Miriam Acuña Rodríguez
macuna@gbm.com
+52 (55) 5480 7095

Daniel Castañón González
dcastanong@gbm.com
+52 (55) 5480 5800 Ext. 6172

Regina Labardini Muench
rlabardinim@gbm.com
+52 (55) 5480 5700

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Nearshoring: Mexico is the smart landing choice

Having one of the world's biggest markets as a neighbor and enjoying important strategic advantages, Mexico is in pole position to be one of the main winners in the global trade reordering and increase its share in U.S. imports. The ongoing global supply chain crisis, aggravated by increasing transportation costs and endless pandemic-related lockdowns in Asia, along with geopolitical conflicts and tariffs on Chinese imports, has led many companies to see nearshoring as an ally to stay resilient and reduce their dependence on "risk territories" for manufacturing.

Amid this supply chain shift, China has lost an important share in total U.S. imports, which so far has been mostly grabbed by low-cost Asian countries, like Vietnam, while we think that the undisputed winner in the long term will be Mexico. In our view, the win of low-cost Asian countries represents a mid-point in the nearshoring process and reiterates Mexico's export growth potential.

Nearshoring in Mexico has started to become a reality. The unequivocal sign is the expansion of industrial capacity and occupancy, which reflect a higher demand for spaces to set up production lines in Mexico, while companies across multiple industries have started to invest in expanding their production capacity in the country. Moreover, Mexico and the United States recently announced they plan to reap the benefits of the Biden administration's massive investment in semiconductor production to push the integration of their supply chains and jointly escalate the production of electric vehicles.

Mexico has exceptional qualities that are impossible to ignore, which make it the natural contender for nearshoring. Mexico has twelve free trade agreements (FTAs) with fifty countries, including the USMCA; it has a young, affordable, and highly qualified labor force, and it has become highly attractive in terms of transportation costs, as shipping costs have skyrocketed in the post-pandemic world.

We estimate that if Mexico substitutes 5% of the exports to the United States from China and its Asian main competitor in ten relevant categories, Mexican exports could grow by an additional US$22.90 billion per year (equivalent to 1.77% of GDP). Per our analysis, the manufacturing industries could take the lead in the race to benefit from the nearshoring opportunity, specifically electric machinery, nuclear reactors, and vehicles & parts.

Still, we recognize that even the best players have areas of opportunity, and Mexico is no exception. Strengthening its rule of law and institutions is Mexico's biggest area of opportunity, while clear energy policies are needed to provide the country with a clear advantage in the nearshoring arena. Moreover, today's main challenge lies in USMCA compliance.

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The race towards a new world trade order

- **Global trade is undergoing a makeover, prompted by recent disruptive events** (China-U.S. trade war, COVID-19 pandemic, and Russia's invasion of Ukraine), where the security and proximity of supply chains to the end market have gained relevance.
- **China's gradual loss of ground in the U.S. import market (-4.8 pp, between 2017 and 2022) has paved the way for alternative suppliers**. Mexico is well-positioned to take full advantage of the nearshoring trends, given its close relationship with the United States. However, recent data shows that, as of yet, a group of thirteen Asian competitive countries (ACCs) is taking the lead in the race to substitute Chinese exports to the U.S.
- **In our view, the boom of Asian countries in the nearshoring context responds to an intermediate stage of the process**, which means Mexico has a chance to take off over the medium and long term and prove its export growth potential.
- **Indeed, between 2017 and 2022, Mexico continued to grow its market share in the U.S. import market, whereas, in terms of Foreign Direct Investment (FDI), Mexico remains the world's tenth largest recipient** of FDI, with inflows amounting to US$32 billion in 2021.

DISRUPTIVE EVENTS HAVE GIVEN RISE TO A STRUCTURAL CHANGE IN GLOBAL TRADE.

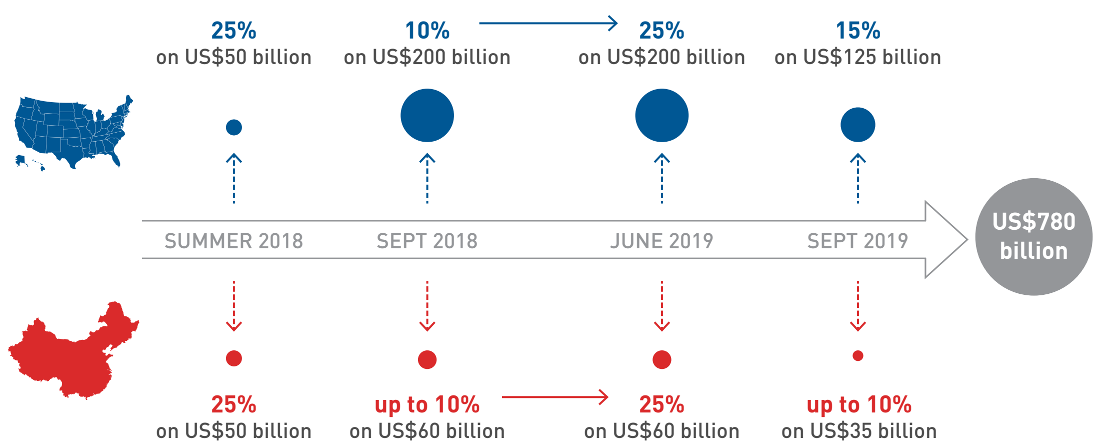
The trade war between the United States and China, followed by the COVID-19 pandemic, have shed light upon the nearshoring opportunity.

Trade War

In 2018, former U.S. President Donald Trump started a global trade war that involved multiple battles and the imposition of tariffs on Chinese imports.

- In 2018, **the trade conflict started with a series of measures from the U.S. to discourage imports of specific products,** such as steel, aluminum, solar panels, and washing machines. Later, those measures began to target Chinese imports.
- **The trade war officially started early in the summer of 2018**, when the United States and China raised tariffs on about US$50 billion worth of each other's goods.
- **The conflict escalated further in September 2018, when the U.S. introduced an additional 10% duty on US$200 billion worth of Chinese imports**. China retaliated by imposing tariffs on U.S. imports worth an additional US$60 billion.
- **In June 2019, the United States increased these tariffs further to 25%, and China responded by raising the rate on a set of products that were already subject to tariffs**. In September 2019, the U.S. imposed a 15% duty on a large subset of the remaining US$125 billion worth of Chinese imports not yet subject to tariffs.

The trade war between the United States and China escalated gradually yet consistently, with some of the tariffs imposed remaining valid to date.

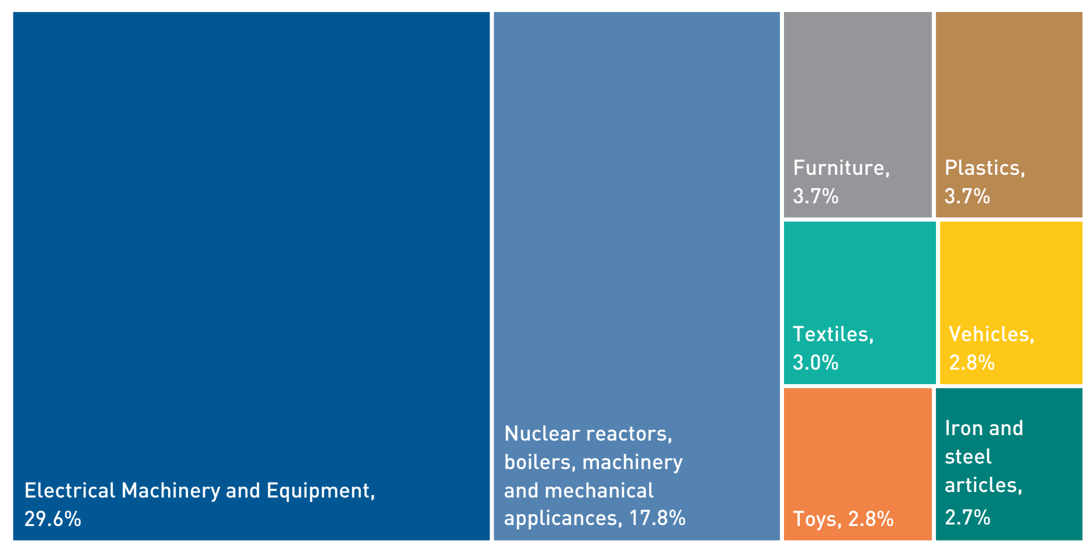


COVID-19 Pandemic

The COVID-19 pandemic had negative repercussions on global trade, with many of its effects still taking a toll on trade flows and inflation.

- **The closure of borders and the simultaneous supply and demand shocks caused worldwide trade flows to decrease by 10% YOY in 2020**, with heterogeneous trade effects across industries. However, trade flows began to decline earlier, in 2019.
- **Trade flows presented a significant rebound in 2021, even surpassing their pre-pandemic levels**. Such trend was possibly driven by a strong demand due to economic stimulus packages in some countries. However, as these effects have started to normalize, global trade flows could soon go back to their previous trend.
- **The pandemic, and the more recent lockdowns in certain key regions of China, have highlighted the vulnerability of global supply chains**, pushing companies worldwide to reassess their logistics, inventories, and supply chains and to evaluate nearshoring opportunities.

China's endless lockdowns highlight the vulnerability of its diversified exports
–% of total exports



Sources: United Nations Conference on Trade and Development (UNCTAD)

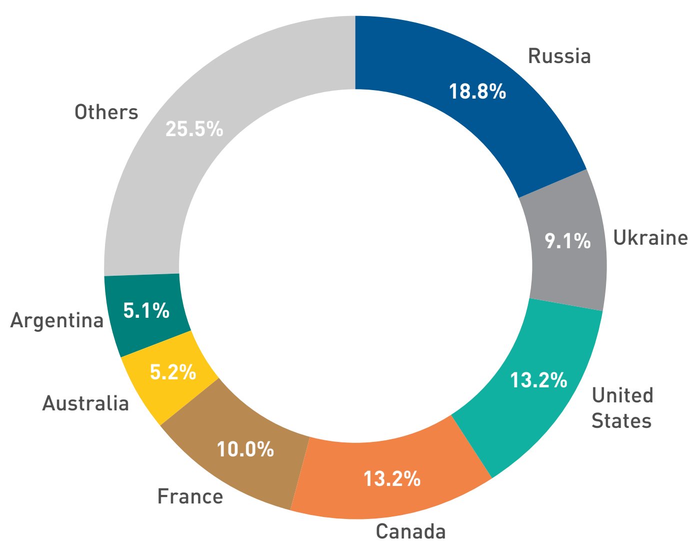
DISRUPTIVE EVENTS HAVE GIVEN RISE TO A STRUCTURAL CHANGE IN GLOBAL TRADE.

The Russian invasion of Ukraine has once again highlighted the vulnerability of global supply chains in the face of geopolitical conflicts.

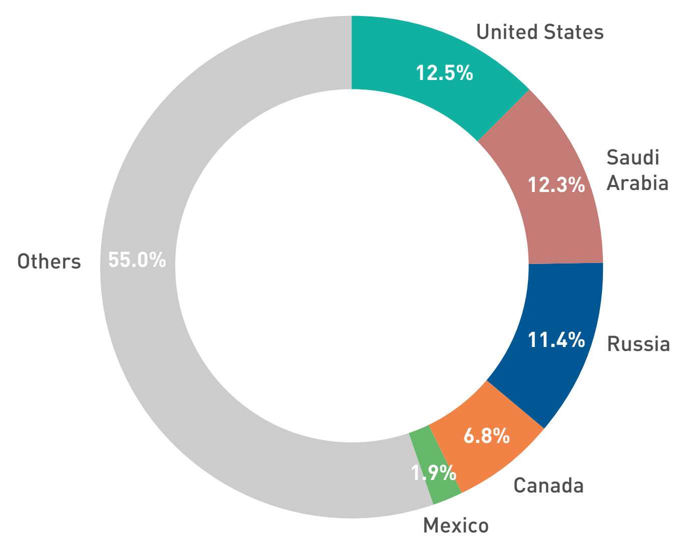
Russia-Ukraine War

- **Russia's invasion of Ukraine in late February 2022 was the third big blow to global supply chains in a decade**. It came at a time when supply chains were already under stress, as they had not fully recovered from the shock brought by the pandemic, as stated earlier.
- **Before the war, Russia and Ukraine accounted for almost 30% of the global wheat trade**. Furthermore, Western sanctions against Russia had a severe impact on other commodity prices, like energy, as the former is one of the world's leading oil suppliers. **Not only has this caused further strains on supply chains but it has also become an additional factor for inflationary pressures.**
- **Supply chains were also affected by the burst of the war, as certain trade routes had to be modified to avoid the ongoing conflict—causing further delays and disruptions in supply chains**. According to the World Bank, Russia's connections to certain European ports have been cut, leaving few export routes available.
- In 2021, Russia and Ukraine accounted for only 1.1% of the total U.S. imports. However, **they remain some of the biggest players in certain commodity markets.** Hence, while there is not much room in the U.S. markets to substitute Ukrainian and Russian exports, the consequences of the ongoing conflict on trade are palpable and, once again, make evident the need for nearshoring in supply chains.

Russia and Ukraine account for 27.9% of global wheat exports.
–% of global wheat exports

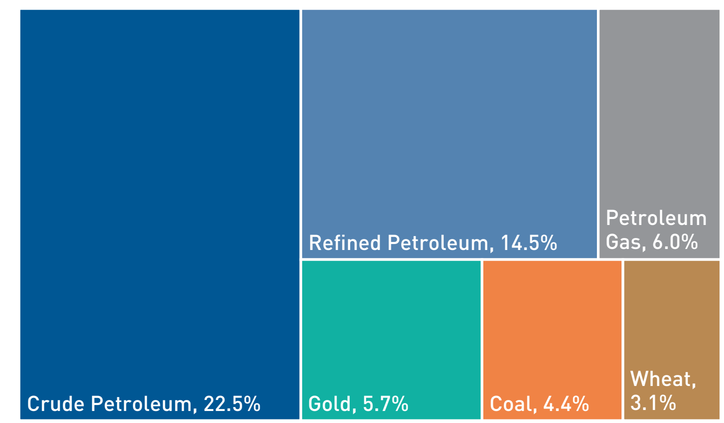


Moreover, Russia is one of the leading players in the global oil market.
–% of global oil exports

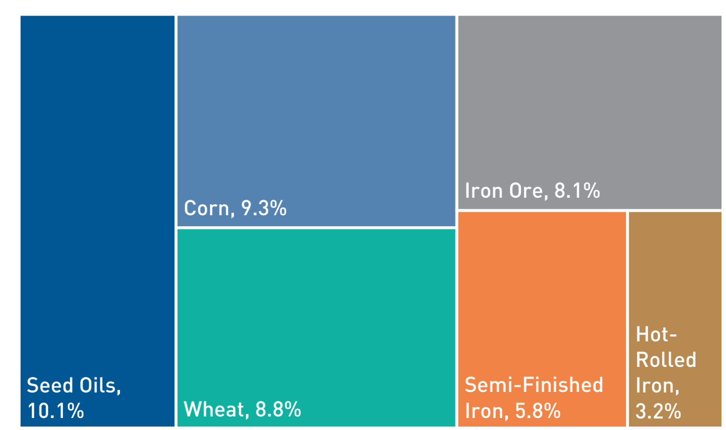


Since Ukraine and Russia are key commodity exporters, the world is left with yet another problem to resolve in terms of global supply.
–% of total exports by country

Russia



Ukraine



Sources: Food and Agriculture Organization (FAO), The Observatory of Economic Complexity (OEC), World Bank

THE RACE TOWARDS A NEW WORLD TRADE ORDER

Mexico and Asia are becoming the pageant winners

Between 2017 and July 2022, China lost 4.8 percentage points in its total share of U.S. imports, going from 21.6% in 2017 to 16.8% so far in 2022.

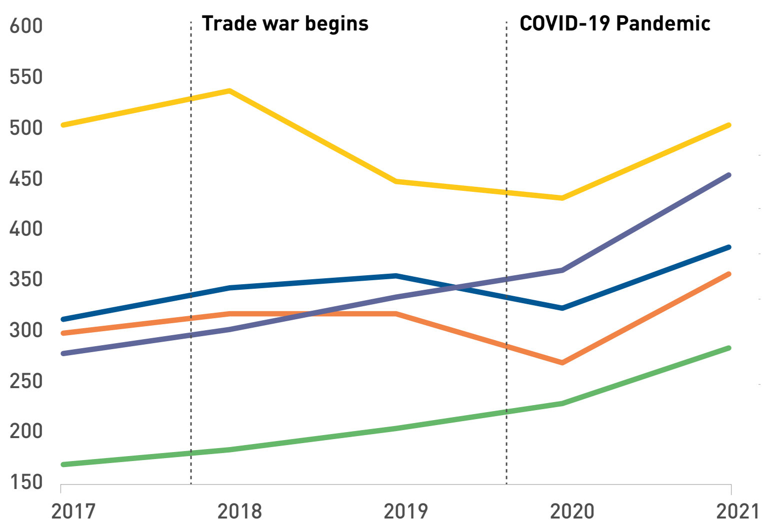
- **Over the same period, Mexico's share in U.S. imports has increased from 13.4% in 2017 to 13.8% today (+0.4 pp.),** with a CAGR of 5.3%.
- **However, we have identified a group of thirteen Asian Competitive Countries (ACCs) that have boosted their total share in U.S. imports**, posting a CAGR of 13.0%. This group of countries includes Bangladesh, Cambodia, Hong Kong, India, Indonesia, Malaysia, Pakistan, Philippines, Singapore, Sri Lanka, Taiwan, Thailand, and Vietnam.
- **Canada is another important player, as its CAGR has expanded by 4.6%.** Furthermore, the country holds a privileged position thanks to its geographical location and its participation in the USMCA.

