NEARSHORING: AN OPPORTUNITY FOR MEXICO

In recent years, the United States has had compelling reasons to diversify its import sources beyond China. Ongoing trade tensions create uncertainty, while pandemic-driven supply disruptions forced global supply chains to become more resilient and flexible. Companies seeking to diversify their supply chains and become more resilient already see Mexico as a viable option. Nonetheless, without the right policies and programs in place to attract and welcome those investments, the country could miss this opportunity. Throughout this document, we analyze the recent trade performance between Mexico, the United States, and China, concluding that despite pandemic-driven disruptions hit the trade between the US and Mexico in 2020, the nearshoring opportunity for Mexico remains. That said, we have updated the estimate we presented a year ago about the potential impact on Mexico’s GDP if the country succeeds in capitalizing on the opportunity.

Key Findings:

- In 2020, the pandemic reduced the overall commercial activity of the United States, and its trade with Mexico was hit harder relative to other countries given the drastic reductions in demand for manufacturing goods.
- This year, through May 2021, Mexico has recovered its position as United States’ main trade partner.
- To assess the potential impact of nearshoring on Mexico’s GDP, we identify nine relevant categories that account for 54.9% of the United States’ total imports, with the common characteristic that China’s market share of total US imports decreased or slowed down as Mexico’s increased. We ran an exercise with different scenarios, assuming Mexico substitutes US imports of these products from China in different proportions. Our conclusion was that for each 5% substitution rate, Mexico’s GDP could grow by an additional 1.4%.
- Although the USMCA poses a huge opportunity and comparative advantage for Mexico, it has important challenges that could cause uncertainty, namely the rules of origin, labor rights and panels, Mexico’s violations of the treaty, and the dispute settlement mechanisms.
- We also consider that the US policy outlook could positively impact nearshoring, specifically through the fiscal stimuli that the US government has granted.
- We identify six strengths that Mexico has over China, including fewer trade frictions, cheaper manufacturing labor, and favorable tax benefits for manufacturers.
- Lastly, we enlist the recent bills and proposals that have undermined business confidence and underscore the importance of recovering it to capitalize on the opportunity.
What happened in 2020? ................................................................. 3

In 2020, the pandemic reduced overall commercial activity: global trade flows decreased by 10.7%, with heterogeneous trade effects across industries. The US trade with Mexico was more affected than with other countries given the drastic reductions in demand for motor vehicles and auto parts after the pandemic forced the shutdown of automotive manufacturing facilities across North America—a strong blow to the heart of Mexico’s core manufacturing export strength.

Pandemic-driven disruptions hit the US-Mexico trade, but the recovery is underway. ................................................................. 4

Since the latter half of 2020, the trade between the US and Mexico started to revive. This year, through May 2021, the US trade is already above its pre-pandemic level (2019), while US imports from Mexico have posted a sharp rebound. Thus, during the first five months of the year, Mexico reclaimed its position as the US’ main trade partner.

Assessing the potential impact of Chinese exports substitution on Mexico’s GDP ......................................................... 5

To assess the potential impact of nearshoring on Mexico’s GDP, we identify nine relevant categories that account for 54.9% of the United States’ total imports, with the common characteristic that China’s market share of total US imports decreased or slowed down between 2017 and May 2021 as Mexico’s increased. We ran an exercise with different scenarios, assuming Mexico substitutes US imports of these products from China in different proportions. Our conclusion was that for each 5% substitution rate, Mexico’s GDP could grow by an additional 1.4%.

USMCA, opportunities and challenges for Mexico ............................................................. 8

The USMCA gives continuity to NAFTA on many fronts and provides governments and market stakeholders in North America with a framework to operate with certainty. Nonetheless, the new treaty also brings challenges. We elaborate on those associated with the rules of origin, labor rights and panels, Mexico’s violations of the treaty, and the dispute settlement mechanisms.

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The US policy outlook could positively impact nearshoring. We explain the most important variables that include the fiscal stimuli that the US government has granted, the executive order on America’s supply chains signed by President Joe Biden this year, and ongoing trade frictions between the US and China. One particular challenge on this matter is that the trade and investment agenda of the Biden administration makes clear that many changes to the US policy introduced by former administrations are here to stay. These include a focus on job creation in the country and discouraging offshoring and investment abroad to encourage onshoring and investment at home.

