Nearshoring: An opportunity for Latin America

USD 35 billion

Estimated increase in Mexico's exports to the U.S. due to nearshoring[1]

USD 4.8/hour

Labour cost in Mexico, compared with USD 6.5 in China and USD ~30 in the U.S.[2]

25% young population

67% of the population is of working age and 25.2% is aged between 0 and 15, which favours the demographic bonus in the medium term[3]

[1] Source: Inter-American Development Bank (IDB). June 2022
[2] Source: Statista. 2020 figures
[3] Source: Mexico 2020 Census

Labour costs, logistics disruption and geopolitical risks are driving the nearshoring phenomenon

Supply chain dynamics have changed

China's entry into the World Trade Organisation (WTO) in 2001 generated a dynamic of globalisation in manufacturing in which a relevant part of the developed economies' production chain relocated to Asia in search of lower labour costs, as a result of which Asian countries experienced unprecedented growth rates. Logistics and transportation processes achieved efficiency levels that minimized the distance factor. In addition, China and the United States strengthened their geopolitical ties, with new synergies in fields such as finance (China became one of the main buyers of US Treasury bonds). These three factors that favoured globalisation (lower labour costs, logistical efficiency and stable geopolitics) have been replaced in recent years by structural factors.

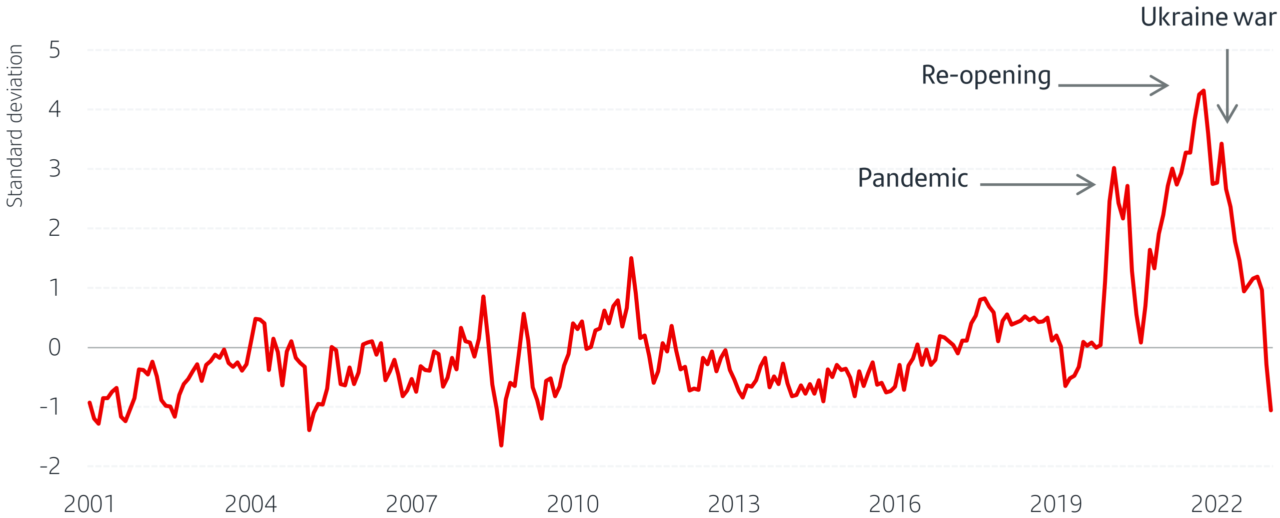
First, as a result of COVID-19 and the subsequent reopening, supply chains experienced major disruptions that led to shortages of all types of godos and took many months to stabilize.

This is demonstrated in the chart below, which plots the Global Supply Chain Pressure Index (GSCPI), an indicator that integrates transportation cost data and manufacturing indicators to provide a picture of global supply chain conditions. The level of pressure was very high from the beginning of the pandemic in March 2020 until late 2022. The most recent data, as of March 2023, show it is back to normal.

Secondly, China gradually shifted from basic manufactures to more complex ones that are classed as strategic and critical to the United States. An increased competitiveness in China combined with a growing trade deficit, led to tension in trade relations that came to a head during the Trump administration and continue to this day under Biden. Solar panels, an example of increasing technological competitiveness and currently a key element in the energy transition, are a case in point. According to data from the International Energy Agency (IEA) in its July 2022 Solar PV Global Supply Chains report, China dominates the supply chains for world photovoltaic market.

