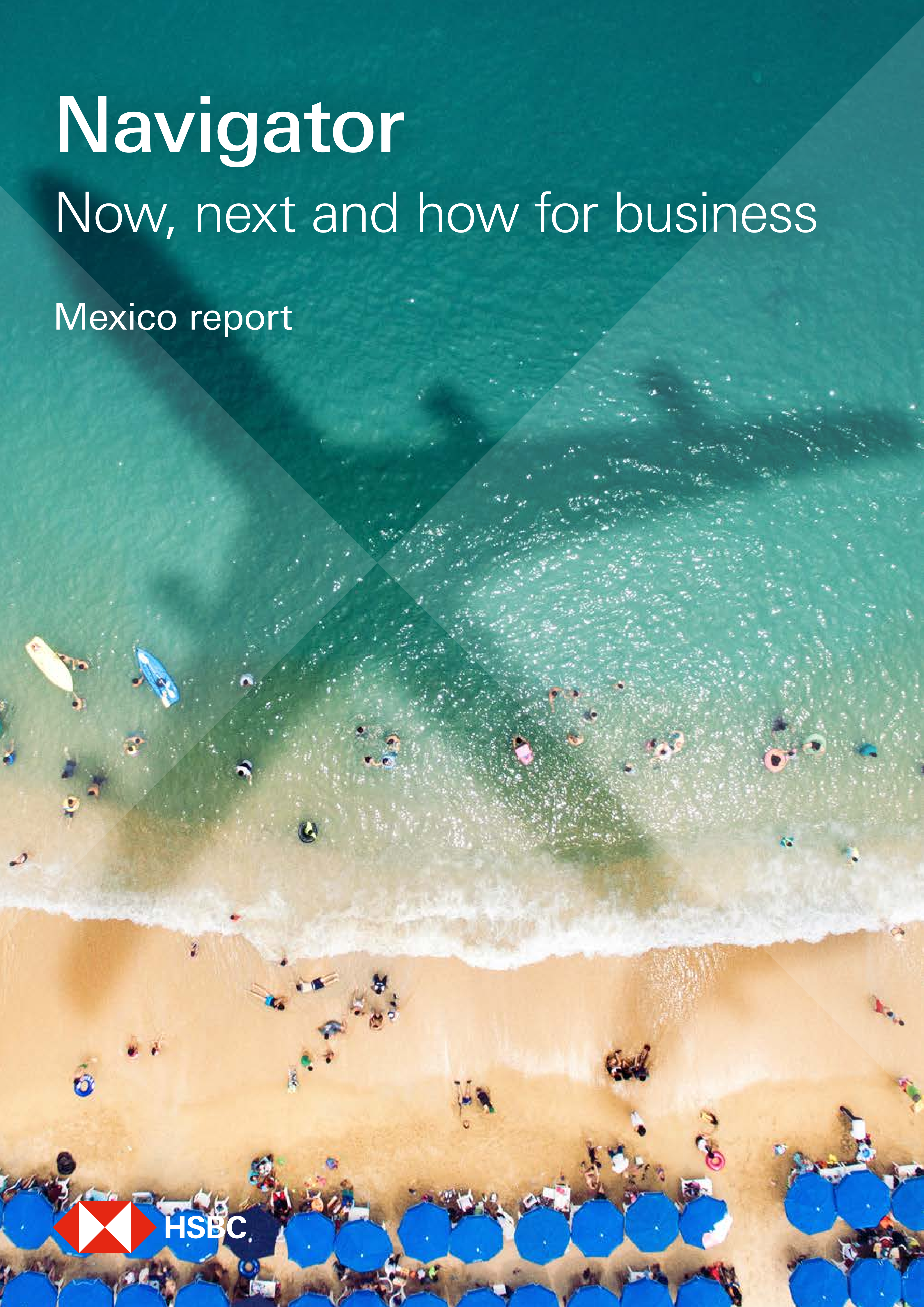
Navigator

Now, next and how for business

Mexico report



HSBC

Mexico

Trading through the uncertainty

Mexican firms remain very positive about trade prospects in 2018, increasingly confident that trade relations with the US will not be disrupted, and buoyed by the combination of a weaker peso and stronger growth in their main export markets. Over the long-term we expect key sectoral strengths in autos, fuels & chemicals, and tourism to remain mainstays of Mexican export growth.

