S&P Global
Market Intelligence

Ep. 180 - Nearshoring to Mexico The supply chain story

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Call Participants

ATTENDEES

Chris Rogers

Kristen Hallam

Unknown Attendee

Presentation

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You're listening to the Economics & Country Risk podcast from S&P Global Market Intelligence. In each episode, our experts will provide you with the where, how and when to make decisions that transform your business.

Kristen Hallam

Cars, steel, semiconductors, appliances, pharmaceuticals. More products are being made in Mexico for the U.S. market, a trend known as nearshoring. I'm Kristen Hallam, content strategist at S&P Global Market Intelligence and your host for this 3-episode series on nearshoring to Mexico. You will hear the story behind the attraction and how long the love affair with Mexico may last.

We started with an overview of the economic and geopolitical risks and opportunities in episode 1. We delved into the operational side in episode 2. And in this, the final episode in the series will tell the supply chain story with Chris Rogers, Head of Supply Chain Research at S&P Global Market Intelligence. Thanks for joining us, Chris. It's good to have you back on the podcast.

Chris Rogers

It's good to be back. Thanks for having me, Kristen.

Kristen Hallam

So we've talked a lot about the past 3 years of supply chain disruptions and the need for companies to put in place long-term plans. Where does reshoring fit into that?

Chris Rogers

I'd say reshoring -- and by the way, you'll hear reshoring, nearshoring, offshoring, onshoring, ex-shoring. We'll just call it reshoring for the purpose of simplicity. But I do see that as part of a broader resilient strategy for companies, both in terms of risk management and also, frankly, in terms of cost mitigation. If we're in a middle of a troubled economy, companies are always looking for ways to reduce their costs and I think reshoring plays into that.

It also often comes alongside multi-sourcing. So rather than just buying your products, whether it's a component for a manufacturer or an assembled good for a retailer, rather than just buying it from one company in one place, you might buy it from several companies in several places to diversify your risk.

I mean it also speaks a little bit from a resilience perspective to mitigating transportation risks. So physically shortening your supply chains, although, and we can get into this a bit later on, just because your supplier is near to you it doesn't mean they can always get their goods to you in a timely or complete manner.

Kristen Hallam

We certainly saw that during the pandemic, didn't we?

Chris Rogers

Yes. Yes, we did.

Kristen Hallam

So what role have tariffs and free trade deals had to play in reshoring?

Chris Rogers

The first point to make is that, and remember this throughout the discussion today, it's not governments that make the decision as to where manufacturing is based. It's companies who are doing the manufacturing or the sourcing who decide where it's going to happen. So tariffs and free trade deals, which are kind of their yin and yang of trade policy, they are just one of the many inputs that go into the decision-making process. And in the previous 2 podcasts, you talked a lot about the actual nuts and bolts of operating in different countries.

I think for tariffs as a trade restriction, obviously, they raise costs. So within that cost-mitigation approach, companies will move where they have lower tariffs. Free trade deals are kind of the mirror image. So they liberalize trade and they provide opportunities for exports.

A good example recently is the U.K. joining the CPTPP, which is a Pacific Basin-based trade deal. Nobody's put a hook on the U.K. and towed it around to the Pacific, by the way, it's just an opportunity for another export market. But obviously, that includes Mexico as well.

So I think that will lead U.K. companies to say, okay, maybe if we want to be selling into Mexico, maybe we reshore of Mexico. Maybe we reshore to Mexico anyway because we want to use the USMCA trade deal, what used to be called NAFTA, as a way of accessing the U.S. as a market as well. So they act as restrictions in the part of tariffs by raising costs, export opportunities in the case of free trade deals.

Kristen Hallam

Now you alluded to the previous 2 episodes of the podcast series that we're doing. And in those episodes, we talked about some of the reasons that companies nearshore, including economic considerations, the lower cost of labor in Mexico versus, say, domestic production in the U.S.; some geopolitical factors, including the geopolitical tensions between the U.S. and other countries; some of the political considerations in Mexico; and just the proximity, it's right next door. What are some of the other reasons that companies would reshore to a given country, not necessarily just to Mexico, but thinking broadly why companies would reshore.

Chris Rogers

A lot of it comes down to convenience of manufacturing and simplifying the way your supply chain works. So we quite often talk about economies of scale, so being bigger. But it's also worth thinking about economies of scope. In other words, bringing together your suppliers and your manufacturing into one location.

Funny enough, that's one of the reasons why we're seeing companies actually relocate manufacturing into the United States now is that we see the change of manufacturing approach in some industries, and the auto industry is one. Having your suppliers close to you once the market becomes big enough for it to be worth specifically targeting.

We're actually seeing that happen quite a bit in India at the moment where the electronics industry is building up there, initially seeing the assembly of electronic products, particularly mobile phones, then branching back upstream, if you like, into some of the components in there as well. So I think that economies of scope element is quite important.