It is worth mentioning that, despite the large increase of ACCs, Mexico still holds a larger share than any of said countries when analyzed independently.

- Altogether, the thirteen ACCs account for 16.8% of the U.S. import market, which implies an average share of 1.3% per nation—well below Mexico's 13.8%.
- It is worth mentioning that we have identified Vietnam and Taiwan as Mexico's main competitors in most of the relevant categories of U.S. imports.

As China has lost market share in U.S. imports since 2018, Mexico and certain Asian countries have capitalized on this window of opportunity to increase their presence in the U.S. market.

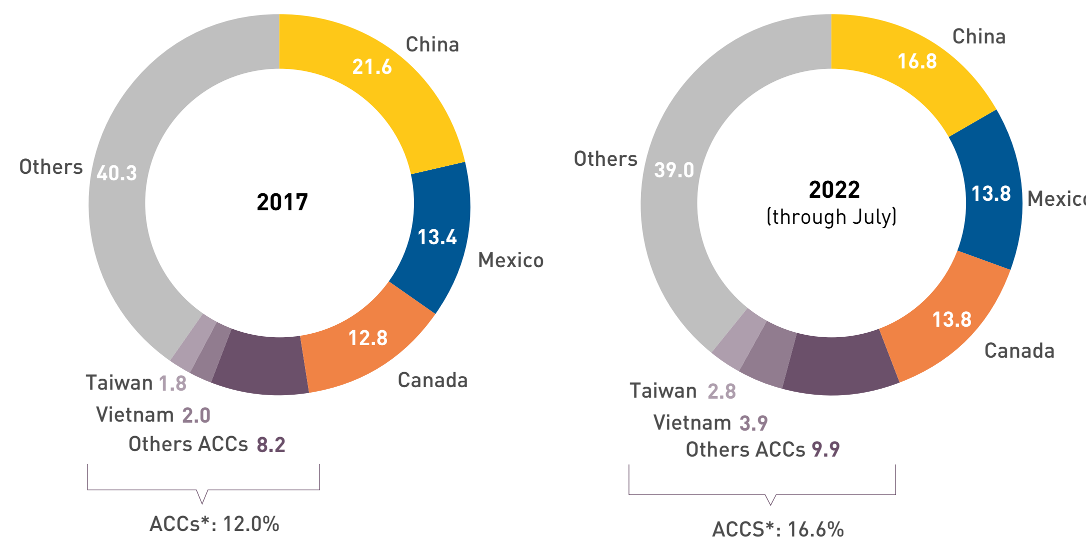
–U.S. imports by country of origin, USD Billion



	Exports to the U.S. (2021) (USD Billion)	CAGR 2017-2021
China	504.9	0.0%
ACCs*	455.5	13.0%
Mexico	384.6	5.3%
Canada	357.8	4.6%
Southeast Asia**	284.7	13.9%

Mexico holds 13.8% of total U.S. imports.

–Gains in market share of U.S. imports (2017-July 2022), in percentage points



**Asian Competitive Countries (ACCs) include Bangladesh, Cambodia, Hong Kong, India, Indonesia, Malaysia, Pakistan, Philippines, Singapore, Sri Lanka, Taiwan, Thailand, and Vietnam.*
***Southeast Asia only considers Cambodia, Indonesia, Malaysia, Philippines, Singapore, Thailand, and Vietnam.*

Source: U.S. Census Bureau

AND, WHAT ABOUT FOREIGN DIRECT INVESTMENT (FDI)?

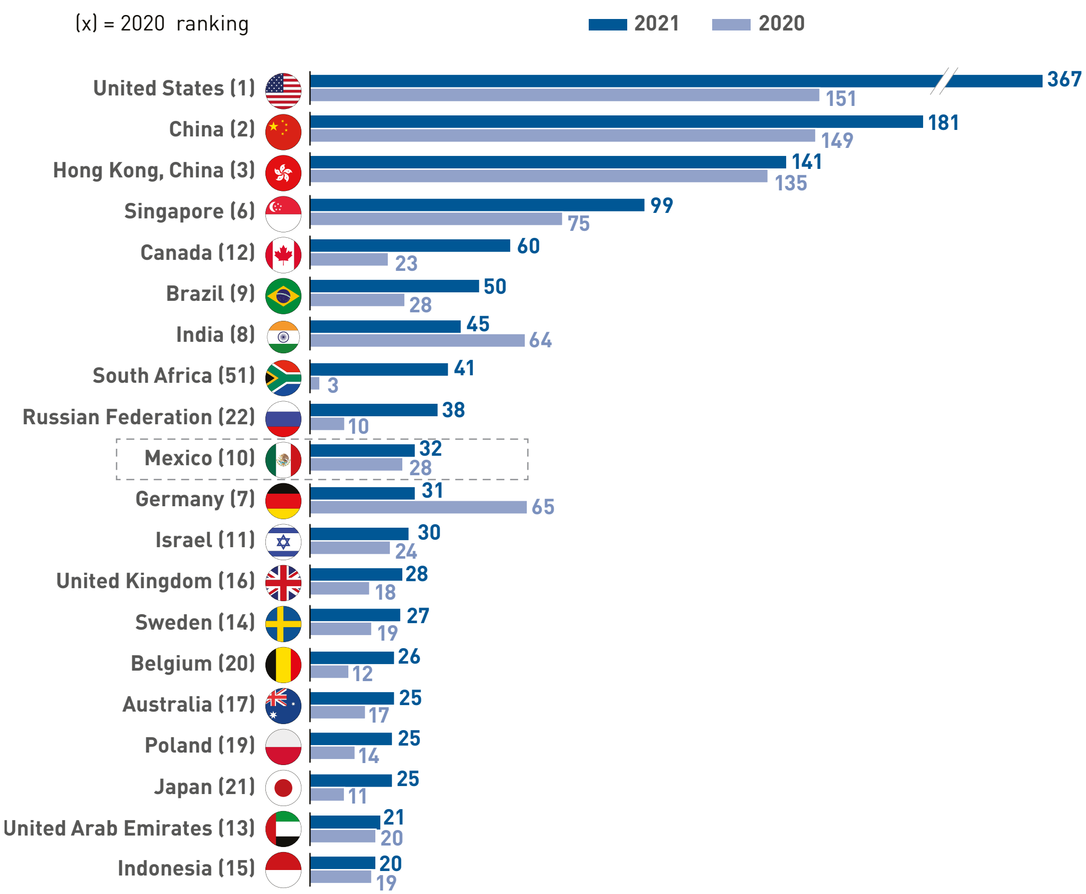
Mexico remains the world's tenth-largest recipient of FDI, with inflows of US$32 billion in 2021.

According to UNCTAD's 2022 World Investment Report, Mexico ranked tenth among the world's largest recipients of foreign direct investment (FDI). The report also highlights that the United States increased its investment abroad by 72% between 2020 and 2021, trebling the amount invested in Mexico. In our view, FDI is a fundamental development driver for all economies and is one of the best ways to keep track of nearshoring.

- **After a sharp decline provoked by the pandemic, FDI started to bounce back in 2Q21**, particularly thanks to a one-off transaction, namely, the Televisa-Univision merger, which is responsible for the peak observed in 1Q22 in mass-media FDI.
- **Although we welcome a fast return of FDI to pre-pandemic levels, the fact that it was mainly due to a one-off transaction underscores Mexico's need to attract more investments to reap the benefits of nearshoring in the coming years.**

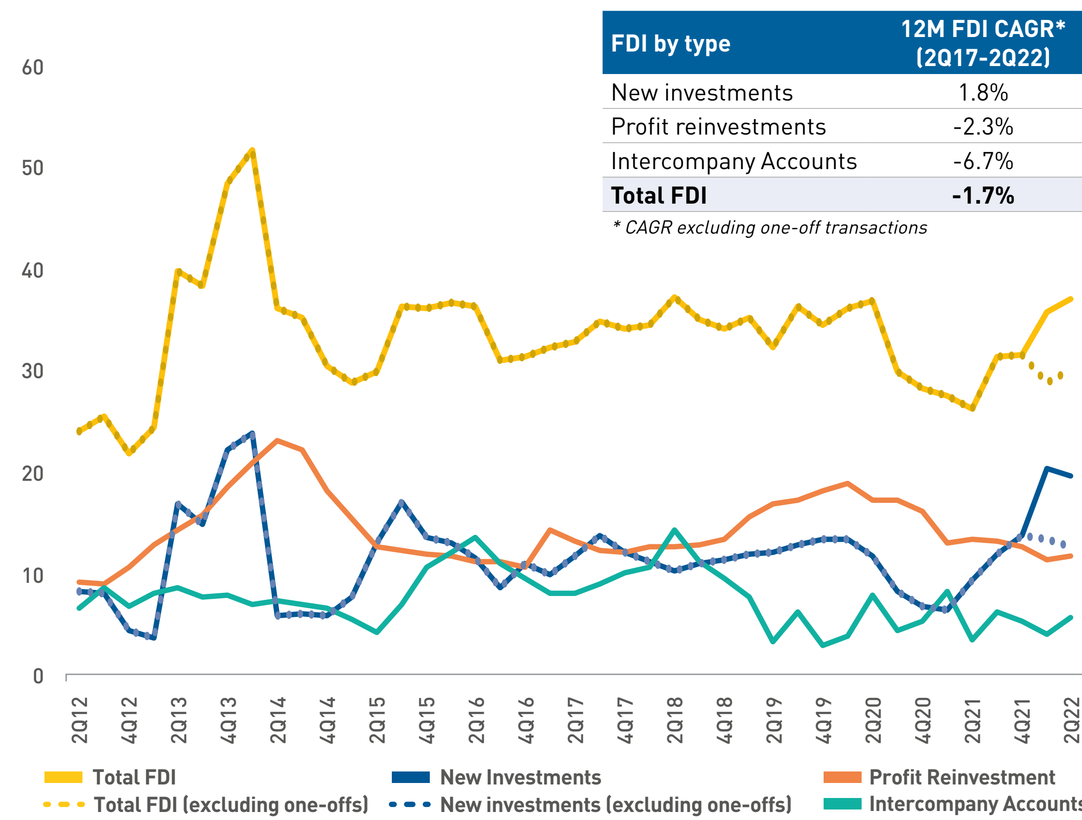
Mexico is the tenth-largest FDI recipient in the world.

–FDI inflows, USD Billion, 2020 and 2021



Excluding the Televisa-Univision merger, FDI remains below its pre-pandemic level.

–FDI by type of investment, USD Billion, 12M flows



FDI by type	12M FDI CAGR* (2Q17-2Q22)
New investments	1.8%
Profit reinvestments	-2.3%
Intercompany Accounts	-6.7%
Total FDI	**-1.7%**

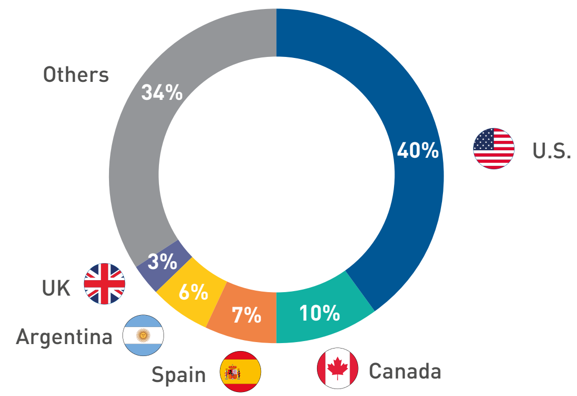
** CAGR excluding one-off transactions*

Sources: Mexico's Ministry of Economy (SE), United Nations Conference on Trade and Development (UNCTAD)

AND, WHAT ABOUT FOREIGN DIRECT INVESTMENT (FDI)?

FDI from the five most relevant countries for Mexico is close to a ten-year average, led by the United States and the United Kingdom.

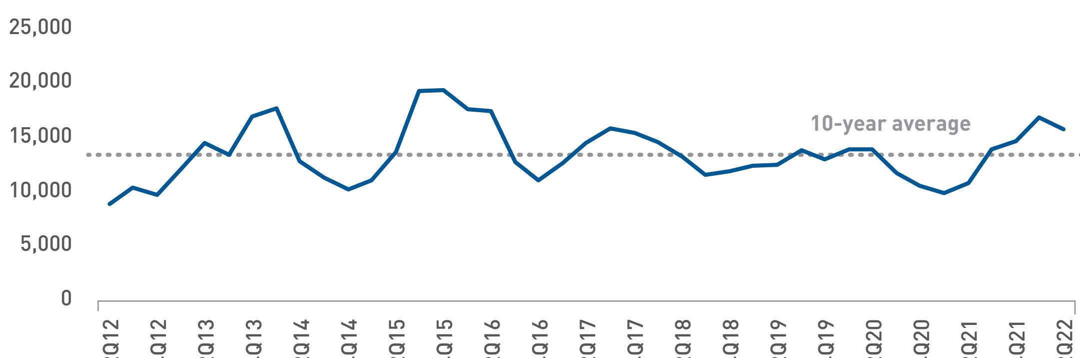
Five countries account for 66% of Mexico's total FDI flows.
–FDI by country of origin, % of total FDI, 1H22 (12M flows)



The United States is the most important participant in Mexico's FDI, accounting for 40% of the total. An encouraging sign is that FDI flows from the U.S. have already bounced back from pre-pandemic levels and stand above their ten-year average.

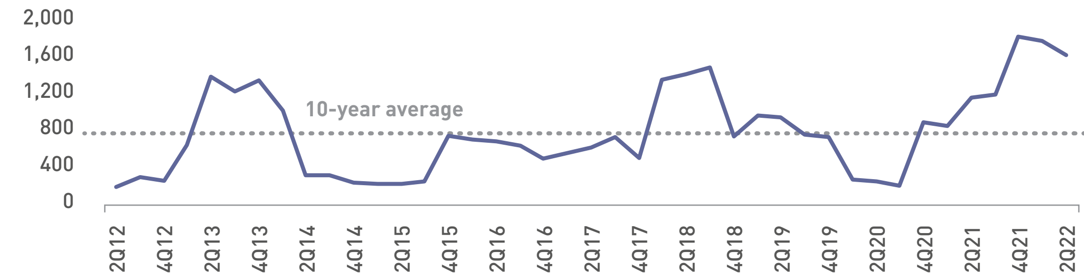
- Even though the rhetoric of President Joe Biden's administration has discouraged offshoring and investment abroad while incentivizing onshoring and domestic investment, U.S. companies continue to heavily invest in Mexico.

U.S. investment flows to Mexico are proof of the solid relationship between both countries.
–FDI flows from the United States, USD Billion, 12M flows



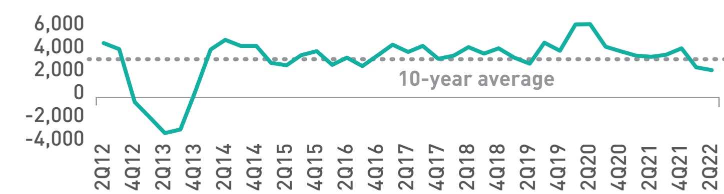
Source: Mexico's Ministry of Economy (SE)

FDI from the United Kingdom has gained momentum since 2020, possibly coinciding with Brexit, which came into force in January 2020.
-FDI flows from the United Kingdom, USD Billion, 12M flows

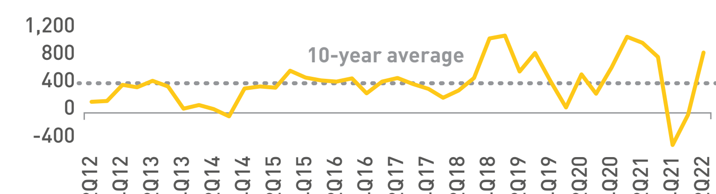


FDI from the other three most relevant nations for Mexico is also near a ten-year average. Moreover, it remains slightly above its historical trend, and the most recent trend is positive.

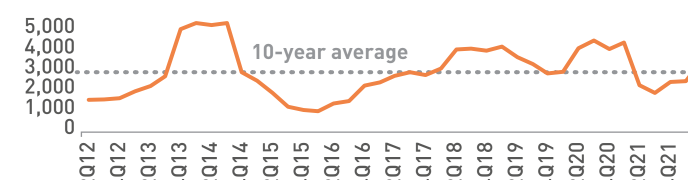
Spain
–USD Billion, 12M flows



Argentina
–USD Billion, 12M flows



Canada
–USD Billion, 12M flows



GBM

GBM Nearshoring Ranking: Assessing Mexico's potential gain

- **Since we are convinced that a positive nearshoring effect could boost Mexico's potential growth in the medium term, we developed our GBM Nearshoring Ranking**, where we identify ten categories that will benefit and be impacted the most by nearshoring. We based our ranking on the size of the market that Mexico could grab (including the Asian Competitive Countries market), the historical trends to substitute Chinese exports to the United States, and Mexico's degree of specialization by industry.

