SPECIAL REPORT

When a draw is considered a victory

State visit and new round in the Brazil-Mexico trade agenda

São Paulo-México, May 2015

d+i developing ideas
LLORENTE & CUENCA

1. INTRODUCTION
2. RECIPROCAL PRESENCE IN EACH MARKET
3. BRAZILIAN PERCEPTION AND THE EXTENSION OF AGREEMENTS
4. A QUESTION OF INTERNATIONAL REPUTATION
5. A LITTLE ABOUT THE SECTORS OF INTEREST FOR BOTH COUNTRIES: MOTOR VEHICLES, TOURISM, ENERGY.

AUTHORS

1. INTRODUCTION

"What does Brazil consider it important to place on the Mexican market and what does Mexico consider it important to place on the Brazilian market?" The question might sound too direct for diplomatic protocol, which generally tends more towards “reading between the lines", when what is left unsaid often reveals more than what is actually uttered. However, the question asked by the Mexican Minister of Economy, Ildefonso Guajardo, during the Latin American World Economic Forum (WEF) at the beginning of May, conveys the realistic tone of the negotiations included in the State visit of Brazil’s president, Dilma Rousseff, to Mexico.

The ultimate purpose of realism in the theory of international relations is survival. It is rather indicative that the president, publicly opposed to foreign policy issues, dedicated last week to an agenda which included receiving the leaders of China and Uruguay and travelling to the United States for a meeting with Barack Obama at the end of June. With inflation forecast at 8.9% in 2015, according to the Brazilian Institute of Economy of the Getúlio Vargas Foundation (Ibre/FGV); the 1% drop in GDP announced by the International Monetary Fund (IMF); the positive balance of trade and the influx of direct foreign investment, estimated at over USD 11.2 and R$ 58.5 billion, respectively, by the Central Bank, they are the only issues in which she can take refuge.

It should be remembered that Brazil is nowadays Mexico’s main trading partner in Latin America and eighth worldwide, with a flow of goods of over USD 9 billion in 2014, and is the fifth destination of Mexican exports in the world and first in Latin America and the Caribbean. In 2013, according to figures published by the Secretary of State for Economy (SE) in Mexico, trade between Mexico and Brazil totalled USD 9,807 million, falling from the USD 10,152 recorded in 2012.

"Brazil offers a very interesting market for Mexican firms"

2. RECIPROCAL PRESENCE IN EACH MARKET

From the Brazilian standpoint, Mexico is currently the fourth largest investor in the country, after the European Union, United States and Japan. Although the average person in Brazil might not be aware of it, companies such as Claro and Embratel (telephone operators in the América Móvil group), Mabe (owner of the household appliance brands Bosch, Dako, Continental and GE), Femsa, (the bottler of Coca-Cola in the country) and Bimbo (which produces the Pullman and Plus Vita bread and the Ana Maria 'tortas'), bring Mexico into everyday private life. These, together with other companies such as Amanco and Cinépolis, among countless others, have been responsible for direct investments of over USD 23 billion (R$ 71 billion) in recent years.

Moreover, although comparatively small – USD 2 billion (R$ 6.2 billion) – direct investments by Brazil in Mexico are rising, with the building of a petrochemical complex in the State of Veracruz, an association between the Brazilian Braskem and the Mexican Idesa and an iron and steel complex in Hidalgo, by Gerdau, totalling USD 5.6 billion (R$ 17 billion). Other Brazilian companies of different sizes, such as the bus manufacturers Marcopolo, the IT solutions provider Stefanini, the franchise group Resolve and the Belgian-Brazilian drinks company AB InBev, have already consolidated operations in the country.

3. BRAZILIAN PERCEPTION AND THE EXTENSION OF AGREEMENTS

A survey carried out by the National Confederation of Industry (CNI) of Brazil on 43 associations representing the industrial, agricultural and services sectors revealed that 87% of these companies believe that an extension of the trade agreement with Mexico is necessary. Mexico was mentioned by 61% of those participating in the survey and was considered third among the countries/blocks that should be given priority on the agenda of Brazil's trade negotiations. Even so, 48% of them complained about the trade barriers, while 35% reported loss of market for rivals with which Mexico has agreements and 19% claimed that they were affected by sanitary or phytosanitary barriers both in export procedures and in the exports of finished goods and/or inputs.

