



FUND LAUNCHED

**2005**

FUNDS UNDER  
MANAGEMENT

**£536.3**  
MILLION

NET ASSET VALUE  
PER SHARE

**377.6%**  
SINCE INCEPTION\*



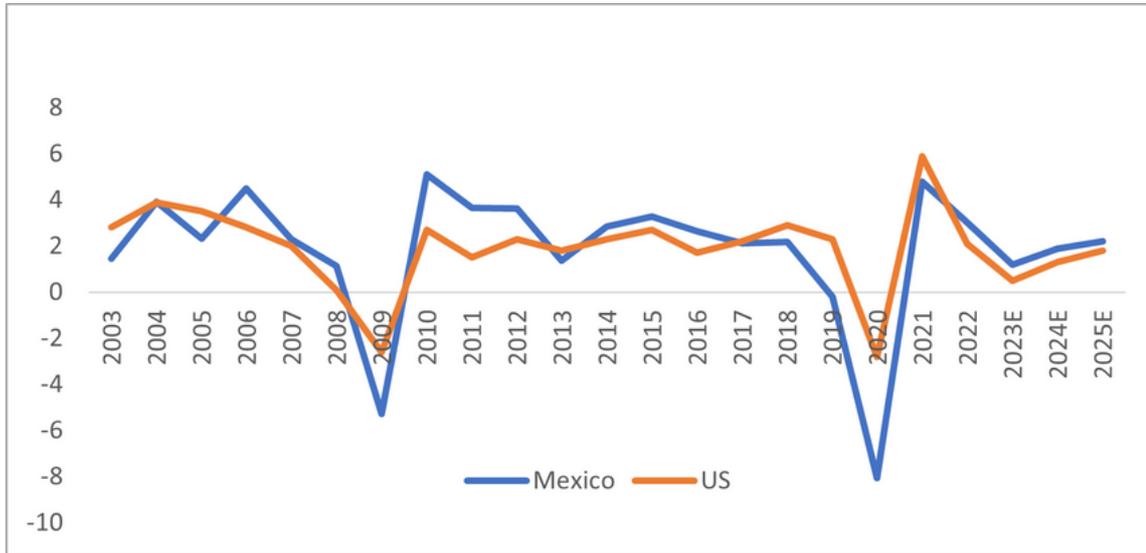
# Mexico

February 2023

Mexico has significant growth potential, primarily driven by secular trends like nearshoring. Over the last 20 years, there has been a strong positive correlation between the GDP growth of Mexico and the United States of 0.85<sup>(1)</sup>. Last year, the recovery of the Mexican economy was faster than anticipated, with economists revising growth upwards. Still, to fully unlock its potential, the country needs to renew economic policies that foster private investment. In recent years Mexico has had relatively stable politics, and the inability of President AMLO's party to approve constitutional reforms (specifically energy and electoral reforms) have provided better policy visibility. This stability is crucial for potential investors who seek a certain level of confidence when considering investments in the country. Monetary policy in Mexico remains hawkish, and fiscal policy remains amongst the tightest in the world. The government and the central bank (Banxico) did not inject large amounts of stimulus into the economy during the pandemic, unlike many regional peers. In fact, both monetary and fiscal policies have been quite orthodox and tight since the onset of the pandemic. While this has been a challenge for some businesses and households, it has been crucial for maintaining financial stability in the country. Going forward, like many emerging market peers, Mexico will undergo a meaningful growth slowdown, which is expected to bring headline and core CPI inflation toward the central bank's target 3.0%.

The Mexican Peso (MXN) appreciated over 4.6% against the USD in the last twelve months, one of the strongest performances in currencies worldwide in the period. There are a several reasons for this. First, Mexican public-sector debt during the pandemic improved relative to many other countries, as the government refrained from stimulus whereas most countries embarked on significant fiscal expansions. Consequently, debt-to-GDP increased only 4 percentage points in Mexico between 2019 and 2021 while ratios jumped 9 percentage points on average in Latam<sup>(2)</sup>. Second, the attractive carry trade due to a high interest rate differential compared to other countries; this is likely to continue for some time as Banxico recently hiked the local interest rates to 11.0%. Third, the US economy, has continuously surprised on the upside with its economic growth. The MXN has undoubtedly benefited from Mexico's connection to the US, but this link is a potential concern considering the US slowdown expected this year.

