THE MEXICAN MOMENT?

From globalization to regionalization and nearshoring

Globalization has been a driving force behind the expansion of supply chains worldwide. As trade barriers lowered and technology facilitated international communication, companies aimed to optimize their production costs by outsourcing operations to different regions of the world. This process led to a significant decentralization of production and the development of intricate supply chain networks.

This production strategy, known as offshoring, gained momentum in the 1980s. This reflected job creation in the United States. In the 1940s the ratio of jobs in the service sector to those in goods production was approximately 1.1. This means that for every job created in manufacture, slightly more than one job was created in the service sector. By the 1980s, there were already 2.4 service sector jobs for every goods production job, and by 2000, this ratio reached 4 service jobs for every production job (Figure 1). While the transition of product manufacturing from the secondary sector to the service sector is natural for a large, developed economy like the United States, the outsourcing or offshoring of production led to lower production cost but increased reliance on others economies.

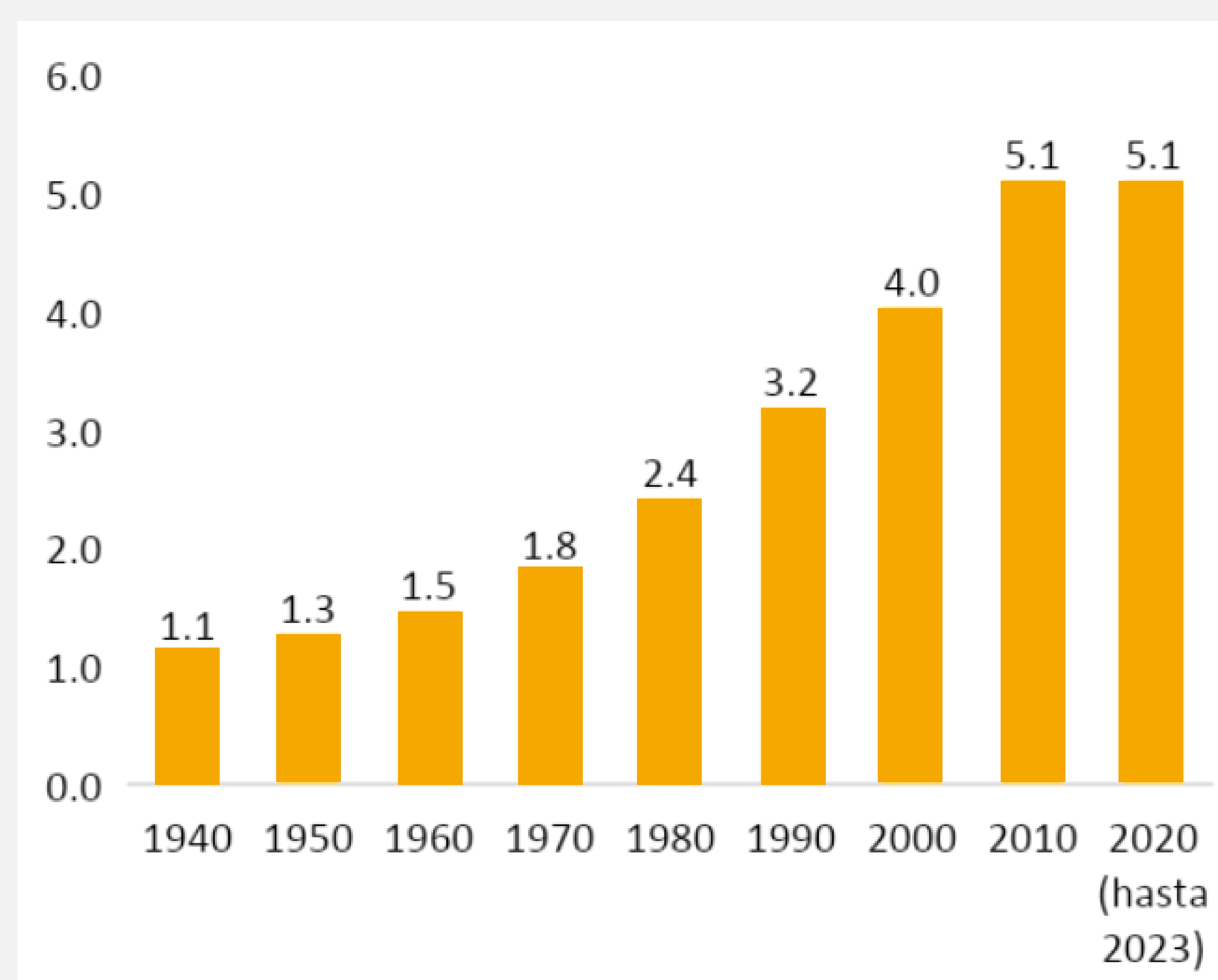
Among the advantages of offshoring were reduced production costs due to lower labor and/or production input expenses, as well as access to other markets. However, the high degree of decentralization also brought forth disadvantages, including logistical complexity, quality controls challenges, interruptions, and susceptibility to changes in trade policies of countries.
In fact, the momentum of the offshoring strategy waned starting with Donald Trump U.S presidential campaign and his slogan "Make America Great Again" which partly implied, bringing back outsourced manufacturing to the country Trump initiated a trade war with China, imposing tariffs and implementing measures, such as rules of origin.[1]

If the trade war triggered the process of de-globalization, the Covid pandemic delivered the final blow, exposing vulnerabilities in the highly decentralized supply chain. Sudden production interruptions, border closures and logistical hurdles highlighted the risk of relying on production located far from the target market.

The process of de-globalization has given way to regionalization. Companies still seek to reduce production costs, but they are aware of the vulnerability of having a large part of their production on the other side of the world.

This led to an acceleration in the trend of nearshoring,[2] where companies began to move parts of their supply chain to locations closer to their core markets. Cost efficiency remains a priority for companies, but they now also seek a balance with other needs, such as less complex logistics processes, resilience in supply chains, agility in their ability to respond to unforeseen events, changes in economic policy, and compliance with environmental, social and governance policies (generally known as ESG) to satisfy shareholders, employees, suppliers and customers. Nearshoring is currently a better answer to the combination of return and risk that any investor or company is looking for.

Figure 1. Ratio of jobs in the service sector to jobs in the production sector



Source: Grupo Financiero BASE with information from the U.S. Bureau of Labor Statistics.

1. For further reference see the Nearshoring report, volume 1 of Banco BASE.
2. **Nearshoring** is a term used to describe the practice of moving business or production operations to countries close to their final destination to take advantage of lower production costs, shorter travel times, lower logistics costs, time zone similarity and other benefits. Instead of outsourcing or moving these operations to distant countries (known as "**offshoring**"), some companies choose to do so with nations closer to home, which allows them to maintain greater control and agility in their supply chains.

Logistics expense and Nearshoring

During the pandemic, freight shipping costs from China to the United States skyrocketed due to port closures and increases in ocean freight costs. This led to supply chain disruptions, global production realignment and increased delivery times.

In contrast, logistics costs and delivery times for products shipped from Mexico to the United States remained virtually unchanged.