Some of the policies adopted by the Brazilian government were, nevertheless, more conducive to international trade and despite continuing trade barriers Brazil offers a very interesting market for Mexican firms. Current rivalry focuses largely on the fact that both nations have projected an appearance of economic growth that would be interesting for any international player and certain sectors of the economy; but the poor political performance and the explosion

"Mexico fares no better in its endeavours to portray a growing economy"

of recurring social problems in both nations, deriving mainly from the corruption and inequality that are wreaking havoc in both countries, have seriously damaged their international reputations.

The last three Brazilian governments, including the existing government, have done a wonderful job of promoting their economies, highlighting it within the BRIC countries as one of the nations that would lead the world economy in 2015. Yet the country is currently hounded by economic slowdown and falling prices of key exporting commodities and in 2014 it recorded its first trade deficit in 14 years of almost USD 4 billion.

In this scenario, the preference for Mexico becomes even more attractive now, when it is in a much more favourable economic position than many Latin American countries that have teamed up with China as a trade partner, as in the case of Brazil. With regard to the two main items on the agenda of Brazilian exports to China, the price of iron ore has a cumulative loss of 17% (below USD 60 / tonne) and soy prices are at their lowest level since 2010 (down 36% over the past twelve months).

In contrast with the world trend of falling commodity prices, Mexico has benefited from the upswing in the United States, its principal trading partner and investor, and emerges as a major buyer of manufactured products from Brazil. At present, 86% of the trade between the two countries consists of products of this nature, half of them from the motor vehicle and parts industry. The IMF estimates that Mexico will grow by 3% this year. The pace is slower than that recorded at the turn of the decade but puts it ahead of Brazil (-1%), Argentina (-0.3%) and Venezuela (-7%), which are suffering the consequences of the economic slowdown in China.

4. A QUESTION OF INTERNATIONAL REPUTATION

On another note, while the 2014 World Cup unveiled some of the inadequacies of the infrastructure, communications and even security, along with the social unrest existing in Brazil, Mexico fares no better in its endeavours to portray a growing economy. As soon as he got into power, Enrique Peña Nieto set the ball rolling for new constitutional reforms designed to attract foreign investment, especially in the energy sector. But it all went to pot when 43 students went missing in the state of Guerrero and major cases of corruption came to light that involved the president, unleashing a chain of events that entirely ruined the government's reputation.

Considering the similarities of the two nations, the existing governments need to take action to improve social conditions, which will help

"Dilma's visit to Mexico is very important for both nations"

them recoup their international reputation. The challenge of signing the new bilateral trade agreement will depend largely on the private investment opportunities presented. Therefore, apart from the meetings between Peña Nieto and Dilma, good opportunities may arise in the parallel agenda of meetings between entrepreneurs and ministers of both countries. Among others, internal pressure may be exerted in both countries for the abolition of barriers –trade or sanitary, some established more to uphold the principle of international reciprocity than to protect markets– and fostering of deregulation.

Among the Brazilian associations interviewed by the CNI, 73% believed their sector benefited from some kind of agreement with Mexico. However, 88% considered it unsatisfactory. "We need new agreements to open Brazil to new markets and discover new opportunities. Although we are not as competitive as China, we are confident that we can sell different products, but we need the facilities that other countries have with Mexico", the Director of Industrial Development of the CNI, Carlos Abijaodi, explained to the Brazilian daily newspaper Valor Econômico.

Current exchanges are mainly made in car parts, mobile telephony and motor vehicles and the bilateral balance of trade has been favourable for Mexico in the past three years (around USD 2,458 million between 2011 and 2013), although from 1997 to 2010 the balance had always fallen on the Brazil side.

