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Our Economic Relationship with Mexico

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President-elect Trump's protectionist attack on Mexico appears to be more than rhetorical. He blames the North American Free Trade Agreement (NAFTA) for enabling companies to freely move manufacturing jobs to Mexico. To correct the perceived problem, he proposes stiff taxes on companies shifting production outside of the United States, as well as high tariffs on many imports. If implemented, Trump's protectionist policies would mark a stunning reversal of 70 years of American global free trade leadership, which could harm both the Mexican and American economies.

Mexico is our third largest trading partner behind China and Canada. We import about \$300 billion worth of manufactured goods from Mexico, and we export approximately \$230 billion. Over the past decade our trade deficit with Mexico ranged between \$50 billion to \$75 billion. Since total manufacturing output in the U.S. is approximately \$3.5 trillion, our trade deficit accounts for less than 2% of American industrial production. Ironically, about 1/3 of our exports are machinery and electrical products that supply Mexican factories.

A trade deficit with a low-income country like Mexico is unsurprising. What is surprising, however, is the small size of our trade deficit since the Mexican economy is 95% smaller than ours and Mexican consumers less able to afford American products than vice versa. About 45% of the Mexican population lives below the poverty line, which the Mexican government defines as individuals in urban areas living on less than 2,500 pesos (\$125) per month or less than 1,000 pesos (\$50) per month in rural areas. Of Mexico's 123 million people, almost 25 million (20%) do not earn enough to eat three meals a day.

Manufacturing accounts for 9% of the U.S. labor force and about 10% of the Mexican labor force. Factory workers earn \$2.75 an hour on average in Mexico, with auto workers at the higher end, earning closer to \$4.50 per hour. While labor costs are much lower than in the United States, American businesses operating in Mexico also need to contend with the poor legal system, monopolies, militant unions, inadequate infrastructure, corruption, insecurity and a host of other costly problems. These are the very same problems that constrain Mexican domestic businesses and are the primary causes of Mexico's poverty.

Poverty and low wages have plagued Mexico for generations, pushing millions of immigrants into the United States. What has changed over the past 20 years, however, is the emergence and growth of the Mexican middle class. A recent study by the market research firm Euromonitor estimates that 47% of Mexican households earn between \$15,000 and \$45,000 per year. The number of middle class households by this definition grew 60% over the last 15 years. While still substantially poorer than the American middle class, the Mexican middle class is now likely to own a refrigerator, a color television and a cell phone.

President-elect Trump's protectionist trade policies are on a collision course with his anti-immigration policies. A poorer Mexico will yield more immigrants, not less. A wealthier Mexico will demand more American products, while simultaneously supplying more products to us. Anyone who has stepped into a very busy Costco in Mexico can witness firsthand the future of a more prosperous trading relationship. There are now 34 Costco stores throughout Mexico. Costco encounters numerous trade barriers in Mexico, but they are generally the same barriers faced by all retailers trying to compete domestically.

Securing locations is more difficult in Mexico; supplier relationships are more difficult; transportation is more difficult, in addition to the numerous other problems common to a third world country. Costco provides credit to its customers since the credit card industry is underdeveloped as are mortgages and banking in general. Financing for Costco's suppliers and its own real estate is tighter and more expensive than in the U.S. None of these barriers are addressed in NAFTA.

Inside the Costco, however, Mexican shoppers clamor for American brands. Luckily Costco can source many of the very same products it sells in its U.S. stores for its Mexican customers, thereby bypassing numerous problems with potential local suppliers. As Costco expands, so do American exports to Mexico. Our problem in Mexico is not that cheap labor entices factories to open shop South of the border, but that Mexico does not aggressively implement policies to remove general barriers for all businesses – both domestic and foreign.

Trade restrictions and taxes will raise prices in America, make Mexico even poorer and exacerbate the immigration flows President-elect Trump seeks to stem. A wealthier Mexico that benefits from greater American investment will certainly export more products to us, but their consumers will also purchase more American merchandise at their local Costco.