- **According to our GBM Nearshoring Ranking, the manufacturing industries have taken the lead in the race to benefit from the nearshoring opportunity,** with electric machinery, nuclear reactors, and vehicles & parts standing out.

- **Additionally, we assessed the potential impact of nearshoring on Mexico's exports**. Per our analysis, for each 5% substitution rate in the ten selected categories, Mexico's exports could grow by an additional US$22.9 billion (equivalent to 1.8% of GDP). However, the effect could be even higher if the substitution rate increases.

GBM NEARSHORING RANKING

We developed the GBM Nearshoring Ranking to determine the probability that Mexico benefits from nearshoring for different categories of products.

We developed the GBM Nearshoring Ranking to determine the probability that Mexico substitutes Chinese and Asian imports in specific categories, allowing the country to capitalize on nearshoring. In that ranking, we weighed Mexico's degree of specialization, the market size, and the potential market share the country could grab in each category from China and irts Asian competitors, which in most cases is Vietnam, followed by Taiwan. Indeed, the GBM Nearshoring Ranking pointed out ten categories that are prone to exploit Mexico's nearshoring potential.

GBM Nearshoring Ranking

Mexico's degree of specialization

- **1. Share in Mexico's total exports** (through July 2022)

Total market size of each category

- **2. U.S. total imports** (through July 2022)

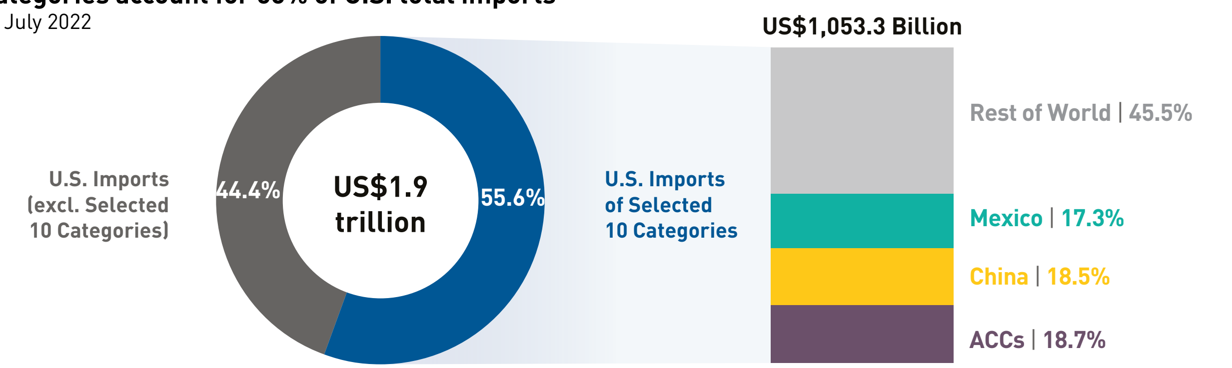
Potential market share that Mexico could grab

- **3. Share of China and ACCs in U.S. imports** (through July 2022)
- **4. Variation of China's market share in U.S. imports** (2017-2022)
- **5. Variation of ACCs' market share in U.S. imports** (2017-2022)

Our nearshoring ranking identifies ten relevant categories where Mexico could outpace China and Asian competitors. The categories that are more likely to benefit from nearshoring trends are in the manufacturing sector: electric machinery, nuclear reactors, and vehicles. These categories are followed by furniture, apparel items (not knitted), footwear, apparel (knitted), mineral fuels, stone products, and wood.

1	**Electric machinery** • Insulated wires • TV receivers • Phone sets
2	**Nuclear reactors, boilers, machinery, etc.** • Automatic data process machines • Refrigerators • Air conditioners
3	**Vehicles and parts** • Individual motor cars and transportation vehicles • Parts and accessories for motor vehicles • Motor cars to transport goods
4	**Furniture** • Seats • Lighting fittings • Mattress supports
5	**Footwear, gaiters, etc** • Rubber footwear • Accessories • Waterproof footwear
6	**Apparel items and accessories; not knitted nor crochet** • T-shirts • Sweaters • Suits
7	**Mineral fuel, oil, wax** • Crude and not crude oil • Other oils • Petroleum gases
8	**Apparel items and accessories; knitted or crochet** • Suits • Tracksuits • Garments
9	**Stone products; plaster, cement, asbestos, mica** • Cement articles • Plaster articles • Abrasive powder
10	**Wood and wood charcoal** • Continuously shaped wood • Carpentry wood • Other wood articles

The 10 selected categories account for 56% of U.S. total imports
- U.S. imports through July 2022



GBM NEARSHORING RANKING

Of the categories identified where Mexico could outpace China and its main competitors, manufacturing industries lead the way.

GBM Nearshoring Ranking Components

China / ACCs

GBM Nearshoring Ranking (feasibility for nearshoring)	Category	Mexico's market share of U.S. total imports 2022 (through July)	1. Share of Mexico's total exports 2022 (through July)	2. U.S. Total Imports (USD Billion) 2022 (through July)	3. Share of China and ACCs in U.S. imports 2022 (through July)	4. Variation of China's market share in U.S. imports (2017 - 2022)	5. Variation of ACCs' market share in U.S. imports (2017 - 2022)
1	Electric machinery	17%	11%	$447 14% of U.S. imports	61%	-12 pp.	11 pp.
2	Nuclear reactors, boilers, machinery, etc.	18%	12%	$460 14% of U.S. imports	41%	-8 pp.	7 pp.
3	Vehicles and parts	34%	16%	$307 9% of U.S. imports	10%	1 pp.	2 pp.
4	Furniture	16%	2%	$82 3% of U.S. imports	66%	-16 pp.	17 pp.
5	Apparel items and accessories; not knitted nor crochet	5%	0.3%	$43 1% of U.S. imports	78%	-13 pp.	14 pp.
6	Footwear, gaiters, etc.	2%	0.1%	$37 1% of U.S. imports	85%	-15 pp.	13 pp.
7	Apparel items and accessories; knitted or crochet	2%	0.3%	$58 2% of U.S. imports	70%	-11 pp.	9 pp.
8	Mineral, fuel, oil, wax	9%	5%	$324 10% of U.S. imports	2%	0 pp.	0 pp.
9	Stone products; plaster, cement, asbestos, mica	11%	5%	$10 0.3% of U.S. imports	33%	-12 pp.	12 pp.
10	Wood and wood charcoal	2%	0.1%	$38 1% of U.S. imports	19%	-11 pp.	6 pp.

Source: GBM with data from U.S. Census Bureau

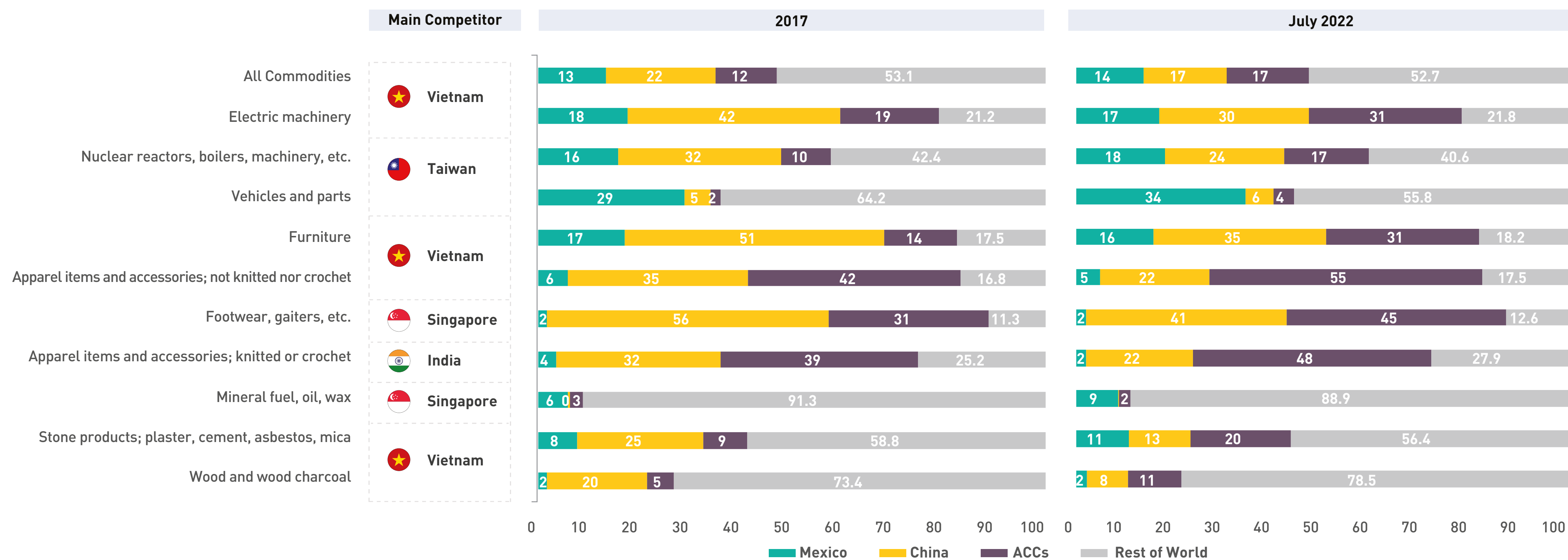
GBM NEARSHORING RANKING

Mexico has many competitors, and we identified the biggest one in each of the 10 selected categories.

Since 2017, Mexico has outperformed China in the selected ten categories; however, the thirteen ACCs have also gained ground in some of these sectors. To identify Mexico's main competitor among those ACCs in each of the selected categories, we analyzed the data and defined the main competitor as the country with the greatest market share increase between 2017 and 2022 (through July).

- **Vietnam is Mexico's main threat in overall trade**, as it is the country that gained the most market share in total U.S. imports between 2017 and 2022 (through July). Moreover, Vietnam was also the biggest winner from the thirteen ACCs in six of the ten selected categories: electric machinery, furniture, apparel items (knitted), apparel items (not knitted), wood, and footwear.
- **Taiwan has also positioned itself as a close competitor to Mexico**, grabbing the largest market share among the thirteen ACCs in two categories: nuclear reactors and vehicles and parts.
- **India and Singapore are Mexico's main competitors in the rest of the categories.**

Market share (as a % of US imports of each category) in selected 10 categories



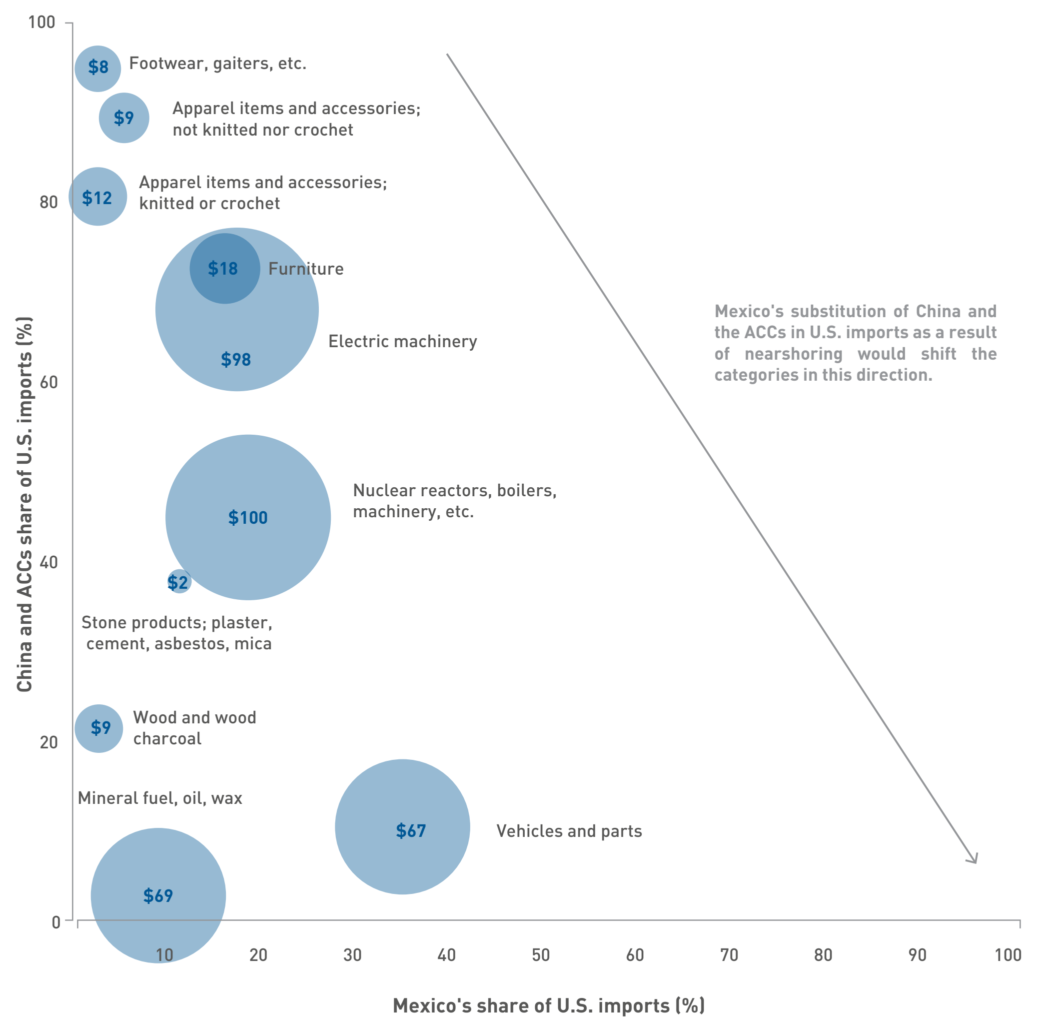
Source: U.S. Census Bureau

GBM NEARSHORING RANKING

Mexico has room to grow its market share by substituting China and the ACCs.

- **China and the ACCs hold a significant share in the imports of the ten most relevant categories in the U.S., and Mexico could steal this market.**
- **Based on the ten selected categories, there is a big market that Mexico could capture** —particularly furniture, electric machinery, and nuclear reactors. Regarding vehicles and parts, the country has started to benefit from the nearshoring boom.
- **The categories at the top left of the graph below describe those in which Mexico still has leeway to grow,** given that China and the ACCs account for most U.S. imports while Mexico holds a smaller proportion. **In other categories, Mexico also has room to develop; however, it would need to substitute other countries aside from China and the ACCs**, as they hold a smaller proportion.

If Mexico capitalizes on the nearshoring opportunity, the categories would show an inclination toward the lower right side of the chart.
–Market share (as % of U.S. imports); the size of the circles represents the size of the U.S. import market.



The size of the circles represents the expected size of the U.S. import market in 2022, assuming imports continue to grow at the same pace in the last leg of the year as they did from January to July.

Source: U.S. Census Bureau

GBM NEARSHORING RANKING: ASSESSING MEXICO'S EXPORTS POTENTIAL GAIN

Mexico's exports could be boosted if the country successfully capitalizes on the nearshoring opportunity in the most relevant categories.

Per our analysis, for each 5% substitution rate in the ten selected categories, Mexico's exports could grow by an additional US$22.9 billion (equivalent to 1.8% of GDP). However, the effect could be even higher if the substitution rate increases; thus, we ran different scenarios. An increase in exports could result in higher imports due to the connectivity of supply chains between Mexico and the U.S.

If Mexico successfully capitalizes on the nearshoring opportunity in the most relevant categories, this trend could also boost potential GDP (currently estimated at 1.5-2.0%), as a more dynamic external sector could result in higher capital investment, technology, and labor productivity.

Nearshoring's potential positive impact on Mexico's exports
–Ten selected categories

For each 5% substitution rate = **~2%** of Mexico's GDP = **~US$23 billion**

	Mexico substituting China		Mexico substituting its main competitor in each category		Mexico substituting China and its main competitor in each category	
Substitution rates	**USD billion**	**% of Mexico's GDP***	**USD billion**	**% of Mexico's GDP***	**USD billion**	**% of Mexico's GDP***
100%	334.7	25.9%	123.3	9.5%	458.0	35.4%
80%	267.8	20.7%	98.6	7.6%	366.4	28.3%
60%	200.8	15.5%	74.0	5.7%	274.8	21.3%
50%	167.4	12.9%	61.6	4.8%	229.0	17.7%
30%	100.4	7.8%	37.0	2.9%	137.4	10.6%
10%	33.5	2.6%	12.3	1.0%	45.8	3.5%
5%	**16.74**	**1.29%**	**6.16**	**0.48%**	**22.90**	**1.77%**
3%	10.0	0.8%	3.7	0.3%	13.7	1.1%

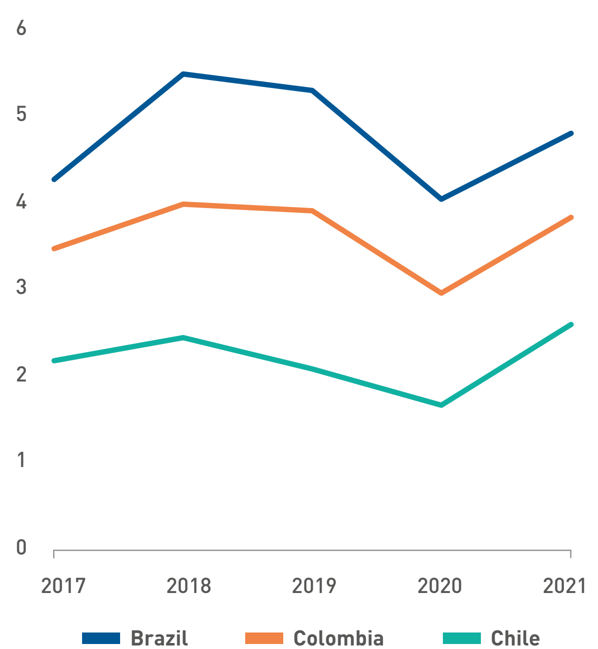
Source: U.S. Census Bureau

OTHER OPTIONS? MEXICO'S NEARSHORING POTENTIAL IS UNLIMITED, AS IT COULD ALSO EXPAND FURTHER SOUTH.

