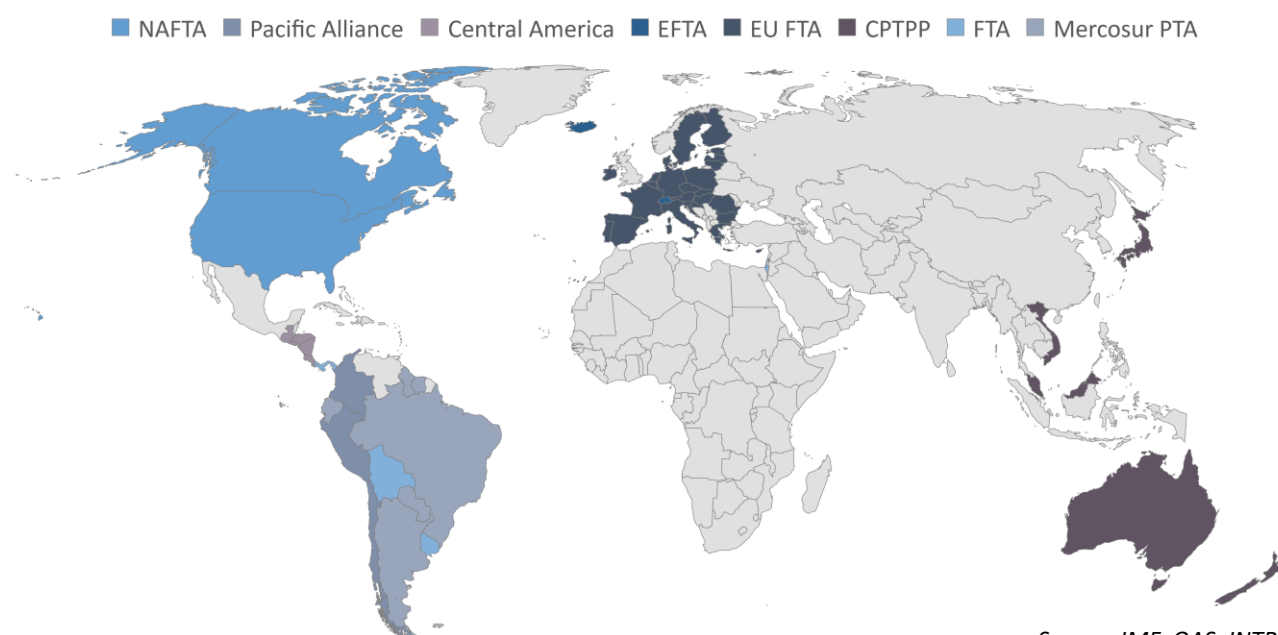


Is Mexico willing to take advantage of supply chains' relocation from China?

JULIO MARQUEZ

As the coronavirus outbreak revealed a dormant risk of excessive dependence on China. Investors, analysts and of course the Janes and Johns Does of the world are wondering if we are about to see a significant relocation of supply chains from China to other countries. In such case, Mexico might be poised to become one of the top destinations for multinationals. However, the grass on the other side may not be as greener as it may seem.

With 14 FTAs, with over 50 countries,
Mexico has access to about 60% of the world GDP



Source: IMF, OAS, INTRACEN

After being a flagship of protectionism during in the 70's and about half of the 80's, in 1986 Mexico adhered to the GATT, signaling that the country was on the path to economic liberalization, and it was!

By 2017, Mexico was the economy with the most free trade and investment agreements in the world, with access to a potential market of nearly one billion consumers on America, Europe and Asia, by having, as of today, 14 FTAs, 5 PTAs and 2 Macro and Multilateral agreements. In short, Mexico possess a clear advantage over its peers when it comes to market access and geographic location.

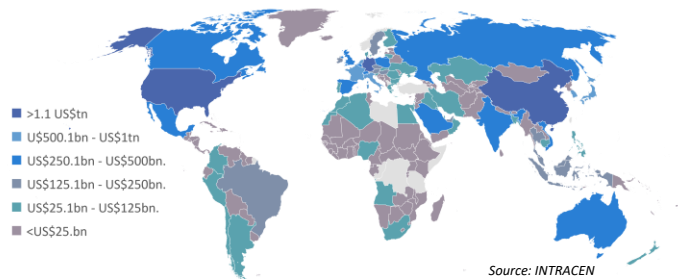
However, Mexico's recent economic policy has not favored investors nor gave them the certainty they demand in order to jump in as, following the launch of the USMCA midway through 2019, several European, Canadian and US companies found themselves filing lawsuits to protect their

investments in the face of unexpected changes imposed by the government on the Mexican energy market that put at risk billions of dollars in projects in the sector.

