

Emerging Insight

Mexico: Is Mexico rerouting from China?

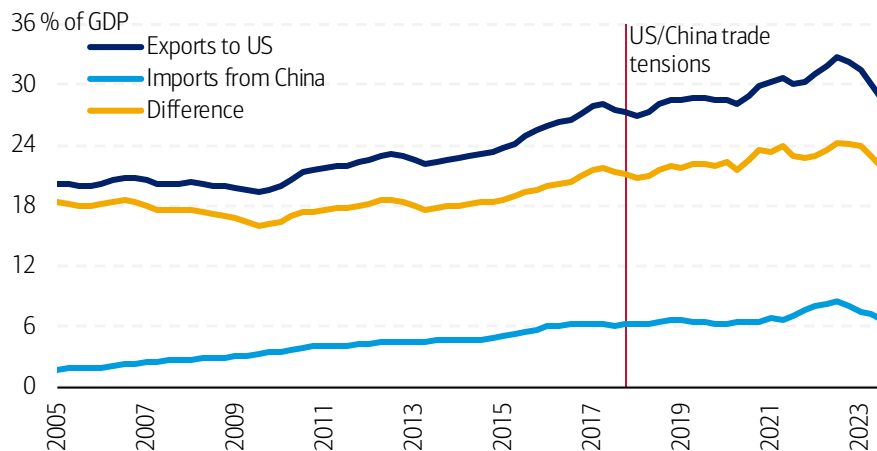
Key takeaways

- It's unlikely. The increase in Mexican exports to the US has been larger than the increase in Mexican imports from China.
- Mexico could be importing more from China because: (i) it is in an economic boom and (ii) the US is also in an economic boom.
- We continue to associate Mexico's gain in the share of US imports mostly to nearshoring and not rerouting.

By **Carlos Capistran** and **Antonio Gabriel**

Chart of the day: Mexican exports to the US and imports from China

An increase in Mexican exports to the US has not been explained by rising imports from China



Source: BofA Global Research, Haver

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Is Mexico rerouting from China?

Mexico has been gaining market share in US imports since 2022, surpassing China as the top US trading partner. At the same time, Mexican imports from China have also increased, opening the possibility that Mexico may just be rerouting from China. However, we do not believe that to be the case. Mexican imports from China have been stagnant at around 6% of GDP since 2016, with only a brief uptick over 2021-2022. In contrast, Mexican exports to the US as percent of GDP show an increasing trend since around 2015, with volatility (Chart of the day). Mexico is importing more from China, in dollar terms, because Mexico's economy is growing, which in part is due to US growth.

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Is Mexico rerouting from China?

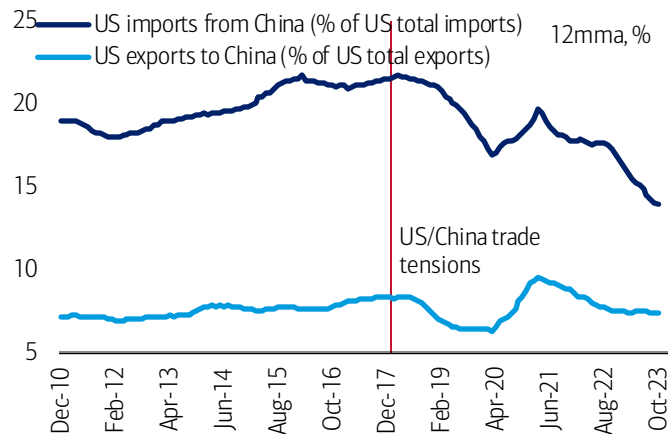
Some analysts have begun floating the idea that the increasing level of Mexican exports to the US is not a sign of nearshoring, but rather a rerouting of Chinese products through Mexico. The argument seems to be validated by the increase in Mexico's imports from China. In this report, we look at the data more closely to evaluate the possibility of rerouting.

Mexico has gained market share in US imports

China has been losing market share in US imports since Trump imposed tariffs to Chinese products and Biden followed with subsidies to bring the production of goods such as semiconductors back to the US (Exhibit 1). This has allowed Mexico to surpass China as the largest US trade partner (Exhibit 2). Mexico is now the country with the largest share of US imports (Exhibit 3), which we see as evidence of nearshoring (see our [Emerging Insight report](#)).