As of May 2023, the latest available data, the logistics cost of total U.S. imports stood at 2.9 dollars per 100 dollars of imports, decreasing for the tenth consecutive month and reaching its lowest level since March 2020, when the pandemic began. In the case of China, after peaking in July 2022 at $7.8, the downward trend in logistics spending has been clear and stood at $4.9 in May, below its pre-pandemic level (Table 1).

On the other hand, the logistics cost for imports from Mexico to the United States stood at US$0.99 per 100 dollars of imports, only above Ireland (US$0.5) and Switzerland (US$0.7). The stability of logistics costs between Mexico and the United States continues to be an opportunity for Mexico to allow companies based in Asia to relocate their operations. However, ocean freight rates from Asia, especially China and Taiwan, have fallen considerably since the last half of 2022, so the biggest opportunity for Mexico in the long term, in terms of Nearshoring, lies in other factors and not in logistics costs.

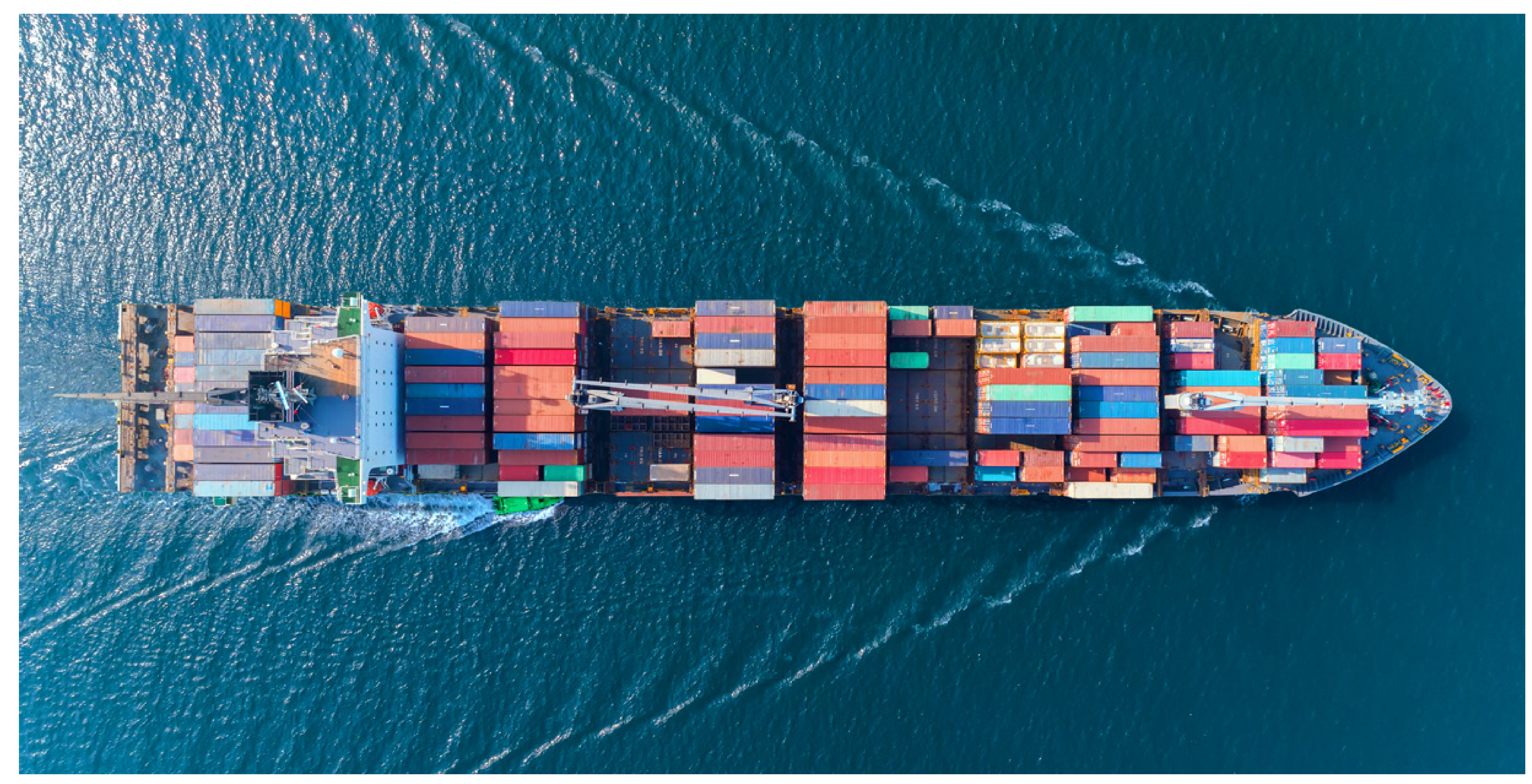


Table 1. CIF Expenditures for Major U.S. Trading Partners

Country	Feb-20	May-22	May-23	Diff. in USD May 23 vs Feb 20	% Variation May 23 vs Feb 20	Diff. in USD May 23 vs May 22	% Variation May 23 vs May 22
World	2.8	4.1	2.9	0.0	1.7%	-1.3	-30.9%
Canada	2.6	2.3	2.3	-0.2	-8.6%	0.1	2.8%
China	4.9	8.0	4.9	0.0	-0.5%	-3.0	-38.2%
France	1.8	2.7	1.8	0.0	0.8%	-0.9	-33.0%
Germany	2.0	2.8	2.2	0.2	9.8%	-0.6	-20.4%
India	4.4	6.3	4.3	-0.1	-1.9%	-2.1	-32.7%
Ireland	0.4	0.6	0.5	0.1	17.4%	-0.1	-18.9%
Italy	2.6	4.0	3.2	0.7	25.5%	-0.8	-19.7%
Japan	2.2	4.2	3.0	0.8	36.7%	-1.3	-30.1%
South Korea	3.1	5.25	3.030	0.0	-1.0%	-2.2	-42.3%
Mexico	1.013	0.950	0.991	0.0	-2.1%	0.0	4.3%
Netherlands	2.2	2.8	3.3	1.1	51.8%	0.5	18.6%
Taiwan	3.1	5.1	2.51	-0.6	-18.6%	-2.6	-50.7%
United Kingdom	1.5	2.3	1.9	0.5	32.4%	-0.3	-14.1%
Vietnam	4.0	7.1	4.0	0.0	0.9%	-3.1	-43.4%
Switzerland	1.1	1.1	0.7	-0.4	-34.3%	-0.4	-35.3%

CIF: Cost, Insurance & Freight. For Mexico, three decimal places were included to avoid a constant in the series.

Source: Grupo Financiero BASE with information from the U.S. Census Bureau.

Trade war and Nearshoring

The trade war between the United States and China, which started in 2016, reshaped the landscape of global trade. China's share of total U.S. imports fell from 20.1% to 13.3% between 2016 and 2023 (Table 2). With this decrease, China dropped from first to third position in the countries from which the United States imports goods and services. With the trade war, Mexico has been the country that has gained the most market share, rising from 13.7% in 2016 to 15.4% in 2023. This implies that China lost between 2016 and 2023, 6.8 percentage points of market share in U.S. imports, of which Mexico gained 1.7 percentage points, i.e. only a quarter of the market that China lost due to the trade war (Figure 2).