## How does Mexico's GDP compare with the US?



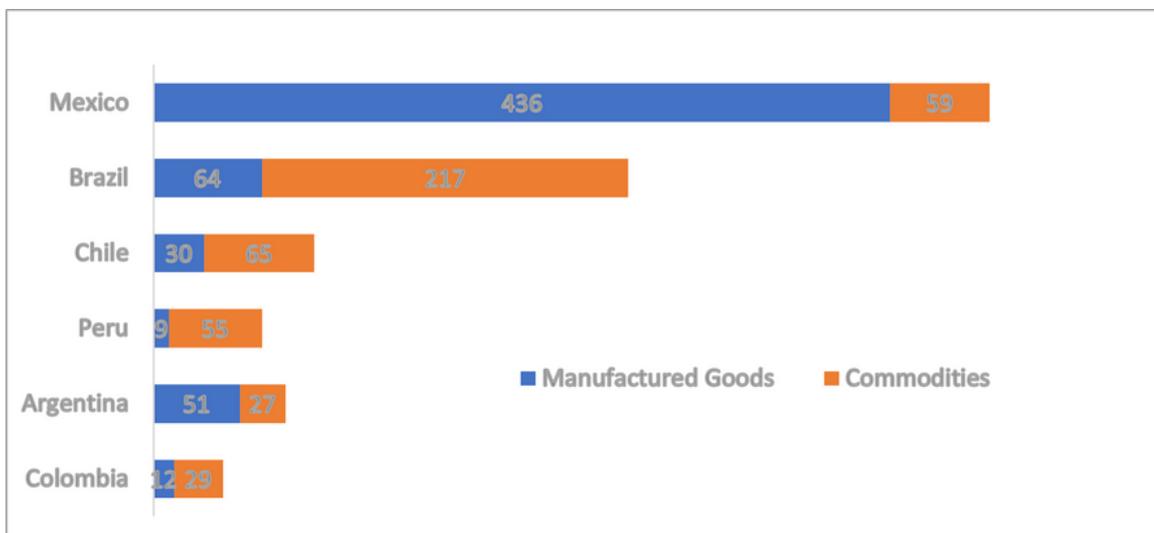
Source: Factset, 2023: Mexico and US Real GDP YoY% Change.

## Nearshoring

Mexico is becoming a popular destination for nearshoring, a phenomenon in which companies move production closer to the place of consumption. Mexico's entrance to the North American Trade Agreement (NAFTA) in 1994, which was updated and rebranded as USMCA, has deepened its trade relations with the US and made its manufacturing sector one of the most important and dynamic in the world. Mexico's trade-to-GDP ratio went from 30.7% in 1994 to 83.6% in 2021, a testament to the success of NAFTA<sup>(3)</sup>.

Mexico is Latin America's leading exporter of manufactured goods, with 2021 exports totalling US\$436 billion, more than 2.6 times the combined exports of Brazil, Chile, Peru, Argentina, and Colombia. The US is the top destination for Mexican exports, accounting for 81%<sup>(4)</sup> of its total, and this presents an opportunity for Mexico to increase its market share. Each market-share point gain in US imports could boost Mexico's GDP by 1.3%, or US\$17 billion<sup>(5)</sup>.

## How does Mexico's GDP compare with the US?



Source: 2021 Latin America Total Exports in USD Bn. Source: INEGI (Mexico), Secretary of State for Foreign Trade (Brazil), Chile Central Bank (Chile), Peru Central Reserve Bank (Peru), INDEC (Argentina), DANE (Colombia).