Short-Term Snapshot

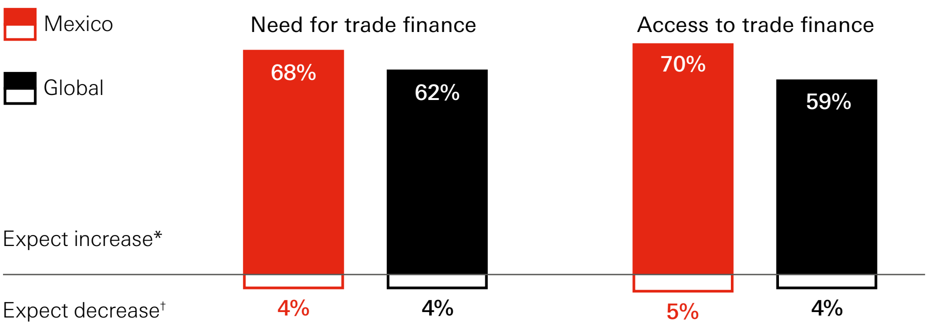
Mexico's economy has enjoyed a solid couple of years, in spite of the financial volatility surrounding President Trump's election late in 2016. GDP growth slowed from 2.7% in 2016 to 2.1% in 2017, but this was due partly to firms postponing investment, while they waited to see whether President Trump would implement his campaign pledges, and a bout of austerity also dragged 2017 growth lower. With both these factors increasingly behind us, our forecast is for GDP growth to rebound to 2.5% in 2018.

A better domestic outlook is matched by improving trade conditions. Despite the ongoing tensions around NAFTA, Mexican firms are increasingly upbeat about their trade prospects in 2018. A full ten percentage points more of Mexican firms expect rising trade volumes in 2018 than at the global level. Policy uncertainty aside, several macroeconomic factors look to be combining in favour of Mexican firms in 2018. Mexico's NAFTA trade partners are enjoying strong economic growth, while trade partners to the south are starting to recover from the political and financial volatility of recent years. And although the peso has recovered from the trough reached in the months after President Trump's inauguration, it remains very competitive in a historical context. All are strongly supportive of Mexican exporters in 2018 and given the role of imported inputs in Mexico's supply-chain, imports will also push higher in 2018

Action points for business

- Mexican firms should use the weakness of the peso to break into new markets where possible, rather than bank profits. Even if the peso appreciates in the longer-run, competing on price now opens up the potential to compete on quality in the future.
- The trade outlook for Mexico is clearly positive in the near term, meaning the urge to borrow and invest will be strong. But some firms may find credit easier to come by later in the year or in 2019 should Banxico cut interest rates.

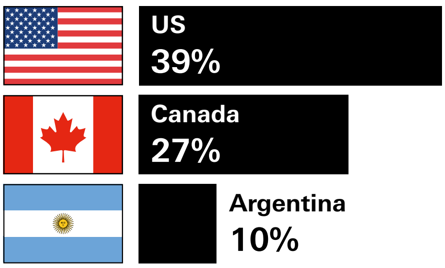
Outlook for trade finance need and access in the next 12 months



*Expect increase = Increase significantly + Increase slightly
†Expect decrease = Decrease significantly + Decrease slightly

