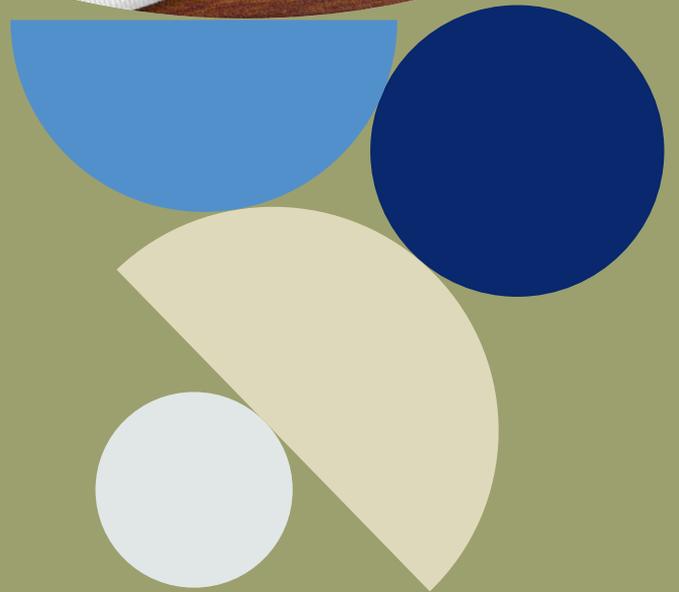




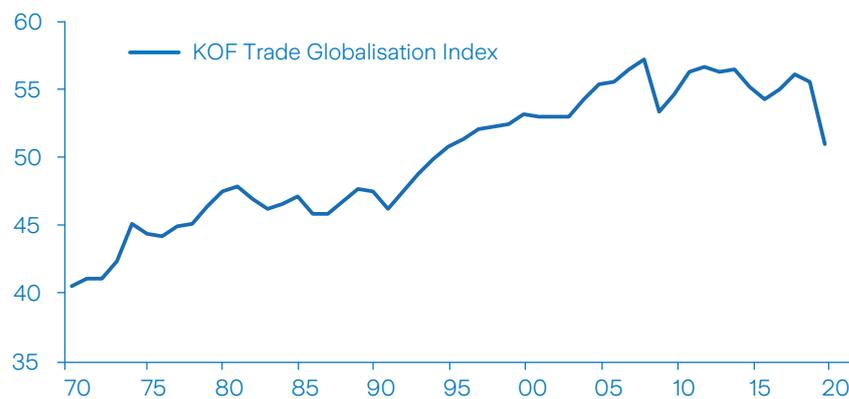
A golden opportunity for Mexico



The pace of globalisation has stalled in recent years and the pandemic revealed weaknesses and vulnerabilities in concentrated supply chains. Rising geopolitical tensions, trade wars and increases in tariffs are all challenging international trade flows and require companies to build more resilience into their business models.

Companies are looking for the best locations for manufacturing activities, especially when considering proximity to the end market. In the coming years, countries with low production costs, global trade linkages, and locations close to the most important economies (the United States, China, and the Eurozone) will likely benefit the most from the new trade environment where new suppliers are sought and nearshoring gains traction. Mexico is an open economy that has increased and strengthened its trade links with the US and is one of the countries best positioned to benefit from nearshoring considering its proximity and relationship with the US as well as its low labour costs in the manufacturing sector.

Globalisation is being rethought



Source: KOF Swiss Economic Institute



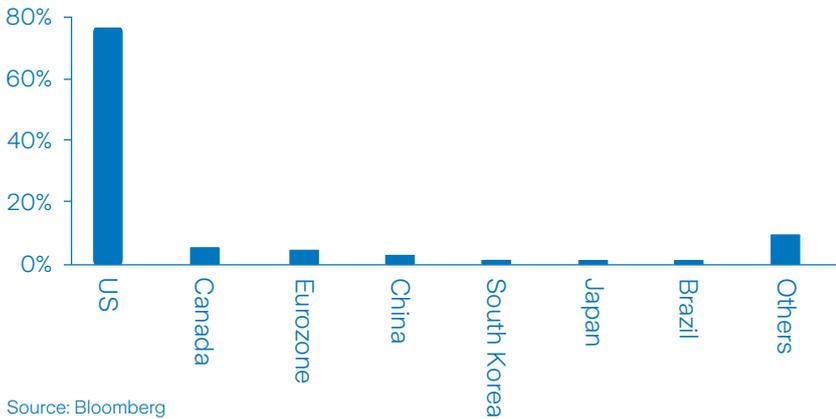
Front cover image
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What is nearshoring and how can Mexico benefit from it?

Nearshoring is the practice of moving factories from one country to another to benefit from its proximity to the final market and reduce economic and operational costs. It typically has a positive impact on local economic activity and financial markets by boosting the export sector of the production country, which has better access to larger trade volumes than its competitors.