After Mexico, Vietnam is the country that has gained the largest share, rising 1.5 percentage points, from 1.9% to 3.4% of total U.S. purchases abroad, followed by Canada with 0.81 percentage points and India with 0.66 points. With this, Vietnam ranks 7th among the economies from which the United States imports in 2023, whereas in 2016 it ranked 12th, while Canada moved up from third to second position.

Despite the trade war, China continues to be the country with which the United States has the largest trade deficit with 30.9% of the total. Mexico follows far behind with 17.9% and Vietnam with 11.4% (Table 3).

Vietnam has acted as a cheap labor substitute for China, while Mexico and Canada have benefited from their geographic location by sharing a border with the United States, which has kept logistics costs and delivery times stable during the pandemic. In addition, Mexico and Canada have a trade agreement with the United States and better meet the ESG criteria so sought after by companies today. These countries have been the closest port of call for returning production to the United States and have been chosen by the U.S. as trade allies, while the trade war with China continues.

The trade war has many explanations, in addition to the large U.S. trade deficit and the vulnerabilities that globalization presents. Other explanations are 1) the political situation in Taiwan, 2) China's accelerated GDP growth with the potential to surpass U.S. GDP in less than a decade, and 3) the global trend toward green and human rights policies.

With this, in 2023 Mexico will be the main trading partner of the United States, with 15.6% of total exports and imports, followed by Canada with 15.3%, China with 11.0%, Germany with 4.7%, Japan with 4.3%, South Korea with 3.5%, the United Kingdom with 2.8%, India with 2.5%, Taiwan with 2.4% and the Netherlands and Vietnam with 2.3% each.

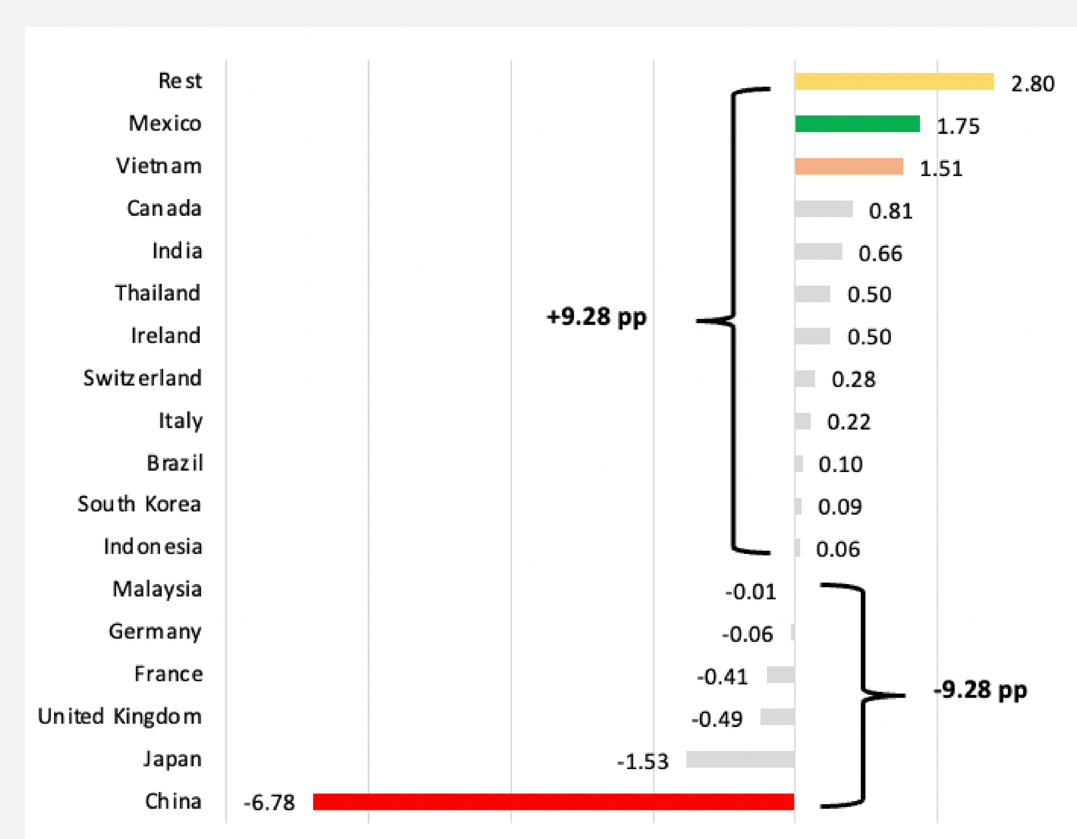
Although Mexico has a privileged geographic position for Nearshoring with the United States, there are other countries that offer other advantages. Moreover, the opportunity to relocate companies will not last forever. If Mexico does not take advantage of this opportunity, there will be other countries that, although geographically distant from the United States, such as Vietnam, will be the recipients of companies that have left China in the face of de-globalization and the trade war with the United States.

Table 2. Participation of each country in U.S. imports.

2016		2023	
China	**20.1%**	Mexico	15.4%
Mexico	13.7%	Canada	13.9%
Canada	13.1%	**China**	**13.3%**
Japan	6.2%	Germany	5.3%
Germany	5.4%	Japan	4.7%
South Korea	3.5%	South Korea	3.6%
United Kingdom	2.5%	Vietnam	3.4%
France	2.2%	India	2.9%
India	2.2%	Ireland	2.5%
Italy	2.1%	Italy	2.3%
Ireland	2.0%	United Kingdom	2.0%
Vietnam	1.9%	Thailand	1.8%
Malaysia	1.6%	France	1.8%
Switzerland	1.5%	Switzerland	1.8%
Thailand	1.3%	Malaysia	1.6%
Brazil	1.1%	Brazil	1.2%
Indonesia	0.9%	Indonesia	1.0%
Rest	18.5%	Rest	21.3%

Source: Grupo Financiero BASE with information from the U.S. Census Bureau.

Figure 2. Change (percentage points) in the share of total U.S. imports, 2016 - 2023



Source: Grupo Financiero BASE with information from the U.S. Census Bureau.

Table 3. U.S. trade deficit with other countries, 2023 figures through may

Country	Deficit (in billions of dollars)	of total
China	-106.3	30.9%
Mexico	-61.8	17.9%
Vietnam	-39.4	11.4%
Germany	-34.8	10.1%
Canada	-29.3	8.5%
Japan	-28.2	8.2%
Ireland	-24.4	7.1%
South Korea	-19.9	5.8%
India	-19.0	5.5%
Italy	-17.8	5.2%

Source: Grupo Financiero BASE with information from the U.S. Census Bureau.

Will Mexico be the new China?

