PRESS RELEASE

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NAFTA renegotiations - could Mexico's "high-risk"[1] automotive industry deteriorate into a crisis?

Mexico's automotive industry plays an important role in its economy. The sector's representativeness rose from 1.5% of country's GDP and 8.5% of its manufacturing output in 1993, to 3% of GDP and 18% of manufacturing output in 2015. Moreover, Mexico has 28 vehicle manufacturing plants which generate, directly and indirectly, jobs for 1.7 million people. President Donald Trump's rhetoric since the beginning of his electoral campaign has not yet damaged the sector, but risks have been intensified by NAFTA renegotiations and Mexico's electoral agenda.

The automotive sector is one of the most controversial topics for NAFTA discussions

Since the beginning of his electoral campaign in 2016, President Donald Trump has continually criticised the NAFTA agreement, blaming it for the trade deficit that the United States holds with Mexico and for destroying jobs. Once of the most controversial topics under negotiation is the automotive industry. The agreement currently requires that 62.5% of the components of finished vehicles emanate from partner nations, in order to qualify for duty free imports. Under the renegotiations, the US wishes to raise this ratio to a total of 85%, with 50% guaranteed to American producers. This proposal has been categorically rejected by Canada and Mexico. This outcome would not be favourable for Mexican exports, as 60% of cars produced in Mexico are exported to the United States.

Despite anti-free trade rhetoric from the US and the postponement of NAFTA renegotiations, Coface expects that the most likely scenario to be reached will be a trade deal which conserves most of the cross-border trade links between the three nations.

The deep extent of the trade relationship between the US and Mexico is one of the factors that increases the likelihood of this scenario. If the US government were to decide to leave the NAFTA agreement, it would experience strong opposition from industries and individual US states.

Risks intensified by Mexico's electoral agenda and consumer trends

Household consumption decisions are likely to be influenced by the uncertainties surrounding Mexico's presidential elections scheduled for 1st July 2018 - and which are likely to overlap with the NAFTA renegotiations. At the end of 2017 inflation grew to 6.8%. The benchmark interest rate has risen by 450 basis points since December 2015, to reach 7.5% a year, as of February 2018. In 2017, Mexican vehicle registrations shrank by 4.6% year on year.

[1] **Coface sector assessments** (13 sectors in 6 geographical regions, 24 countries representing almost 85% of the world's GDP) are ranked on a four-level scale: low risk, medium risk, high risk and very high risk

P R E S S R E L E A S E

A change in government could impact the country's pro-business economic stance, leading to a marked shift in Mexico´s position on the NAFTA negotiations. The dissatisfaction among the country's population, with rising criminality (2017 was the most violent year in two decades) and corruption have created an environment of anti-establishmentarianism. This has strengthened the chances of a populist candidate winning the presidential race.

Thinking beyond the US trade relationship

Mexico currently has a network of ten foreign trade agreements with 45 countries. It appears to be seeking further agreements, as well as updating existing ones (such as its trade deal with the European Union). In case of the worst outcome for Mexico in the NAFTA negotiations, the country should focus on strengthening its own business climate, as the recent increase in violence and the weak rule of law are hampering investments. According to the *2017-2018 Rule of Law Index of The World Justice Project (WJP)*, Mexico is ranked in 92nd place among the 113 countries assessed (only ahead of Guatemala, Nicaragua, Honduras, Bolivia, and Venezuela in the 30 Latin America economies analysed).

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