International Trade

Nearshoring and BBVA Mexico's role in boosting Mexican exports

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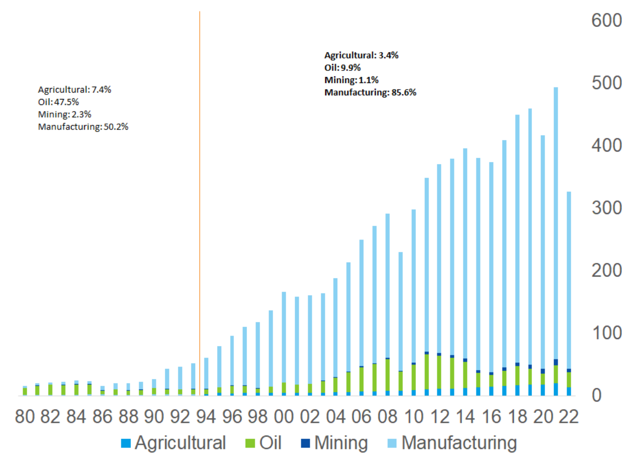
Since the entry into force of the North American Free Trade Agreement (NAFTA) in 1994, foreign trade has gained greater relevance in the Mexican economy to the extent of making structural changes in it. The renewal of this trade agreement between Mexico, the United States and Canada (USMCA) in 2020, raised fears about a potential reduction in trade between these countries. However, even though the pandemic effectively reduced trade between these countries due to an overall reduction in economic activity, the truth is that structurally the North American region is solidly linked through global value chains, where the concept of nearshoring plays a fundamental role. This same factor has also encouraged the increase in Mexican exports of final goods, and not only the exports of goods used as inputs by other industries.

How trade between Mexico and North America changed

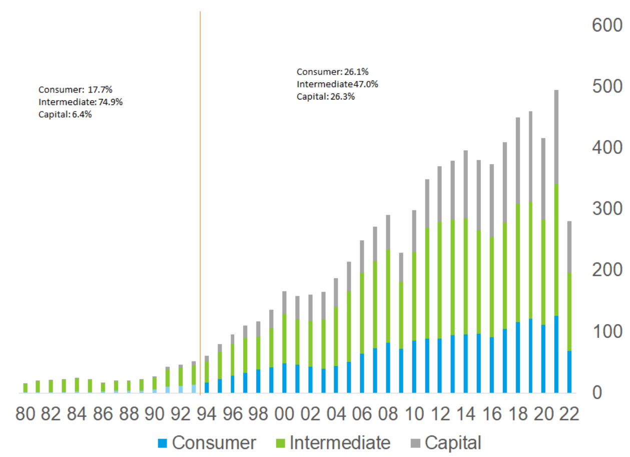
Before NAFTA, manufacturing was already the main component of Mexican exports, averaging a share of 50.2% between 1980 and 1993; nearly followed by oil, whose share in exports averaged 47.5% during the same period. In contrast, since 1994 manufacturing has averaged a share in exports of 85.6%, while oil's share fell to 9.9%. In terms of value, manufacturing went from averaging annual exports of 13 billion dollars to 228 million dollars after NAFTA, i.e. more than 16 times. Meanwhile, oil exports went from an annual average of 11 billion dollars to only 27 million dollars after NAFTA, a modest increase of about 1.5 times its prior value.

Chart 1. **EXPORTS FROM MEXICO (USD BILLIONS)**



Source: BBVA Research with data from Inegi

Chart 2. **EXPORTS FROM MEXICO (USD BILLIONS)**



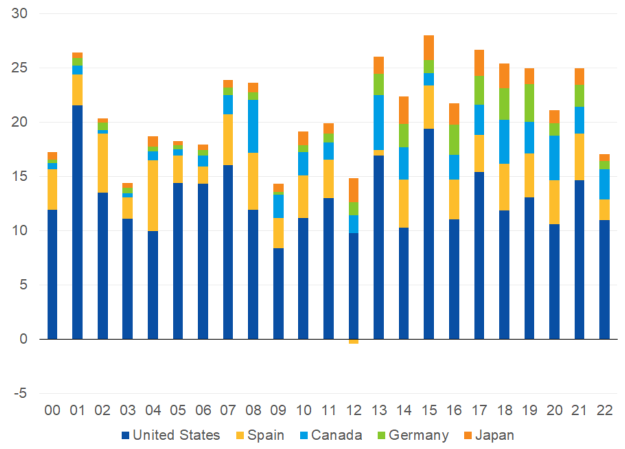
Source: BBVA Research with data from Inegi

Despite the increase in global demand for oil in the 1980s, manufacturing Mexican exports continued to grow. This greater demand was given both by American manufacturers as well as by its consumers. Until today, most demanded goods are transportation equipment, machinery and equipment, as well as electrical and electronic equipment. These merchandises are aimed both at intermediate demand and as inputs to produce other goods, for example, auto parts for automobile manufacturing. Also as capital goods for investment necessary for economic activity, for example construction machinery. As well as for final consumption by the North American market, such as automobiles.