Exhibit 1: Trade between the US and China

China's participation in US trade has fallen consistently since 2021

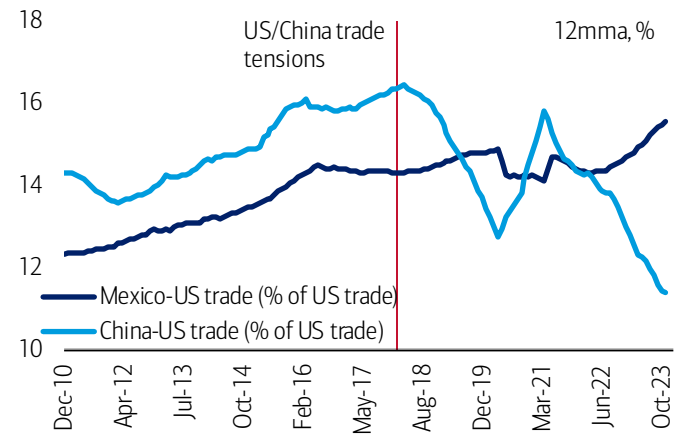


Source: BofA Global Research, US Census

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Exhibit 2: Trade between US, Mexico, and China

Mexico surpassed China as the largest trade partner of the US in 2019

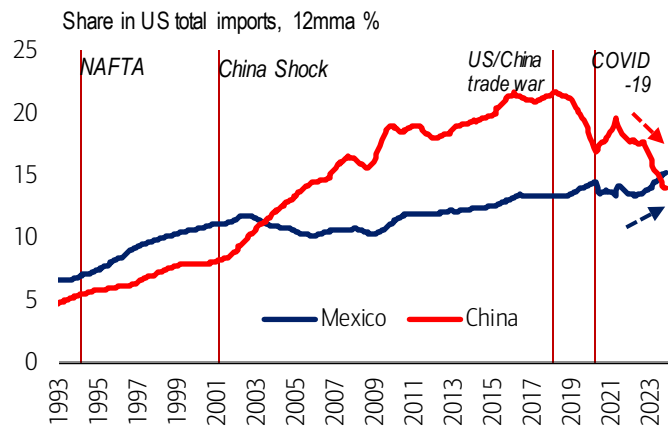


Source: BofA Global Research, US Census

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Exhibit 3: Mexico's vs China's share in US total imports

Mexico now has a larger share than China in US imports

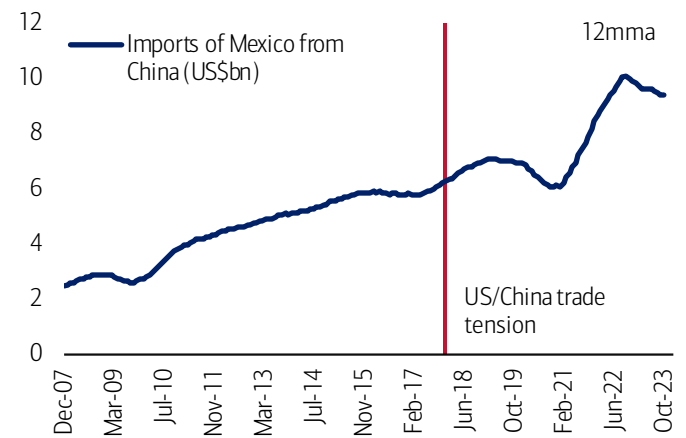


Source: BofA Global Research, Haver

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Exhibit 4: Mexico's imports from China

Mexico's imports from China have been growing



Source: BofA Global Research, INEGI, Haver

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But Mexico has also been importing more from China

Mexico’s imports from China have grown significantly since US-China trade tensions began. Mexico’s imports from China increased from US\$4.7bn on average in the 2008-2017 period to US\$7.8bn on average for the 2018-2023 period (66% increase, Exhibit 4). Could it then be that Mexico is just importing more from China, and exporting that to the US without any change to the products in the process (i.e., rerouting)?