Playing into that as well, and we talked a little bit about policy with regards to tariffs, but also rules of origin. These are slightly abstruse, but effectively, what it says is you can move your product from one part of a free trade area to another as long as the components that have gone into it meet certain threshold levels from having been sourced in that region.

So for example, you can move a car across the border from Mexico to the U.S. duty-free as long as 3/4 of the components in that car have come from somewhere within the Canada, Mexico, U.S. area. So again, by reshoring more of your supply chain to a given free trade area, you can take advantage of those rules of origin and make your life a lot simpler. Life in supply chains is complicated enough. So simplicity can be a winner, I think, and adds to resilience as well.

Kristen Hallam

Yes. Yes. We have talked a few times on this podcast, you and I, about the complexities of the supply chain. And I know we've got plenty of material for many more podcast episodes, Chris, so I hope you're game for that.

Chris Rogers

Oh, yes.

Kristen Hallam

So let's zero in on Mexico and talk about how Mexico fits into some of these broader aspects that you've talked about like economies of scope and things like this.

Chris Rogers

The question is, is Mexico a great place to reshore to? And I think it's got a lot going for it. I think the first point is that it's actually quite an open economy in terms of its trade deal membership. So it already has trade deals with countries that account for over 90% of its export partners, right?

So as a jigsaw piece when you're trying to put together these different trade deals then actually -- I mentioned rules of origin. Being in Mexico gives you kind of rules of origin access to a lot of different trade areas. Clearly, proximity to the U.S., and frankly put, Latin America more broadly as major consuming markets is clearly very helpful, particularly for final assembly. A lot of products that we buy have got a lot of air in them or are very bulky. And so being close can help.

I think when you talk about that labor cost element, I know you've covered it in the previous podcast, but labor costs are lower than Mainland China, although it is higher than other countries, particularly, I would say, Vietnam and some of the ASEAN countries. So it's cheaper, not the cheapest, but that's only part of the matrix of decision-making.

I mentioned economies of scope, so being integrated deeply into supply chains. I think, clearly, it's very much in that position in the assembly of electronics, in the assembly of what I call old-school autos, so petrol -- gasoline-, I should say, powered vehicles. Supply chains there are very well integrated, although much less so in electric vehicles, much less so in terms of some of the upstream electronics around microchips, for example, where there's a lot of debate at the moment about security of supply.

Clearly, going to Mexico obviates a lot of the geopolitical risk. But obviously, both Mexico and the U.S. have elections next year, so strike through the geo, you still got political risk. I would also say that the operational risk side is challenging in some areas. Business regulation implementation, cargo theft has been an issue. And one of the ironies of the USMCA trade deal is that it actually requires stricter implementation of labor laws.

So actually, it increases the risk of strikes and interruptions and the need to review your operations. So Mexico has got a lot going for it. And certainly, that's allowed it to build a significant manufacturing base. But there's questions about whether it's still going to be fit for purpose for the coming years.

Kristen Hallam

I would encourage our listeners to tune in to episode 2 of the series where we talk a bit about some of those operational issues you just raised, including like the labor and the risk of strikes and protests as well as some of the political considerations between the national government, the state governments in Mexico. So Chris, who are Mexico's main competitors for reshoring investment?

Chris Rogers

Yes. So I think there's the obvious ones, right? The ASEAN markets, particularly Vietnam, as I mentioned, it's got lower labor costs, lower operational risk. I think some of the global multinationals based in Asia, and particularly Mainland China, have preferred to set up in those countries, particularly Vietnam, not necessarily just to supply the U.S., but also to supply Europe to supply growth markets in Asia.

So Mexico's proximity to U.S. and Canada is an advantage on the one hand, but a disadvantage on the other because it's maybe not necessarily seen as being a base for global export manufacturing. I think a lot of Central and South American countries have got lower labor costs than Mexico. They have higher operational risks, again, and many of them members of as many free trade areas. So that kind of rules of origin pickup that Mexico can bring they maybe don't have.

So what we've seen there is that in some labor-intensive products, for example, around apparel, maybe Mexico's lost ground to places like Honduras and Guatemala. So those are competitors in some areas. One major competitor to Mexico has to compete with for reshoring investments in the United States because as we see a move towards a desire in the U.S. and in Europe to bring back manufacturing jobs, particularly around the green economy, around electrification of vehicles, around renewables, around securing critical minerals, semiconductor supply chains, this is all money that's being thrown out by the U.S. government.

Now some of those subsidies and so on are eligible for products from free trade area partners, so that's good for Mexico. But big chunks of that financing are designed to encourage production of materials and manufacturing in the United States. So I'd actually see the U.S. as being a fairly major competitor for Mexico in that regard.

Kristen Hallam

Very interesting. Almost reminds me of that horror movie trope, the call is coming from inside the house so...

