ANDBANK RESEARCH

Global Economics & Markets

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Mexico – Some reasons to remain bullish in 2013 and … other reasons to be concerned

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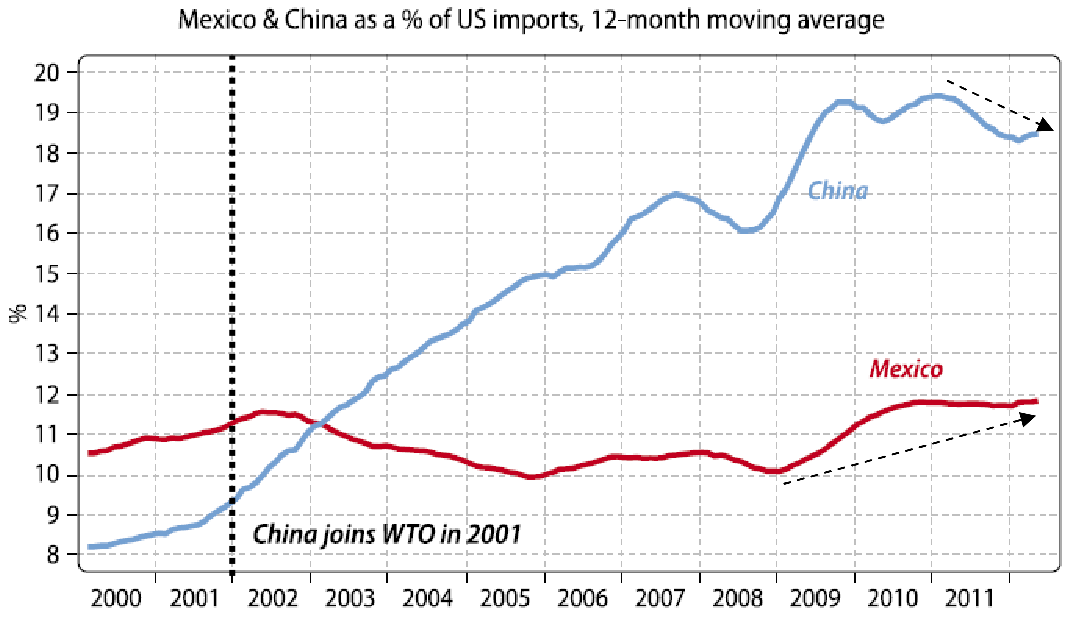
Mexico: A comeback story?

After China's WTO entry in 2001 (Dec. 11), Mexico was unable to compete against this low-cost industrial Leviathan…

… loosing a significant share of US imports and …

… more importantly, witnessing how China's share of US imports rocketed from 9% to near 20%



But from 2009, Mexico's share of US imports has returned to the "golden age" levels (from 10% to 12%) …

… and more importantly, it seems that has been at China's expense.

Do you believe recent trend will continue?

Mexico…

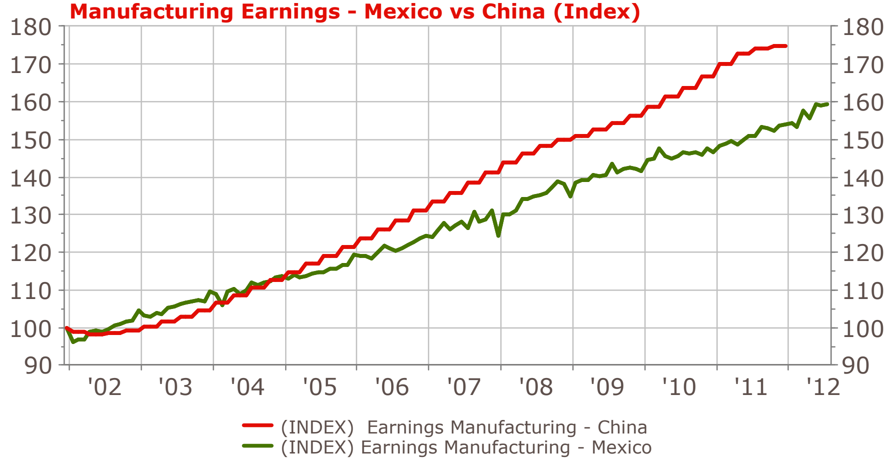
… and the 5 reasons that fuel our optimism for the period 2013-2014

Mexico: The strengths

1. The wage gap with China has disappeared

From Dec. 2001 wages in China has increased at a much rapid pace ..