Mexico’s Strengths ....................................................................................... 12

We identify six strengths that Mexico has over China, namely fewer trade frictions; cheaper manufacturing labor; favorable tax benefits for manufacturers; lower shipping transit time; access to qualified, affordable, and young labor, and its good positioning in light of nearshoring decisions by US executives.

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Mexico needs to refocus its efforts to strengthen its macroeconomic environment, ensure total respect for the rule of law, and foster business confidence. Some recent government decisions have undermined investor confidence, including those concerning the Hydrocarbons, Electricity and Outsourcing laws reforms, the Zama oil field, the creation of a state-owned low-cost Mexican LPG company (Gas Bienestar), the proposal to dissolve autonomous bodies, and the bill to modify the Central Bank Law.
WHAT HAPPENED IN 2020?

Mexico saw a contraction in its relative share of US imports, especially in 1H20.

2020 was an atypical year in terms of trade patterns. The COVID-19 pandemic had negative repercussions on the trade of importing and exporting countries, with the most harmful effects seen during the first wave of contagions. Worldwide trade flows decreased by 10.7% in 2020, with heterogeneous trade effects across industries.

World total trade flows
–USD Billion, YOY %

For Mexico, the impact was also severe. In 2020, the United States imported relatively less from Mexico than from Asian low-cost countries (LCCs) when compared to the preceding year. Recall that both the US and the Mexican governments ordered the temporary shutdown of nonessential activities; however, a lack of cross-border coordination caused initial disruptions even to critical industries like manufacturing.

On this matter, AT Kearney launched last year the near-to-far trade ratio (NTFR), primarily to account for Mexico as an increasingly prominent low-cost country alternative for US companies. This index is calculated by dividing the total of US manufacturing imports from Mexico by the total of US manufacturing imports from 14 Asian LCCs covered in the study, including China. A decline in the NTFR indicates that the US imported relatively less from Mexico than from the Asian LCCs when compared to the previous year. That was the case in 2020, when Mexico saw a contraction in its relative share of US imports, largely due to pandemic aftershocks.

Mexico saw a contraction in its relative share of US imports when compared to Asian low-cost countries.

–AT Kearney’s NTFR Index: YOY chg. in bps. (2019-2020)

Most of the decline was attributed to the drastic reductions in demand for motor vehicles and auto parts after the pandemic forced the shutdown of automotive manufacturing facilities across North America—a strong blow to the heart of Mexico’s core manufacturing export strength.

US vehicles and parts imports from Mexico
–USD Billion

Note: NTFR stands for near-to-far trade ratio.
PANDEMIC-DRIVEN DISRUPTIONS HIT THE US-MEXICO TRADE, BUT THE RECOVERY IS UNDERWAY.

In 2021, Mexico reclaimed its position as the US’ main trade partner as nearshoring regained relevance.

The COVID-19 pandemic reduced the overall commercial activity of the US, but its trade with Mexico took a harder hit. Nonetheless, since the latter half of 2020, the trade between the US and Mexico started to revive. This year, through May 2021, the US trade is already above its pre-pandemic level (2019), while US imports from Mexico have posted a sharp rebound. Thus, during the first five months of the year, Mexico reclaimed its position as the US’ main trade partner as nearshoring regained relevance.

In light of the US-China trade tensions and the pandemic aftershocks, many US firms are reconsidering their global production networks and prioritizing the security and resilience of supply chains. This offers North America a tremendous opportunity to reshore investments to the region. Companies already see Mexico as a viable option, particularly for industries like automotive, aerospace, and electrical components, where Mexico has established infrastructure and a skillful labor force. Besides, the implementation of the USMCA is expected to encourage nearshoring as well.

In 2020, the trade between the US and the rest of the world posted a sharp decline; however, its total trade is now back at pre-pandemic levels.

Total trade of the US with the rest of the world
-USD Billion, YOY %

US imports from Mexico started to recover as those from China fell.