Source: TNS Kantar

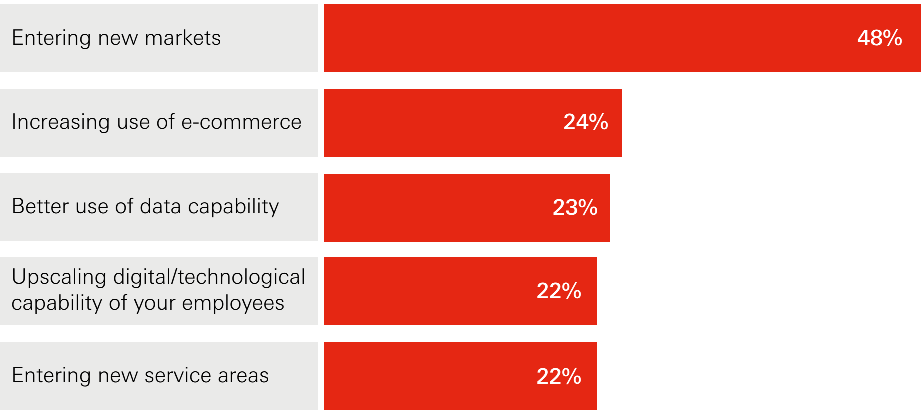
Which are the top 3 markets where your business will look to expand in the next 3-5 years?



Source: TNS Kantar

Mexican firms are also upbeat about trade financing. More than two-thirds expect to require more trade financing in 2018 than last year, and a full 70% expect access to trade finance to get easier. One key driver of easier access will likely be lower interest rates from Banxico, as inflation cools back towards the policy target. Mexican scores for demand for and access to trade finance are both substantially more optimistic than the global average.

How do you plan to grow your services business?



Source: TNS Kantar

A stronger world economy plus a weak peso means a good short-term outlook for trade.

Services exports have become increasingly important to Mexican firms over the past couple of decades, rising from 1.6% of GDP in 2007 to 2.2% of GDP ten years later. Travel and tourism is clearly a sectoral strength for Mexico, and the weaker peso and strong consumer demand in major economies will mean the sector enjoys a solid coming couple of years. Meanwhile, protectionist threats aside, faster goods trade between Mexico and NAFTA partners will drive complementary growth in transport services. Finally, although firms are concerned about the threat of protectionism in existing markets, 48% of survey respondents said entering new markets would enable their business to grow in the years ahead.

Trade Policy Developments

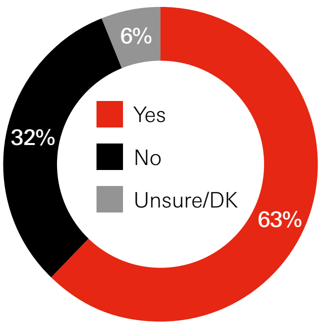
Mexican trade success in 2018 and beyond remains heavily determined by trade policies set in Washington. More than two-thirds of Mexican respondents to our survey said NAFTA was relevant to their business, more than 20% more than any other trade agreement. Within this, 53% expect developments within NAFTA to be positive for their trade prospects, with only 16% expecting new barriers to trade to inhibit their growth.

Trade policy developments elsewhere were still of interest to Mexican firms though. Almost half of respondents were looking forward to further developments in the Pacific Alliance - a trade bloc comprising Mexico, Peru, Colombia and Chile - with the ultimate goal of free movement of goods, services, capital and labour across borders. Mexican trade relations with Canada also mean discussions between Canada and the EU have a relevance for Mexican exporters.

Action points for business

- Firms should keep a close watch on trade policy developments in the US, but also increase their awareness of potential opportunities offered by trade liberalisation elsewhere, including in Latin America, and between Canada and the EU.
- Mexican firms should press for improvements to technology infrastructure to enable them to better-exploit opportunities in the digital economy.

Are governments becoming more protective of their domestic business?