Moreover, in late March of this year, after an informal poll, the President cancelled the license of an almost finished *Constellation Brands* plant worth US\$1.4 billion—needless to say, shortly after taking office, he cancelled Mexico City's US\$13 billion airport that was halfway under construction, arguing, although failing to prove it, that the project was "corrupt".

To understand this behavior, it should be mentioned that since his early political life, President López has accused the government and businessmen (national and foreign) of corruption, favoritism, and abuse of power, frequently referring to them as the *power mafia*.

Exported Value by Country in 2019



Now, the big questions,

Is Mexico's President (AMLO) willing to give legal certainty to investors and stick to contracts?

As seen in the above lines, the answer is rather uncertain, as López is known to do his will overlooking the consequences; however, in recent days he declared that this year's slowdown of China, should attract investors to Mexico, saying that "That means this big factory, the biggest factory in the world, will reduce its output, and this gives us the opportunity, to Mexico, for more investment to arrive, for companies to set up, for jobs to be created.", which gives some hope that he might be willing to work alongside with investors to bring them in.

Will investors believe him?

It is well known that if a country such as Mexico wants to attract investors, it should show the world that it is willing to become more alluring, and in this case, there are issues that the government can address to send that message. To gain perspective, in 2019 Mexico stood at the

48th place (out of 141) of the World Economic Forum's Competitiveness Index, just behind Bahrain, Kuwait and Hungary and before Bulgaria, Indonesia and Rumania. Turns out that, despite improving by 0.3pts from the previous year, it fell two places due to other countries improving at a faster pace. In addition, the WEF points out that while improvements to institutions have been concentrated in the public sector's administrative efficiency; security and transparency are still problematic.

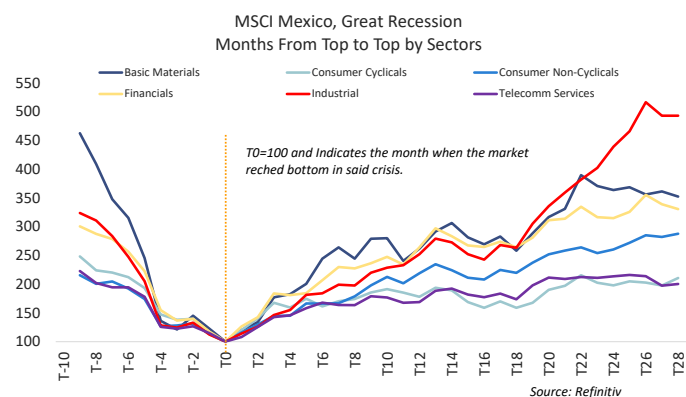
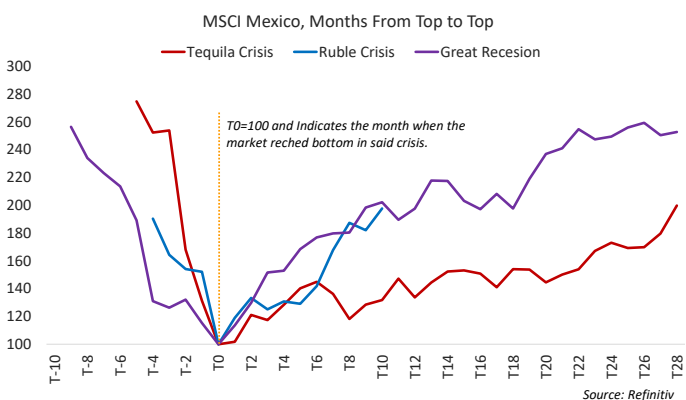
And, are those investors in a position to invest?

As said before, the pandemic has revealed the downside of lean manufacturing based primarily on keeping costs as low as possible and thus, when China locked down, manufacturers proved unable to pivot their chains due to a lack of flexibility in their supplier base. As this happened, manufacturers saw cash inflows halt and thus, they started to allot cash in their balance sheets at almost all cost to increase their chances of survival.