… to the poin that manufacturing wages in China are currently similar (or even higher) than wages in México



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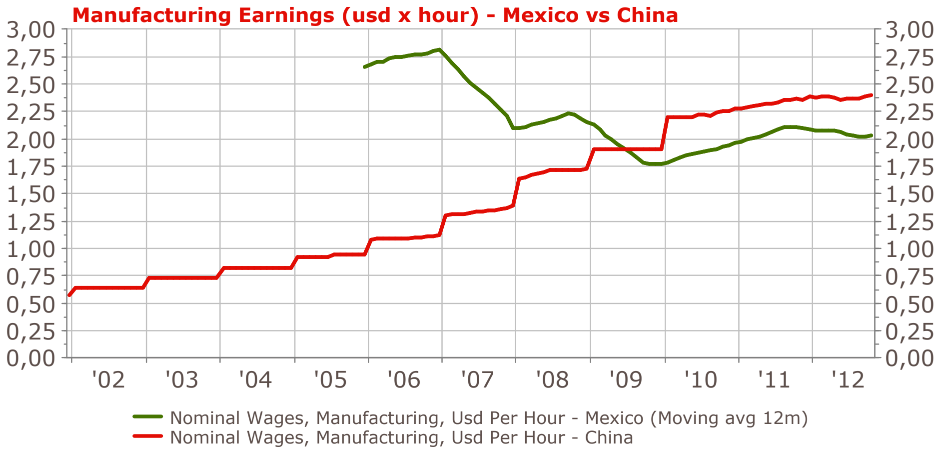


Andbank, INEGI, NAtional Bureau of Statitics of China *©FactSet Research Systems*

Thus, it will be difficult to see Mexico loosening share of US imports on the back of uncompetitive salaries.

Mexico
Other favourable aspects that fuel our optimism for 2013

2. Despite container shipping market is oversupplied, **bunker fuel costs remain at a considerable high level, keeping trans-Pacific costs significantly high**. This could explain why transport links between the US and Mexico have improved. We do not foresee substantial changes in the coming months or quarters.

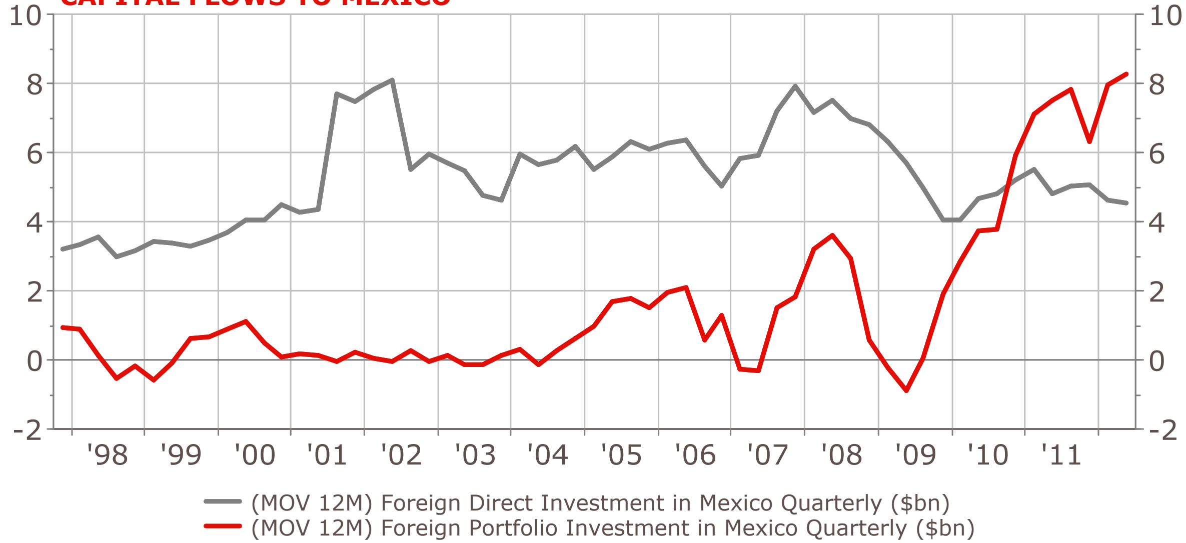
3. While energy costs are rising in China, **Mexico is benefiting from the US shale gas production boom** and the consequent fall in gas prices.

4. Who knows if **this event could spur a Mexican natural gas boom along the lines of that unfolding in the US**. Just consider that Mexico could be the fourth country in the world with largest reserves of shale gas, tripling proven reserves.

Mexico

5. The important flows of capital seen in the last 3 years could suggest that the development of this new industry is feasible

CAPITAL FLOWS TO MEXICO



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Some investors could be visualizing as this story could develop, and …

… this could explain why **Mexico has seen important investment flows from 2000** (specially in the foreign portfolio investment)

Mexico…

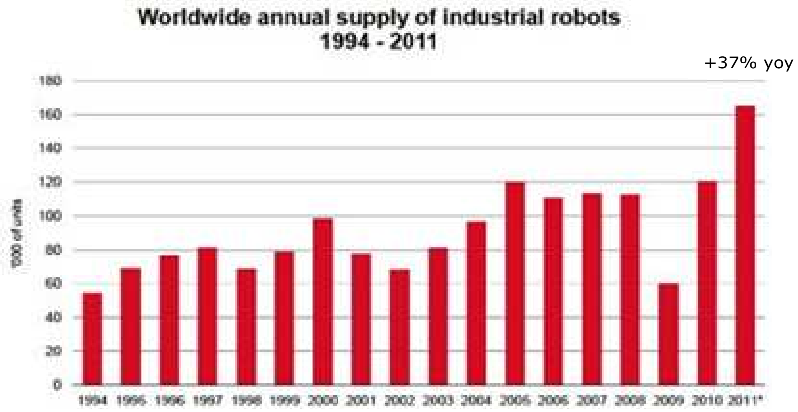
… and the 4 reasons that makes us think in a very challenging economic environment for Mexico from 2015

