

## Final details of USMCA agreed on, paving the way for approval

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- **Today, authorities from Mexico, US, and Canada, announced changes to the USMCA trade agreement, oriented towards the ratification by the US Congress and the Canadian government**
- **In the US, these changes have the approval of the Democratic Leadership in the House of Representatives, the Trump administration, and one of the most important union organizations in the country (AFL-CIO)**
- **Relative to the original agreement, the main changes include:**
  - (1) **The creation of labor panels for the enforcement of new labor standards**
  - (2) **New measures to ensure compliance of environmental protections**
  - (3) **The elimination of the protection period that would apply in patents of biological drugs**
  - (4) **A higher requirement for regional content in steel, to be phased out by five years**
- **According to several reports, the approval by the House of Representatives could be as soon as next week**
- **Despite of the latter, the final approval by both the US and Canada will probably materialize until early 2020**
- **We believe this news is positive for the Mexican economy, as it could help reduce uncertainty, particularly in terms of the outlook for investment**
- **We reiterate our 2020 GDP forecast at 1.4% yoy, slightly above consensus around 1.1%**

**Agreement on the USMCA trade deal, after difficult negotiations.** Today, representatives from the governments of Mexico, the US and Canada announced modifications to the USMCA trade agreement in Mexico City. The dignitaries in charge of the signature were Jesús Seade (Mexican Deputy Foreign Relations Minister for North America), Robert Lighthizer (US Trade Representative) and Chrystia Freeland (Vice-Prime Minister of Canada). These changes are aimed to calm demands made by Democrats in the US, as well as special-interest groups in that country, paving the way for its approval. It should be noted that said party has the majority in the House of Representatives. Its leader, Nancy Pelosi has the power to introduce legislation for its approval, making her support a must for the process to continue. In this context, she led a press conference this morning confirming her backing. It should be noted that she was accompanied by some members of her party, including the Chair of the House Ways and Means Committee, Richard Neal, who was also the chief negotiator from the Democrats on this matter.

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**Important changes in labor standards.** The aim of these modifications is to ensure that that compliance of new labor standards outlined within the document are met. One proposed measure was to allow the direct oversight in our country from attaches of the US and Canada to ensure enforcement, which was ultimately rejected. In turn, arbitration panels will be set to solve labor disputes. In this context, President López-Obrador assured the labor reform, together with the strengthening of departments within the Ministry of Labor and the Judiciary branch –which will have additional resources to ensure compliance of the deal– were accepted by the negotiators. It should be noted that that this was one of the main hurdles for approval in the US, particularly given the opposition of the AFL-CIO. In this sense, the head of this organization of labor unions, Richard Trumka, voiced support for the new agreement.

**Elimination of the 10-year patent-protection period for biological drugs.** Another modification was the removal of the patent protection period for biological drugs. Previously, the agreement included a 10-year period for which patent protection is granted, starting from the date of commercialization of the product. This contrasted with the usual process for non-biological drugs, for which the three countries assign a 20-year period starting not from the commercialization date, but its registration. With the prevision removed, it is up to each local government to regulate the patent period for this type of drugs, in line with current standards.

**Increased supervision in environmental matters.** Similar to adjustments made in labor standards, authorities will have additional power to monitor and enforce laws in this matter. Further details have not been published yet, so we will be attentive in this front in coming days.

**Modifications to rules of origin in steel.** During the weekend, changes were also announced to increase the regional content for steel trade exempted from tariffs. In particular, the agreement states that 70% of the content should be produced in Mexico, the US and/or Canada, to be exempted from tariffs. This rule will be enforced with a 5-year lag from the day the agreement comes into effect. The original proposal from the US contemplated this modification to also apply to aluminum; nevertheless, Mexico rejected it. This is a very important subject for our country given the risk it could represent in terms of a loss in relative competitiveness in some key export sectors, such as autos.

**These changes need to be approved by the Mexican Senate.** It is important to remember that the original agreement –signed November 30<sup>th</sup> by former President Peña-Nieto, Trump, and Trudeau in Buenos Aires– had already been approved by the Senate on June 19<sup>th</sup>. However, these modifications need to be signed-off by legislators. In this regard, during the weekend meetings were held between the Ministry of Foreign Affairs, Economy and the Senate to review some of the possible changes. Morena’s leader, Ricardo Monreal, affirmed that an amendment protocol would be enacted, where changes will have to be agreed upon by commissions and the whole Senate. It should be noted that only new changes will be discussed, with the rest of the accord left unchanged. Considering the latter, we expect it to be ratified relatively fast in Mexico, with the goal of minimizing uncertainty in the local front.

**The approval in the US will likely take place until early 2020.** The legislative process in the US still has to go through additional steps. Firstly, on April 18<sup>th</sup>, the USITC published its report on the possible economic impact of the agreement, which it regarded as positive. Having already fulfilled this requirement, the implementation law has to be delivered to the House of Representatives within the first 30 days of the presentation of the bill, which is where we stand currently. From here, the House Ways and Means Committee has up to 45 sessions to vote on the agreement, after which 15 sessions can pass for a full vote by the House. The initiative would then go to the Senate, where the Finance Committee has 15 sessions to discuss and vote, passing to the Senate floor for another 15 sessions. It is important to mention that these limits represent the maximum time frame allowed under the *Trade Promotion Authority* (TPA) Nevertheless, the process could be faster, with the possibility of waiving some of these requirements. In addition, they only require a simple majority to be approved in all of these instances.

