

# Mexico Is In A Good Position

Mexico is downstream of shifting trade winds.

By Vaibhav Tandon



One of the many buzzwords that has emerged from the pandemic period is “nearshoring,” the practice of bringing production closer to home.

As global corporations recalibrate the risks of relying on Chinese factories for their supplies, Mexico is emerging as one of the preferred destinations. Foreign direct investment (FDI) flows into Mexico have increased since the pandemic to the highest level in a decade, distributed across various states and sectors of the economy. FDI in Mexico rose to \$31.4 billion in 2021 and reached \$32.1 billion in just the first nine months of 2022. Growth is likely to persist this year, despite weaker global trade. More than 400 American companies intend to relocate from Asia to Mexico, according to the country’s economy minister.

Amid the pressure to adapt to altering supply chains, Chinese businesses are also making large investments and setting up factories in the Latin American nation, essentially allowing them

duty-free access to the U.S. In 2021, Chinese firms accounted for 30% of foreign investment in Mexico's border state of Nuevo León, after the U.S. at 47%. Last year, of the 101 confirmed projects in the state, 47 originated from the United States and 22 from China.

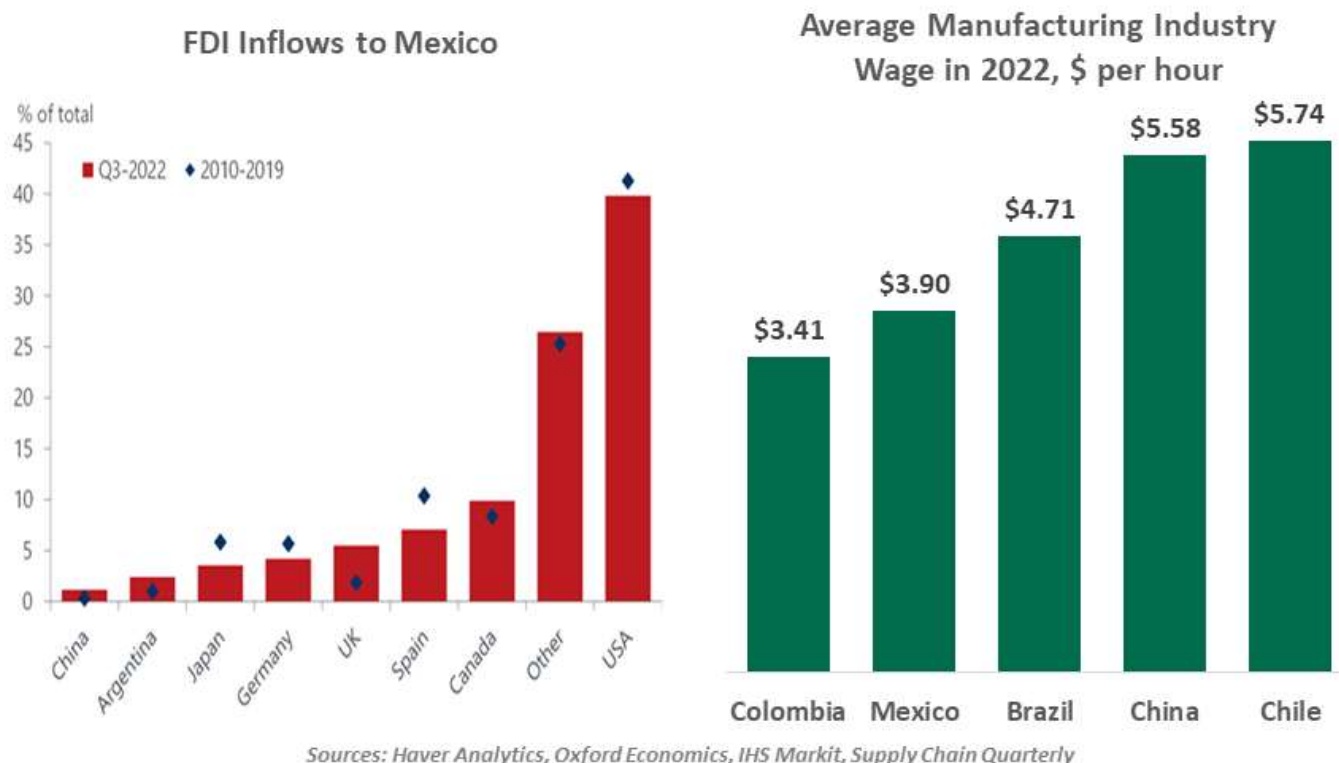
The manufacturing sector remains the main destination of FDI flows, a key factor behind the strong recovery in Mexican industrial activity. While automobile components lead manufacturing activity in Mexico, other sectors like electrical equipment and computer products are also witnessing strong growth.

Mexico is one of the world's most open and globalized economies, having free-trade agreements with over one-fourth of the countries around the world. Trade represents nearly 80% of its gross domestic product, up from below 30% before the implementation of the North American Free Trade Agreement in 1994. Mexico has a dynamic industrial base, vast mineral resources, favorable demographics and a wide-ranging service sector. It is also conveniently located next to the U.S.

A shipping container generally takes a month to reach the shores of the United States from China, a time frame that tripled during the worst stages of the pandemic. By contrast, goods from factories in Mexico are generally delivered to U.S. retailers within two weeks.

While the pandemic and geopolitical tensions are motivating more businesses to explore nearshoring today, structural factors such as lower shipping and labor costs also work in Mexico's favor. China's wages have been rising with fewer people entering the labor market, while Mexico's have remained low.

**Mexico is uniquely positioned to profit from nearshoring.**



Stable regulations, a prudent fiscal framework and a healthy balance of payments position have boosted investor confidence, generating higher capital inflows and a resilient currency.

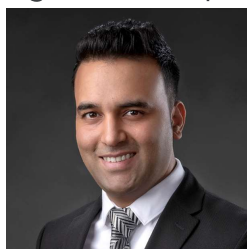
After a solid performance in 2022, the Mexican peso remains among the top performing emerging market currencies this year.

That said, the biggest impediment to Mexico realizing its true economic potential may be Mexico itself. Foreign energy firms are locked in legal battles with the government over recent changes in electricity and hydrocarbon laws. Organized crime in Mexico has had a **negative** impact on FDI. Infrastructure, essential for commerce, has not been the priority of the current administration. And Mexico has about 44% of its population living in poverty.

Foreign investments often have positive effects on recipient countries. Therefore, higher investments across regions and sectors of the economy should aid the distribution of income more evenly, thereby reducing disparity and preventing social unrest.

Nearshoring is bringing immense openings for Mexico, and it must capitalize on this trend.

Nothing is more expensive than a missed opportunity.



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Vaibhav Tandon is an Economist within the Global Risk Management division of Northern Trust. In this role, Vaibhav briefs clients and colleagues on the economy and business conditions, supports internal stress testing and capital allocation processes, and publishes the bank's formal economic viewpoint. He publishes weekly economic commentaries and monthly global outlooks.

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