Thanks to Mexico's geographical location and its relationship with North America, along with the opening-up of trade presenting attractive tax incentive and a competitive labour force, Brazilian companies in the different industrial sectors (e.g. Food, Aerospace, Health and Energy) may find an important investment opportunity. In the case of Mexico, the motor industry is not the only sector that benefits from a more open relationship with Brazil, if we recall the companies mentioned earlier with considerable economic power, which have a strong presence in the country and invest in a market of almost 200 million people.

Dilma's visit to Mexico is very important for both nations and it is hoped that a new agreement will be reached to define the rules of the game for the coming years, establishing a better trade relationship that will foster improved economic development in both countries. Progress may also be anticipated in the negotiations for a free trade treaty between the two countries, but with patience and without haste. Any agreement in this regard would have to be approved by Brazil's partners in MERCOSUR (Argentina, Paraguay, Uruguay and

"The Mexican Motor Industry Association (AMIA) expects a new record production"

Venezuela), and although the block has already undertaken to negotiate a broad trade agreement with Mexico in the future, the current changes and/or political instability in some of these countries will doubtless slow down any possible development in this area.

A LITTLE ABOUT THE SECTORS OF INTEREST FOR BOTH COUNTRIES:

MOTOR VEHICLES

The most important trade factor in the relations between Mexico and Brazil is the motor industry. According to ProMexico, 52% of the total Mexican exports to Brazil and 23% of Brazilian exports to Mexico correspond to the motor industry. In 2012, the two countries signed additional protocols to the Economic Complementation Agreement within Mercosur, setting import quotas for light vehicles up to that year.

The original treaty set an annual limit of around USD 1.5 billion, subsequently allowing free trade in vehicles upon its expiry on 19 March 2015. Owing to the low productivity of the Brazilian motor industry, a slump in exports and redundancies affecting almost 9% of its labour force, Mexico has positioned itself as the largest car manufacturer in Latin America.

The Mexican motor industry is booming: in 2014 production rose by almost 10% to a record level of 3.22 million vehicles, while exports rose 9.1% to an all-time high at 2.64 million units. The Mexican Motor Industry Association (AMIA) expects a new record production of 3.5 million units in 2015, 82% of which will be for external markets.

In view of the crisis in the Brazilian motor sector, Dilma's government pressurised for an extension of the quota system and the two countries agreed to renew the motor trade agreement between them up to 2019, avoiding free trade for the time being. The quota for light vehicle exports was maintained at USD 1.56 billion for the first year, growing 3% each year up to expiry of the agreement in 2019. A 35% duty will be levied on exports above this threshold.

TOURISM

The elimination of visas between the two countries has generated an increase in the flow of Brazilian tourists visiting Mexico. Just in 2014 over 300,000 Brazilians visited Mexico, 16% more than in 2013. There are 71 direct flights a year between Mexico City and Sao Paulo, so Brazil has become the sixth market of international tourists in Mexico.

Some Brazilian companies in the sector, such as the airline TAM –which already operated direct flights to Mexico City and started offering flights also from São Paulo to Cancun–, saw investment opportunities, but more for the flow leaving

"President Dilma Rousseff presented the energy sector as a point of interest for Brazil"

Brazil than on the Mexican side. Within Brazil, Mexico is still the 16th source of tourism. There were around 70,000 Mexican tourists in 2014, which is considered stable in respect of 2013, including the flow generated by the World Cup. The challenge on the agenda for the meeting held in Brasilia in early May between the Brazilian minister of tourism, Henrique Alves, and his Mexican counterpart, Claudia Ruiz Massieu Salinas, was to promote a greater balance between the two countries, attracting more Mexican tourists to Brazil.

ENERGY

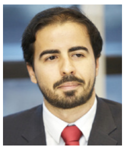
President Dilma Rousseff presented the energy sector as a point of interest for Brazil. "I think our countries are in a position to reach agreements based on the complementary relationship of the chain of production, producing part here and part there. This can be done in the shipping industry and the gas and oil grids, where Mexico has Pemex and Brazil Petrobras, both companies with similar regulatory models", the president said during an interview published by the Mexican newspaper La Jornada.