The nearshoring phenomenon is slowly emerging in other parts of the world, and the Latin American region is the perfect place to start.

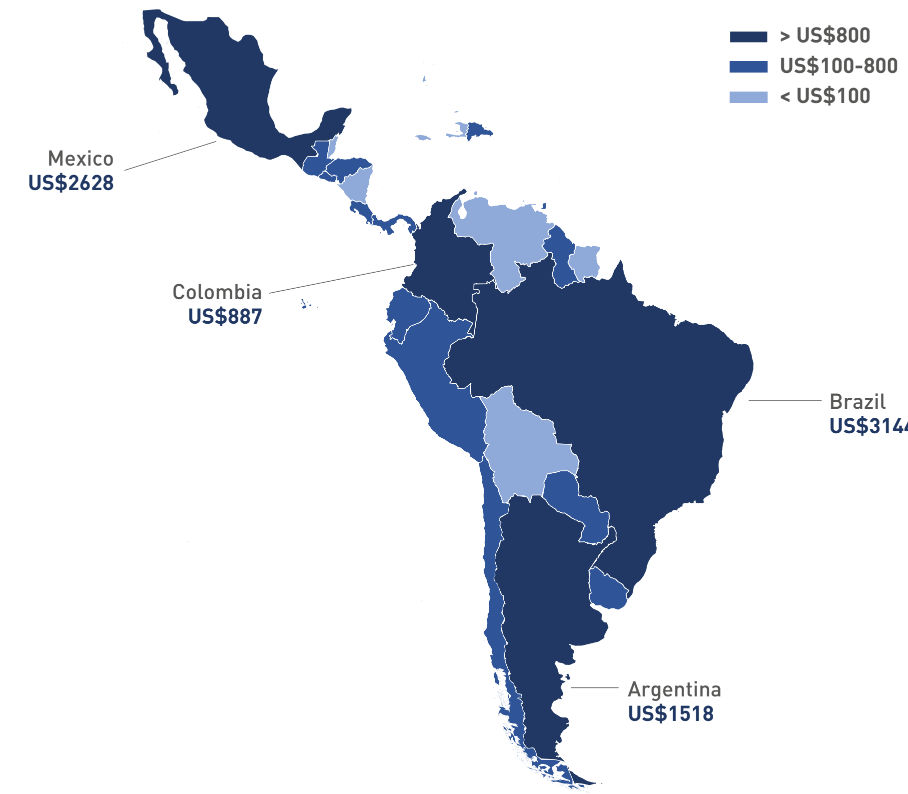
- **Mexico could also capitalize on the nearshoring trend by substituting other competitors in LatAm and Caribbean imports.** According to the Inter-American Development Bank (IDB), Mexico could improve the value of its exported goods by US$2.7 billion if it were to increase exports to its Latin American partners by 15%, substituting competitors from the Eastern Hemisphere (mainly Europe and Asia). Some of the best opportunities for quick wins lay in the auto, textiles, pharmaceuticals, and renewable energy industries, among others.
- **Following the same logic, all Latin American countries could benefit from a regional reshoring**, where Brazil, Mexico, Argentina, and Colombia could become the biggest winners.

Mexican exports to top Latin American economies have remain solid.
–USD Billion



Mexico's nearshoring potential in the U.S. and LatAm amounts to US$25.6 billion.
–USD Billion

Potential gains from intraregional nearshoring, according to the IDB.
–USD Million



Sources: Inter-American Development Bank (IDB), Organization for Economic Co-operation and Development (OECD).

GBM

Nearshoring in Mexico is blooming, and its fruits look promising.

- **Nearshoring in Mexico is no longer a promise; it has started to become a reality.** Recent data and news hint at the start of a positive nearshoring trend in some specific sectors in the country.

- **The unequivocal sign is the expansion of industrial capacity and occupation**, which reflect a higher demand for spaces to set up production lines in Mexico.

- **Gross absorption, which measures the total square meters leased over a given period, is bound to keep growing**. Through March 2022, gross absorption reached 370,000 m^2 in nearshoring transactions—just over half of the 2021 figure and very similar to the 2020 reading.

- **Moreover, the automotive industry is a pioneer of nearshoring in the country, as it has been a clear beneficiary of a high integration in North America's automotive sector**. Today, Mexico is the United States' top auto part trading partner, being 2.8x bigger than China and Canada, which stand in second and third place.

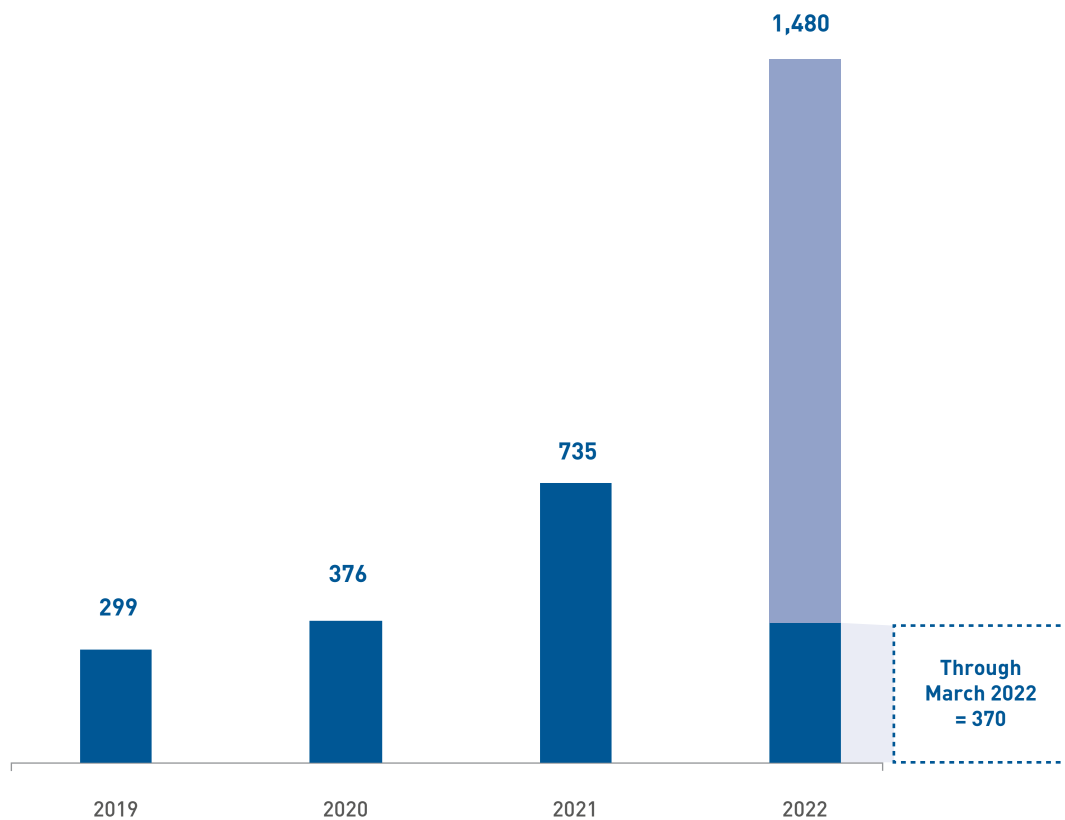
- **Lastly, companies across multiple industries have started to invest in expanding their production capacity in Mexico. And more are to come.**

NEARSHORING IN MEXICO IS BLOOMING, AND ITS FRUITS LOOK PROMISING.

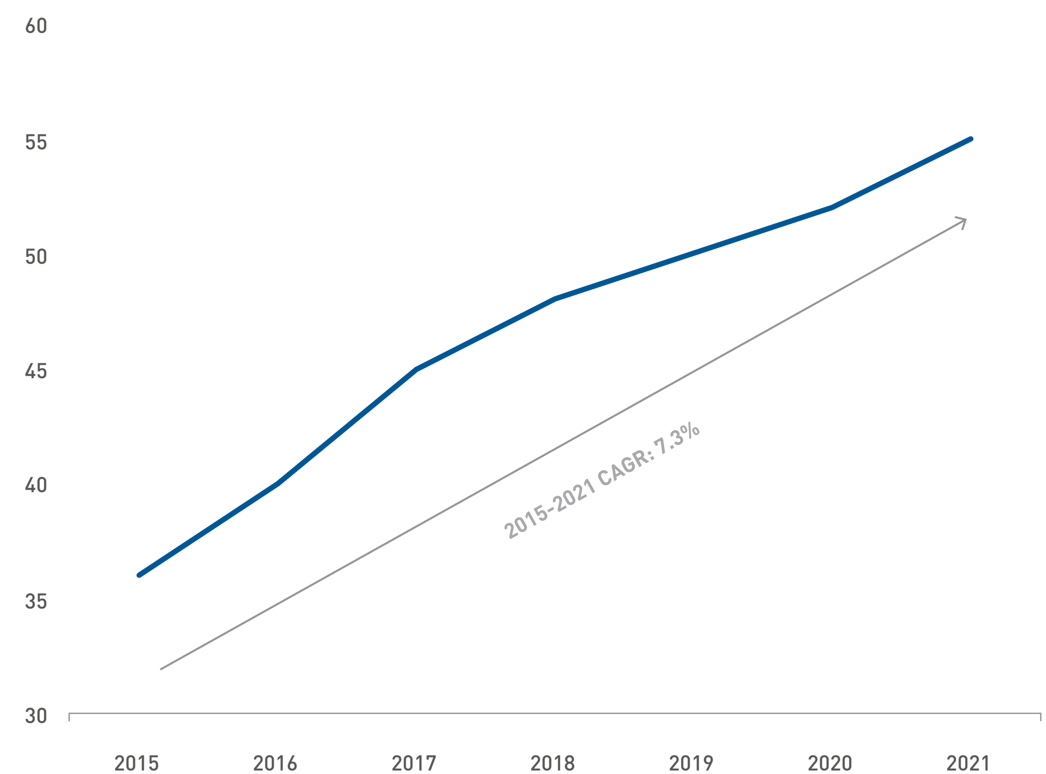
The expansion of industrial capacity and occupation clearly reflect a higher demand for spaces to set up production lines in Mexico

- **The increase of industrial capacity, along with a strong and consistent demand for industrial leasing, hints at the possibility that the nearshoring phenomenon has already arrived in Mexico**. The relocation of supply chains to Mexico could be the main driver behind strong demand for industrial capacity and leasing spaces in recent years.
- **Gross absorption, which measures the total square meters leased over a given period, is bound to keep growing**. Through March 2022, gross absorption reached 370,000 m² in nearshoring transactions—just over half of the 2021 figure and very similar to the 2020 reading.
- **Industrial inventory, which indicates the industrial capacity in terms of land, has increased steadily in recent years, reflecting the surge in demand for spaces to install production facilities**. The industrial market grew at a compound annual rate of 7.3% between 2015 and 2021. Even in the middle of the pandemic (2020-2021), capacity kept on expanding in the country.

At the rate seen in 2022, gross absorption is on track to surpass its previous levels.
–Gross absorption by area of nearshoring transactions in Mexico, Thousand m²



Mexico's consistent growth of industrial inventory reflects the increasing demand for that kind of space.
–Industrial inventory in Mexico's main markets, Million m²



Source: CBRE Research

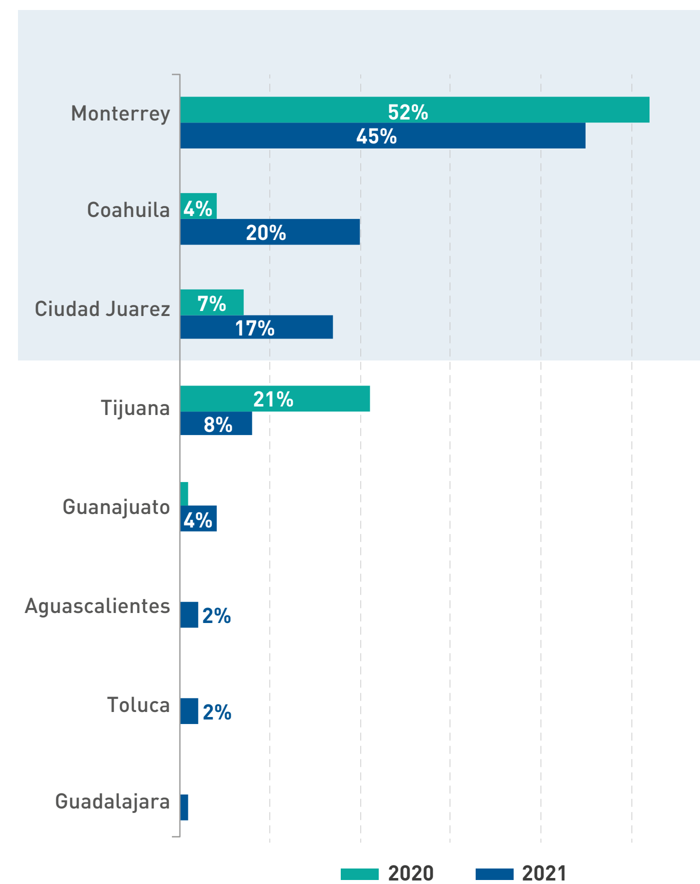
NEARSHORING IN MEXICO IS BLOOMING, AND ITS FRUITS LOOK PROMISING.

Specific states in northern and central Mexico have been catching the eye of foreign companies for relocation purposes.

- **The demand by foreign companies to relocate in the north is apparent**. Given the higher degree of economic development in northern states and their proximity to the U.S., it is only natural that foreign companies choose the former as the best option to move their production processes to.
- **However, the center region of the country is beginning to gain some ground, slowly capturing the attention of foreigners as the place to be**. Going forward, the percentage of foreign companies that relocate to each state could increase in the central region, as these states make continuous efforts to attract FDI and better their infrastructure and connectivity.

In 2021, eight of Mexico's 32 entities attracted 99% of nearshoring candidates. Yet, there is plenty of room for everyone.
–% of foreign companies that relocated their production to Mexico, by state (2021)

Monterrey, Coahuila, and Ciudad Juarez lead the demand for nearshoring spaces in Mexico.
–% of industrial space absorption



Source: GBM with CBRE data.

GBM

NEARSHORING IN MEXICO IS BLOOMING, AND ITS FRUITS LOOK PROMISING.

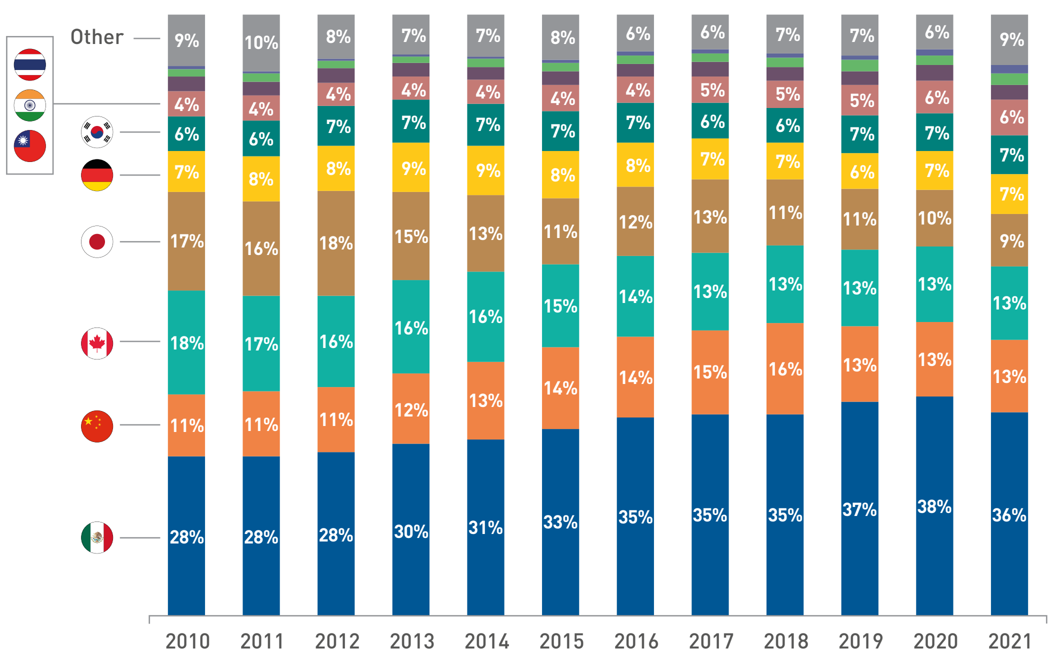
The automotive industry, a pioneer of nearshoring in Mexico

Mexico has been a clear beneficiary of a high integration in North America's automotive sector.