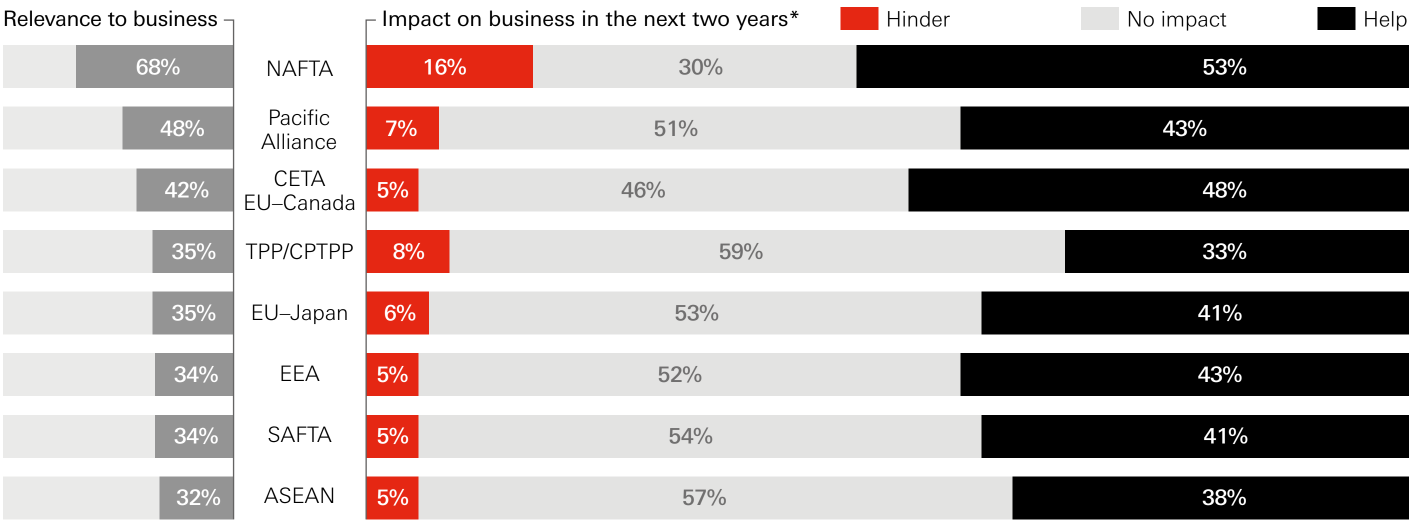
Note: may not total 100% due to rounding

Source: TNS Kantar

Top 3 impacts of protective policies on my business

Source: TNS Kantar

Relevance and impact of trade agreements



Source: TNS Kantar

*May not total 100% due to rounding

Long-Term Outlook for Trade

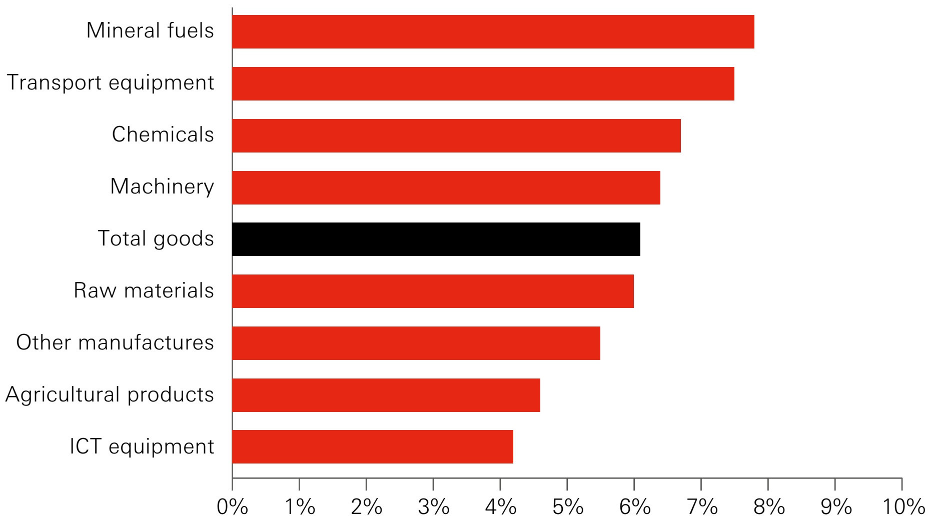
Looking ahead, our forecast is for continued deepening of relations between Mexico's economy and its NAFTA partners, as well as ongoing gradual trade integration with other big economies around the world. This will help attract further inward investment into sectors where Mexico has key sectoral strengths, and enable Mexican factories to source inputs from a broadening range of overseas suppliers. From a sectoral perspective this will mean that goods exports tilt increasingly towards higher value-added sectors. But this will also impact on the type of goods imported, with cross-border supply linkages continuing to become more complex. Services exports, primarily driven by tourism but also with a role for financial services, will become an increasingly-important part of Mexico's overall trade mix in the coming decade.