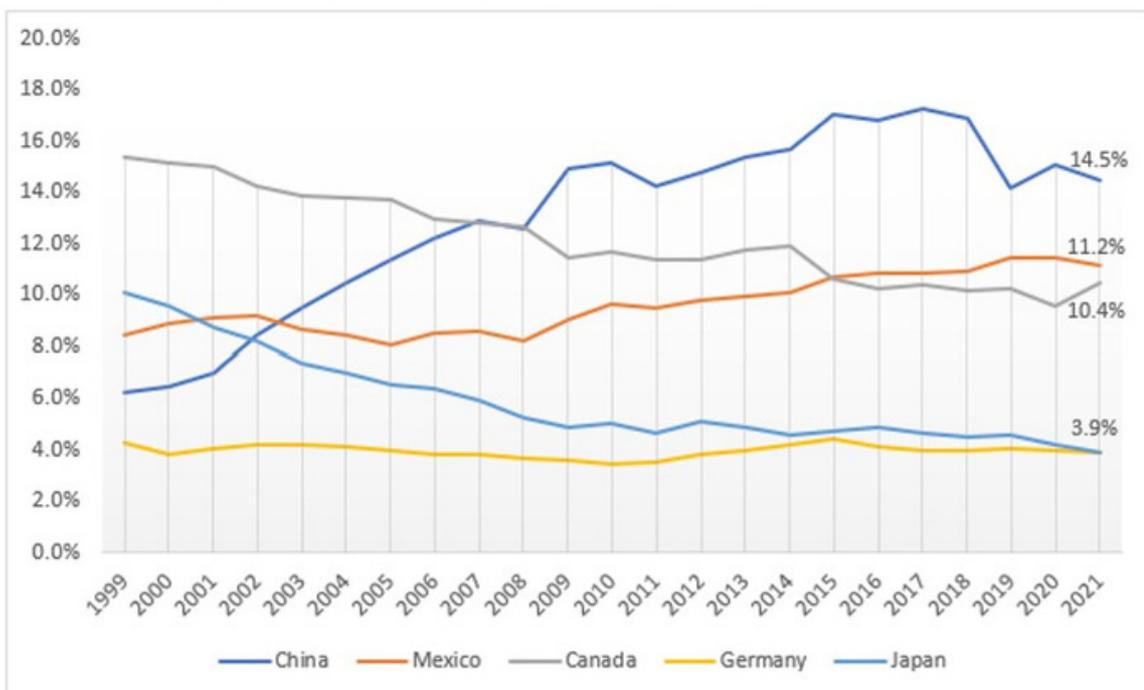
## How does industrial markets in Latin America compare in size?



Source: CBRE Research, 2022

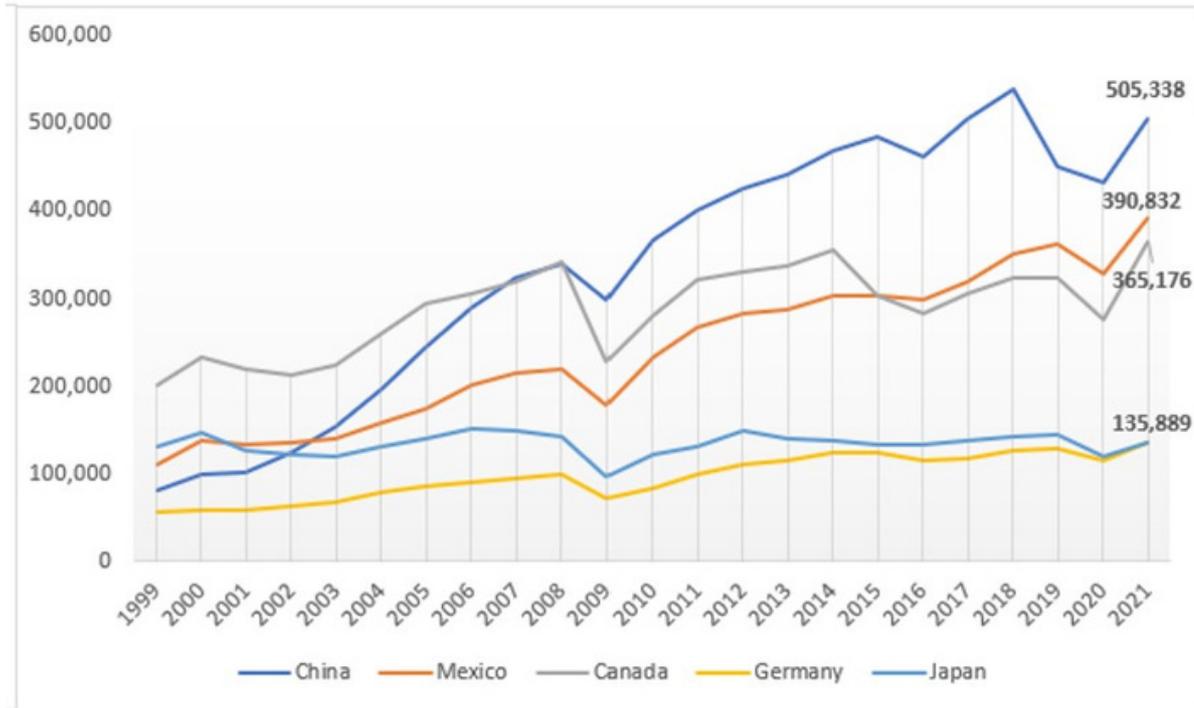
Mexico is poised to take advantage of the recent trend of nearshoring due to the disruptions in the global supply chain caused by the US-China trade war, the Covid-19 pandemic and the war in Ukraine. The political fallout from US-China provides Mexico with an opportunity to capture some of this market that has historically been serviced by China. Mexico's strong trade relations with the US and the certainty provided by the USMCA trade agreement gives it an advantage in attracting nearshoring opportunities. Since 2018, China has been losing market share of US imports of goods, moving from 17.3% in 2017 to 14.5% in 2021<sup>(6)</sup>.