A closer look at the trade balance looking for clues

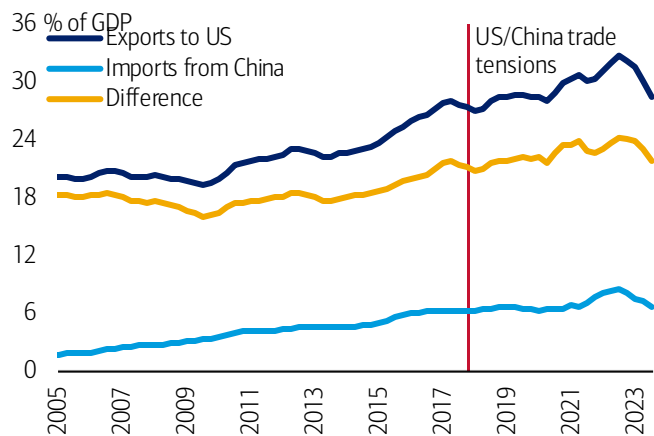
A look at Mexican exports to the US and Mexican imports from China speaks by itself. If large-scale rerouting was taking place in Mexico’s case, we would expect to see the uptick in (gross) exports to the US to be closely aligned with an uptick of a similar magnitude in (gross) imports from China. We focus on variables as a share of GDP to control for economic activity, which we believe is key to analyze these data. Mexican imports from China have been remarkably stagnant as a share of GDP since 2016 until 2021. Furthermore, after a brief uptick during the post-pandemic recovery, they remain around the same level at 6% of GDP. In contrast, after being stagnant for several years since the early 2000’s, Mexican exports to the US have shown a continuous increasing trend since around 2015, although with some volatility. At their peak, they reached 33% of GDP, compared to about 23% before. Exhibit 5 underscores these facts.

Mexican exports to the US have grown above and beyond imports from China

The difference between Mexican exports to the US and Mexican imports from China has then been generally rising over most of the last decade. This can also be contrasted by looking at the overall bilateral trade balance of Mexico with the US and China (Exhibit 6). Both the Mexican trade surplus with the US and the trade deficit with China had been steadily increasing before 2015. In contrast, since around 2015, the bilateral trade surplus with the US has grown faster than before, while the bilateral trade deficit with China has remained stable absent a temporary uptick over the post-pandemic recovery.

Exhibit 5: Mexico exports to US and imports from China

Higher exports to US do not seem explained by rising imports from China

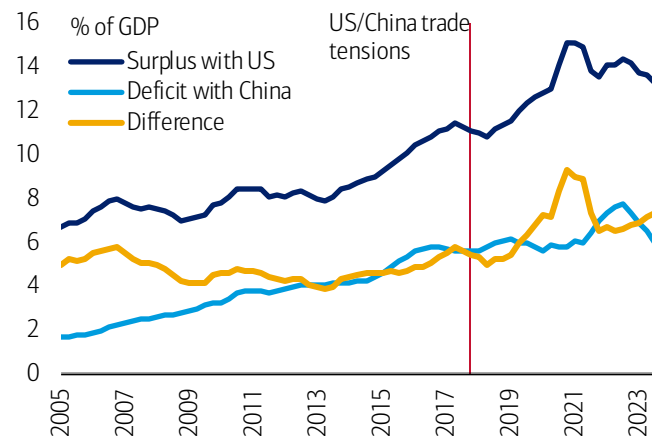


Source: BofA Global Research, Haver

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Exhibit 6: Bilateral trade with the US and China

Mexico’s trade surplus with US has grown above its trade deficit with China



Source: BofA Global Research, Haver

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A rolling beta approach also aligns with the nearshoring narrative