Deepening NAFTA supply-chains to drive trade

Mexico's comparative advantages in natural resource sectors, and as a workshop for higher-value added manufacturing goods, will continue to be sectoral strengths over the coming decade. Reforms to make PEMEX more agile and competitive should help boost crude oil output in the years ahead, as well as the production of downstream products such as fuels and chemicals.

Meanwhile, barring substantial changes to NAFTA, the ongoing deepening of supply-chains across the border with the US will continue. This will mean Mexico builds on its strengths in car manufacturing (where Mexico ranks eighth in the world in volume terms) and other big-ticket manufactured goods such as industrial machinery. In agricultural products though, the relatively modest links between Mexico and Asian markets mean that Mexican exports will lag some other Latin American economies, such as Brazil. However, rising incomes will mean Mexico becomes increasingly uncompetitive in low value-added activities such as electronics assembly and clothing manufacture.

Exports of goods by sector, 2017-30 (average annual growth)



Source: Oxford Economics

Action points for business

- Firms should regard trade liberalisation as a route towards greater competitiveness, via the opportunity to outsource lower-cost parts of manufacturing, while retaining parts of the supply chain where Mexico's geographical location is key.
- Although substantively smaller in economic terms than China, firms should be aware of the opportunities in India, particularly for tourism amongst India's increasingly-affluent middle class.
- Given that uncertainty over the US government's attitude towards free trade may well persist for some time, Mexican firms should seek to gradually diversify their export customers, particularly those in manufacturing sectors.

Top 5 Hotlist destinations of goods exports

Rank	2016	2030
1	USA	USA
2	Canada	Canada
3	China	China
4	Germany	Germany
5	Japan	India

Note: Ranking among the 24 trade partners covered in the forecast

Source: Oxford Economics

Export partners will remain heavily concentrated in US and Canada – is there room to diversify more?

The continued deepening of trade links and cross-border supply chains with NAFTA partners will mean the USA and Canada will remain the top two export destinations for Mexican firms out to 2030. Between them, these two economies accounted for 82% of total goods exports in 2017, and although other economies will provide faster growth rates, NAFTA partners will still take 79% of Mexico's exports in 2030. Elsewhere though, rising incomes in China and India will mean that households in these economies demand more goods and services from higher-income economies. Mexico is well-placed in both respects (including through its role in producing for popular US brands), and together these countries will purchase 4% of Mexican goods exports by 2030. Although no individual Latin American economy will be ranked in the top five export destinations for Mexico by 2030, as an aggregate the region will take just short of 6% of total Mexican goods exports.

China to become an increasingly-important input supplier
Given the high degree of cross-border trade in key manufacturing industries, Mexico's export prowess also has important implications for import demands. Anecdotal evidence from the auto industry for example, suggests that some car parts cross the US-Mexico border back and forth eight times, from the start of the manufacturing process to the car arriving in the showroom. This underlines the importance of friction-free trade across borders within NAFTA, but the operation of these cross-border supply chains also helps explain why imports of transport equipment, chemicals and machinery are all expected to grow at 6% or so per year over the coming decade. By contrast, goods that are destined for final consumption in Mexico, such as clothing and other lower-cost manufacturers, will grow at a more restrained pace.