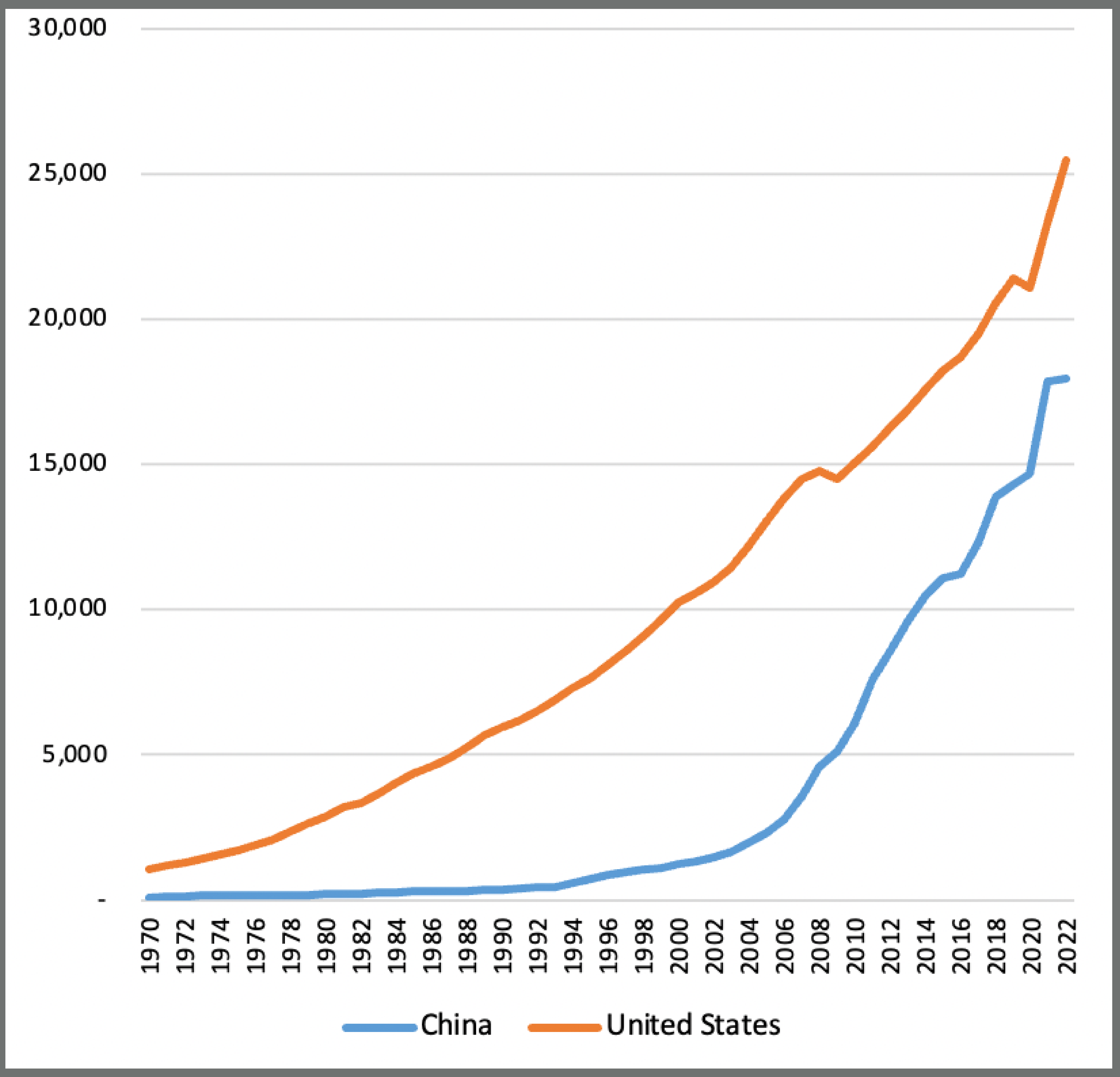
Mexico has very different conditions than China, as it does not represent an economic and political threat to the United States.

At the beginning of globalization, China had a cheap labor force that ensured lower production costs. As China's economy grew, labor costs rose, making it no longer attractive for companies to locate their production in that country. Economies of scale in China continue to be attractive, as does the country's infrastructure, which is immersed in global trade. On the other hand, the scarce intellectual property protection policy in China, the variation in quality level, the business culture and the possibility of more tariffs and restrictions by the United States represent a challenge and therefore risks for companies that want to migrate to that country.

With de-globalization and increasing regionalization, China has lost economic momentum, while Mexico has gained, but to a lesser extent.

In the case of Mexico, labor costs have risen due to outsourcing reforms, minimum wage increases, a greater number of vacation days and economic growth that drives labor demand. In addition, there is a perception of insecurity and companies have increasing costs due to corruption and organized crime. Also, Mexico's infrastructure represents a challenge due to the possibility that there will not be enough water and electricity in the future for companies that migrate to the country. All in all, with the right economic policies in place, Mexico could be experiencing its "historic Mexican moment".

Figure 3. GDP of China and the United States in billions of dollars. Current Dollars



Source: Grupo Financiero BASE with information from the St. Louis Federal Reserve.

Winning and losing subsectors

The growth in Mexico's share of U.S. imports as a result of the U.S.-China trade war and de-globalization has not been uniform at the sub-sector level.

The share of Mexican products in total imports of the beverage and tobacco sector rose from 22.1% to 36.6% between 2016 and 2023, this implies a growth of 14.51 percentage points, being the subsector in which market share with the United States has gained the most. In second place were imports of transportation equipment, with Mexico's share rising from 26.1% to 34.4% of total U.S. imports of that subsector (Table 4).

A subsector of high relative importance but that has not gained much market share in the United States is computer equipment, communication, measurement and other electronic components equipment products, as they account for 15.99% of U.S. imports from Mexico, but between 2016 and 2023 Mexico have only gained 0.45 percentage points of market share. This indicates that there has not been a strong substitution effect (from other countries to Mexico) despite the trade war and Nearshoring. This also indicates that the accelerated growth of computer equipment exports is an advantage for Mexico in absolute terms, but not in relative terms as has occurred with the transportation equipment subsector, where a large market share has been gained.

A brake within this industry has been the lack of fixed investment, which has not reached levels like those observed in the transportation equipment industry, despite the fact that exports have accelerated in recent years .
The Nearshoring or relocation of companies is evident in foreign direct investment, exports and job creation. Available data show that foreign direct investment through Nearshoring is concentrated in only a few sectors and has not yet fully materialized.