US imports from Mexico and China
-As a % of US total imports
ASSESSING THE POTENTIAL IMPACT OF CHINESE EXPORTS SUBSTITUTION ON MEXICO’S GDP

Given that trade composition has changed, this time, we identified nine relevant categories that account for 54.9% of the US’ total imports.

A year ago, to assess Mexico’s potential of the nearshoring effect due to the US-China trade war, we identified twenty relevant categories in which China’s market share of the total US imports decreased between 2017 and 2019, while that of Mexico increased. However, over the last 17 months, trade composition has changed and some categories, like medical instruments and beverages, spirits & vinegar, significantly increased their share of total US imports.

This time, instead of the original twenty relevant categories, we selected nine, which account for 54.9% of the total US imports (vs. the previous 54.7%). All nine categories represent at least 1% of the total US imports, and they share the common characteristic that China’s market share of total US imports decreased as Mexico’s increased. We identified and included two exceptions, vehicles and parts and iron & steel items, where even though China’s market share has risen, Mexico’s has done so by a greater proportion. The latter can be interpreted as a positive effect of nearshoring towards Mexico, showing that it has grabbed market share not only from China but also from other countries.

US imports including selected nine categories

- Wood and articles thereof
- Mineral fuel, oil, wax
- Iron and steel
- Optical, photographic, medical, or surgical instruments
- Iron or steel items
- Nuclear reactors, boilers
- Electric machinery
- Beverages, spirits & vinegar
- Vehicles and parts

Selected nine categories and their respective market share

<table>
<thead>
<tr>
<th>Category</th>
<th>% of total US imports</th>
<th>Difference in market share per category (May 2021 vs. 2017)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Nuclear reactors, boilers</td>
<td>14.9%</td>
<td>-5.3</td>
</tr>
<tr>
<td>Electric machinery</td>
<td>14.0%</td>
<td>0.4</td>
</tr>
<tr>
<td>Vehicles and parts</td>
<td>10.6%</td>
<td>-10.9</td>
</tr>
<tr>
<td>Mineral fuel, oil, wax</td>
<td>6.8%</td>
<td>-0.3</td>
</tr>
<tr>
<td>Optical, photographic, medical, or surgical instruments</td>
<td>3.7%</td>
<td>-1.2</td>
</tr>
<tr>
<td>Iron or steel items</td>
<td>1.5%</td>
<td>0.5</td>
</tr>
<tr>
<td>Wood and articles thereof</td>
<td>1.3%</td>
<td>-12.0</td>
</tr>
<tr>
<td>Iron and steel</td>
<td>1.1%</td>
<td>-1.1</td>
</tr>
<tr>
<td>Beverages, spirits &amp; vinegar</td>
<td>1.0%</td>
<td>-0.2</td>
</tr>
</tbody>
</table>

US$599.9 billion

- Mexico 19.0%
- China 18.2%
- Rest of the world 62.8%
- US imports of top 9 categories 54.9%
- US imports (excl. selected 9 categories) 45.1%
- Total US imports US$1.093 trillion
ASSESSING THE POTENTIAL IMPACT OF CHINESE EXPORTS SUBSTITUTION ON MEXICO’S GDP

Mexico has significantly increased its market share in the US, although some categories are still behind pre-pandemic levels.

Looking at the nine selected categories and their market share since 2017, we observed that beverages, spirits & vinegar, iron & steel, iron or steel items, mineral fuel & oil wax, and medical & surgical instruments have improved consistently and even surpassed their pre-pandemic market share. Meanwhile, vehicles and parts have managed to return to pre-pandemic levels, whereas other categories like nuclear, reactor & boilers, electrical machinery, and wood & articles thereof have significantly grown their market share relative to 2017 but have been unable to reach pre-pandemic levels.