Global Supply Chain Pressure Index (GSCPI)

Source: Federal Reserve Bank of New York, Global Supply Chain Pressure Index, https://www.newyorkfed.org/research/gscpi.html



Security of supply is now paramount

In this line, in an attempt to limit dependence in semiconductors, another of the sectors it considers essential and a matter of national security, the United States decided in October 2022 to restrict China's access to any element associated with chip production that is from the U.S. or incorporates U.S. technology.[1] **The United States lead this industry in terms of R&D, design, design software production and, further down the value chain, marketing, but accounts for only 13% of global chip production, a fact that is identified as a supply chain risk.**[2]

Therefore, having that supply chain closer to home is now more important than ever.

The free trade agreement between the United States, Mexico and Canada (USMCA, formerly NAFTA) is a very positive factor in this context. At present, the United States' two largest trading partners are Canada and Mexico, the latter having overtaken China, which was the #2 trading partner for almost two decades, in 2020.

Geographic proximity is decisive

Mexico's land border with the United States is more than 3,000km long and, according to Statista, more than 80% of exports are made by land. This represents a major advantage as it avoids bottlenecks in maritime transport.

In addition, **proximity allows trade not only in finished goods but also in intermediate goods, as well as joint production, which is an incentive for U.S. companies to invest.**

The labour market plays a key role in three ways: costs, availability and demographics

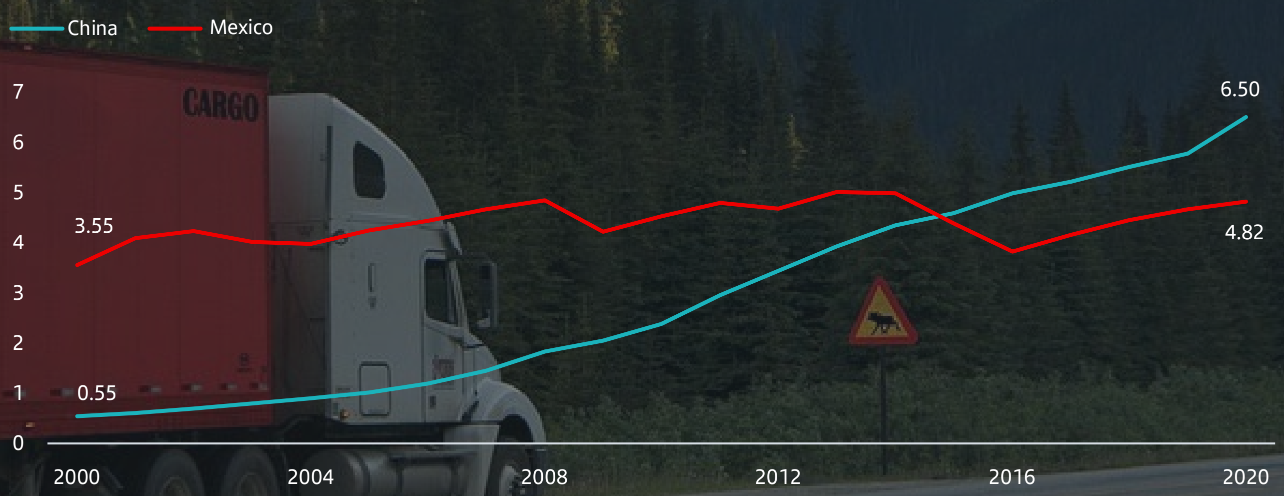
China's competitive advantage in terms of lower labour costs has disappeared since 2015, as can be seen in the chart below. In terms of production **costs, the hourly wage in Mexico (USD 4.82) at the end of 2020 was 25% lower than in China** (USD 6.50).

In terms of labour availability, **developed markets generally have labour shortages and, consequently, wage pressure**. According to INEGI, as of February 2023, Mexico had an economically active population (EAP) of 60 million, as well as 5 million in the non-economically active population (NEAP) who declare themselves available for work — this represents an ample supply of labour. That said, Manpower Group's Q3 2023 survey3 reports that 69% of Mexican employers face difficulties in finding talent with the required skills.

It's also important to talk about demographics. According to **Mexico's National Population Council (CONAPO), the population is expected to continue to grow until 2040, expanding the labour force**, whereas China's one-child policy means it has now reached a point where its population is declining, according to United Nations estimates.