- **Over the last decade, Mexican auto parts have gained share in the U.S. market**. Indeed, Mexico is the United States' top auto part trading partner, being 2.8x bigger than China and Canada, which stand in second and third place, respectively.
- **The automotive sector is at the core of Mexico's manufacturing export strength**. Mexico's external sector has specialized to a great extent in the production of motor vehicles and parts. In July 2022, this category had the largest share in Mexico's exports to the rest of the world (22.8% of total exports).
- **Since the signing of the USMCA (2018), there were early signs of a surge in the regional content of Mexican auto parts**. Based on a sales-weighted average of content from Mexico, the regional content of Mexican auto parts increased in six of the nine big original equipment manufacturers (OEMs) between 2018 and 2022, while it stayed constant in two of them and decreased in only one.

Mexican auto parts have gained share in the U.S. market over the last decade.

–% of U.S. auto part imports



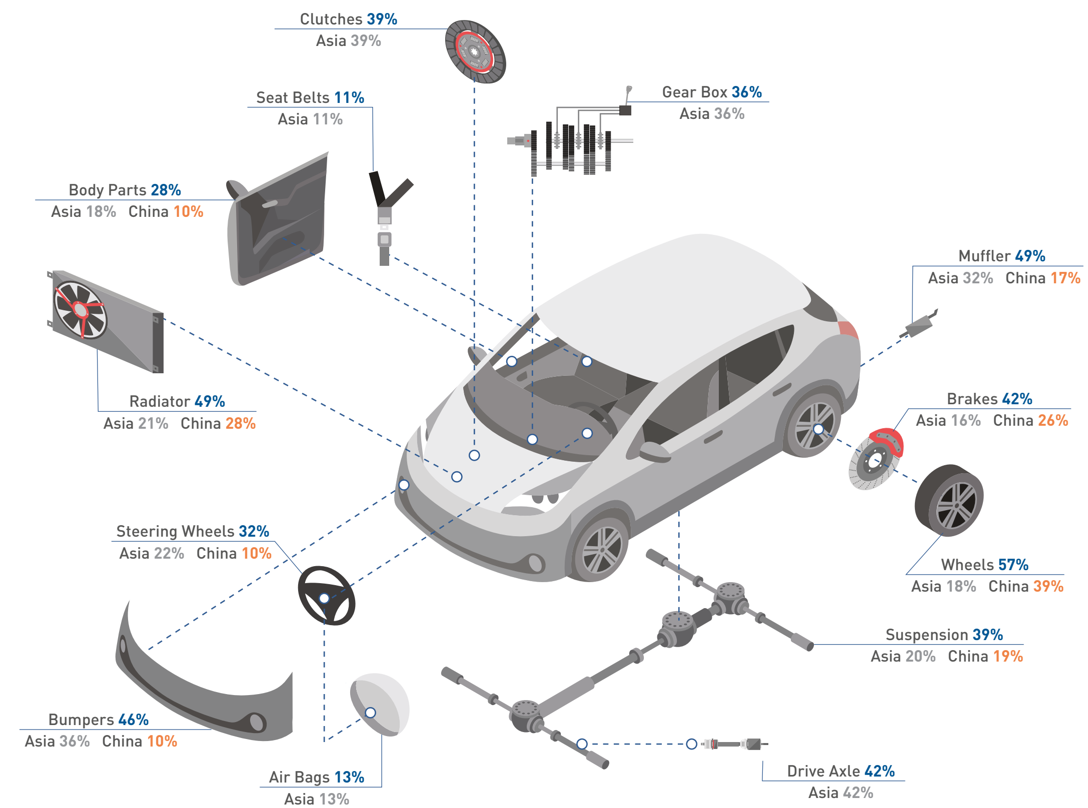
GBM Capital Goods & Building Materials
Source: US Census Bureau

Mexico has outperformed its main competitors in the auto part industry and still has leeway to keep growing.

- **The biggest opportunity for Mexico could come from substituting China and the rest of Asia.** Overall, Asia represents ~37% of imported auto parts in the United States, while China alone accounts for 13%.
- **Moreover, Mexico has a large opportunity in each auto part**, with some variations across the components of a car.
- **Note that Europe is an important player in this market as well. Hence, an additional substitution effect could derive from this market**, which accounts for around 13% of the total U.S. auto parts imports.

Mexico's potential market if it substitutes Asia in each component.

–% of U.S. auto part imports by component



NEARSHORING IN MEXICO IS BLOOMING, AND ITS FRUITS LOOK PROMISING.

Companies across multiple industries have started to invest in expanding their production capacity in Mexico. And more are to come.

Automotive

- The government of Nuevo Leon is working closely with Tesla, who is pushing its main suppliers to relocate closer to the U.S., for which the state would be an ideal candidate.
- In August 2022, Mitsubishi Motors said Mexico could be a very important hub to produce parts and spare parts for the North American market as it looks for auto part suppliers.
- In May 2022, Nissan announced it will invest US$700 million in its manufacturing plant in Aguascalientes, Mexico, over the next three years.
- In May 2022, Pirelli disclosed a US$15 million investment over the next two years for the construction of an advanced technology and digitization center to produce tires at its plant in Silao, Guanajuato.
- In February 2022, Hisun Motors unveiled a US$152 million investment to install its manufacturing plant in Saltillo, Coahuila. The plant will be dedicated to the production of all-terrain vehicles.
- In November 2020, Volkswagen invested approximately US$234 million in a new engine production line at its plant in Guanajuato, Mexico.

Electric Machinery & Electronics

- In September 2022, Bosch announced a US$215 million investment in a new manufacturing plant in Queretaro, to produce components for mobile applications designed for machinery.
- In July 2022, Samsung informed it will invest US$500 million to expand the production capacity of home appliances at its plants in Mexico, located in Queretaro and Tijuana.
- In May 2022, manufacturing services company Jabil said it plans to invest US$100 million over the next five years in its plants in Mexico. The company currently operates manufacturing plants in Tijuana, Monterrey, Chihuahua, Ciudad Juarez, and Guadalajara.

Toys

- In March 2022, Mattel announced it had spent around US$50 million to expand its toymaking plant in Escobedo, Nuevo Leon, becoming the company's largest manufacturing plant and overtaking other plants in China, Malaysia, and Vietnam.
- As a result of the pandemic, the toy company MGA Entertainment faced several challenges with the supply chains of its Chinese products. Therefore, the company decided to expand the toy production capacity at its plant in Ciudad Juarez, Chihuahua. Additionally, MGA plans to begin construction of a second factory in Mexico this year, seeking to move part of MGA's Chinese output to these plants.
- In June 2022, Lego announced it would upgrade and expand its manufacturing facility in Monterrey, Nuevo León, which currently supplies the U.S. market.

Furniture

- Chinese furniture manufacturer Keeson Technology, in alliance with Ergomotion and Tecma Group, inaugurated its first plant in Ciudad Juarez in April 2021, creating more than new 600 jobs in the area.

Medical

- Ambu, a Danish medical device company, began the construction of its new plant in Ciudad Juarez, Chihuahua, in March 2021, and expects it to be fully operational in the 2022-2023 financial year.
- Bayer recently announced it will invest US$7.5 billion in Mexico over the next three years. Part of the resources will be used for modernizing its production plant in Lerma, State of Mexico.

Food & Beverage

- In July 2022, Nestlé announced a US$340 million investment in its coffee processing plant in Veracruz, where the company will process an additional 40,000 tons of sustainable coffee for the Nescafé brands.

GBM

Mexico emerges as the natural contender for nearshoring.

- **We firmly believe that Mexico will bear fruit from the rearrangement in global supply chains, as its structural profile positions the country as the natural contender to benefit from nearshoring**. Mexico has twelve free trade agreements (FTAs) with fifty countries, including the USMCA. Moreover, it has a privileged relationship with the United States ('friend-shoring'); the Mexico-U.S. border is the busiest in the world; it has a young, affordable, and highly qualified labor force, and it has become highly attractive in terms of transportation costs, as shipping costs have skyrocketed in the post-pandemic world.

- **Mexico's labor costs remain an attractive trait for investors** and have increased relatively slowly in recent years. The real wage in Mexico has risen by 0.2%, on average, between 2014 and 2021—way below the 6.1% observed in China and 5.9% in Vietnam, its main competitor.

- **Moreover, the hands-on approach that the Mexican government has adopted regarding nearshoring, with the implementation of supportive policies, such as fiscal incentives**, poses a unique advantage for the country against its competitors.

- **Additionally, despite Mexico's energy policy, it is undeniable that the country has access to a variety of cheap energy sources.**

- **Lastly, ESG could become Mexico's** ally since its proximity to the end market could entail lower CO2 emissions.

MEXICO EMERGES AS THE NATURAL CONTENDER FOR NEARSHORING.

Mexico's wide array of free trade agreements provides companies with a key to multiple markets around the world, including the United States.

Trade Openness

Firms that settle down in Mexico have access to multiple markets around the globe under free trade conditions.

FTAs

Mexico has twelve Free Trade Agreements (FTAs) with fifty different countries, including the USMCA, and many more in progress:

- The first round of negotiations to reach an FTA **between Mexico and the United Kingdom** began in July 2022, and authorities are striving to seal the deal before year-end.
- **Mexico and South Korea** recently agreed to promote a bilateral trade agreement.

WTO

Mexico has been an active member of the World Trade Organization (WTO) since 1995.

- According to the WTO, **Mexico ranked 11th among the leading exporters in world merchandise trade in 2020**, holding 2.4% of the global market share.

Mexico and the United States have a privileged relationship. The United States-Mexico-Canada Agreement (USMCA) allows companies in Mexico to import and export certain goods to and from the U.S. and Canada under tariff-free conditions. In the face of the trade war between the United States and China that arose a couple of years ago, **Mexico's free trade agreement with its northern neighbors has become an increasingly valuable advantage that will be in place for many years ahead.**

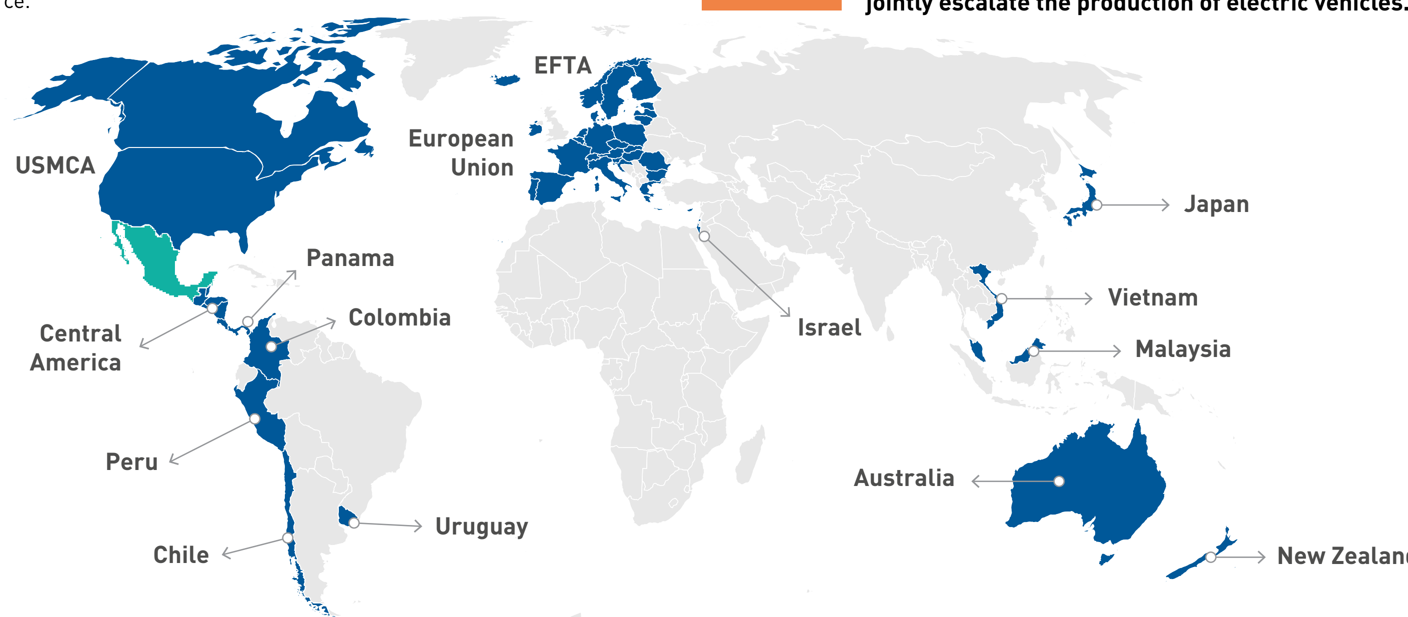
Mexico-US Border

The U.S.-Mexico border is the busiest in the world. In 2021, over US$1.2 million worth of products moved across the border every minute.

Friend-shoring

Mexico's proximity to the U.S. might be more valuable than ever. A new concept among trade experts has arisen. 'Friend-shoring' advocates believe that global trade can benefit from reducing the reliance on countries with autocratic governments and nonmarket economies (e.g., China and Russia). Hence, Mexico has a unique and privileged position concerning the United States. **Indeed, Mexico and the United States recently announced they plan to reap the benefits of the Biden administration's massive investment in semiconductor production in order to push the integration of their supply chains and jointly escalate the production of electric vehicles.**

Mexico has FTAs with the world's largest and most important partners.
–Countries with which Mexico has an FTA in force.



Sources: Foreign Relations Ministry (SRE), WTO

MEXICO EMERGES AS THE NATURAL CONTENDER FOR NEARSHORING.

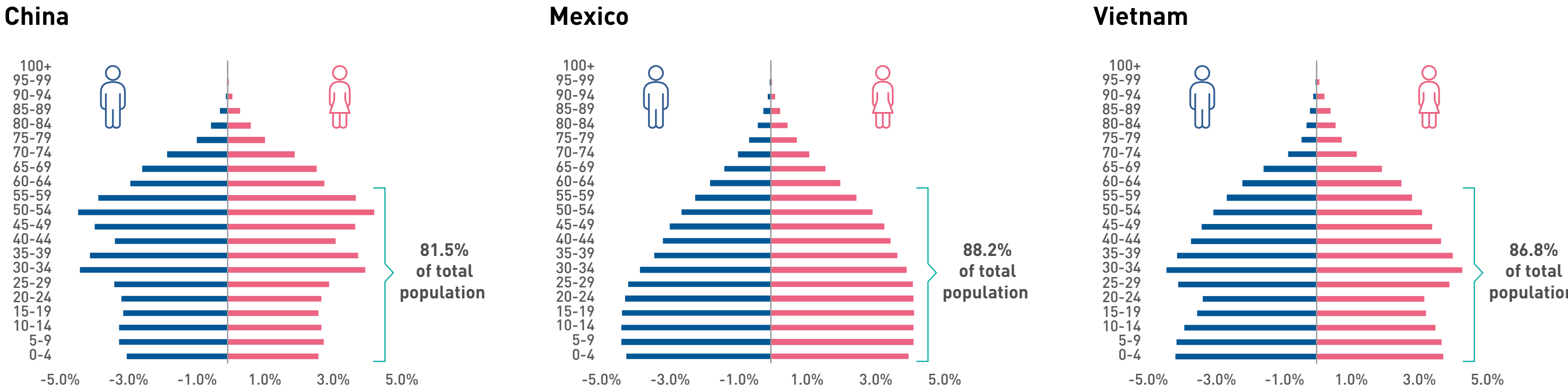
Mexico, a paradise for nearshoring, with a young, affordable, and highly qualified labor force

When it comes to population dynamics, labor costs and degree of specialization, Mexico is an ideal destination for nearshoring.

Population

- **Mexico will continue to have a large portion of young population in the coming years**. Mexico still has a demographic advantage over its main competitors that will only become apparent in the years ahead.
- **Around 88.2% of Mexico's total population is under the age of sixty**. Most of Mexico's population will continue to be young and in working age in the short to medium term. In contrast, 86.8% of the population in Vietnam and 81.5% in China is under sixty years of age.

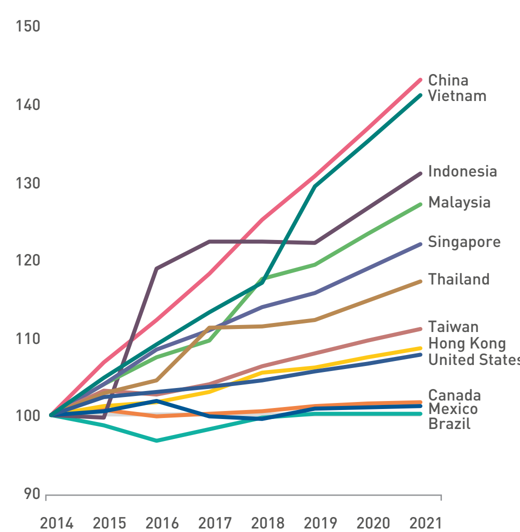
Demographic pyramid by country (2022)



Labor Costs

- **Mexico's labor costs remain an attractive trait for investors and have increased relatively slowly in recent years**. The real wage in Mexico has risen by 0.2%, on average, between 2014 and 2021—way below China's growth rate of 6.1% and Vietnam's 5.9%.
- **While real wages in Asia have increased significantly, in Mexico, they have remained virtually unchanged.** China has seen an exponential economic growth in recent years, and wages have risen accordingly. This has compelled companies to consider switching production to other Asian countries with lower manufacturing costs. However, real wages in Vietnam, Indonesia, Malaysia, Singapore, and many others have also started to pick up.