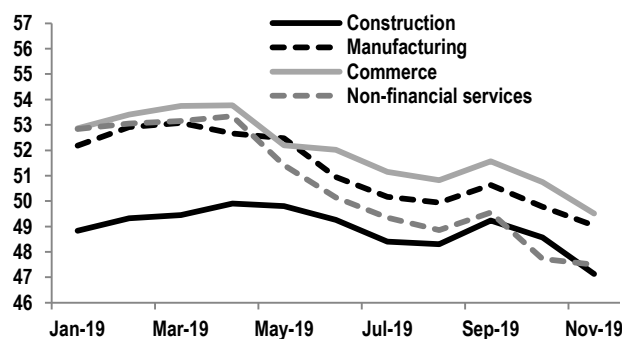
In this context, the House's legislative calendar was modified to include additional sessions, from December 17-20. We believe that the approval by this chamber will be targeted for next week, even though the calendar is packed given that they need to deal with the impeachment process and a potential government shutdown, which could materialize on December 21<sup>st</sup>, among other issues. In the Senate, the calendar publicly available so far points that the last session of the year will take place on December 12<sup>th</sup>, resuming on January 7<sup>th</sup>. Nevertheless, we do not rule out the possibility of an extension in order to deal with this matter.

Given the previously outlined time-frame, we consider that approval in the US before year-end will be very complicated. In this sense, the Republican Majority Leader, Mitch McConnell, stated that the bill will not be contemplated this year, and it will be taken until impeachment proceedings are over. Despite of these comments, the agreements struck between different participants, including legislators, the Trump administration, and workers, leave us relatively optimistic that the process will be speed up with the aim to achieve a more expedited ratification.

**In Canada's case, everything points to an easier process.** President Trump and Prime Minister Trudeau held a phone call on this matter, although details were scarce. It should be noted that the Canadian government had already introduced an implementation bill, which wasn't approved before the October 21<sup>st</sup> election. Therefore, it must be introduced again in the new Parliament, which started in early December. The administration has mentioned repeatedly that they were waiting for the US to advance in order to approve it in their own country. Given the need to bolster business confidence, we believe that the process will be easier despite Trudeau's government losing its legislative majority in the recent election.

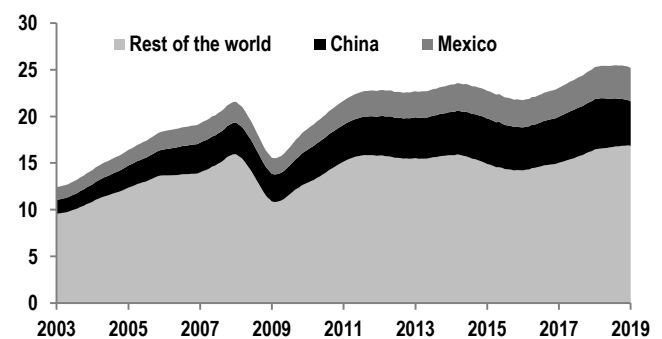
**Positive news for the Mexican economy.** In our opinion, the new agreement will likely be positive and will help diminish the high degree of uncertainty that the Mexican economy is facing, particularly regarding the outlook for investment. In this sense, it will be very important to monitor a potential rebound in business confidence after today’s news, which we believe is a necessary condition to observe an improvement in this component of aggregate demand. Nevertheless, confidence levels are still low in all sectors (see graph below on the left). On top of the latter, we must add the recent announcement to boost private sector investments, which could also have a favorable impact in 2020. For details see: “*The government announced the first phase of its Infrastructure Program*”, <[pdf](#)>, November 26<sup>th</sup>, 2019. In this context, we reiterate our GDP forecast for 2020 at 1.4% yoy, slightly above consensus (1.1% given the latest Banxico survey). More specifically, we also expect an improvement in investment, to 0.3% yoy from -4.6% this year.

**Business confidence**  
Index



Source: INEGI

**US imports by country of origin**  
US\$bn



Source: US Census

Globally, the backdrop remains challenging in terms of trade tensions. The US and China have not reached an agreement, with negotiations still complicated due to other geopolitical factors between them. Press reports suggest the US government will delay the imposition of additional tariffs scheduled for December 15<sup>th</sup>, which suggests that negotiations are advancing. These have had a negative impact in global growth prospects, particularly in manufacturing, which is key for Mexico’s economy as it is highly exposed to international trade. Nevertheless and on a more positive note, so far they seem to also have had a favorable impact for Mexico in terms of its market share in US imports. From year-end 2016, when the Trump administration was about to begin, and until October 2019, Mexico’s market share has risen from 20.5% to 21.1% (+0.7%-pts). On the contrary, the same metric for China has declined from 32.3% a 28.2% (-4.2%-pts), as shown in the chart above on the right.

Lastly, the ratification of USMCA does not imply that the risk of new threats by Trump’s administration has been discarded. Considering next year’s presidential election in the US, these could materialize for electoral purposes, which could result in higher volatility and renewed uncertainty for the Mexican economy.

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