Market share of the top nine products (as a % of US imports of each category)

<table>
<thead>
<tr>
<th>Category</th>
<th>2017</th>
<th>2019</th>
<th>May 2021</th>
</tr>
</thead>
<tbody>
<tr>
<td>Vehicles and parts</td>
<td>28.8%</td>
<td>33.2%</td>
<td>33.2%</td>
</tr>
<tr>
<td>Beverages, spirits &amp; vinegar</td>
<td>21.2%</td>
<td>23.9%</td>
<td>31.3%</td>
</tr>
<tr>
<td>Electric machinery</td>
<td>17.5%</td>
<td>18.3%</td>
<td>17.9%</td>
</tr>
<tr>
<td>Optical, photographic, medical, or surgical instruments</td>
<td>16.4%</td>
<td>16.7%</td>
<td>17.3%</td>
</tr>
<tr>
<td>Nuclear reactors, boilers</td>
<td>15.8%</td>
<td>17.8%</td>
<td>17.4%</td>
</tr>
<tr>
<td>Iron or steel items</td>
<td>11.9%</td>
<td>13.2%</td>
<td>14.3%</td>
</tr>
<tr>
<td>Iron and steel</td>
<td>6.3%</td>
<td>8.7%</td>
<td>10.6%</td>
</tr>
<tr>
<td>Mineral fuel, oil, wax</td>
<td>5.8%</td>
<td>6.5%</td>
<td>7.5%</td>
</tr>
<tr>
<td>Wood and articles thereof</td>
<td>1.7%</td>
<td>2.2%</td>
<td>2.0%</td>
</tr>
</tbody>
</table>
ASSESSING THE POTENTIAL IMPACT OF CHINESE EXPORTS SUBSTITUTION ON MEXICO’S GDP

Amid economic recovery and relentless trade tensions, Mexico still has room to increase its market share in the US trade and further boost its own economic growth.

According to our analysis, assuming the already referred positive trend in Mexican trade flows to the US continues and Mexico keeps increasing its market share in the US in the top nine categories we identified, then, for each 5% substitution rate, Mexico’s GDP could grow by an additional 1.4%.

Mexico’s exports to the US increased by US$26.2 billion from 2017 to 2021 (through May each year).

We ran different scenarios assuming different substitution rates achieved by Mexico in the US market, considering only the selected nine categories. To put this into perspective, Mexico’s substitution of all US imports from China would account for 27% of the Mexican GDP.

<table>
<thead>
<tr>
<th>Substitution Rates</th>
<th>USD Billion</th>
<th>% of Mexico’s GDP*</th>
</tr>
</thead>
<tbody>
<tr>
<td>100%</td>
<td>291.64</td>
<td>27.1%</td>
</tr>
<tr>
<td>80%</td>
<td>233.31</td>
<td>21.7%</td>
</tr>
<tr>
<td>60%</td>
<td>174.98</td>
<td>16.3%</td>
</tr>
<tr>
<td>50%</td>
<td>145.82</td>
<td>13.6%</td>
</tr>
<tr>
<td>30%</td>
<td>87.49</td>
<td>8.1%</td>
</tr>
<tr>
<td>10%</td>
<td>29.16</td>
<td>2.7%</td>
</tr>
<tr>
<td>5%</td>
<td>14.58</td>
<td>1.4%</td>
</tr>
<tr>
<td>3%</td>
<td>8.75</td>
<td>0.8%</td>
</tr>
</tbody>
</table>

*To estimate Chinese exports of the nine selected categories in 2021, we multiplied the exports through May 2021 by the average growth factor from June to December over the past ten years.

The low level of friction between Mexico and the US makes the former relatively more competitive over China. However, there are many factors and political decisions, particularly in the energy sector, that might aggravate these frictions and reduce the comparative edge that Mexico has on the trade front.

In our view, Mexico has challenges and areas of opportunities to capitalize on the opportunity. We enlist both on the following slides.
Mexico has twelve Free Trade Agreements (FTAs) with 46 countries—the highest number worldwide. The main FTAs are the following:

- USMCA (81.2% of Mexican exports)
- European Union (5.0%)
- Pacific Alliance (1.8%)

Mexico’s Free Trade Agreements

USMCA, OPPORTUNITIES AND CHALLENGES FOR MEXICO

The USMCA offers nearshoring opportunities, but it also brings challenges.