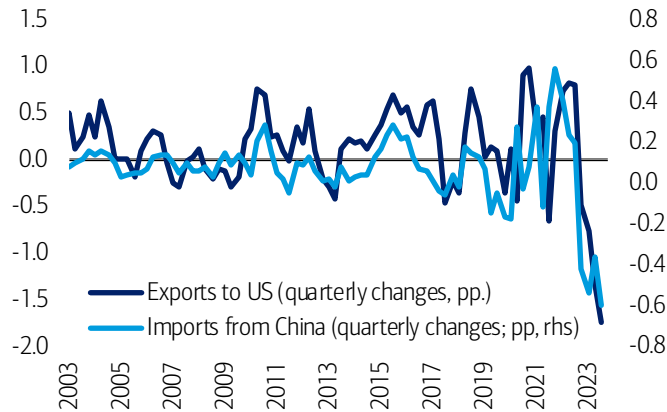
Looking at the data from a different angle broadly confirms these insights. We run a linear regression of the quarterly changes in exports to the US and imports from China as a share of GDP (Exhibit 7) and compute the beta using both a three-year rolling sample and an expanding sample since 1996, as shown in Exhibit 8. There are several macroeconomic drivers behind both exports and imports which such a simple exercise does not incorporate. However, it is remarkable that the correlation (or sensitivity) between exports to the US and imports from China has remained at similar levels since the Global Financial Crisis until around the pandemic. If anything, this relationship has



become even weaker since the pandemic, although it seems to be heading back to its pre-pandemic norm. This simple exercise is consistent with Mexico doing something else than just importing more products from China and shipping them without change to the US, that is, the results are more consistent with a nearshoring than with rerouting.

Exhibit 7: Quarterly changes in exports to US and imports from China

Exports to US and imports from China seem less correlated since COVID

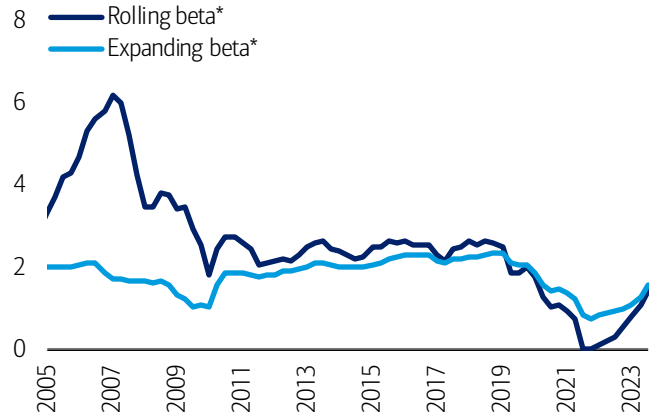


Source: BofA Global Research, Haver

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Exhibit 8: Sensitivity of exports to US vs imports from China

Exports to the US have not become more correlated to imports from China



Source: BofA Global Research

* Betas computed using quarterly changes of imports from China and exports to US. Rolling beta uses a three-year rolling sample, expanding beta an expanding sample since 1996.

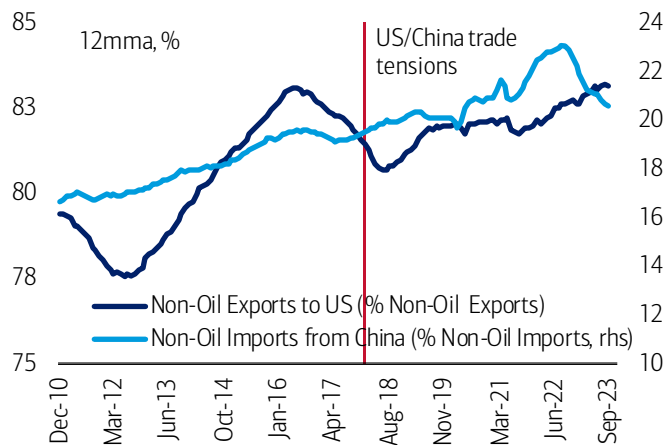
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Mexico's imports from China are falling as percentage of total imports

Looking again at Mexico's imports from China, we note that its participation in Mexico's total imports has been falling (Exhibit 9). This is the opposite of what we would expect to see under rerouting. If rerouting was happening, we would expect a larger presence of Chinese products in Mexican imports. Furthermore, Mexican exports to the US as share of total Mexican exports have been growing.