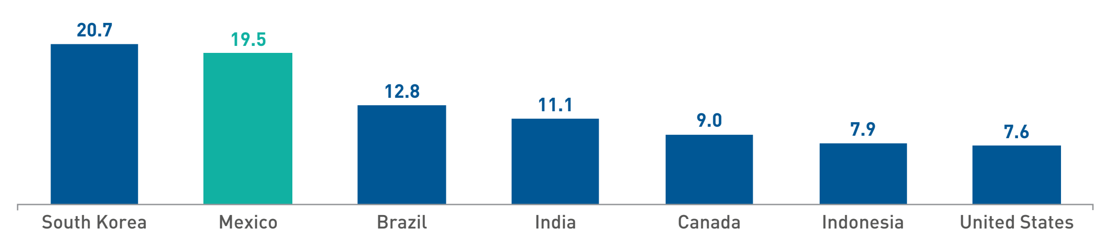
China's cheap labor isn't so cheap anymore, while Mexico outstands
-Average real wage per country, Index 100 = 2014



Specialization

- **As for the quality of labor and specialization, Mexico is ahead of most of its competitors**. Almost a fifth of Mexico's university graduates specialize in engineering, manufacturing, and construction, whereas this percentage is significantly lower (below 15%) among most of its Asian peer countries.
- **Mexico's degree of specialization offers a certain level of know-how that is crucial for specific industries**, particularly those looking into nearshoring.

Mexico has a broader base of highly qualified labor for engineering, manufacturing, and construction activities.
–% of graduates with a degree in engineering, manufacturing, and construction (2019)



Sources: International Labor Organization (ILO), Organization for Economic Cooperation and Development (OECD), Population Pyramid

GBM

MEXICO EMERGES AS THE NATURAL CONTENDER FOR NEARSHORING

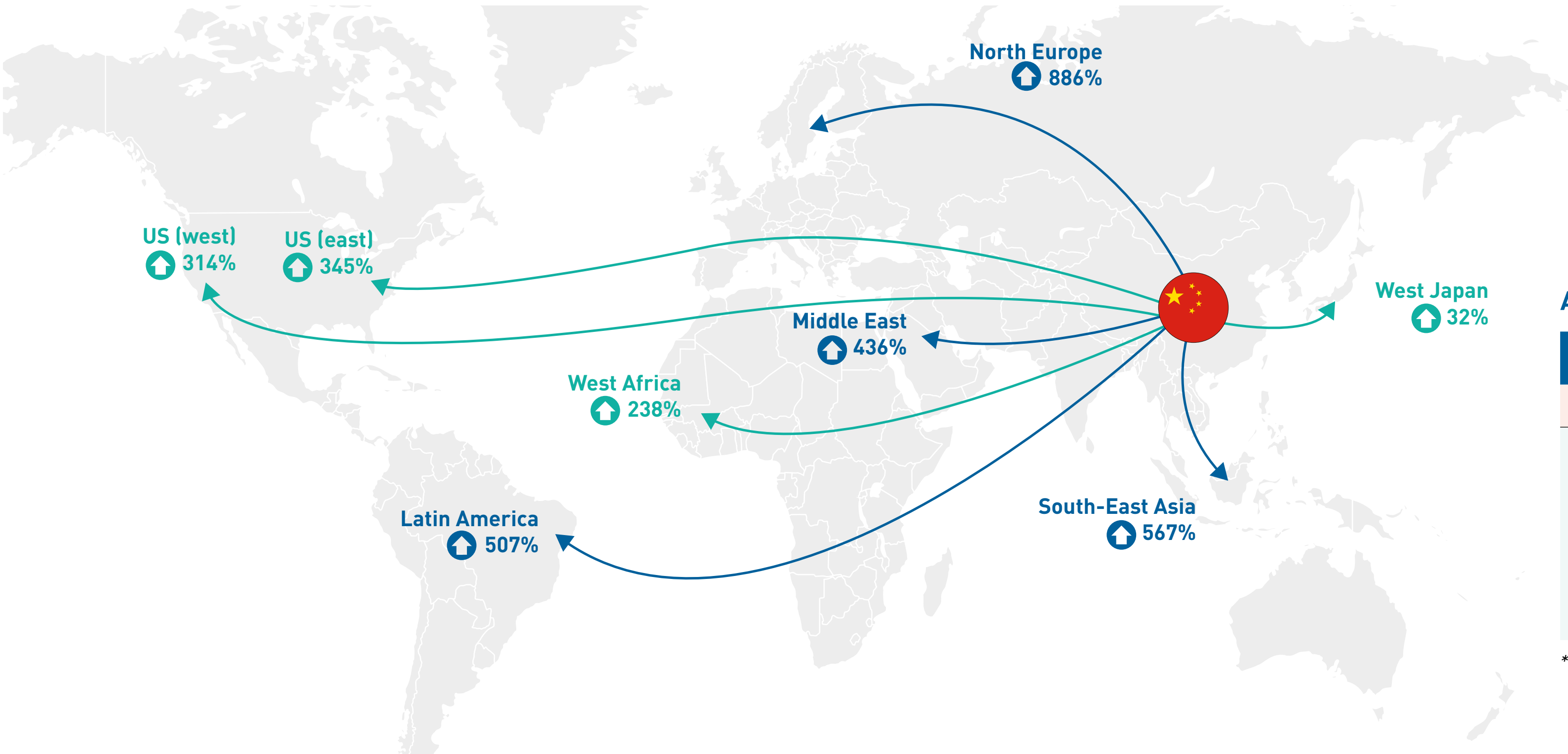
Supply chains far from home have once again proven that time is money.

Transportation Costs

It is evident that relocating supply chains closer to home is the best strategy based on the increase in transportation costs. In our view, and in that same line, two key factors make Mexico stand out as a better alternative:

- **International freight rates.** Since 2019, freight rates have skyrocketed, particularly for routes departing from China. Indeed, between 2019 and September 2021, freight rates from China to the U.S. climbed by 345% to the East Coast and by 314% to the West Coast.
- **Time is money**. Asia to U.S. delivery times skyrocketed, hampered by fragile supply chains, which are dependent on long journeys and several checkpoints before products reach their final destination. As a result, companies struggled to handle inventories, and consumers have lost confidence in businesses, becoming more sensitive to in-time deliveries and goods availability. On this front, Mexico's proximity to the U.S. significantly weighs in and provides several freight options —like highways, rail, or sea—, so companies can ship cargo from anywhere in Mexico to major cities in the U.S. in less than four days —vs. the 40-day average travel from Asia to the U.S., without considering idle time.

Rates on all routes from China to the rest of the world have skyrocketed
– Spot container freight rates (growth rate between 2019 (average) and September 2021)



Time is money

Mexico's proximity to the USA allows for an improved logistics strategy

Average transit time in days to Los Angeles

Country	Origin City	Shipping time (Days)*
China	Shanghai	37
Mexico	Guadalajara	2.4
	Monterrey	1.5
	Mexico City	2.4
	Tijuana	1
	Aguascalientes	2

Only considers travel time, not including idle time at export or import facilities

Source: The Economist

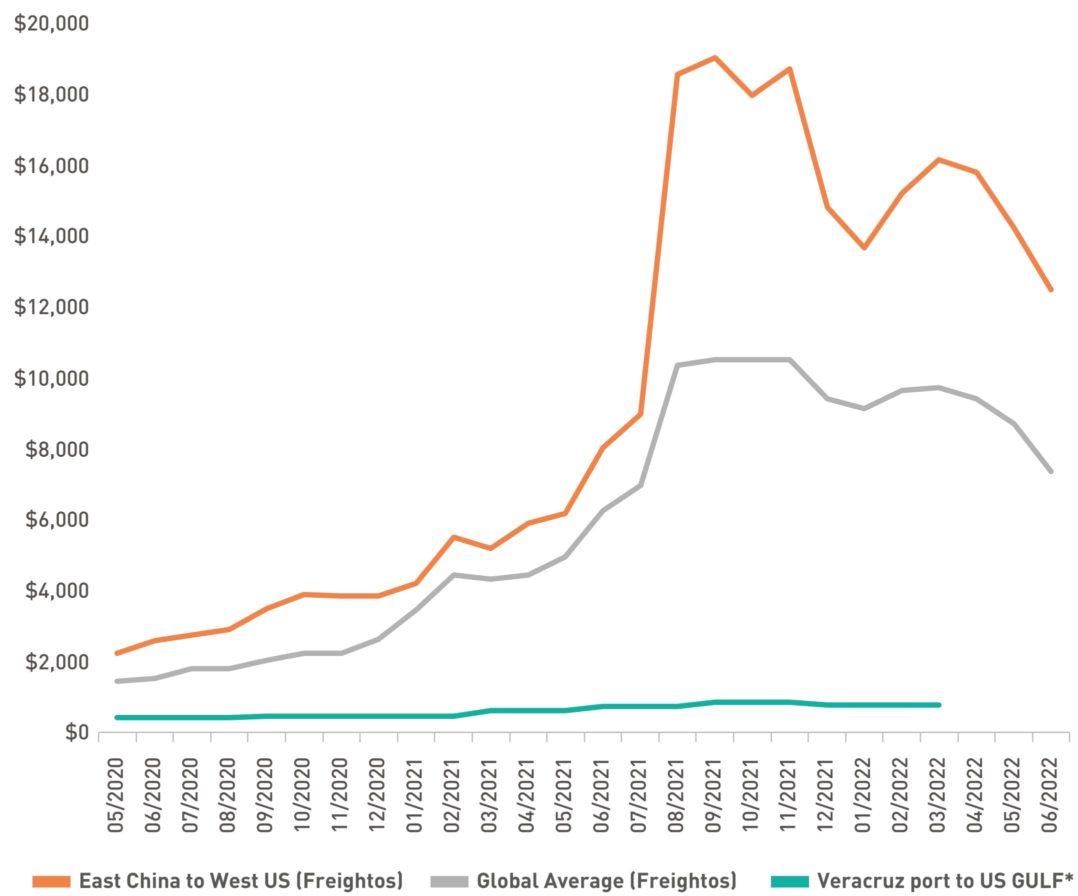
GBM

THE RACE TOWARDS A NEW WORLD TRADE ORDER

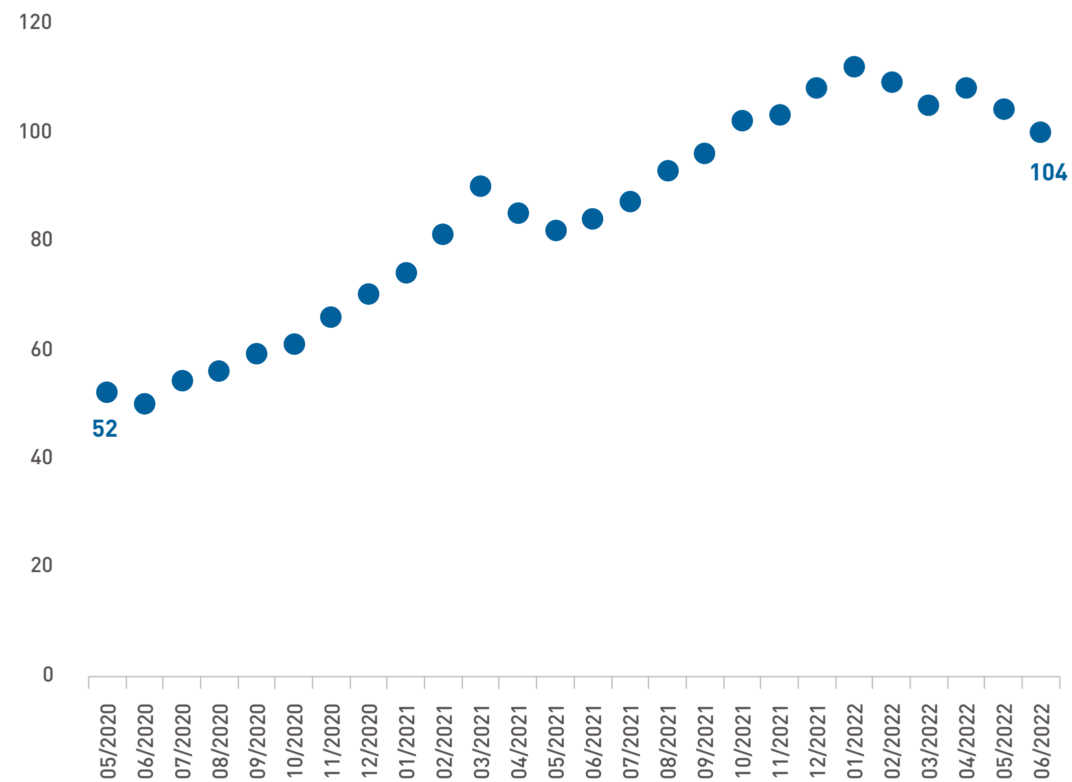
Supply chains far from home have once again proven that time is money.

Transportation Costs

Ocean freight rates have significantly increased in routes departing from East China, whereas rates from Mexico have remained virtually flat.
–Ocean freight rate of a 40-foot container in USD



According to the Ocean Timeless Indicator by Flexport Inc., which measures the total travel time of a container from ready-to-ship to importer pick-up, the total transit days from Asia to North America increased by 52 days between May 2020 and June 2022, which represents a surge of 100%.
–Total transit days of transpacific container shipping from Asia to North America



Sources: Flexport, Freightos, U.S. Department of Agriculture

GBM

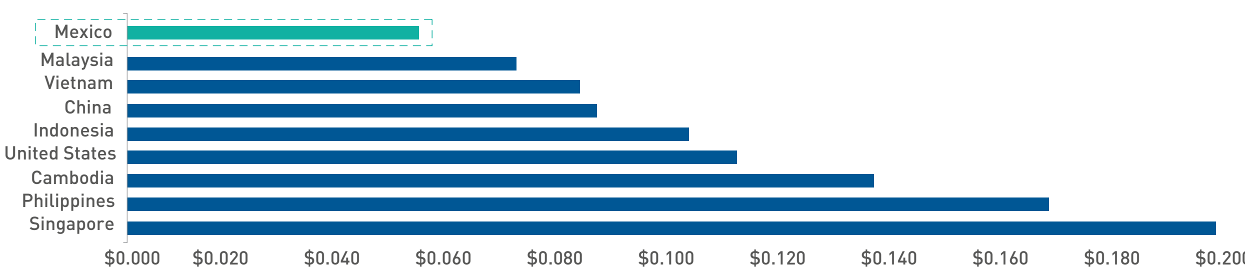
MEXICO EMERGES AS THE NATURAL CONTENDER FOR NEARSHORING.

Despite Mexico's energy policy, it is undeniable that the country has access to a variety of cheap energy sources.