The USMCA, in effect since July 1, 2020, put an end to the uncertainty triggered by the renegotiation of the North American Free Trade Agreement (NAFTA) and the threat of its elimination. The USMCA gives continuity to NAFTA on many fronts and provides governments and market stakeholders in North America with a framework to operate with certainty. Nonetheless, even if the USMCA preserved much of NAFTA, we enlist the most relevant changes the USMCA has introduced that could pose a challenge for the Mexican economy.
USMCA, OPPORTUNITIES AND CHALLENGES FOR MEXICO

The USMCA offers nearshoring opportunities, but it also brings challenges.

### Rules of Origin

1. **Rules of Origin (ROO).** Three aspects are noteworthy: i) The regional value content (RVC) requirement increased from 62.5 to 75%; ii) A labor value content (LVC) requirement was that 45% for Pickups and 40% for automobiles and SUVs must be manufactured with wages of at least US$16 per hour, and iii) Certain automobile parts and components must be wholly produced in the region, and 70% of aluminum and steel content must originate in the region.

### Labor Rights and Panels

2. **Labor Rights and Panels.** The USMCA had three important features concerning labor rights. First, the Labor Chapter included new state obligations such as prevention of violence against workers, prohibition on gender discrimination, and protection of migrant workers. It also included explicit recognition of the right to strike as a component of the right to freedom of association.

   Second, the Labor Chapter’s Annex includes a commitment by Mexico to reform its labor laws and institutions. Mexico adopted its new law on May 1, 2019, and is now in the implementation phase.

   Lastly, the Protocol of Amendment created a new expedited enforcement mechanism called the Rapid Response Panels. This mechanism allows for review and remediation of a denial of rights in a relatively short process (120 days). The panelists may verify whether a violation exists by visiting the facility in question.

### Challenges

**Challenges:** Recently, the United States has struggled with Mexico and Canada over regulations for cars. The conflict centered on how to calculate the percentage of vehicles arriving collectively from the three countries under the USMCA. People said the US insists on a stricter method than Mexico and Canada, believing that they have agreed to calculate the origin of some of the main parts, including the engine, transmission, and steering system, in the overall calculation. This makes it difficult for plants in Mexico and Canada to meet the new 75% regional content cap, up from 62.5% under NAFTA, in order to trade duty-free.

**Challenges:** The changes introduced by the USMCA will require important adjustments in Mexico. If the federal labor law is implemented effectively, workers would be able to associate, form independent unions, and bargain collectively, in a way they have not been able to do for decades. The labor reform could gradually result in better wages for Mexican workers. Higher wages could incentivize employers in various export sectors to rely less on cheap labor as their main competitive advantage and rather seek to add value in the production chain, innovating in their products, manufacturing processes, or business strategies. On the downside, statements from the United States Trade Representative (USTR) and the American Federation of Labor and Congress of Industrial Organizations (AFLCIO) indicating that they expect to use the rapid response panels against Mexico suggest that the mechanism will be tested in the near future. Indeed, the US has filed labor disputes against Mexico [specifically against General Motors and Tridonex] that have made it clear that companies must comply with the USMCA, setting a precedent.
**USMCA, OPPORTUNITIES AND CHALLENGES FOR MEXICO**

The USMCA offers nearshoring opportunities, but it also brings challenges.

<table>
<thead>
<tr>
<th>Violations to the Treaty</th>
</tr>
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<tbody>
<tr>
<td><strong>3. Violations to the treaty.</strong> As mentioned earlier, through the dispute settlement panels, when a violation is confirmed and goes unredressed, the complainant country may impose sanctions on the goods produced in violation of the agreement, including higher tariffs, fines, or denying entry.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Renewable Mechanism</th>
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</thead>
<tbody>
<tr>
<td><strong>4. Renewable Mechanism.</strong> While the United States’ original proposal for a five-year sunset clause did not make it to the final text, the USMCA is effective for a renewable sixteen-year term. Upon the sixth year of the treaty (2026), the Free Trade Commission will meet to conduct a “joint review” and the parties may confirm they want to renew the agreement for another sixteen-year term. If a party does not renew the agreement in the sixth year, the Commission will meet and conduct a review every year during the subsequent ten years, in which the parties may confirm at any point their desire to renew it for another sixteen years.</td>
</tr>
</tbody>
</table>