The recent opening of the Mexican oil sector to national and foreign private initiative provides an opportunity for Petrobras. At a time when the company (with a mixed economy but predominantly controlled by the state) needs to generate cash to pay for the internal investments required to extract oil from the pre-salt layer, offering its shipyards and technology services to enable Pemex to operate in ultra-deep waters is a clear alternative. For a network of suppliers formerly dedicated almost exclusively to serving the Brazilian company but whose contracts were suspended following a recent review of the Petrobras contracting policy, in the wake of investigations of suspicious activity and a move to refocus investments, operating on the Mexican market could provide a solution to their own crisis.

Authors

Guillermo Máynez Senior Manager for Public Affairs in LLORENTE & CUENCA Mexico. Graduated in International Relations from Universidad Iberoamericana (IBERO), with a Master in International Studies from the Johns Hopkins University. He worked for the Federal government of Mexico in political negotiation with social actors such as the Central American Refugees (SEGOB), subversive groups such as EZLN (SEGOB), foreign correspondents and diplomats (PRI), trade unions and agricultural workers organisations (SEDESOL) and the Congress of the Union (IPAB). In private initiative, he has been Government Relations consultant (STRUCTURA), and subsequently Institutional Relations Manager in the Lala Group and executive chairman of the Mexican Meat Industry Council. Since 2004 he has been giving courses on information analysis at the Army and Air Force Study Centre and he is a member of the Mexican International Affairs Council (COMEXI).

gmaynez@llorenteycuenca.com



Thyago Mathias Account Manager of LLORENTE & CUENCA in São Paulo. He graduated in Journalism from the Pontifical Catholic University in Rio de Janeiro and in Law from the Federal University of Rio de Janeiro. He has 10 years' experience in the major media enterprises in Brazil, such as UOL and TV Globo, for which he was correspondent in the Middle East (G1 portal). Specialising in International Relations and with an MBA in Project Management from the Getúlio Vargas Foundation, Thyago has provided counselling for different public and private institutions on communication and reputation strategies and assessment.

tmathias@llorenteycuenca.com

LLORENTE & CUENCA

CORPORATE MANAGEMENT

José Antonio Llorente
Founding Partner & Chairman
jallorente@llorenteycuenca.com

Enrique González
Partner & CFO
egonzalez@llorenteycuenca.com

Jorge Cachinero
Corporate Manager Innovation
jcachinero@llorenteycuenca.com

MANAGEMENT SPAIN AND PORTUGAL

Arturo Pinedo
Partner & Managing Director
apinedo@llorenteycuenca.com

Adolfo Corujo
Partner & Managing Director
acorujo@llorenteycuenca.com

MANAGEMENT LATIN AMERICA

Alejandro Romero
Partner & CEO Latin America
aromero@llorenteycuenca.com

Luisa García
Partner & CEO Andean Region
lgarcia@llorenteycuenca.com

José Luis Di Girolamo
Partner & CFO Latin America
jldgirolamo@llorenteycuenca.com

HR MANAGEMENT

Antonio Lois
HR Manager for Latin America
alois@llorenteycuenca.com

Daniel Moreno
HR Manager for Spain and Portugal
dmoreno@llorenteycuenca.com

SPAIN AND PORTUGAL

Barcelona

María Cura
Partner & Managing Director
mcura@llorenteycuenca.com

Muntaner, 240-242, 1º-1ª
08021 Barcelona (Spain)
Tel. +34 93 217 22 17

Madrid

Joan Navarro
Partner & Vice President Public Affairs
jnavarro@llorenteycuenca.com