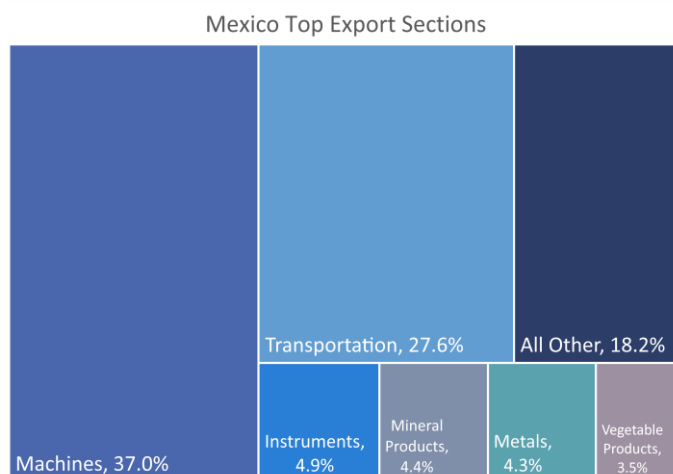
Therefore, it is very likely that companies lack the funds to invest in new production hubs immediately after the global lockdown comes to an end; however, if they have learnt something from this crisis, it is very likely that, in the long run, manufacturers will seek diversification to avoid putting themselves in such a difficult position again.

Mexico Top Export Sections ¹ vs Top 20 Exporters of the World							
	Transportation	Machines	Instruments	Vegetable Products	Metals	Mineral Products	Total Exports
World Total (US\$ Billion)	\$1,924	\$4,768	\$682	\$512	\$1,342	\$2,639	\$18,740
Share of World Totals							
Mexico	6.3%	3.4%	3.2%	3.0%	1.4%	0.7%	2.5%
China	4.9%	25.4%	11.9%	5.0%	14.4%	1.8%	13.3%
United States	9.8%	7.0%	13.7%	12.6%	5.3%	7.7%	8.8%
Germany	16.6%	9.0%	12.0%	2.7%	8.6%	1.1%	7.9%
Netherlands	1.7%	2.5%	5.5%	5.7%	2.5%	2.8%	3.8%
Japan	8.7%	5.4%	8.2%	0.2%	4.6%	0.5%	3.8%
France	6.0%	2.3%	2.9%	3.3%	2.9%	0.7%	3.0%
South Korea	4.6%	5.6%	4.3%	0.2%	3.9%	1.8%	2.9%
Italy	3.0%	2.9%	2.2%	2.1%	3.9%	0.8%	2.9%
Hong Kong	0.1%	1.1%	0.9%	0.6%	0.4%	0.0%	2.9%
United Kingdom	4.0%	2.1%	3.0%	0.6%	1.8%	1.8%	2.5%
Belgium-Luxembourg	2.6%	1.0%	1.8%	1.8%	3.0%	1.7%	2.4%
Canada	3.7%	1.0%	1.0%	4.3%	2.6%	4.1%	2.4%
Russia	0.4%	0.3%	0.3%	2.8%	3.6%	10.2%	2.3%
Singapore	0.5%	2.7%	3.1%	0.1%	0.5%	2.1%	2.1%
Spain	3.5%	0.9%	0.6%	4.1%	2.2%	0.9%	1.8%
Taipei, China	0.6%	4.3%	2.7%	0.2%	2.4%	0.4%	1.8%
India	1.2%	0.7%	0.5%	3.4%	2.1%	1.8%	1.7%
Switzerland	0.3%	0.8%	5.9%	0.5%	0.8%	0.1%	1.7%
Vietnam	0.2%	2.7%	0.9%	2.2%	0.7%	0.2%	1.6%
All other countries	21.4%	18.7%	15.6%	44.6%	32.2%	58.8%	28.0%