Chris Rogers

Yes, exactly. Don't go in the basement of your supply chain, that's for sure. We'll have to do the Halloween supply chain podcast at some stage. That can be a lot of fun.

Kristen Hallam

That could be a lot of fun, let's pencil that in. So what's the current shape of trade between the U.S. and Mexico? And how might that change in the future?

Chris Rogers

Yes. trade currently is dominated by autos, right? They're nearly 30% of Mexico's exports to the United States if you include vehicles and all the components and so on. If we then look at consumer electricals and electronics, you mentioned home appliances at the top of the call, they are around another 10% or so of the exports.

You then got food products, including beer and cookies and all that kind of stuff. And then you got energy, including electricity and so on. So very much skewed at the moment towards manufactured goods. The area I'd probably worry about where there's a potential for changes is the automotive industry specifically.

Mexico is already a significant provider to the U.S. There's probably not a lot of room for growth in traditional autos there that has expanded quite a bit recently. But it does, as I mentioned earlier, seem to be behind the curve a little bit in some aspects of electrification.

I'm guessing you probably covered this with other folks, but labor costs have also been growing pretty quickly as well.

Kristen Hallam

Yes, yes.

Chris Rogers

And so that cost advantage that Mexico has had in the past is eroding. And so cheaper labor for labor-intensive products, particularly around apparel, but even assembled goods may drift away from Mexico towards maybe the ASEAN countries or even elsewhere in Latin America.

So none of these things change quickly. I remember back when we were looking at the U.S. elections going into 2016 and discussions about a more hawkish trade policy, there were discussions about reshoring and what might happen to Mexico's trade relations with the U.S. back then, and those changes that were started then are still playing out now. These things take years to work through.

Kristen Hallam

Yes. In the previous episode of the series, we talked about how the USMCA will be under review in 2026 and how that's something to watch out for. And as you mentioned, Mexico is going to have an election next year. The U.S. is going to have an election next year. So 2026 could be a very interesting year.

Chris Rogers

Yes. Absolutely.

Kristen Hallam

Put that in your calendars, everyone. So Chris, would you say Mexico has benefited from the U.S.-China rivalry that we've seen playing out in trade and elsewhere?

Chris Rogers

I would say, yes, Mexico has been a winner from U.S.-China trade rivalry, but it has had to share the spoils of that trade war with other countries, particularly with Vietnam. So I mentioned earlier these tariffs that were applied by the Trump administration as part of this kind of trade war and how China's share of U.S. imports had dropped as a consequence of that.

If we look at Mexico's share of U.S. imports of those products, it's increased to just over 17% in the past 12 months from around 15% in 2016. So it's picked up a bit there. Vietnam has also picked up, although by a much smaller amount. Vietnam is at around 4%, it was at 2%.

Now these percentage points don't sound like very much, but we're talking about billions of dollars’ worth of trade here that's being reoriented. Thousands of companies having to make decisions about where they're manufacturing and where they're sourcing.

I would say that where Mexico's kind of gained has been more in these kind of deep supply chain products, so components, particularly electrical components, automotive components. Whereas consumer goods and assembled goods haven't been as affected by the tariffs generally and more specifically for the shift between Mexico and Vietnam.

The downside, I guess, is the trade conflict doesn't benefit anybody overall because higher tariffs mean less spending power. But in that regard, I think less of an impact for Mexico. Mexico seemed to have done a reasonably good job of threading the needle with regards to managing their relationships with China and with the U.S. separately to that. But if you're looking purely at product flows, I would say, yes, Mexico has very much been a winner from the rivalry between U.S. and Mainland China.

Kristen Hallam

As you've alluded to, there are lots of inputs, lots of data companies need to consider when they're looking at where to put their manufacturing, their operations. You mentioned some products there, including electronic components. What other products have been reshored to Mexico already? Or what are we expecting to be reshored in the near future?

Chris Rogers

Yes. So I think the easiest way to measure reshoring is by looking at the share of imports the country gets from another country in a given product area. So if Mexico's market share, if you like, of U.S. imports of product X have increased, then there's been a degree of reshoring.

Whether that's a company specifically moving their factory to Mexico, or let's say, a retailer in the U.S. saying, okay, actually I'm now going to buy everything from that factory in Mexico and that factory in Mexico now, I'm not sending anything to Europe because it's sending it all to the U.S. But I count all of that as being reshoring.

I'll open up the infamous supply chain data firehose here. I know numbers don't always work well through all the [other], here it comes. If we look at televisions, the share of U.S. imports of televisions from Mexico was 75% in the past 12 months. In 2016, it was 54%. So it's been a really big pickup there. And really, there's 3 main companies have really been involved there.

