Economic analysis

Nearshoring: Optimism vs. reality of the Mexican economy

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Since the onset of the trade war between China and the US in 2018, the term nearshoring has become more and more popular, referring to the practice of transferring the business operation of USA companies to regions closer to the North American country. The Covid-19 contingency accelerated this process of restructuring production chains, highlighting the risks of concentrating key stages of production within regions that may become difficult to reach when trade networks are hampered. In addition, the Russia-Ukraine conflict has caused Western companies to look after reducing their dependence on countries involved from a geopolitical perspective.

In this context, the race begins among Asian and Latin American countries aiming to draw this production to their economies. Given its geographical location, trade integration with North America, and being part of a modernized agreement such as the USMCA, Mexico is a natural candidate for this relocation of production processes. Mexican manufacturing is one of the most competitive at a global scale, particularly in heavy industry. Spanning from primary metal to transportation equipment, Mexico is at the top of the competitiveness ranking, second only to China.

While it is true that Mexico can already see an increased demand derived from USA nearshoring (16% of EMAER surveyed companies observed a demand increase from USA relocation), the data shows that Mexico is far from leading this race. Most of the production that has left China since 2018 has remained in adjacent countries of the Asian giant such as Vietnam, Taiwan or Singapore.

It could be argued that Mexico's profits from nearshoring are falling short of what it should be. In a simulated scenario realized by BBVA Research in the report "Mexico Regional Sectoral Outlook 2H22", we analyze the economic growth under the hypothesis that Mexico received all the trade flows that have left China since 2018. Under this scenario, the Mexican economy would have grown 1.42% annually, and not -0.40%. Manufacturing would have grown around 7% annually, instead of 0.69%. And relevant sectors such as wholesale trade and transportation would have doubled their annual growth in this period.

However, in terms of infrastructure, it is unclear if Mexico is ready for a massive capital inflow. A clear example is access to electricity. Our simulation suggests that the electricity demand would have increased around 25% compared to that observed in 2020. This increase in demand would have required an annual growth in the electricity sector of 1.64% between 2018-2020. In stark contrast with the observed growth of -0.3% in this period. The reality is that the construction of electrical infrastructure in Mexico has fallen at double-digit rates measured in Enec survey variations since 2019. This is reflected in the fact that, during 2022, the Mexican press has reported that investment projects were canceled or postponed due to the shortage of electrical infrastructure.

An increase in electricity generating capacity and the modernization of the transmission and distribution infrastructure are only the first steps in shifting Mexico into a feasible recipient in this nearshoring process. The country must prepare its energy mix for an expansion focusing on clean energies that, in addition to being more efficient in terms of costs, will decrease greenhouse gas emissions. Paying attention to environmental, social, and governance (ESG) issues will become increasingly critical for all companies in the medium term.

Meanwhile, the nearshoring race continues and Mexico must take advantage of this opportunity.

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