Market Conditions Index, a diffusion index of 24 labor market indicators watched by the Federal Reserve, has been indicative of expanding and robust economic growth for nearly 2 years. This signal was triggered when it broke above 0 for the first since he Housing Bubble and Global Financial Crisis. The Index of Leading Indicators, a nearer term indication of growth, has been positive for more than a year and indicative of the same.

The Mexico Fund is a closed end fund focused on Mexico. It invests primarily in Mexican equities with a small allocation to fixed income. It targets Mexico's largest and best established businesses positioned to deliver capital gains and income on the side. The fund trades on the NYSE under the ticker symbol MXF and yields about 3% under the current Managed Distribution Plan. The fund has been lagging the broader Mexican market, the discount to NAV widening to -12% and near historic lows, offering an attractive entry for value minded investors.

*Disclaimer: The opinions in this article are for informational purposes only and should not be construed as a recommendation to buy or sell the stocks mentioned. Please do your own due diligence before making any investment decision.*