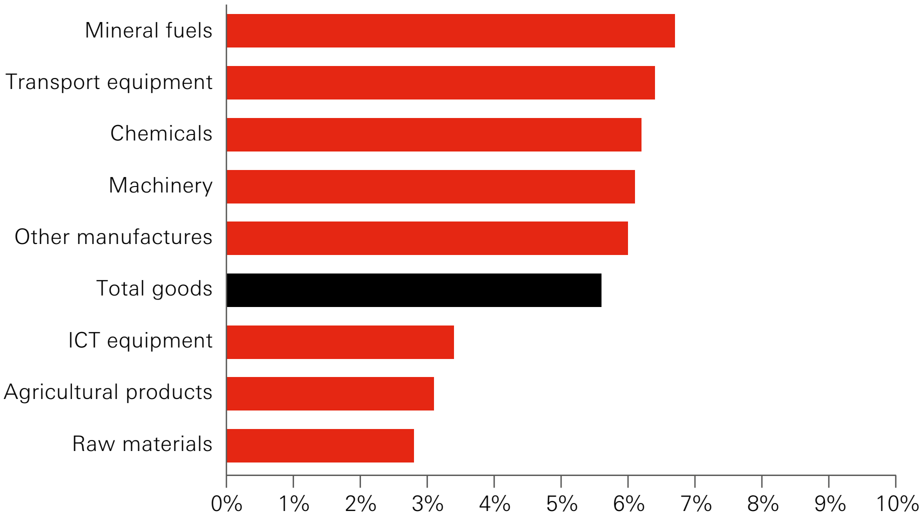
Top 5 Hotlist origins of goods imports

Rank	2016	2030
1	USA	USA
2	China	China
3	Germany	Germany
4	Japan	Korea
5	Korea	Japan

Note: Ranking among the 24 trade partners covered in the forecast

Source: Oxford Economics

Imports of goods by sector, 2017-30 (average annual growth)



Source: Oxford Economics

Frictionless trade with NAFTA partners is critical to key Mexican manufacturing sectors.

Mexico's import sources are rather more diversified than its export destinations, with one clear exception – the US accounted for close to 60% of total goods imports into Mexico in 2017. The importance of other countries reflects their different contributions to Mexican industry, with auto remaining a key theme. German and Japanese manufacturers provide key capital equipment for factories, as well as components to car manufacturing for their brands to retail in NAFTA markets. Korean exports again incorporate inputs for Korean-brand car factories, but also higher-end consumer electronics and steel.

China exports a broad range of consumer goods, industrial inputs and machinery to Mexico, accounting for 8% of total imports of goods into Mexico. We forecast China's share to rise steadily over the coming decade, as Chinese firms move up the manufacturing value chain and increasingly compete with higher-income economies to supply Mexican factories with inputs and equipment, as well as supplying Mexican retailers with goods. But the US will remain by far the number one source of imports in the years to 2030.

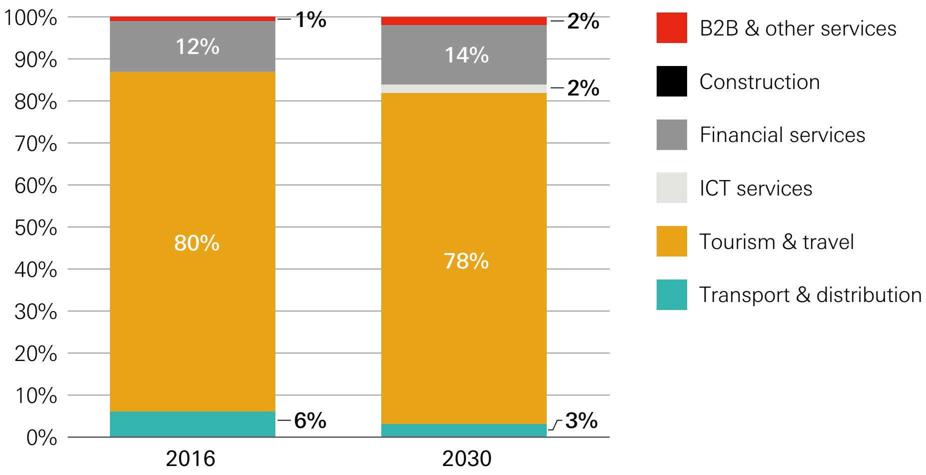
Tourism trade continues to dominate services exports

Tourism is by far the most important sector for Mexican service exports. A total of 35 million arrivals from overseas in 2016 makes Mexico the eighth most-visited country in the world, more than 2m ahead of Thailand and less than 1m behind the UK. Within this, around 30m visitors in 2016 were from the US, up from 20m just three years earlier. Mexico's tourism sector in aggregate contributes around 80% of total service exports.