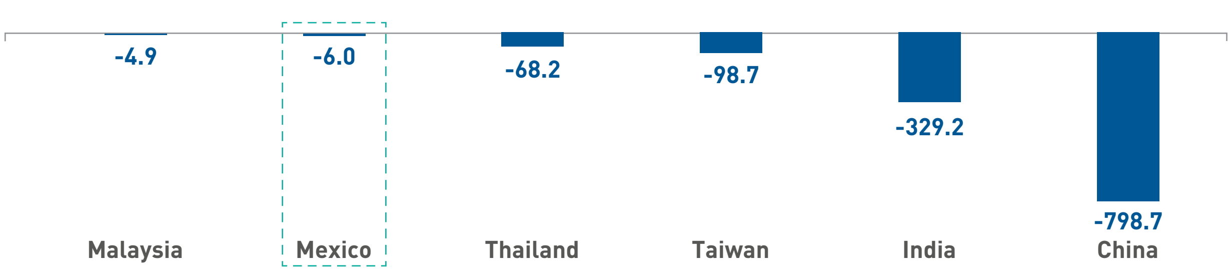
Energy

- **Mexico is less dependent on energy imports**. This poses an enviable advantage, mainly when compared to its Asian competitors, who tend to rely more on energy imports. In 2019, Mexico imported around 45% of its needs for refined petroleum products—the country's main energy consumption type. By contrast, China—the world's largest energy consumer—imported ~70%. Additionally, China's coal imports are the largest in the world, representing ~67.3% of its coal consumption—the country's main energy consumption type.
- **Furthermore, Mexico's low electricity costs represent another great advantage**, particularly when considering economic activities whose production processes are energy-intensive.
- **While Mexico is rich in resources and has the cost structures required, it is a fact that public energy policies are needed to build on those resources and provide the country with a clear advantage in the nearshoring arena.**

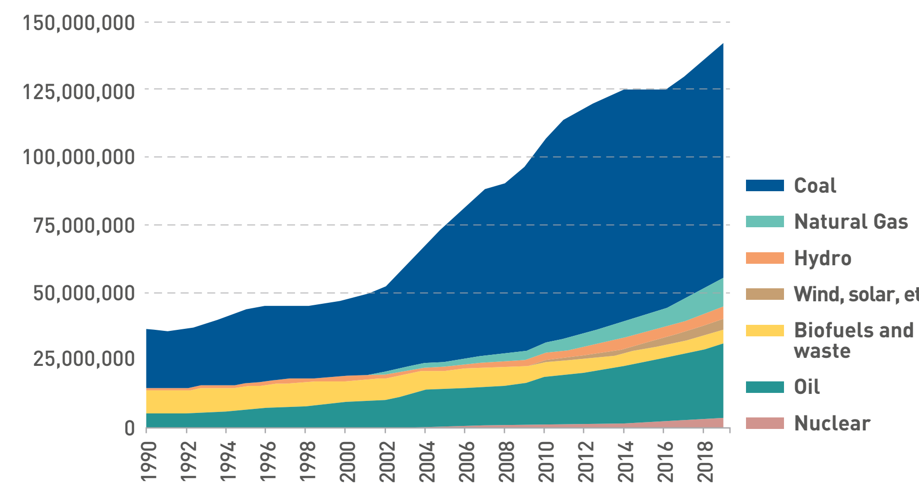
Mexico still offers one of the cheapest electricity rates in the world, which is ultimately reflected in companies' net profits.
–Average price of 1 KW/hr. per country (in USD)



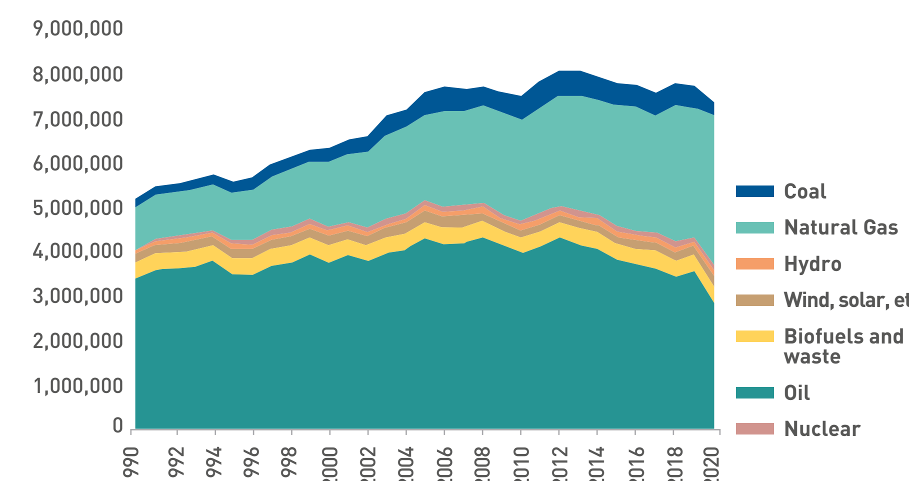
Mexico heavily relies on natural gas imports; however, its energy trade deficit is much smaller compared to China and other Asian economies.
–Energy balance of trade per country, Mega tons of oil equivalent (Mtoe)



China is the world's largest importer of coal —one of the world's most polluting energy sources.
–China's total energy supply (TES) by source



In contrast, Mexico has a vast and diverse energy matrix, which has become increasingly valuable.
–Mexico's total energy supply (TES) by source



Sources: Energy Information Administration (EIA), Cable Co. UK, Enerdata

MEXICO EMERGES AS THE NATURAL CONTENDER FOR NEARSHORING.

ESG could become Mexico's ally since its proximity to the end market could entail lower CO2 emissions.

ESG

- **By moving supply chains closer to the end market, companies would significantly reduce their CO2 emissions** related to transportation, production, and raw materials.
- **ESG has become one of the latest trends** that companies and investors look at when deciding to relocate their production and supply chains.
- **The Social front could also benefit from nearshoring in Mexico,** where labor practices are better ranked than in China.
- **Pushing for gender equality regulations,** BoD independence, and higher accountability, among other factors, could help Mexico better position itself on the Governance front.

Enviromental	By moving supply chains closer to their home country, companies would considerably diminish their Scope 3 greenhouse gas (GHG) emissions, as the need to travel long distances to transport merchandise would reduce.
Social	Mexico outranks China in the International Trade Union Confederation's (ITUC) Global Rights Index, which stands for better labor rights protection.
Governance	Mexico has no widespread advantages on the Governance front. Rather, it has plenty of room to improve on this aspect, pushing for the implementation of stricter and more transparent governance regulations.

Sources: Energy Information Administration (EIA), Cable Co. UK, Enerdata

MEXICO EMERGES AS THE NATURAL CONTENDER FOR NEARSHORING.

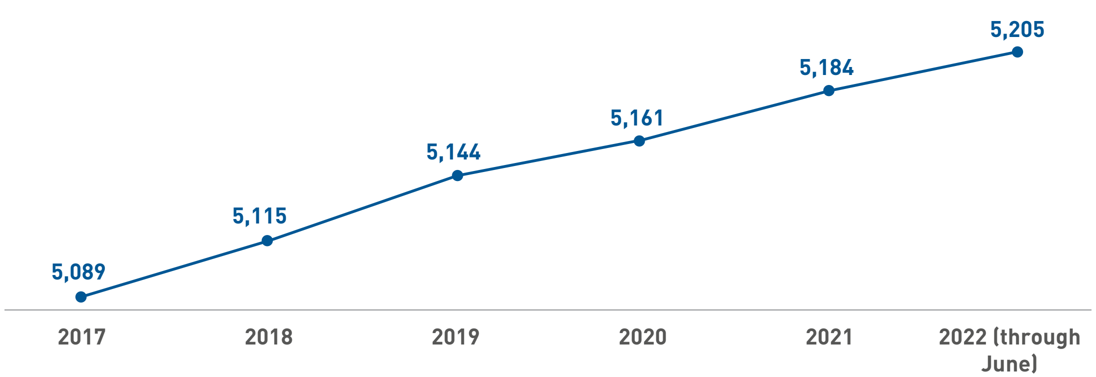
Fiscal incentives without having to sacrifice quality are a once-in-a-lifetime opportunity for foreign companies.

Fiscal Incentives

Mexico's fiscal incentives provide a unique competitive edge against its competitors, as nearshoring remains one of the government's priorities.

- **The Program for the Manufacturing, Maquila, and Export Services Industry (IMMEX)**—launched in 2006—allows U.S. firms to temporarily import goods and services that will be manufactured, transformed, or repaired, and then re-exported without payment of taxes, compensatory quotas, and other specific benefits.
- **Additionally, according to Mexico's Finance Ministry, the federal government plans to take measures that encourage foreign firms to relocate part of their production to Mexico**. These actions would include fiscal benefits, credits, and financial policies.

The IMMEX program has proven successful, as a growing number of companies have joined.
–Number of manufacturing firms that operate under the IMMEX program



Inter-American Development Bank (IDB) - US$1.8-2.3 billion in short- and long-term financing program

- In July 2022, the IDB announced its collaboration with the Mexican government to promote nearshoring, especially in the country's south-southeastern states. Over the next three years, the IDB will provide US$1.8-2.3 billion in short- and long-term financing for new industrial parks, investment in anchor companies, and development of innovative mechanisms to finance small and medium-sized companies (SMEs) working in global supply chains.

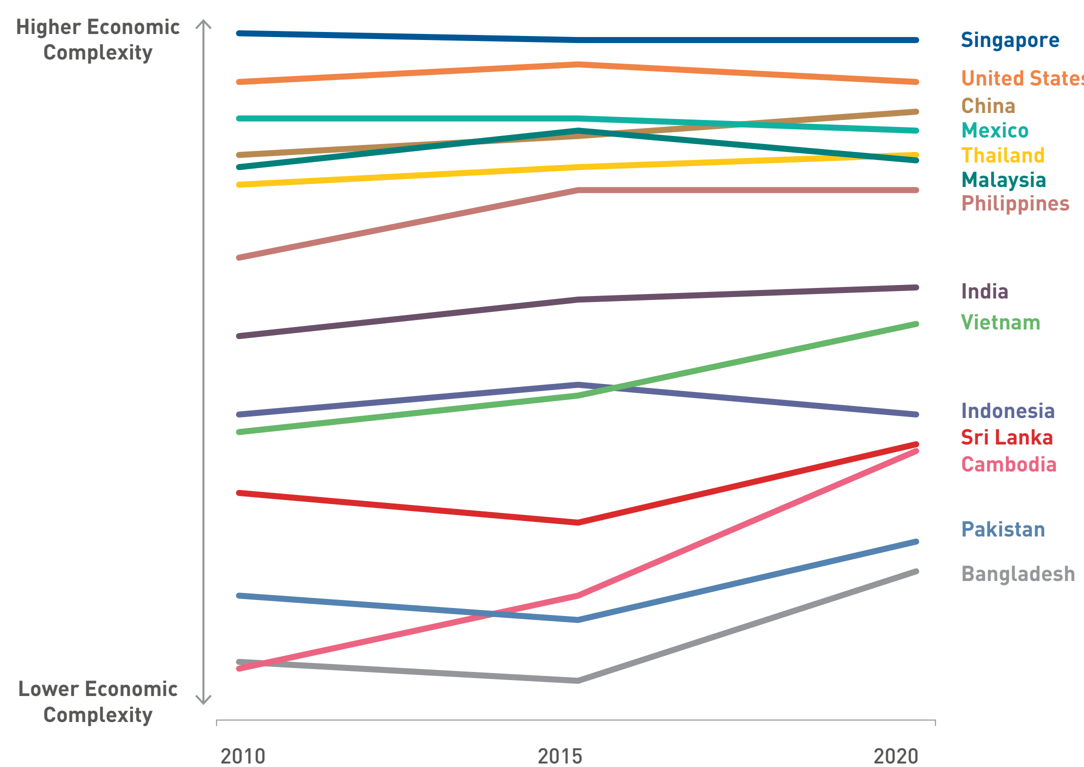
Recently, Deputy Minister of Finance Gabriel Yorio informed that the International Finance Corporation (IFC), a member of the World Bank, will double its investments to US$1.0 billion annually to help Mexico's private sector.

Quality & Diversity

Quality is important and Mexico has been highly competitive among complex economies over the past years and remains far ahead of many Asian competitors.

- **Mexico has managed to maintain a diverse range of productive and sophisticated know-how and skills**, allowing it to produce a wide assortment of goods and become one of the closest competitors of China and the United States. Hence, Mexico has advantages not only when it comes to costs but also quality.
- **Harvard's Economic Complexity Index (ECI) measures the diversity of exports a country produces and how unique these exports are**, i.e., the number of countries that can produce those exports.

Mexico's quality of goods is way ahead of ACCs, making it the closest substitute to China.
–Harvard's Economic Complexity Index (ECI)



Sources: Atlas of Economic Complexity, Mexico's National Statistics Agency (INEGI), Mexico's Ministry of Economy (SE)

MEXICO EMERGES AS THE NATURAL CONTENDER FOR NEARSHORING.

Mexico is top-of-mind for executives' nearshoring plans.

Executives' Mindset

A.T. Kearney's 2021 Reshoring Index and the analysis conducted by GBM's Data Science Team revealed interesting insights that confirm nearshoring is here to stay.

- Per a survey conducted by A.T. Kearney, **70% of CEOs around the globe have already planned, are considering, or will be nearshoring part of their manufacturing operations to Mexico.** Indeed, 17% of them claim their companies have already nearshored to Mexico and 16% have done so to Central America.

- Businessmen often cite **labor costs and availability, the quality of goods produced, and logistics costs among Mexico's main advantages for nearshoring.**

- When delving into the nuances between full reshoring to the United States and moving part of the supply chain to countries closer to the U.S., **data suggests Mexico, Canada, and Central America have equal possibilities for future investment.**

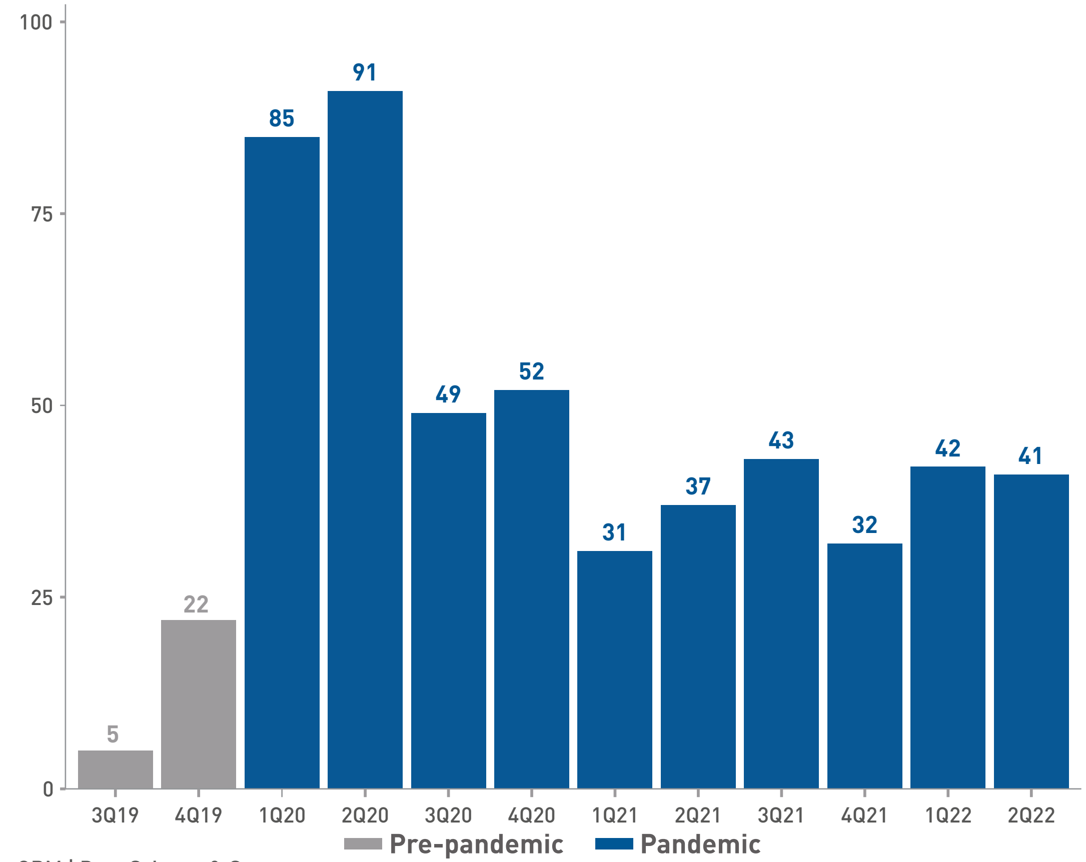
- A.T. Kearney's survey of CEOs of American manufacturing companies found that **more companies are seeking to invest in manufacturing assets not only in the United States but also in Mexico.**

- Indeed, **more Chinese manufacturers are investing in Mexican operations to supply the U.S. market** with materials, parts, or finished goods.

In line with AT Kearney's conclusions, our Data Strategy Team analyzed a database of over 23,000 earnings calls from both Global and Mexican companies in search of the Nearshoring topic and concluded that the nearshoring/reshoring topic seems to have sustained its relevance after more than two years. The number of mentions of this topic increased significantly when the pandemic began, and supply chain issues followed. Mentions related to this topic peaked in 2Q20 (with 91 mentions).

The mentions of 'nearshoring' skyrocketed when the pandemic began, and the topic remains relevant after more than two years.
–Number of mentions related to 'nearshoring' or 'reshoring' in global companies' earnings calls among 23,000+ earnings calls analyzed by GBM's Data Science Team.

Period: 3Q19–2Q22. Total mentions: 530



GBM | Data Science & Strategy

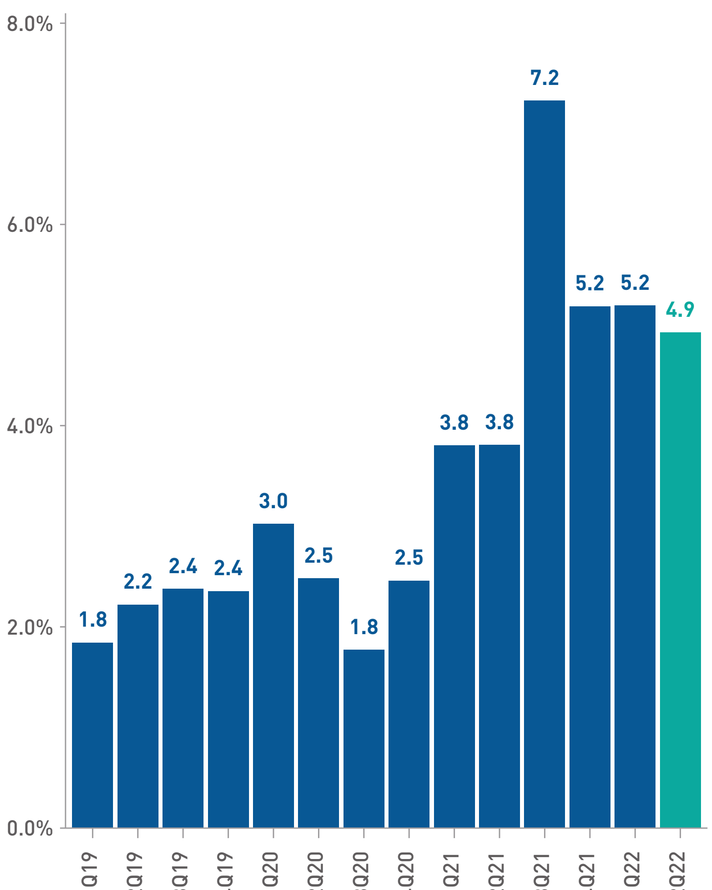
MEXICO EMERGES AS THE NATURAL CONTENDER FOR NEARSHORING.