Table 4. Sub-sectors that have gained and lost relevance in U.S. imports

Subsector in SCIAN classification	Mexico's share of U.S. imports for each subsector		Variation in percentage points	Imports from Mexico by subsector, % of total (sum 100%)
	2016	2023		
Beverage and tobacco industry	22.1%	36.6%	14.51	2.49%
Transport equipment	26.1%	34.4%	8.30	34.12%
Furniture, mattresses and blinds	6.8%	12.2%	5.42	1.20%
Petroleum and coal products	2.0%	6.0%	3.98	0.98%
Agricultural products	38.0%	41.7%	3.79	5.07%
Non-metallic mineral-based products	13.8%	17.3%	3.52	1.07%
Plastic and rubber industry	10.1%	13.0%	2.94	2.02%
Oil and gas extraction	7.4%	10.3%	2.91	3.98%
Metal products	12.2%	15.1%	2.87	3.03%
Other manufacturing industries	7.3%	9.9%	2.65	3.30%
Textile supplies and textile finishing	6.9%	9.4%	2.42	0.17%
Textile products except clothing	3.8%	5.7%	1.91	0.28%
Wood industry	1.1%	2.7%	1.64	0.13%
Paper industry	6.3%	7.2%	0.96	0.40%
Machinery and equipment manufacturing	11.5%	12.4%	0.84	6.66%
Printing and related industries	8.9%	9.7%	0.78	0.12%
Computer equipment, communication, measurement and (...)	16.3%	16.7%	0.45	15.99%
Fishing, hunting and trapping	3.9%	4.1%	0.27	0.11%
Food industry	13.0%	13.2%	0.21	3.04%
Leather tanning and finishing	5.8%	5.9%	0.18	0.50%
Chemical industry	2.5%	2.4%	-0.04	1.89%
Forest harvesting	1.6%	1.5%	-0.04	0.01%
Clothing	4.4%	4.3%	-0.18	0.75%
Mining of metallic and non-metallic minerals	5.8%	5.2%	-0.57	0.07%
Basic metal industries	10.9%	8.5%	-2.41	2.71%

Source: Grupo Financiero BASE with information from the U.S. Census Bureau.

In order for exports to grow, investment flows are needed to allow for the expansion of installed plant capacity. These investment flows have boosted since NAFTA came into effect in 1994, but by analyzing the inflow of foreign direct investment, it is possible to determine whether its growth has accelerated due to the Nearshoring[3] opportunity.

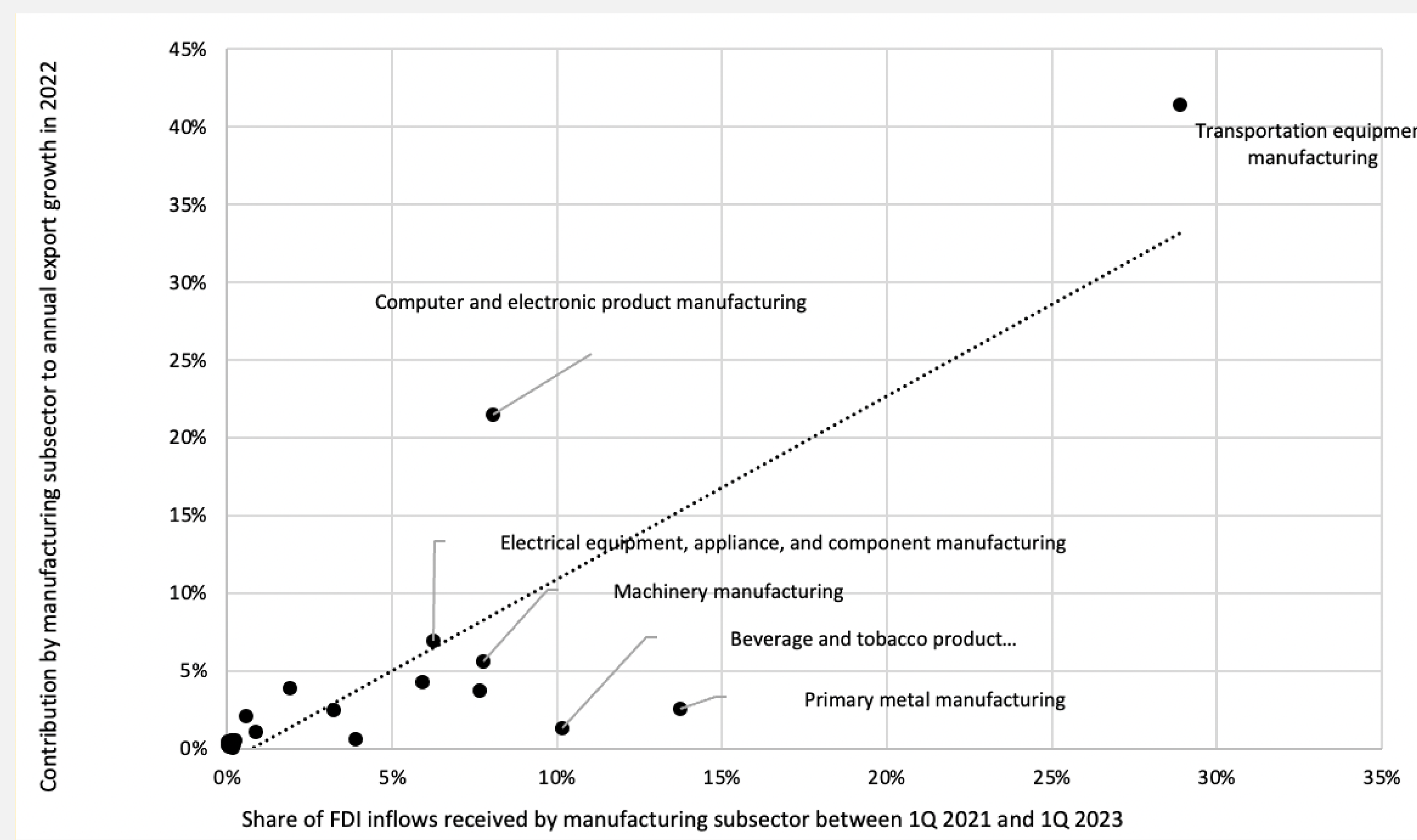
Nearshoring can take shape through new investments or an increase in the plant capacity of companies already established within a country. In Mexico, due to the accelerated growth of exports in the post-pandemic period, there are sectors that have a plant capacity utilization that reached historic highs: 1) manufacture of machinery and equipment, 2) manufacture of computer, communication, measuring and other electronic equipment, 3) manufacture of accessories, electrical appliances and electricity generation equipment, and 4) manufacture of transportation equipment. In order to continue producing and exporting, an increase in installed plant capacity is necessary.

During the period spanning 2021 to 2023, there is a positive relationship between foreign direct investment flows by subsector and their impact on the growth of exports of the same subsector. The most notorious example is the transportation equipment manufacturing subsector, which in this period received 28.9% of foreign direct investment flows directed to manufacturing and in turn explained 41.5% of export growth in 2022.

Comparatively the computer equipment manufacturing subsector received 8.1% of foreign direct investment flows, but accounted for 21.5% of export growth. This indicates that export growth is due to factors such as price growth due to the temporary shortage of semiconductors and, to a lesser extent, Nearshoring. It is important to remember that strong investment flows have not materialized in this subsector to support high export growth in the long term. This implies that growth in exports of computer products will be limited in the near future if no new investments are made and that, therefore, the proportion of exports of this subsector will tend to decrease in relation to Mexico's total exports.