Amalio Moratalla
Partner & Senior Manager
amoratalla@llorenteycuenca.com

Lagasca, 88 - planta 3
28001 Madrid (Spain)
Tel. +34 91 563 77 22

Lisbon

Madalena Martins
Partner
mmartins@llorenteycuenca.com

Tiago Vidal
Managing Director
tvidal@llorenteycuenca.com

Carlos Ruiz
Director
cruiz@llorenteycuenca.com

Avenida da Liberdade nº225, 5º Esq.
1250-142 Lisbon
Tel: + 351 21 923 97 00

MEXICO, CENTRAL AMERICA & THE CARIBBEAN

Mexico City

Juan Rivera
Partner & Managing Director
jrivera@llorenteycuenca.com

Av. Paseo de la Reforma 412, Piso 14,
Col. Juárez, Del. Cuauhtémoc
CP 06600, Mexico, D.F.
(Mexico)
Tel: +52 55 5257 1084

Panama

Javier Rosado
Partner & Managing Director
jrosado@llorenteycuenca.com

Av. Samuel Lewis.
Edificio Omega - piso 6
Panama
Tel. +507 206 5200

Santo Domingo

Alejandra Pellerano
Managing Director
apellerano@llorenteycuenca.com

Av. Abraham Lincoln 1069
Torre Ejecutiva Sonora, planta 7
Santo Domingo
(Dominican Republic)
Tel. +1 809 6161975

ANDEAN REGION

Bogota

María Esteve
Managing Director
mesteve@llorenteycuenca.com

Carrera 14, # 94-44. Torre B – of. 501
Bogota (Colombia)
Tel: +57 1 7438000

Lima

Cayetana Aljovín
General Manager
caljovin@llorenteycuenca.com

Av. Andrés Reyes 420, piso 7
San Isidro. Lima (Peru)
Tel: +51 1 2229491

Quito

María Isabel Cevallos
Director
micevallos@llorenteycuenca.com

Avda. 12 de Octubre N24-528 y
Cordero – Edificio World Trade
Center – Torre B - piso 11
Quito (Ecuador)
Tel. +593 2 2565820

SOUTH AMERICA

Buenos Aires

Pablo Abiad
Partner & Managing Director
pabiad@llorenteycuenca.com

Enrique Morad
President-Director for Southern Cone
emorad@llorenteycuenca.com

Av. Corrientes 222, piso 8. C1043AAP
Ciudad de Buenos Aires
(Argentina)
Tel: +54 11 5556 0700

Rio de Janeiro

Yeray Carretero
Director
ycarretero@llorenteycuenca.com

Rua da Assembleia, 10 - Sala 1801
Rio de Janeiro - RJ - 20011-000
(Brazil)
Tel. +55 21 3797 6400

São Paulo

Juan Carlos Gozzer
Managing Director
jcgozzer@llorenteycuenca.com

Rua Oscar Freire, 379, Cj 111,
Cerqueira César
São Paulo - SP - 01426-001
(Brazil)
Tel. +55 11 3060 3390

Santiago de Chile

Claudio Ramírez
Partner & General Manager
cramirez@llorenteycuenca.com

Magdalena 140, Oficina 1801.
Las Condes.
Santiago de Chile (Chile)
Tel. +56 22 207 32 00

d+i developing ideas
LLORENTE & CUENCA

Developing Ideas is the Thought Leadership Unit of LLORENTE & CUENCA.

Because we live in a new macroeconomic and social context and communication moves forward.

Developing Ideas is a global combination of partnership and knowledge exchange, identifying, focusing and communicating new information paradigms, from an independent perspective.

Because reality is neither black nor white,
Developing Ideas exists.

www.desarrollando-ideas.com
www.revista-uno.com

amo

AMO is the leading global network of strategic and financial communications consultancies, with over 940 professional consultants and offices in more than 20 countries.

The network brings together local market leaders with unrivalled knowledge of financial markets and cross-border transactions in the key financial centers of Europe, Asia and the Americas.

Providing sophisticated communications counsel for M&A and capital market transactions, media relations, investor relations and corporate crises, our member firms have established relationships with many S&P 500, FTSE 100, DAX 30, SMI, CAC 40 and IBEX 35 companies.

www.amo-global.com