December 2022

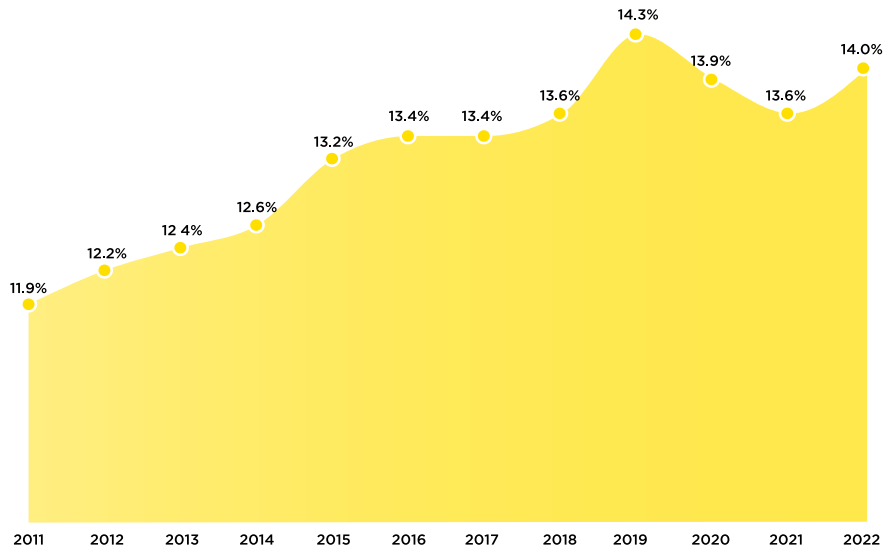
Industrial Production Shifts to Mexico Drawn by Labor and Location Advantage

The United States imports more goods from Mexico than from any other country except China. Top Mexican-made products include cars and trucks, household appliances and medical instruments as well as food and beverages such as beer. Trade volume from Mexico to the U.S. totaled $382.1 billion during the first 10 months of 2022 and is making up an increasing share of total imports as the nearshoring trend gains momentum. Nearshoring means bringing manufacturing closer to but not necessarily within U.S. borders. A slight variation on this theme that has gained traction since the escalation of the Russia-Ukraine conflict is called friend-shoring, referring to moving production to the shores of political allies. Both labor and transportation costs are the primary drivers of this significant global transition of production from China to America's southern neighbor.

China is no longer the lower-cost alternative for labor. Since 2012, manufacturing wages in China have grown by an average of 9.3% annually, while manufacturing wages in Mexico have grown by only 5.3% annually over the same period. Due to these growth trends, China is now a more expensive place for factory workers, with wages equating to about $6.50/hour compared with $4.82/hour for the same laborer in Mexico. More recently, transportation costs have created an even greater incentive for reshoring operations. While ocean freight rates have come down significantly after spiking in 2021, they are still up 84% from the beginning of 2020. While Mexico always possessed the advantage of proximity, that delta has expanded significantly as of late.

A Growing Share of U.S. Imports Produced in Mexico

Labor in Mexico is now more affordable than China, which has seen manufacturing wages grow five times faster since 2000.



Top Imports to United States from Mexico

Machines
- Appliances
- Computers
- Semiconductors
- Televisions

Transportation
- Auto parts
- Cars
- Trucks

Food & Beverages
- Beer
- Fruit

Medical Intruments

Metals

Beyond labor arbitrage, Mexico possesses the following advantages that position its industrial sector well for sustained growth:

1. Labor demographics: 57% of its total 126 million population is under 34 years old, and the average is 29 years old. This creates availability of labor for the next 50 years, with young people looking for good manufacturing jobs.

2. Logistics oriented: Mexico offers access to the United States by truck in less than two days, making the speed and cost of transportation the most competitive in the world.

3. Taxes: Under NAFTA 2.0, now called USMCA, producing in Mexico guarantees no taxes.

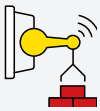
4. Landlords and general contractors: There is a large ecosystem of world-class landlords, as well as general contractors, that are funded and capable of building state-of-the-art manufacturing operations.

5. Resources: There is abundant land, rain and water in most locations and energy to attract middle-to-large-scale manufacturing projects.

Mexico's Industrial Landscape



819.9M
square feet of industrial inventory



19.7M
square feet under construction (121 buildings)



1.6%
vacancy rate



17
leases with Chinese companies in Mexico in 2022

Mexico's more-than-800-million-square-foot (msf) industrial property market has already seen the results of the nearshoring trend. Vacancy stands at just 1.6%, and developers are responding to increased demand by adding 19.7 msf, a total of 121 buildings, to the inventory. Savills research is also tracking 17 leases totaling more than 5.0 msf involving Chinese companies being executed during the first three quarters of 2022, up from just under 4.0 msf during 2022.

The most notable transactions of 2022 involving Chinese companies include the following:

- **Hengli Group**, a petrochemical company, purchased land just outside of Monterrey to house a 1.5 msf campus, bringing more than 300 jobs.

- **Lizhong** purchased land in the Interpuerto Industrial Park in Monterrey to build a new manufacturing facility with an annual production capacity of 3.6 million ultra-lightweight aluminum alloy wheels.

- **CITIC Dicastal**, the world's largest supplier of aluminum wheels and chassis components, purchased land to build a facility in Saltillo.

- Global e-commerce giant **Alibaba** completed a significant lease in Mexico City.

- **CFMoto**, a manufacturer of motorcycles and all-terrain vehicles, leased a facility in Monterrey.

Lack of government incentives and energy infrastructure challenge future growth

While the nearshoring trend is clearly accelerating, obstacles to further growth remain. Electricity supply is a major barrier to the growth of manufacturing operations that require heavy power. In recent years, operating reserve margins have reached new lows, with demand often outpacing capacity. Investment is needed, particularly in the northern portions of the country, to increase generation capacity and improve transmission lines, which are congested and in poor condition in certain regions. Another challenge is the lack of incentives from the Mexican government. Going forward, nearshoring at a larger scale will involve U.S. companies leaving China as well as, at a smaller scale, Chinese companies wanting access to the U.S. market. However, there is the risk that the Chinese government could limit access to their markets if large U.S. companies decide to move critical manufacturing operations from China to Mexico.

> **"A bigger effort from the Mexican government is needed to actively promote investment, especially as China is unlikely to sit quietly and let manufacturing operations move away."**
>
> *Carlos Olson, VP, Occupier Services, Mexico City*

Despite these hurdles, Mexico remains a strategic location to expand manufacturing and logistics operations, as the nearshoring trend is expected to continue to advance. This growth stands to be a boon for both the industrial sector and the national economy.



Source: Morgan Stanley, PGIM, Market Analysis, International Energy Agency, National Bureau of Statistics of China, Organization for Economic Co-operation and Development

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