In general, for the 21 manufacturing subsectors in the indicated period, it is observed that with a 1% growth in the proportion of foreign direct investment flows, the contribution to the growth of total manufacturing exports grows 1.18%. This indicates that the growth of investment directed to sectors with high growth capacity, such as computer equipment manufacturing, will be key for Mexico to continue gaining market share in U.S. imports. However, it also suggests that Mexico's exports could become increasingly concentrated in a few sectors, favoring growth in the states where they are produced.

Figure 4. Ratio of FDI inflows by manugacturing dub-sector (Q1 2021 to Q1 to 2023) and contribution by sector to total export growth in 2022



Fuente: Grupo Financiero BASE with information from INEGI and the Ministry of Economy.

The low level of investment in some subsectors means that the nearshoring opportunity is being only partially exploited.

3. Mexico's increased share of U.S. imports does not remain in the manufacturing sector. Mexican agricultural products now account for 3.79 percentage points more of total U.S. imports of agricultural products. Thus, the value of U.S. agricultural imports from Mexico has grown 55.1% between 2016 and 2023. However, this sector by its nature does not involve off-site outsourced production or nearshoring.

Winning states

Exports from most states show significant growth in the period from 2016 (pre-China trade war and pandemic) to 2023. However, many states have a low share of Mexico's total exports, so it is important to consider the contribution to total export growth over the period. The states with the highest contribution to export growth are: Chihuahua (14.1%), Coahuila (14.3%), Nuevo Leon (10.8%), Baja California (9.0%), San Luis Potosi (5.6%), Tamaulipas (3.6%) and Jalisco (+4.2%). Together, these entities account for 68.4% of export growth in the period from 2016 to 2023 (Table 5).

These states are mostly bordering the United States or belong to the Bajío region, where rapid growth in the transportation equipment manufacturing sector has been observed.

More revealing are the figures for foreign direct investment growth by state. In 2022, removing the extraordinary flows from the merger of Televisa and Univision and the restructuring of Aeromexico, it stands out that Nuevo Leon and Jalisco were the entities with the highest growth and amount in foreign direct investment. By sector, investment was directed to the transportation equipment subsector in Nuevo León, while in Jalisco it was directed to the computer equipment manufacturing subsector.

Considering states of great relevance, in 2023 Nuevo León (+110.9%) is the state, after Mexico City (+541.0%) and Puebla (159.8%), with the highest growth in its foreign direct investment flows, while Jalisco shows an annual drop of 10.6% in the first quarter, due to the low level of investment in the computer equipment manufacturing sector.

Foreign direct investment figures generate skepticism regarding the nearshoring opportunity, but it is possible that this is due to the disinvestment of foreigners[4] and the high concentration of foreign direct investment arrivals in some states and sub-sectors. In fact, there are states where Nearshoring is still a myth because no new investments have been received. This points to the importance of the specialization of the labor force in sectors favored by the relocation of companies, as well as the particular efforts of state governments to bring in new companies.

In addition to investment, the creation of formal employment is related to Nearshoring, and the states that have taken the best advantage of this opportunity are also those where labor formality has increased. The state of Nuevo Leon stands out, which in the month of July (latest available data) had the highest growth in IMSS affiliates due to the creation of formal private sector employment. Also noteworthy is the creation of formal employment in Puebla, a state where foreign direct investment grew 159% annually in the first quarter of the year and its exports show a cumulative growth of more than 100% since 2016.

Although Nearshoring represents a golden opportunity for Mexico, it is not being taken advantage of by all states, nor is it reaching all manufacturing sectors. Rather, it is an opportunity that is seen very specifically in the manufacture of beverages and tobacco, transportation equipment and to a lesser extent in the manufacture of computer equipment.

Table 5. Contribution of exports by state to Mexico's total exports

Figures in millions of dollars	1Q 2016	1Q 2023	Growth	Contribution to export growth between 2016 and 2023
Total	**73,508**	**127,109**	**72.9%**	**100.0%**
Chihuahua	9,360	16,934	80.9%	14.1%
Coahuila	8,578	16,243	89.4%	14.3%
Nuevo Leon	7,365	13,176	78.9%	10.8%
Baja California	7,479	12,312	64.6%	9.0%
Guanajuato	5,163	7,939	53.8%	5.2%
Tamaulipas	5,718	7,637	33.6%	3.6%
Jalisco	4,397	6,640	51.0%	4.2%
Sonora	4,365	6,382	46.2%	3.8%
San Luis Potosi	2,235	5,222	133.7%	5.6%
Mexico	4,264	4,649	9.0%	0.7%
Puebla	1,824	4,578	151.0%	5.1%
Queretaro	2,448	4,373	78.6%	3.6%
Campeche	1,643	3,469	111.2%	3.4%
Aguascalientes	2,037	3,195	56.9%	2.2%
Tabasco	933	2,318	148.5%	2.6%
Veracruz	1,008	2,223	120.4%	2.3%
Michoacan	204	1,819	792.9%	3.0%
Sinaloa	292	1,306	347.2%	1.9%
Hidalgo	398	1,016	155.2%	1.2%
CDMX	576	969	68.3%	0.7%
Zacatecas	630	954	51.4%	0.6%
Durango	380	839	121.0%	0.9%
Morelos	961	767	-20.1%	-0.4%
Tlaxcala	333	512	53.6%	0.3%
Guerrero	142	319	125.3%	0.3%
Oaxaca	162	317	95.9%	0.3%
Yucatan	334	309	-7.4%	0.0%
Chiapas	138	269	94.6%	0.2%
Colima	61	265	336.6%	0.4%
Baja California Sur	41	87	110.9%	0.1%
Nayarit	41	70	73.0%	0.1%
Quintana Roo	2	2	30.6%	0.0%

Source: Grupo Financiero BASE with information from INEGI.

4. Some arrive looking for the nearshoring opportunity, while others leave Mexico due to different factors.

The risk of Reshoring

Mexico is competing with other economies to attract foreign investment. Countries in Eastern Europe, Asia and even South America also offer attractive opportunities for Nearshoring. On the other hand, reshoring, i.e., the return of business operations to their country of origin, in this case, mainly the United States, is also gaining momentum. Companies are reconsidering the decentralization of their operations and are now opting to keep them closer or in-house for greater control. Therefore, while Mexico has several advantages, it is imperative that it continues to improve its infrastructure, political and economic stability, public safety and its institutional framework to build confidence and maintain its attractiveness for foreign investment in this increasingly competitive market.

In the post-pandemic period (2020-2022), Mexico ranks as the economy with the second highest FDI inflows among Latin American countries, being surpassed by Brazil, which has managed to receive 70% more FDI than Mexico (measured in current dollars). However, analyzing the average annual percentage changes in foreign direct investment in the post-pandemic period, Mexico is among the lowest. Even the United States has managed to increase its foreign investment flows more than Mexico.

That is, instead of relocating to Mexico, some U.S. companies are choosing to return their operations to the United States. This trend not only represents a lost opportunity for Mexico, but goes beyond that, manifesting itself also in the withdrawal of foreign investment that had been channeled to Mexico, but now decides to return to the United States. This is evident in the disinvestment that in the first half of 2022 stood at US$5,998.4 million (annualized to US$11,997 million).[5]

Although Nearshoring is not only reflected in foreign direct investment, it is the most obvious indicator that companies are coming to a country, or that they are expanding their productive capacity within it. Another relevant indicator in the de-globalization process is employment.