**Challenges:** The violations of the USMCA by Mexico have piled up. Among other things, the government designated Pemex as the operator of the country’s largest oil field, which was discovered by private companies. It has also imposed restrictions on fuel imports (discriminatory treatment), announced the creation of a state-owned low-cost Mexican LPG company (Gas Bienestar), and proposed a constitutional reform to the Electricity Law. The highest risk is that the value of the USMCA could diminish if violations continue, and it would impact Mexico’s economy, especially the agricultural sector if retaliatory measures are applied by the US or Canada. Furthermore, the Mexican government could be increasingly pressured by the Biden administration to fully comply with the USMCA commitments, hence becoming one of the most important counterweighs for President López Obrador’s administration.

**Challenges:** This term-specific feature of the USMCA may create uncertainty about the continuation of the treaty in the long term and reduce incentives to invest in large-scale projects that require hefty upfront expenditure with expected returns spanning many years. However, unlike NAFTA, this mechanism give the opportunity to evaluate the operation and effects of the agreement and to update or amend it accordingly. By institutionalizing the review process, parties may be able to clarify interpretations when in doubt and correct the course if something is not operating as expected.
US POLICY, OPPORTUNITIES AND CHALLENGES FOR MEXICO

The outlook of the US policy could have a positive impact on nearshoring.

The shifts in the US domestic policy under the Biden administration would bode well for nearshoring. We enlist the most important variables:

**OPPORTUNITIES:**

- **The trade war between China and the United States has become less vocal** since the Biden administration took office in January 2021. However, the current US administration does not seem willing to ease the commercial policies implemented during the trade war.

- In February 2021, President Biden signed the **Executive Order on America’s Supply Chains**, in which the White House expressed that close cooperation on resilient supply chains with allies and partners who share US values will foster collective economic and national security and strengthen the capacity to respond to international disasters and emergencies.

- **The US government started to grant fiscal stimuli** since the onset of the pandemic, reaching US$5.3 trillion (25.5% of GDP) until April 2021, according to the IMF Fiscal Monitor. The economic recovery in Mexico has been boosted by the strength of the external sector, especially in the US. The fiscal stimuli given by the US government will continue to support the external demand.
  - On June 24, President Joe Biden and Vice President Kamala Harris announced their endorsement of the Bipartisan Infrastructure Framework, the largest long-term investment in infrastructure and competitiveness in nearly a century. The Package is worth a total of US$579 billion, of which US$312 billion will be devoted to transportation, including roads, bridges, airports, ports, and waterways.

- **US Congressmen seek the approval of a law that promotes the strengthening of supply chains** between Mexico, the United States, and Canada. If approved at the end of this year, it could be very positive for Mexico.

**CHALLENGES:**

- **The trade and investment agenda of the Biden administration makes clear that many changes to the US policy introduced by former administrations are here to stay.** There will be permanent attention to job creation in the US, the wellbeing of American workers, with a focus on discouraging offshoring and investment abroad to encourage onshoring and investment at home. That is the case of the proposed 10% offshoring tax on products US companies manufacture abroad to sell domestically.
MEXICO’S STRENGTHS

Mexico has important comparative advantages over China.

1. Few trade frictions
An analysis conducted by consulting firm De la Calle, Madrazo, Mancera [CMM] of the US Trade Representative’s 2021 national trade estimate and US Census data identified the barriers that US exporters and investors faced in 2020, shedding light on the difficulties to trade with different countries. Results revealed that Mexico is the second country with the least friction with the US, which is proportional to the enormous trade volume in the region. China ranks tenth, showing more frictions by dollar traded with the US when compared to Mexico.

CMM’s trade friction index for US exporters, providers, and investors
– 2021 US National Trade Estimate (text length to 2020 US exports ratio)

2. Mexico offers cheaper manufacturing labor.
-USD/hour

3. Mexico offers high tax benefits to manufacturers (USMCA & IMMEX).
The USMCA allows companies in Mexico to import and export goods to and from the United States tariff-free under certain conditions. Also relevant is Mexico’s maquiladora program (IMMEX), which supports cash flows by allowing manufacturing companies to import production parts, materials, and assets “temporarily.”