The other one where we've seen a big uptick is in routers and smart devices. This is a pretty big bucket of stuff. So that's the WiFi device in your house through to various gadgets that you can connect to your computer, even includes smartwatches. But when we take all of those together, the Mexican share of U.S. imports is just over half over the past 12 months compared to 30% in 2016. So we've seen quite a lot of relocation there amongst the electrical space.

I think if we turn to autos, we mentioned a couple of times already how important Mexico has been in terms of automotive supply chains. But the share of U.S. vehicle imports from Mexico of gasoline-powered cars was 30% in the past 12 months. It was only around 20% in 2016. So there's been a major shift there.

You've got to be careful with the data, right? You've always got to be careful with the data. The shift in flows aren't always because of some company taking a major call on geopolitics and differential labor costs and the operational risks of getting products from A to B. Sometimes it's just because people want their products.

So the share of U.S. beer imports coming from Mexico has increased to 80% in the past 12 months from 64% just a few years ago, all of the hoo-ha around light beer consumption that has driven that. The other one is cookies. Everyone loves a cookie. Around half of U.S. cookie imports now come from Mexico. It's about 40% 5 years ago.

Kristen Hallam

Well, that's good to know. I do care very much about the sources of my favorite foods and beverages. Maybe we should have a chocolate episode in the future, chocolate supply chain.

Chris Rogers

We can dig into the joys of EU deforestation regulations as well. I know that's something people are clamoring to hear about.

Kristen Hallam

You just turned off the data firehose and then you had to bring in the EU regulations, Chris.

Chris Rogers

Yes. Sorry. That's like the foam we use to put on top of the data water when it just doesn't put out the fire of excitement enough.

Kristen Hallam

So you mentioned a couple of times the shift that we're seeing in the automotive industry from gasoline or petrol because we do have a big U.K. component who listens to this podcast. So that's useful. Powered cars to electric cars. So what does that shift mean for Mexico, which, as you noted, is a historic center for U.S. auto manufacturing?

Chris Rogers

Yes. I think the shift to electric vehicles, governments get excited about it and companies get worried about it because it really is a generational shift in the way automotive supply chains are constructed. Electric vehicles are complicated, but they're not as complicated as internal combustion engine vehicles in terms of just like how many parts go into the engine block and so on.

And it's given governments an opportunity to apply incentives to get manufacturing relocated to their country. Now clearly, the poster child for that legislation is the Inflation Reduction Act in the U.S. or IRA. And IRA basically allocates subsidies to vehicle purchases of up to $7,500 per vehicle if certain boxes are checked.

And the original plan was very much for that to encourage manufacturers to make their vehicles soup to nuts in the U.S. -- soups to nuts is probably not the right way to put it. Lithium to steering wheel in the United States. Now really, the practicalities of actually making that happen led to the inclusion of free trade area partners within that eligibility.

And obviously, Mexico being a part of USMCA, batteries and vehicles manufactured there should be, and it's all subject to Treasury Department interpretation, should be eligible for that. But you don't build your business plan on the basis of should. You build it on the basis of what is actually happening and what you can actually see.

There's also a challenge for Mexico in the past from an autos perspective, it's been the closest best place to build for the U.S. market. However, if free trade areas give you access to this U.S. funding, why not dig your lithium out of the ground in Chile and convert the lithium into batteries in Chile and then ship that to the U.S. and take advantage of a trade deal that way. So Mexico, in many regards, may have more competitors than it's had in the past.

I think a bigger question as well is whether Mexico can move beyond being a factory for the U.S. and be a factory for the rest of the world. There is an opportunity to do that in autos as we go through the shift to electric vehicles. And we've already seen both Ford and GM have started producing electric vehicles in Mexico. But it's very early days in that process. There's a lot at stake for the Mexican government and the Mexican people in getting that shift right.

Kristen Hallam

The electrification of the automotive industry is moving very quickly, one to watch there. So Chris, we have covered a lot of ground as usual when you're on the podcast. Do you have 1 or 2 top takeaways for our listeners today?

Chris Rogers

Yes. So I think the key takeaways are reshoring is a global thing. And it's enacted by companies bringing together a lot of different variables into their business decision, everything from geopolitics and tariffs through to the labor costs and operational risks involved, the potential for economies of scope.

Mexico checks a lot of those boxes, which is why it's become such a center for reshoring for supply into the United States. However, past performance is no guarantee of the future. And Mexico faces a lot of competitors, and not just the ASEAN countries or Latin America, but the U.S. itself. And it's got to make sure it's got the policies in place and the attractiveness of the business in place to make sure that it can be as successful in the next 20 years as it's been in the past 20 years in being that reshoring location of choice.

Kristen Hallam

Right. Well, thanks, Chris, for sharing your insights with us today. And that concludes our series on nearshoring to Mexico. Tell us what you want to hear about next on the Economics & Country Risk podcast, and join us next week when we continue delving into the big themes in 2023.

Unknown Attendee

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