Figures collected by the Reshoring Initiative[6] show that after the 2020 pandemic, the U.S. has seen a significant acceleration in manufacturing job creation from reshoring or foreign direct investment. This contributed to the U.S. posting 3.16% growth in the number of manufacturing jobs in 2021 and 3.10% growth in 2022 (year-end figure comparisons), the highest rates since 1983. While this growth could be attributed to recovery from the 4.70% drop in 2020 due to the pandemic, one only has to compare with the recovery from previous crises to conclude that this is not just a rebound effect. In 2008 and 2009 there were drops of 6.52% and 10.70%, respectively, but in 2010 it only grew 1.05%, and the level of manufacturing employment at the end of 2007 was never recovered and to date continues to be lower. With these data, it is evident that the U.S. manufacturing sector is benefiting from the reshoring.

Among the reshoring cases identified by the Reshoring Initiative in 2022, the 10 most cited factors motivating the relocation of activities were government incentives, political instability, proximity to markets, infrastructure, time to market, and innovation and development. It is easy to notice that some of these points coincide with areas of opportunity for Mexico's economy, which in recent years has been affected by high uncertainty, as well as political and economic instability, insufficient infrastructure and lack of investment in innovation; but at the same time they also coincide with characteristics that Mexico already possesses, such as proximity to the U.S. target market, short lead times and stable logistic costs.

Table 6. Factors cited that motivated Reshoring or FDI to the United States in 2022.

#	Factor	Quotations
1	Government incentives	348
2	Availability and training of skilled labor	234
3	Risk of supply chain disruption, risks of natural disasters, and political instability	218
4	Proximity to customers/markets	198
5	Ecosystem synergies	163
6	Infrastructure	124
7	Capacity underutilization	110
8	Automation/technology	107
9	Time to Market	104
10	Joint manufacturing-innovation (R&D)	101

Source: Grupo Financiero BASE with information from Reshoring Initiative.

5. Unfortunately, the Ministry of Economy stopped updating this data in the second half of 2022.

6. Reshoring Initiative 2022 Data Report: IRA and Chips Act Boost Reshoring to Another All-Time High, Up 53% (https://reshorenow.org/content/pdf/2022_Data_Report.pdf)

How much is Nearshoring being leveraged?

Nearshoring is a golden opportunity that is not being fully exploited. It is estimated that Mexico is receiving only between 10% and 20% of foreign investment flows for business relocation. Moreover, these investment flows are highly focused on a few states and manufacturing subsectors. Thus, it can be said that Nearshoring is not arriving in waves to Mexico, nor is it arriving indiscriminately to all states.

Investment decisions are long-term. Once a company has decided to migrate its production to another country, it will take between 15 and 20 years to consider moving it again. If Mexico does not take advantage of the current Nearshoring opportunity, it will have missed out on the possibility of greater formal job creation, growth in gross fixed investment, increased productivity and higher economic growth for many years to come.

Foreign direct investment[7] generates jobs, potential export growth and GDP growth. In addition, with the entry of dollars into the country, it promotes exchange rate stability[7], as it is a long-term investment.

Nearshoring should be reflected in higher foreign direct investment flows into Mexico. It's noteworthy that foreign direct investment that arrived in Mexico grew 14.77% in 2022, but when removing the extraordinary flows from the restructuring of Aeromexico and the merger of Televisa and Univision, it results in a drop of 7.01% in 2022. This raises the question of whether there has really been a Nearshoring benefit in Mexico.

The immediate answer when looking at the drop in foreign direct investment would be no, but we have to look at the details of the figures.

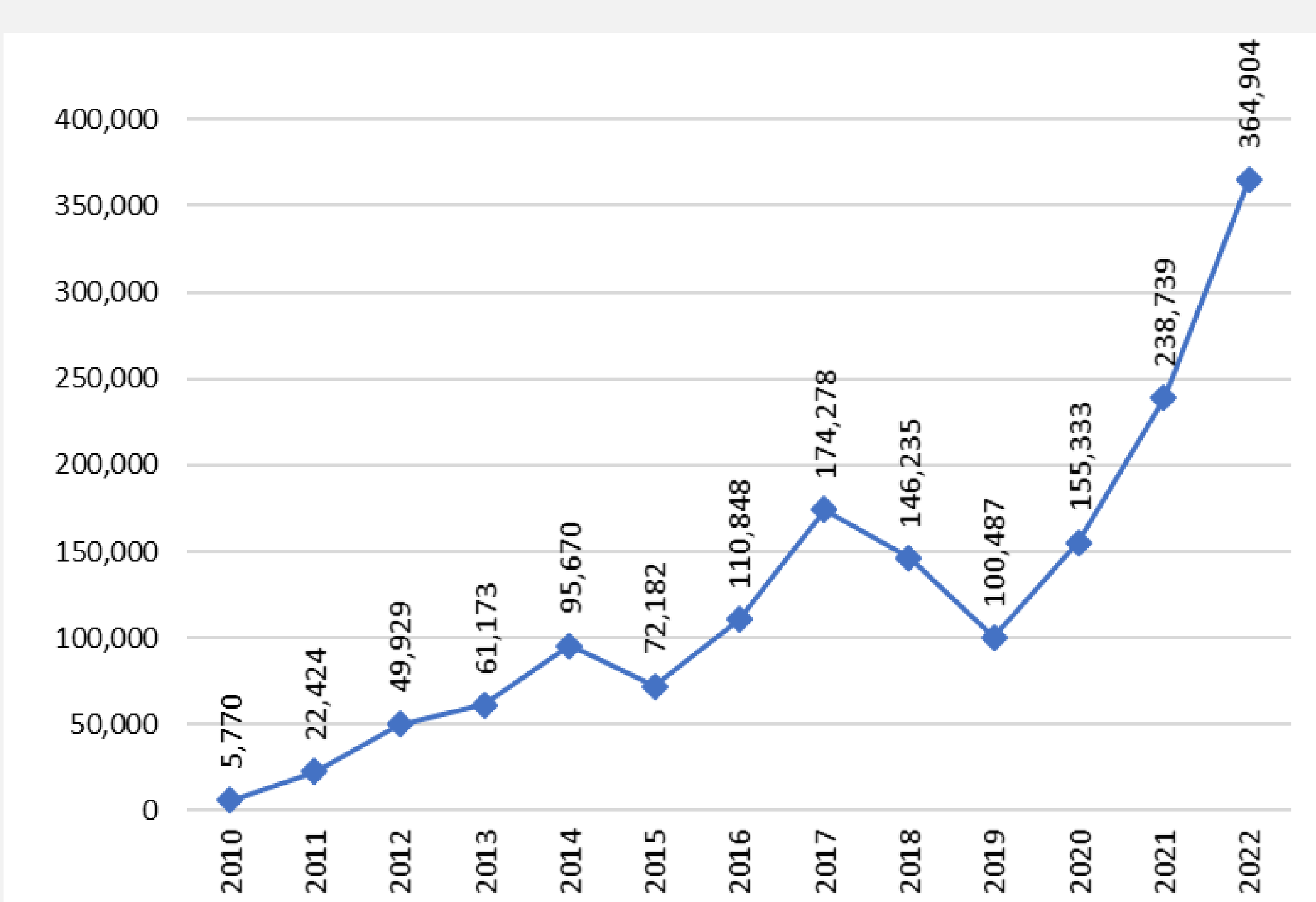
If there had not been a large disinvestment by foreigners, foreign direct investment would have reached a flow of at least 47 billion dollars in 2022. This implies that there has been a benefit for Mexico from Nearshoring, but it has not been reflected in the net figures of foreign investment because some enter looking for the Nearshoring opportunity and others leave Mexico for different factors.