Looking ahead this is likely to remain the case, with modest growth in some other sectors of the economy. Mexico's financial services sector will make a growing contribution to services exports though. The majority of Mexico's banking sector is foreign owned, and through the outsourcing of back-office functions to lower cost operations in Mexico, Spanish banks in particular are able to leverage cost savings. This process will help financial services grow from 12% of total Mexican service exports to 14% by 2030.

Inbound visitors from the US to rise by 50% in the coming ten years.

Sectoral shares in total services exports



Source: Oxford Economics

Top 5 Hotlist destinations of services exports

Rank	2016	2030
1	USA	USA
2	UK	China
3	China	UK
4	Canada	Canada
5	Germany	Germany

Note: Ranking among the 23 trade partners covered in the forecast

Source: Oxford Economics

Since the US population will continue to grow robustly over the coming decade, American visitors will remain a key source of growth for the Mexican tourist industry for some years to come. Tourism Economics forecasts suggest the number of US arrivals to Mexico will rise by 50% (a further 15m visitors) between 2017 and 2030. British and Canadian tourists will also remain key, accounting for 1m and 2m visitors per year respectively by 2030. Financial and transportation services underpinning Mexican goods trade with China will help move China up to second position amongst Mexico's service export destinations by 2030.

About the HSBC Navigator

The HSBC Navigator presents a blend of survey evidence, policy analysis, and economic modelling to generate unique and timely insights into the changing landscape for global trade.

The business survey is a quantitative indicator of the short-term outlook for global trade. The survey, which is the largest of its kind, is conducted on behalf of HSBC by Kantar TNS. It is compiled from responses by decision-makers at over 6,000 businesses – from small and mid-market to large corporations – across a broad range of industry sectors in 26 markets. Interviewees were polled on a range of questions including expectations around future growth in trade, trade finance needs, attitudes toward trade policy developments and strategic business plans.

The survey represents a timely source of information on the fast-evolving trade environment. And it can provide a useful contextual setting for interpreting developments in official data. In this way, economists at Oxford Economics are able to blend insights from the survey with their own analysis and modelling of developments in trade.

Oxford Economics has tailored a unique service for HSBC which forecasts bilateral trade in goods and services, in part based on HSBC's own analysis and forecasts of the world economy. A top-down approach is employed, with Oxford Economics' suite of models used to ensure consistency between HSBC's forecasts for economic growth and exchange rates in key countries and the more granular projections for bilateral trade flows presented here.

Oxford Economics employs a global modelling framework, with headline bilateral trade forecasts constructed as a function of demand in the destination market and the exporter's competitiveness (as measured by unit labour costs in nominal USD terms). Exports, imports and trade balances are identified, with both historical estimates and forecasts for the periods 2017-20 and 2021-30.

These headline bilateral trade forecasts for goods and services are also disaggregated by sector, using Oxford Economics' Industry forecasts to inform future production trends and taking into account the historic relationship between output and exports in each sector, by market:

- For trade in goods, sectors are classified according to the UN's Standard International Trade Classifications (SITC) system at the two-digit level and grouped into 30 sector headings.
- For trade in services, we identify five broad sectors: B2B and other services, tourism & travel, transport & distribution, financial services, ICT services and construction.

Drawing on the Kantar TNS survey results and Oxford Economics' long-term forecasts, Oxford Economics produces in consultation with HSBC a global report and specific reports on the following 23 markets: Argentina, Australia, Bangladesh, Canada, China, Egypt, France, Germany, Hong Kong, India, Indonesia, Ireland, Japan, Malaysia, Mexico, Poland, Saudi Arabia, Singapore, Turkey, UAE, UK, USA and Vietnam. The analysis of trade in goods also includes trade with Brazil and Korea for a total sample of 25 key trading markets; for trade in services the analysis also includes Korea for a total sample of 24 key trading markets.

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