Exhibit 9: Mexican exports to US, and imports from China

Rerouting is not likely since one would expect to see more imports as well



Source: BofA Global Research, INEGI

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Exhibit 10: Correlation between imports from China and Exports to US

Correlation of imports from China and exports to US, low since 2019



Source: BofA Global Research, Ministry of Economy

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Digging deeper gives the same answer: little evidence of rerouting

Rerouting implies that Mexican imports from China and Mexican exports to the US increase in a synchronized manner at the product level. We look at the relationship between exports and imports by product following the international Harmonized System classification on a yearly basis. Under the rerouting hypothesis, one would expect to see high correlation coefficients. But correlation coefficients do not show evidence of this. Correlation was much higher before 2015. After 2018 this relationship seems to ease,



and it is not until 2022 that the correlation returned to pre-2015 levels (Exhibit 10). So it seems Mexico is not increasing imports of a product that then is exporting to the US. Data is more consistent with Mexico importing more from China for domestic consumption (for example, Mexico is importing more cars from China for domestic consumption) or importing more from China as inputs in products which are exported to the US (with some transformation, such as included as part of other, larger items).

Rerouting: Nearshoring's alter ego?

Rerouting, by definition, is the decision to send something by a different route. In this sense, it does not seem to be different to Nearshoring. However, it is usually used by countries facing trade restrictions, since they look up for a third country to 'by-pass' them. Though the third-party could be anyone, some countries make more sense than others, and countries that are part of Free Trade Agreements or that are closer to the destination appear to be more attractive, as the 'rerouter' country tries to take advantage of these characteristics.

In this sense, Mexico stands out as a good prospect to reroute to the US. However, benefitting from the advantages of Free Trade Agreements is not a trivial task. There are clauses in these agreements that are specifically designed to prevent this type of rerouting behavior. In fact, the trade agreement between the US, Mexico, and Canada (USMCA) encompasses regulations on local content to benefit from a tariff exemption. As a result, rerouting through Mexico is less attractive ex-post.

And Mexico's investment is increasing substantially, which is also more consistent with nearshoring than rerouting. Investment is more local than foreign (see our reports, [Investment is booming](#) and [foreign direct investment from China into Mexico has been falling lately](#)).

News and Views

Mexico: Industrial production surprised to the upside at 5.5% yoy nsa in October

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Industrial production was better than expected in October at 5.5% yoy (E. 4.1%, BofA 4.0%) with a monthly print at 0.6% mom sa (E. -0.0%, BofA 0.4%). The upside surprise was driven by construction at 4.7% mom sa, while manufacturing was -0.4% mom sa, mining was 0.6% mom sa and utilities came in at 0.1% mom sa. In annual terms, construction grew 27.7% yoy nsa. Year to date, industrial production has increased 3.9% sa.

- **To follow:** Regarding construction, we have highlighted it has been driven by nearshoring in the north and by government expenditure in the south (trains, airports). The economy remains in a boom which in our view limits what Banxico can do in the short term. We believe that room for Banxico to cut significantly will open, but not before the June election (as before the election government expenditure will likely remain high).

Mexico: Nominal wages posted a 2-decade high at 11.6% yoy in November

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Nominal wages increased 11.6% yoy in November from 5.8% in October (8.4% a year ago). This is the largest increase since November 2000. By sector, public employees' wages increased 11.2% yoy (vs. 4.2% in October) and private employees' wages increased 11.6% yoy (vs. 8.1% in October). In real terms, aggregate wages increased 6.9% yoy, while public employees' wages increased 6.6% yoy and private employees' wages increased 6.9% yoy.

- **To follow:** The labor market in Mexico is quite tight, noting that the unemployment rate has been surprising to the downside recently and was 2.7% sa in October. The large rise in nominal wages will likely put further upside pressure to services' inflation in Mexico. We see very limited room for Banxico to cut rates now and at least in the first few months of 2024.

Brazil: Services Volume declined 0.6% momsa in October

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Brazil Volume of Services declined again in October, registering -0.6% momsa (vs -0.3% in September), the third consecutive negative result. The print was weaker than expectations (BBG: -0.1%). In yoy terms, the revenue contracted by 0.4% in the month. Deceleration came due to Transportation (-2.0% momsa) – driven by a drop in cargo transport, notably waterway transportation was affected by the worsening of navigation conditions in the North corridor.

- **To follow:** We expect deceleration in activity throughout the end of 2023.

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