Company exits from Mexico do not only impact the figures for that particular year in which the divestment occurred. Typically, companies reinvest their profits, so when they leave Mexico they also take with them the profits they would have reinvested in their operations.

It's worth noting that taking advantage of the Nearshoring opportunity will be reflected to a greater extent over time, as there are investments that have already been announced but have not materialized, as in the case of Tesla.

An important thing to note for Mexico's economy is that, according to data from the Reshoring Initiative, Mexico is the second country that has lost the most jobs by reshoring to the United States between 2010 and 2022, being only surpassed by China. Likewise, according to the same report, Mexico ranks tenth in the list of countries that have generated the most jobs in the United States through FDI.

Figure 5. Announcements of the new manufacturing jobs in the U.S. from FDI and Reshoring



Source: Grupo Financiero Base with information from Reshoring Initiative

7. Foreign direct investment is investment by foreigners in machinery, equipment and construction. Foreign direct investment is different from foreign portfolio investment, since portfolio investment is in financial instruments such as stocks and bonds.

BASE

Nearshoring benefits

If Mexico were to lay the groundwork to take greater advantage of the Nopportunity, foreign direct investment would reach annual inflows between US$55 and US$60 billion over the next 3 to 5 years, providing the opportunity for non-oil exports to double in 8 years.

Nearshoring has the capacity to generate greater economic growth not only through foreign direct investment and job creation directly related to new companies coming into the country. The Nearshoring opportunity has increased optimism, reflected in the survey conducted by the Bank of Mexico to private sector specialists, specifically in the question "right time to invest" which is at its best level since 2015. This optimism may lead local companies to invest to prepare for the arrival of new foreign investment. On the other hand, as companies arrive, the service sector is boosted first, then the construction sector and finally manufacturing, with the development of suppliers. Nearshoring leads to a domino effect of increased production due to the growth of suppliers, who in turn will buy more from their own suppliers.

By taking better advantage of the Nearshoring opportunity, Mexico's GDP could grow around 4% annually, there would be greater formal job creation, the informality rate would drop below 50% for the first time in Mexico's history, and household consumption would depend less on remittances sent from abroad by their families, as well as on government transfers. Taking advantage of Nearshoring would generate a structural change in the Mexican economy, similar to that observed with the entry into force of NAFTA.

Exchange rates and Nearshoring

In 2023, the Mexican peso is the second most appreciated currency, behind only the Colombian peso, due in part to foreigners' preference for peso investments. Exports and remittances represent the largest inflow of dollars into the country, but have slowed. For its part, the Bank of Mexico has said that it expects to keep the interest rate at the current level for a period of time, which implies that it does not expect to raise it. Therefore, it is estimated that foreigners' preferences to invest in Mexican pesos are the main cause of the decrease in the exchange rate, and not the current flow of dollars into the country or the Bank of Mexico's monetary policy.

This is due to the expectation that Nearshoring will generate greater economic growth and a greater flow of foreign exchange to Mexico through foreign direct investment and exports. The foreign exchange market is not waiting for expectations to materialize and is anticipating to obtain the highest possible return. The appreciation of the peso, leveraged on the expectation of growth from Nearshoring, is a double-edged sword, as investors could become disenchanted with the peso or Mexico and switch their investments to another currency or asset, which could lead to a rapid increase in the exchange rate.

On the other hand, there has been much talk that the appreciation of the peso discourages Mexican exports, but with the right economic policies and taking advantage of the Nearshoring opportunity, exports would continue to grow even as the Mexican peso continues to appreciate.

For Mexico to take better advantage of the Nearshoring opportunity, four conditions must be met:

1. **Governance** that generates certainty: rule of law, low public insecurity and domestic economic policies that foster a good business environment.
2. **Packages aimed at receiving Nearshoring**, which include incentives, as well as guidance on the procedures and operation of Mexico.
3. **Active search for foreign investments that wish to relocate their production:** promotion of Mexico abroad as an attractive destination for fixed investment.
4. **Strengthening infrastructure and supply chains.** Safe roads and ports are needed, as well as communication routes that facilitate transportation. It must be ensured that there will be sufficient electricity and water for companies that choose to come to Mexico.

Elections 2024.
Opportunity or risk for Nearshoring?

If the elections were to take place at this time, the candidates for the U.S. presidency would be Joe Biden for the Democratic Party and Donald Trump for the Republican Party. According to available polls, Biden would emerge as the winner potentially setting the stage for continuity in Mexico regionalization or Nearshoring process.

The United States is increasingly hearing complaints about potential USMCA rule violations by Mexico To date there are several trade disputes that the U.S. has opened against Mexico, but none have been taken to panel, despite the expiration of the consultation process.

In the presidential election race, Joe Biden could be forced to be tougher with Mexico on trade issues, which would represent a risk for the flourishing of Nearshoring in the country, but this would be determined by Mexico's behavior, not that of the United States, because if Mexico fully complies with the treaty, trade disputes and complaints would diminish.

On the contrary, if Trump remains the Republican Party's candidate, it is very possible that part of his campaign will be about "making America great again" (MAGA). This could imply a stronger trade war against China, which would be beneficial for Mexico indirectly through the loss of market share from Chinese imports. However, it could also discourage the relocation of companies outside the United States, which would affect Mexico, regardless of the country's behavior in relation to what was agreed in the USMCA. That is, Trump could be a greater risk or a key player in the arrival of new companies to the country.

In Mexico, the risk factors for Nearshoring related to elections are the possibility of changes in the rules of the game, weakening of the institutional framework, deterioration of governance, rule of law and the possibility of changes in the Constitution. This implies that if only one party wins the presidency and the majority in Congress, new investments could be scared away, due to the possibility of changes in the Constitution that affect the way Mexican companies and the financial market operate. This would be followed by the possibility of reforms that increase labor costs, increased public insecurity and deterioration in governance.

Generally, elections lead to an increase in uncertainty; therefore, to the extent that pre-candidates or candidates in Mexico give speeches in favor of the rule of law, market economy, respect for institutions and openness to free trade, they will favor the arrival of new companies. Speeches of disregard for foreign debt, radicalization of economic policy and reforms that represent an increase in labor costs would scare away new investments.

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