Mexico is top-of-mind for executives' nearshoring plans.

Executives' Mindset

In Mexico, according to the Text Analysis from 2Q22 Earnings Calls, "Supply Chain" was the most repeated bigram (pair of words) in our tracked investment-related topics, yet its relevance was flat compared to previous quarters. In 2Q22, the single most mentioned bigram among our investment-related themes was "Supply Chain" (similar to 3Q21 and 4Q21).

Supply-related Pairs of Words in Mexico's Earnings Calls (2Q22)
–% of Total Monitored Pairs of Words



Nearshoring is in Mexico's executives' top-of-mind as well
–Comments by companies in earning calls (1Q19 - 2Q22)

"We remain optimistic regarding the outlook for the US despite rising interest rates. We have not seen evidence of softening residential demand in our markets, ***the industrial and commercial sector shows important recovery due to onshoring of manufacturing activity in the resurgence of the oil industry.*** *We expect these industrial trends to persist with additional supply chain pressures from the Ukraine war. [...]* ***We continue to see the build out of manufacturing and warehousing facilities in Northern states with companies taking advantage of nearshoring opportunities****, demand for industrial space is growing significantly led by cities such as Tijuana and Monterrey."*
—Cemex, 1Q22 Earnings Call

"We're focused on expanding our e-commerce footprint into new markets through strong relationships with high-quality global clients in diversifying industry sectors, ***while capturing the opportunities we're seeing related to U.S. clients nearshoring trends as well as exciting new Asian clients now reshoring to Mexico.****"*
—Vesta, 2Q22 Earnings Call

"A potential recession in the US could translate into lower external demand for Mexico, lower investments and remittances, resulting in lower the GDP growth, especially for the year 2024. ***However, this could be offset by the Mexico's potential gains for nearshoring strategies****. With growth increase the current export levels by the approximately 10%, thanks to Mexico logistic advantages, geographical location and younger demographics."*
—Grupo Financiero Banorte, 2Q22 Earnings Call

"For the first 6 months, demand increased ***almost 20% year-over-year and in our markets mainly from manufacturing expansion due to nearshoring in border markets, and demand from logistics operators to serve e-commerce adoption in consumer markets has kept a positive trend****. Quarterly demand was more than 8 million square feet in our 6 markets, an increase of 23% year-over-year, outpacing supply by more than 2 million square feet, resulting in market vacancy of 1.8%. [...]* ***Nearshoring has been accelerating, and if it keeps the same pace, it will double the demand for space from 2021. The main markets have been Monterey, Tijuana, Juarez and Reynosa.****"*
—FIBRA Prologis, 2Q22 Earnings Call

Even the best players have areas of opportunity, and Mexico is no exception.

- **We recognize that Mexico has room for improvement**. Strengthening its rule of law and institutions is Mexico's biggest area of opportunity, while clear energy policies are needed to provide the country with a clear advantage in the nearshoring arena.
- **Meanwhile, the current main challenge lies in USMCA compliance**. On this, we explain the dispute-settlement consultations with Mexico that the United States requested under the USMCA.
- **In our view, the U.S. request is positive to ensure USMCA compliance, as it ensures the continuity of nearshoring trends in the region.**
- **If the dispute-settlement mechanism results in new tariffs against Mexico (possibly within ten months), we do not believe they will prevent the ten categories selected as favorites from reaping the benefits of nearshoring**, as agricultural products are more likely to bear the brunt.

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EVEN THE BEST PLAYERS HAVE AREAS OF OPPORTUNITY, AND MEXICO IS NO EXCEPTION.

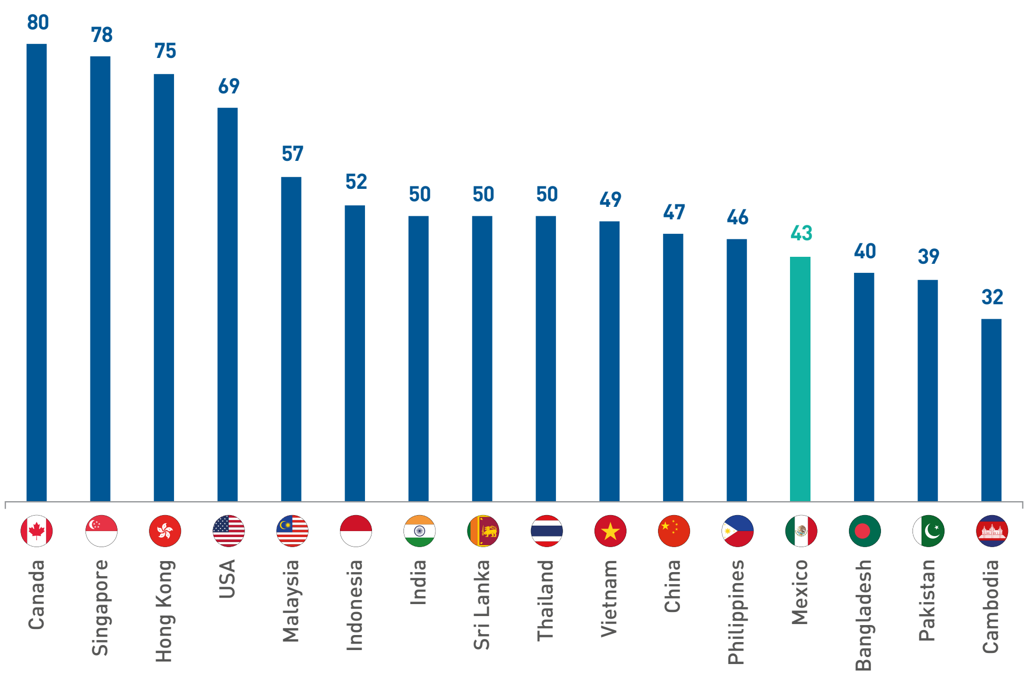
Mexico needs to strengthen its observance of the rule of law to become a more attractive destination for investors.

Rule of law is a core component of a favorable business environment and a key feature that balances the perceived costs for investors.

Mexico has room to improve its rule of law and become more competitive. Indeed, according to the Rule of Law Index published by the World Justice Project, Mexico ranks 113 out of 139 countries. Said index is comprised of eight factors: Constraints on Government Powers, Absence of Corruption, Open Government, Fundamental Rights, Order and Security, Regulatory Enforcement, Civil Justice, and Criminal Justice.

Two key components for business decisions where Mexico could do better are Absence of Corruption (135/139 global ranking) and Order and Security (130/139 global ranking). Mexico also has plenty of room to strengthen its respect for the rule of law in the rest of the components, as shown below.

Strengthening its rule of law and institutions is Mexico's biggest area of opportunity, as it ranks well below most of its competitors in this aspect.
–Rule of Law Index 2021 (0 to 100, with 100 indicating the strongest adherence to the rule of law)



Source: World Justice Project (WJP)

Mexico

Overll Score	Regional rank: Latam and the Caribbean	Global Ranking
0.43	27/32	113/139

	Regional Ranking: Latm and the Caribbean	Global Ranking
Constraints on government powers	26/32	102/139
Absence of Corruption	32/32	135/139
Open Government	7/32	43/139
Fundamental rights	26/32	91/139
Order and security	30/32	130/139
Regulatory enforcement	24/32	105/139
Civil justice	28/32	131/139
Criminal justice	26/32	129/139

EVEN THE BEST PLAYERS HAVE AREAS OF OPPORTUNITY, AND MEXICO IS NO EXCEPTION.

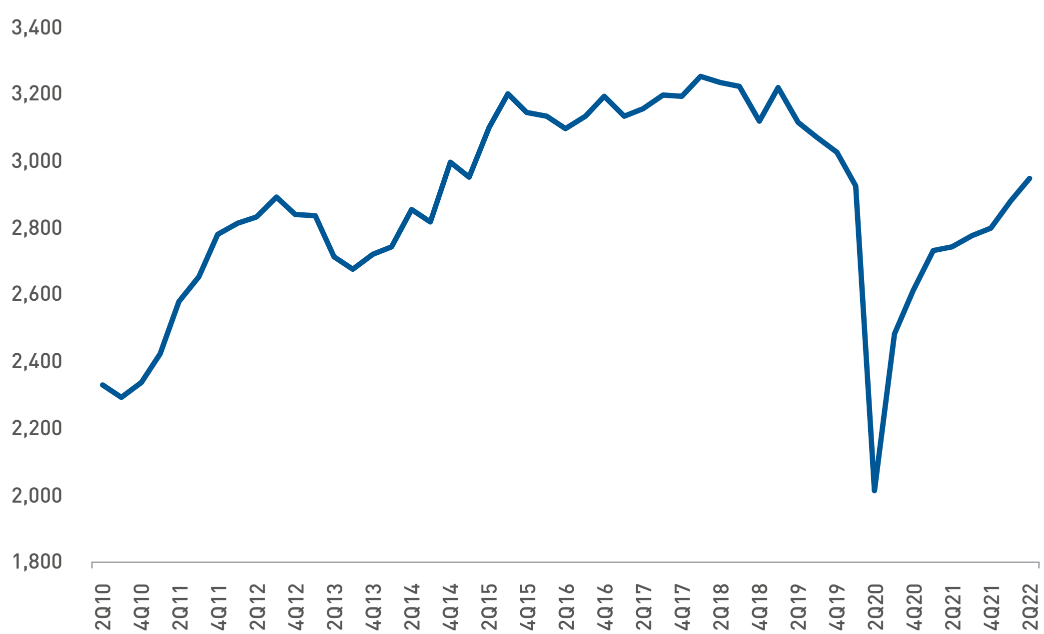
Mexico needs to regain investor confidence, and some recent domestic decisions have pulled in the opposite direction.

Despite the USMCA ratification and the nearshoring trends, Mexico needs to refocus its efforts to strengthen its macroeconomic environment, ensure total respect for its institutions, and foster business confidence.

Since 2020, Mexico has been left out of A.T. Kearney's list of the 25 most attractive countries to receive Foreign Direct Investment (FDI). The main reasons for Mexico's exclusion from this list are related to growth concerns and the rhetoric of President López Obrador, who has constantly challenged the privatization of crucial sectors of the Mexican economy, including the energy industry.

However, since most of President Lopez Obrador's campaign proposals have materialized, we believe the uncertainty around new policies could have hit rock bottom.

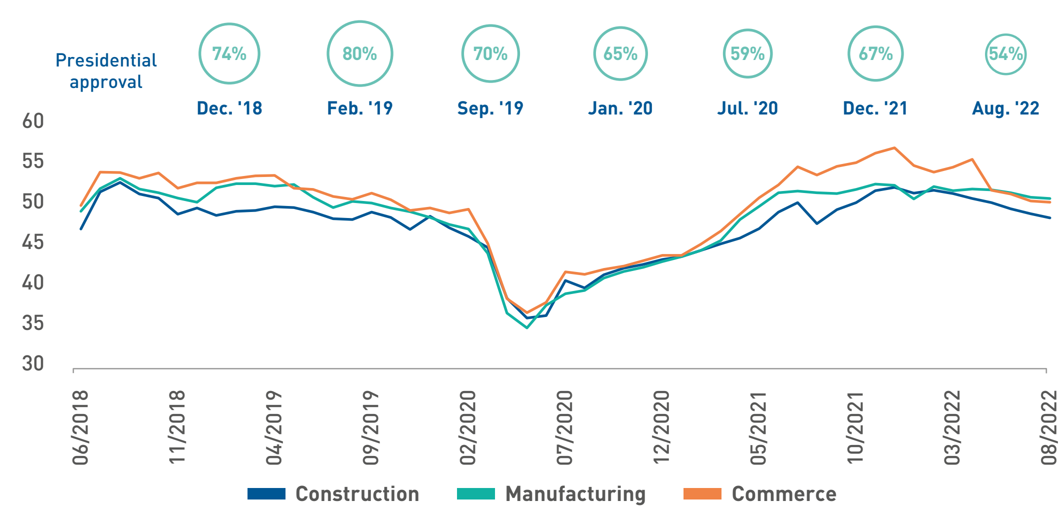
Private investment starts to recover, but remains far from pre-pandemic levels.
-MXN Billion



Most of President Lopez Obrador's campaign proposals have materialized.

Level of Fulfilment	Proposal
Materialized	**Energy:** Radical modifications of the energy policy, which include the reforms to the Hydrocarbons and Electrical Industry Laws **Infrastructure:** Dos Bocas refinery, Mayan Train **Social Programs:** "Youth Building the Future", Pension for the elderly **Undone:** Education Reform, New Mexico City International Airport (NAIM)
Not Materialized yet	National Electoral System Reform (already sent to Congress), National Guard Reform (already sent to Congress)
Unfulfilled	Constitutional Electricity Reform Bill

Business confidence is a paramount to realize the nearshoring potential.
–In points, SA



Source: National Statistics Institute (INEGI)

EVEN THE BEST PLAYERS HAVE AREAS OF OPPORTUNITY, AND MEXICO IS NO EXCEPTION.

The current main challenge lies in USMCA compliance.

USMCA Challenges and Disputes

Energy

In July 2022, the United States and Canada formally requested dispute settlement consultations under the USMCA, stating that Mexico's energy policy favors state-owned enterprises, Pemex and CFE. The U.S. Trade Representative Office argues that, among other violations, Mexico prioritizes the distribution of power generated by CFE over cleaner energy sources (e.g., wind and solar) supplied by private sector providers.

Rules of Origin (ROO)

A dispute settlement mechanism is taking place about the interpretation of the ROO under the USMCA. The conflict centers on how to calculate the percentage of vehicles arriving from the three USMCA member countries, for which the United States insists on a stricter method than Mexico and Canada.

Labor Rights and Panels

Under Mexico's federal labor law, workers can associate, form independent unions, and bargain collectively in a way they have been unable to do for decades. Mexico's labor reform could gradually result in higher wages that could incentivize employers to rely less on cheap labor as their main competitive advantage

Renewable Mechanism

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", where the parties may confirm if they want to renew the agreement for another sixteen-year term. If a party does not extend the term of the agreement upon the sixth year, the parties will meet again in subsequent years to keep confirming their participation. However, this term-specific feature of the USMCA may create uncertainty about the continuity of the treaty in the long term.

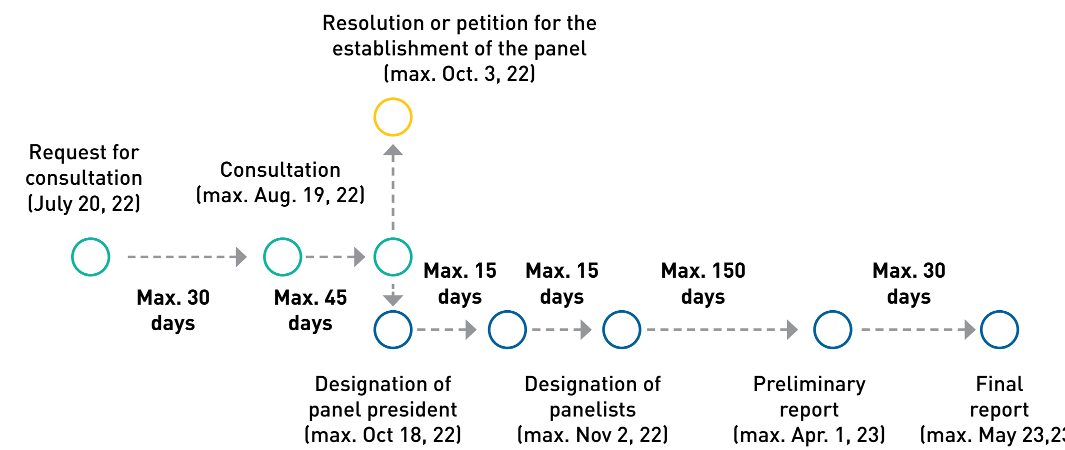
Threat to the Electric Vehicles Sector

Biden's Build Back Better bill would provide a subsidy in the form of a US$12,500 tax credit for purchases of electric vehicles. If eventually passed by Congress, the bill would represent a disadvantage for Mexico's automotive sector, which remains one of the pillars of the Mexican economy.

The energy sector is in the spotlight.

- **In our view, the U.S. request is positive to ensure USMCA compliance, as it ensures the continuity of nearshoring trends in the region**. The USMCA works as an anchor for rule of law in the topics covered by the Treaty.

Dispute settlement process under the USMCA



At the end of the dispute settlement process, the panel ascertains the amount of damage that Mexico caused by violating the USMCA, and the U.S. and Canada are allowed to impose tariffs on Mexican exports in any sector they wish by that same amount.

- **In our view, the most likely outcome will be that the dispute settlement process ends with the panel determining that Mexico indeed violated the Agreement.**
- **If this scenario materializes and the resolution on compliance results in new tariffs being imposed against Mexico (possibly within ten months), we don't expect them to prevent the ten categories selected as favorites from reaping the benefits of nearshoring** since the United States would try to avoid products to which its supply chains are connected. This would be the case for manufacturing goods and most products in our sample. In our view, the United States might impose tariffs on agricultural goods, including products where they want to protect national producers and have good substitutes.

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