4. Shipping transit time and costs
Mexico’s proximity to the US means manufacturers have more distribution options, including trains, trucks, or planes. Also, dedicated deepwater ports and commercial border crossings make transport much easier. Indeed, Mexico has great infrastructure:
• 3rd Country with the most airports
• 57 Border crossings
• 117 Inhabited ports (commercial & touristic) and terminals
• 17 thousand mi. of railways

5. Access to qualified, affordable, and young labor
Source: CMM with information from USTR National Trade Estimate Report of Foreign Trade Barriers 2021 and USITC trade data

82.6% of population
88.8% of population

Source: CMM with information from USTR National Trade Estimate Report of Foreign Trade Barriers 2021 and USITC trade data

Russia
Argentina
Indonesia
South Africa
United Kingdom
Malaysia
Thailand
New Zealand
Peru
Saoud Arabia
Brazil
Colombia
India
Vietnam
Japan
South Korea
China
Mexico
Canada
United States
August 9, 2021
Mexico is well-positioned in light of nearshoring decisions.

According to an AT-Kearney survey, many of the US executives polled perceive nearshoring to Mexico or Canada as even more advantageous than reshoring. This is particularly true among the largest firms and companies that already operate offshore facilities. Moreover, respondents selected a right-shoring decision framework based on a range of relevant variables. Notably, Mexico complies with most of these variables, especially regarding financial, geographical, and ecosystem considerations. We identified political and legal considerations as the biggest downside risk for Mexico.

### Agree/disagree: Nearshoring to Mexico or Canada is more advantageous than reshoring manufacturing to the US.

---

**Overall**
- Strongly agree: 9%
- Agree: 21%
- Somewhat agree: 24%
- Somewhat disagree: 21%
- Disagree: 14%
- Strongly disagree: 11%

**Small and medium-sized enterprises**
- Strongly agree: 6%
- Agree: 11%
- Somewhat agree: 24%
- Somewhat disagree: 26%
- Disagree: 20%
- Strongly disagree: 13%

**Large companies**
- Strongly agree: 14%
- Agree: 34%
- Somewhat agree: 24%
- Somewhat disagree: 14%
- Disagree: 6%
- Strongly disagree: 8%

**Manufacturers with offshore facilities**
- Strongly agree: 3%
- Agree: 37%
- Somewhat agree: 34%
- Somewhat disagree: 18%
- Disagree: 8%

Source: AT Kearney

### Right-shoring decision framework and Mexico’s compliance

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<table>
<thead>
<tr>
<th>Economic concerns</th>
<th>Political and legal considerations</th>
<th>Geographical considerations</th>
<th>Ecosystem considerations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Raw material costs and availability</td>
<td>Trade policies and agreements</td>
<td>Proximity to customers</td>
<td>Workforce education and skill level</td>
</tr>
<tr>
<td>Labor cost</td>
<td>Government incentives (including subsidies, economic zones)</td>
<td>Proximity to suppliers</td>
<td>Population age and growth</td>
</tr>
<tr>
<td>Operating costs (including transportation, inventory)</td>
<td>Political stability</td>
<td>Access to ports, airports, trade routes, and so on</td>
<td>Labor union ecosystem</td>
</tr>
<tr>
<td>Infrastructure availability</td>
<td>Labor policies (including union policies, minimum wage)</td>
<td>Climate and environmental considerations (e.g., weather disruptions)</td>
<td>Academic institutions</td>
</tr>
<tr>
<td>Public infrastructure development</td>
<td>Intellectual property protection</td>
<td>Proximity to contingency manufacturing sites</td>
<td>Supplier ecosystem</td>
</tr>
<tr>
<td>Taxes and tariffs (including import taxes)</td>
<td>Environmental regulation</td>
<td>Domestic market demand</td>
<td></td>
</tr>
<tr>
<td>Monetary stability</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Overall compliance:
- Full compliance: 37%
- Not in full compliance: 63%

Source: GBM based on AT Kearney input
MEXICO’S WEAKNESSES

Recent bills or proposals have undermined business confidence.