Manufacturing labour costs per hour: China vs. Mexico (USD)

Source: https://www.statista.com/statistics/744071/manufacturing-labour-costs-per-hour-china-vietnam-mexico/



[1] https://www.reuters.com/business/exclusive-biden-hit-china-with-broader-curbs-us-chip-tool-exports-sources-2022-09-11/
[2] https://legrandcontinent.eu/es/2022/11/08/guerra-tecnologica-10-puntos-sobre-el-semiconductores/
[3] Manpower Group Mexico Encuesta de Expectativas de Empleo 3Q 2023

Latin America's opportunity: USD 78 billion, with Mexico as the main beneficiary

Nearshoring is defined as the outsourcing strategy under which a company transfers part of its production to third parties in other **countries that are nearby and in a similar time zone.**

According to 2022 estimates by the Inter-American Development Bank (IDB), nearshoring could add USD 78 billion per year in annual exports of goods (USD 64bn) and services (USD 14bn) from Latin America and the Caribbean in the short to medium term, with opportunities for quick wins in the auto industry, textiles, pharmaceuticals and renewable energy, among others. Mexico and Brazil would experience the largest gains (USD 35bn and USD 8bn, respectively) but all countries in the region could benefit as well (see map).

Accordingly, in July 2022, the IDB announced its support for the Mexican government's plans to promote nearshoring, i.e. the relocation of companies closer to end markets, to help foster sustainable development, especially in the country's southern and south-eastern states.

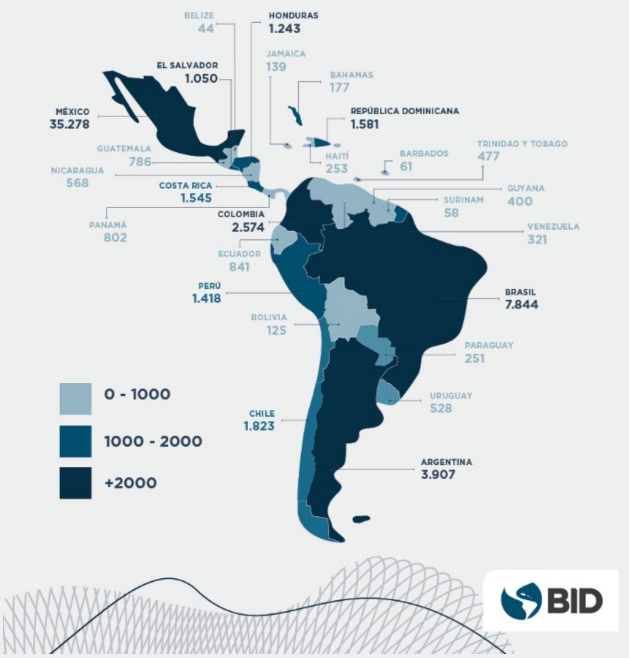
This is a commitment by the IDB and its private sector arm, IDB Invest, to help Mexico seize the enormous new opportunities resulting from the reconfiguration of global supply chains. IDB Invest can provide an estimated USD 1.75-2.25bn in short- and long-term funding over the next three years.

The table below details some of the foreign investment projects in Mexico that have been announced in recent months. It highlights the strategic importance of the companies that are investing, the diversity of industries involved, and the sizeable amounts of planned investment, which are expected to have a very positive impact on the Mexican economy.

In conclusion, nearshoring is expected to drive many industrial processes in Mexico and throughout Latin America in the coming years. The need to increase security of supply, diversify production chains and limit technology transfer to China make Mexico more attractive as an investment target for U.S. companies.

Breakdown by country of total neashoring opportunities Additional value of good exports (Mn$)

(Millions of dollars)



Main announcements of foreign investment in Mexico (2022-23)

Source: Expansión and other media

Company	Country	Project	Sector	Location	Amount (USD mn)
Tesla	USA	Factory	Auto	Nuevo León	5,000
TC Energy Corp	Canada	Gas pipeline	Energy	Veracruz / Tabasco	4,250
Jetour	China	Plant	Auto	Bajío/ Aguascalientes	3,000
NewFortress Energy	USA	Natural gas	Energy	Baja California	1,870
Tarafert	Netherlands	Plant	Fertilizer	Durango	1,500
OMNI Hotels	USA	Hotels	Services	Nayarit	1,500
Mercado Libre	USA	Logistics	Distribution	DF, Nuevo León and Guadalajara	1,475
Constellation Brands	USA	Beer	Beverages	Veracruz	1,300
Google	USA	Data	Technology	Domestic	1,200
Microsoft	USA	Cloud	Technology	Querétaro	1,100
Solarever	China	Batteries	Energy	Jalisco	1,000
BMW	Germany	Batteries	Auto	San Luis Potosí	868
Volkswagen	Germany	Plant	Auto	Puebla	763
Nissan	Japan	Plant	Auto	Aguascalientes	700

Private Banking

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