Nearshoring shaped the current structure of mexican exports

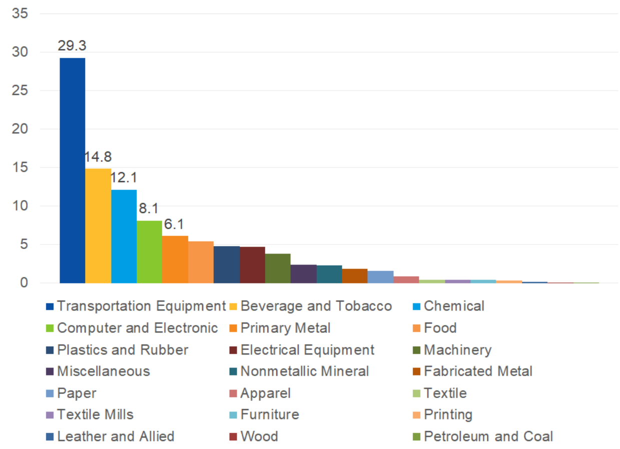
Although the demand for these goods has increased significantly by the members of NAFTA (now T-MEC); this would not have been possible without Mexico's greater capacity to produce such goods; a process that required heavy investment. Did investment in manufacturing actually increase? Where did this investment come from? What motivated this investment to be made in Mexico and not in the United States?

Chart 3. **FOREIGN DIRECT INVESTMENT (USD BILLIONS)**



Source: BBVA Research with data from Ministry of Economy

Chart 4. **FOREIGN DIRECT INVESTMENT 99-22 (SHARE)**



Source: BBVA Research with data from Ministry of Economy

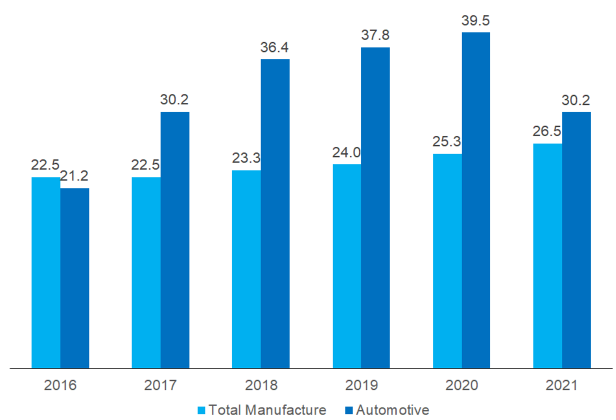
The largest foreign direct investment (FDI) comes from North America, in particular from the United States. Between 2000 and 2022, this country contributed 46.3% of total FDI inflows. By economic sector, the manufacturing industry is the main economic activity to receive this type of investments, receiving 50.0% of the total from 2000 to 2022. And within manufacturing, transportation equipment, beverages and tobacco, chemicals, computers and measurement, as well as basic metals have been the main FDI receivers. This has increased the productive capacity of the Mexican economy in these areas.

Much of these exports require a great degree of coordination among different levels of supply chain on both sides of the border, such as in the case of the automotive industry, denoting the strong level of integration of Mexican production chains with North America. Similarly, most of these export manufactures have a high transportation cost as they are related to heavy industry. Although nearshoring refers to the relocation of production processes abroad to lower costs, and lower labor costs are the most obvious reason why some of these industries have prospered in Mexico, so are transportation costs. For example, using NAPS figures for 2018, a 53-foot container costs $600 to ship from Tijuana to Los Angeles; while from China to this port it costs 5,000 USD. Costs that have increased considerably in recent months.

BBVA: the main source of financial services for exporting firms

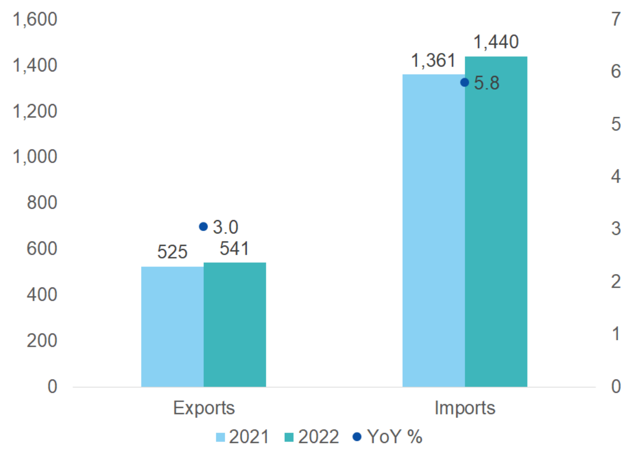
BBVA Mexico leads credit to companies in the manufacturing industry with a market share of over 20% that increased from 2016 to 2021 (based on figures from the CNBV). On the other hand, it has increased its offer of other specialized financial products for companies focused on foreign trade. In particular, the number of export letters of credit has increased 3.0% from January to July 2022 compared to the same period of the previous year. In the case of imports, letters of credit increased 5.8% in the same period of time.

Chart 5. **BBVA LOAN PORTFOLIO (SHARE)**



Source: BBVA Research with data from CNBV

Chart 6. **BILLS OF CREDIT BBVA MEXICO (NUMBER OF BILLS & YOY %)**



Source: BBVA Research with own data

In this way, BBVA Mexico presents itself as a source of financial services for companies whose scope is the foreign market; a fundamental task for the economic recovery of the country, after the period of the pandemic contingency and in general for the long-term commercial dynamics of Mexico.

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