¹ XVII (HARMONIZED SYSTEM 1992 FOR SECTION)
Source: INTRACEN, OEC, UN Comtrade

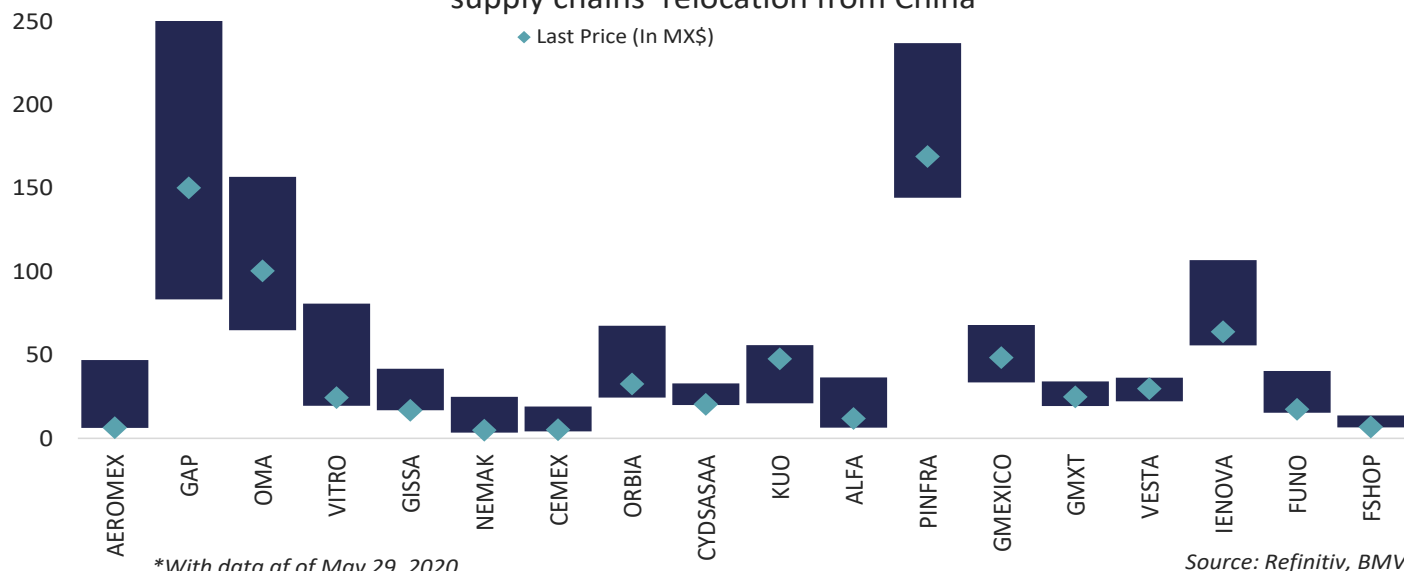


All in all, while supply chains may not relocate as soon as the world economy reactivates, because cash-starved companies will be unable to invest in new manufacturing hubs, we should expect that, in the medium and long term, they will seek to geographically diversify operations and suppliers. As for Mexico, it is still time to address key issues that would attract investors by giving clarity and send a message of commitment to legal certainty. Otherwise, the opportunity to capitalize a likely and profitable diversification of supply chains may be easily lost to India, Taiwan, or Vietnam, to name a few.



Source: INTRACEN, OEC

5Yr Price Range of some companies that might benefit from supply chains' relocation from China



*With data as of May 29, 2020

Source: Refinitiv, BMV

Companies that might benefit from supply chains' relocation from China

Company	Description
AEROMEX	Airline: provision of passenger and cargo air transport services.
GAP	Airports: 10 international airports in the Pacific and Central regions of Mexico, and an international airport in Jamaica.
OMA	Airports: Over 10 airports in Mexico.
VITRO	Auto & Construction Materials: Flat glass for the construction and automotive industries, glass containers, precision components, machinery and molds for the glass industry, carbonate and sodium bicarbonate.
GISSA	Auto Parts & Others: Manufactures blocks and iron heads for diesel and gasoline engines; residential and industrial water heaters and Houseware.
NEMAK	Auto Parts: Design, manufacture and distribution of aluminum components for powertrain and body structure applications.
CEMEX	Building Materials: Cement and other construction materials throughout the world.
ORBIA	Chemicals: Precision Agriculture, Building & Infrastructure, Fluor, Data Communication and Polymer Solutions.
CYDSASAA	Chemicals: Refined edible salts, industrial salts, caustic soda, sodium hypochlorite, refrigerant gasses, among others and, acrylic and cotton threads and fibers for the textile industry.
KUO	Conglomerate: Manufacture and sale of consumer business products, including processed food, beverages and pork meat, chemical products and auto parts.
ALFA	Conglomerate: Sigma , foods; Alpek, polyester, polyethylene terephthalate (PET) and fibers, and expandable polystyrene (EPS) and caprolactam, among others; Nemak light weighting solutions for automotive industry; Axtel , information technology and communication services and Newpek , oil and gas exploration and production company.
PINFRA	Infrastructure: supervision of construction, operation and maintenance of highways, as well as production of asphalt and other supplies related to road construction.
GMEXICO	Mining-metallurgical industry
GMXT	Railway cargo services
VESTA	Real Estate: Development, acquisition, sale and leasing of industrial buildings and distribution centers.
IENOVA	Utilities (Gas and Electricity)
FUNO	REIT: Operating and developing a range of real estate assets for leasing, mainly in the industrial, retail and office segments.
FSHOP	REIT: Acquisition, development and operations of shopping malls in Mexico.

Source: Refinitiv, BMV