1. Mexico will not pick up business in low value added industries … <u>but is in the spotlight to loose market share in more sophisticated industries</u> (automotive, aviation…)

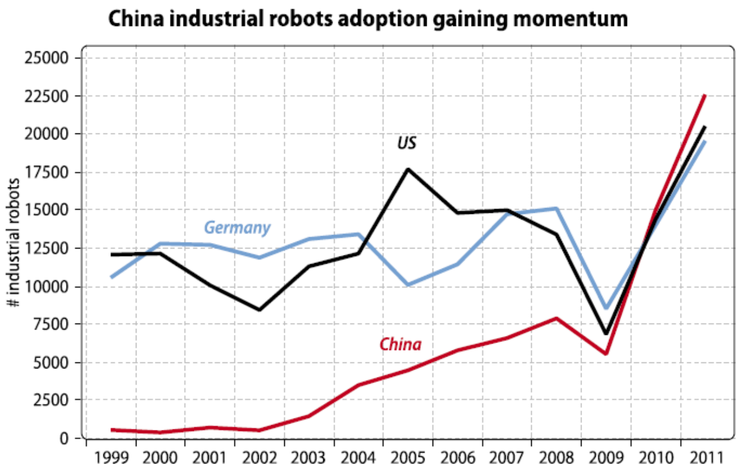
China is getting more expensive, yes. But is rapidly moving up in the value chain (for first time in history, China has acquired more robots than Germany and the US, seeking fast return on investments and <u>dramatic improvements in terms of quality</u>)

The implications for Mexico are clear: While it will be hard for it to pick up business in low value-added, labour-intensive industries (there will always be some million people in China willing to work at near 2$ per hour salary) …

… China is positioning it self for business in sophisticated industries where Mexico has performed strongly (autos, aviation)



IFR – International Federation of Robotics



2. Mexico's strength in cars & trucks … could become a vulnerability.

- Mexico's automotive industry (assembling & parts) have performed extremely well so far …
  - ✓ 45 different car & truck models manufactured in Mexico
  - ✓ Chrysler, Nissan, Honda and Mazda all plan to open new factories in the coming years
  - ✓ Since 2010, Mexican auto exports have risen 70% (averaging an annual 20% growth pace)
  - ✓ The US buys 64% of Mexico's auto exports …
  - ✓ … but has been Latin America that has been driving growth, acquiring 15% of total Mexico's auto exports (growing at a 80% pace in 2011 vs 9% rise in the US demand)
  - ✓ Mexico has been so competitive, that has become the main threat for Brazil's manufacturers (this explain why Brazil has hiked tariffs on Mexican auto-related imports)
- … so well that **automotive activity** accounts for 16% of total manufacturing activity and **is the biggest source of overseas income** with a 20% share of total exports.
- **Could this strength in cars & trucks be also a vulnerability?**

3. Its arch rival, China, is betting big … and this could result devastating for auto producers

- China **produces more automobiles than any other** country (1 in all 4 cars made in the world, 14.5mn cars in 2011,)

- That **kind of scale brings competitive advantages never achieved** that could be devastating for other competitors

- The escalation in the observed growth says it all!
  - $49bn shipment only in auto parts in 2011
  - Five times more than in 2004

- More importantly, if Chinese projections are met, China's annual exports in the auto industry will reach $ 105bn in 2015 … from which $26 bn would be aimed at the US. How could this impact the Mexican auto-related exports to the US? Lets see
  - Annual exports of Mexico are $350bn
  - And autos accounts for almost 20% of total exports: $70bn
  - And 64% of auto & parts' exports go to the US: $44bn

- **If Chinese authorities are right in their projections, the Mexican's will see reduced 6 of each 10 usd of their auto–related exports to the US.**

Source – National Bureau of Statistics of China, INEGI, Bank of Mexico

4. And do not forget that …

- … buying auto-parts from China may also help US automakers **gain access to China's domestic market**.

- Thus, **US automakers seeking penetration into China's domestic market will have another incentive than just costs** to buy Chinese-made auto parts.

- Additionally, low cost Chinese carmakers (Geely or Chery) plan to accelerate overseas sales in Latin America and have you clear one thing: **Mexico will be one of the markets targeted** ($15.000 in GDP per capita). Can you get a minimum idea of the potential impact of this development?

In summary, we are optimistic about the economic performance of Mexico in 2013 (even in 2014). **Nevertheless, we have reasonable doubts about the economic behaviour of the country from 2015 and onwards.**

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