Mexico needs to regain investor confidence. Despite the ratification of the USMCA and the nearshoring trends, Mexico needs to refocus its efforts to strengthen its macroeconomic environment, ensure total respect for the rule of law, and foster business confidence. Recent government decisions that have undermined investor confidence include:

- President López Obrador sent a bill to Congress that could enable the government to suspend permits in the oil industry. According to the bill already passed, permits for the import, export, storage, and distribution of oil and fuel could be suspended on the grounds of national security. However, the bill fails to detail which circumstances would be considered a national security matter.

- Additionally, another bill related to the Hydrocarbons Law reform was sent to Congress, which would increase Pemex’s market power, as it withdraws from the Energy Regulatory Commission (CRE) the power to control and impose asymmetric regulation on the oil company.

- After both reforms were passed and published in the Federal Official Gazette, federal judges granted injunctions with general effects against the first reform, whereas for the asymmetric regulation reform, they granted permanent injunctions with general effects.

- Both of the bills passed violate the USMCA and other international treaties, so Mexico’s trade partners could launch dispute resolution panels and impose tariffs on the country’s main exports.

- The legislation approved prioritizes power generation by the state utility CFE over private renewable projects.

- After a federal judge granted a definitive suspension of the Electricity Law reform, President López Obrador stated he would send a bill to Congress to reform the Constitution if the Supreme Court declares the amended Electricity Law unconstitutional. To achieve this change, the President would need a qualified majority in both Chambers and the approval of 17 of 32 state legislatures.

- The Electricity Law reform violates the USMCA and other international treaties, which could cause Mexico’s trade partners to launch dispute resolution panels and impose tariffs on the country’s main exports.

- The President submitted a draft bill to Congress that would ban outsourcing in the country and regulate the provision of specialized services and works.

- In this regard, round tables were held between the federal government and the private sector from December to February, which concluded with the agreement to limit the profit-sharing to three months’ salary. The bill forbids the outsourcing of personnel, except for specialized work outside a company’s main economic activity.

- Given the agreement, the bill was revised and passed in Congress and later published in the Federal Official Gazette.

- With the elimination of outsourcing, labor costs in Mexico would increase, probably reducing the absorption capacity of the labor market. This would also slow down the economic recovery, especially on the consumption front.

- It is expected to take force in September.
**Zama Field**

- The Mexican Ministry of Energy awarded state-owned Pemex the rights to operate one of the country’s biggest oil discoveries, the Zama field.
- The Talos consortium (including UK’s Premier Oil and Germany’s Wintershall DEA) discovered the field in 2017 and have invested US$325 million to date.
- Talos had argued that Pemex doesn’t have the technical expertise or the financial resources to develop this field. This is a huge setback for private oil companies operating under terms of the Energy Reform.
- Talos is considering taking legal action, as it deems the award unfair.

**State-Run LPG Company**

- Mexican President López Obrador said that his government will create a state-owned low-cost LPG company (Gas Bienestar) that would be a subsidiary of oil major Pemex to distribute liquefied petroleum gas directly to consumers.
- This new state-run company will generate distortions in the market since the price it would offer to the public will be subsidized. Besides, it may operate at a loss because of the high operating costs that running a company of this type implies.

**Autonomous Bodies**

- The President proposed to eliminate autonomous bodies in the country on the rationale of saving money.
- Our base-case scenario is that the President will be able to eliminate some of the autonomous bodies, such as the National Institute for Transparency, Access to Information and Personal Data Protection (INAI) or the National Council for Evaluation of Social Development Policy (CONEVAL), but others like the Federal Telecommunications Institute (IFT) and the antitrust authority (COFECE) will have less risk of disappearing, mainly because they are included in international treaties, like the USMCA.
- In our view, the proposal represents a setback for transparency.

**Banxico Law**

- MORENA put forward a bill to the Senate to modify the Central Bank Law.
- The Ministry of Finance, the Central Bank [Banxico], the National Banking and Securities Commission [CNBV], and leaders of the Mexican Banks Association [ABM] addressed congressmen’s main concerns by providing an alternative solution to the reform that was threatening Banxico’s autonomy.
- Thus, the government and the private financial institutions committed to facilitating people’s access to better exchange rates for remittances and making it easier for Mexicans living abroad the account opening process in the Mexican banking system.
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