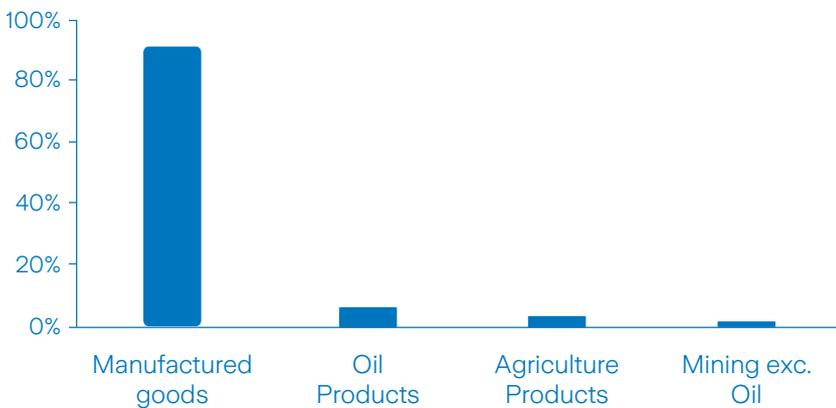
Mexico's strategic location creates significant nearshoring opportunities and benefits. Furthermore, the more than 3,000 kilometres of border with the US, which is also its main trade partner, provide an advantage to Mexico and is now more relevant considering the current trade tensions between the US and China. While the benefits are not yet clearly reflected in current economic activity, they are beginning to be more tangible and have already been incorporated in the analysis of the medium-term outlook for Mexico. Although it is complex to measure ex-ante, the direct effect of nearshoring will include higher fixed investment, increased economic activity, and an improved trade balance.

Mexican exports by country

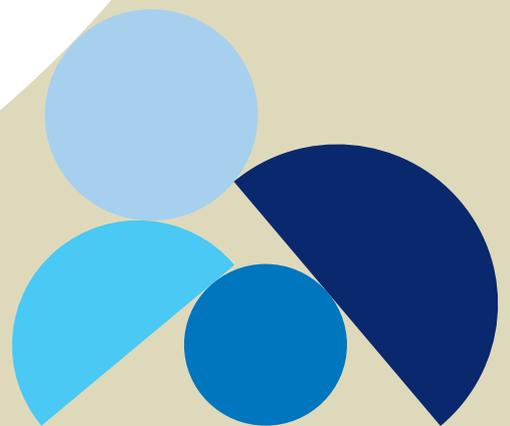


Source: Bloomberg

Mexican exports by sector



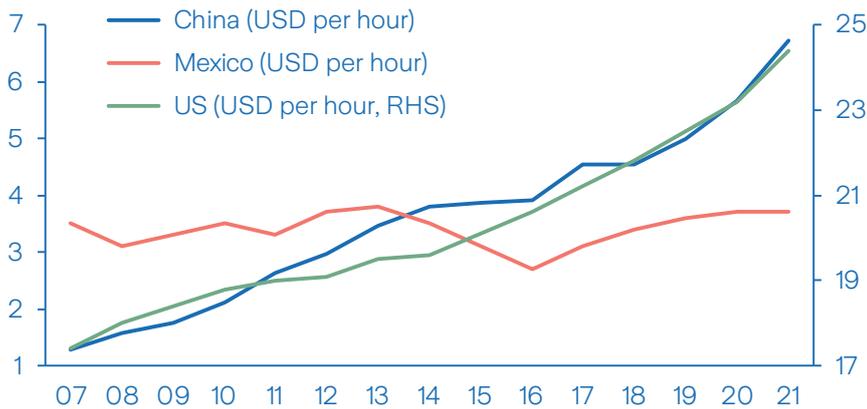
Source: Bloomberg



The manufacturing sector will be the one that benefits the most from nearshoring as manufacturing exports account for more than 85% of Mexico's total exports, and the US is Mexico's most important trade partner, accounting for ~75% of its exports. The US is also the world's leading importer of manufactured goods, while China is the world's leading exporter of manufactured goods. Considering that a large part of Mexico's manufacturing exports, mainly auto and electronics, compete directly with China, the trade war between the US and China has already provided Mexico with the possibility to improve its external sector. In fact, in 2022, Mexican exports gained ground over Chinese ones in some specific products.

When comparing the average wages per hour of the manufacturing sector, Mexico shows an increasing advantage over China. In recent years, wages in China have increased seven fold, while in Mexico they have remained stable. Currently, wages per hour in Mexico are almost half of those in China, an additional incentive to move factories to Mexico.

Manufacturing wages per hour



Source: Bloomberg, National Institutes of Statistics.

Nearshoring in Mexico will also have a positive impact on fixed investment. Foreign companies have already announced plans to invest and install part of their supply chain in Mexico, which will likely boost economic activity in the medium term, increasing trend growth. An example is Tesla's decision to build a new auto plant near the US border in Monterrey. According to Bloomberg, this investment will likely reach USD 10bn, while the government estimates it will add 6'000 new jobs. In 2022, foreign direct investment in Mexico reached USD 35bn, one of the highest levels in the last two decades, and ~40% are new investments, the highest since 2014. The manufacturing sector was the one that benefited the most from the increase in FDI, receiving ~USD 13bn, mainly in the auto sector. Furthermore, FDI coming from Asia also increased, likely trying to mitigate supply chain risk by bringing production closer to the final market. We see this as one sign that nearshoring is starting to benefit the economy.

Even with the positive outlook, some local challenges must be overcome to fully benefit from nearshoring. An improvement in logistics would make distribution channels more efficient and more clarity in the rule of law would boost investors' confidence, improving business sentiment. A more competitive energy sector, including new renewable energy sources, would reduce companies' costs, making the Mexican market more attractive.

source: iStock



Conclusions

The Mexican economy is well positioned to benefit from the changes in international trade flows, which should boost economic activity and bolster the financial markets. Its proximity to the US and the free trade agreement, the strength of the manufacturing sector, and its relative advantage in terms of labour cost are key attributes that will likely allow Mexico to be one of the nearshoring winners. Despite the logistical and legislative challenges that must be solved to consolidate Mexico's advantageous position, some green shoots associated with nearshoring are already being observed and now need to be nurtured.

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