## How have US Imports of goods changed by country of origin (USD bn)?



Source: US Bureau of Economic Analysis, 2023

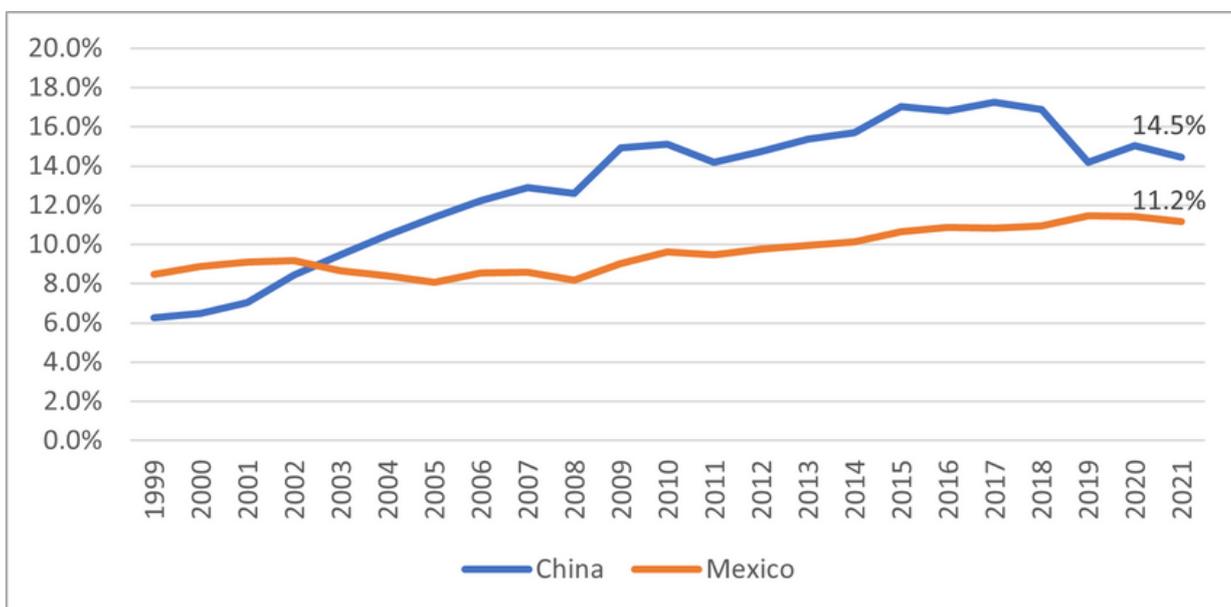
## How have US Imports of goods changed by country of origin (USD bn)?



Source: US Bureau of Economic Analysis, 2023

According to the OECD, Mexicans work longer hours than their North American counterparts, with a 20% longer workweek than the US and 26% more than Canadians. Mexico's manufacturing employment has recovered, whereas the US's remains 7% below pre-pandemic levels. Mexico has twice the number of engineering, manufacturing, or construction bachelor's degrees per capita compared to the US, but manufacturing wages in Mexico are lower than in the US. Despite a 68% increase in minimum wages, the gap remains, and not all Mexicans have benefited. In comparison, Chinese manufacturing wages have surged by over 200% in the last three years, which has impacted their competitiveness<sup>(7)</sup>.

## Mexico gaining share of US Imports



Source: US Bureau of Economic Analysis, 2023

## Outlook for Mexican Equities

Mexico currently represents 2.4% of the MSCI Emerging Market Index. Utilico Emerging Markets Trust plc ("UEM") is overweight Mexico with a 4.8% position as at 31 January 2023, allocated to companies with a proven track record and which we expect to be well-positioned to benefit from the nearshoring trend. The country's Pension Reform, which came into effect in 2023, should generate c.US\$104 billion in additional contributions from 2023 to 2030<sup>(8)</sup>. Assets under management (AUM) of Mexico's Pension System (AFORES) should double this decade which should all help stimulate the market further.

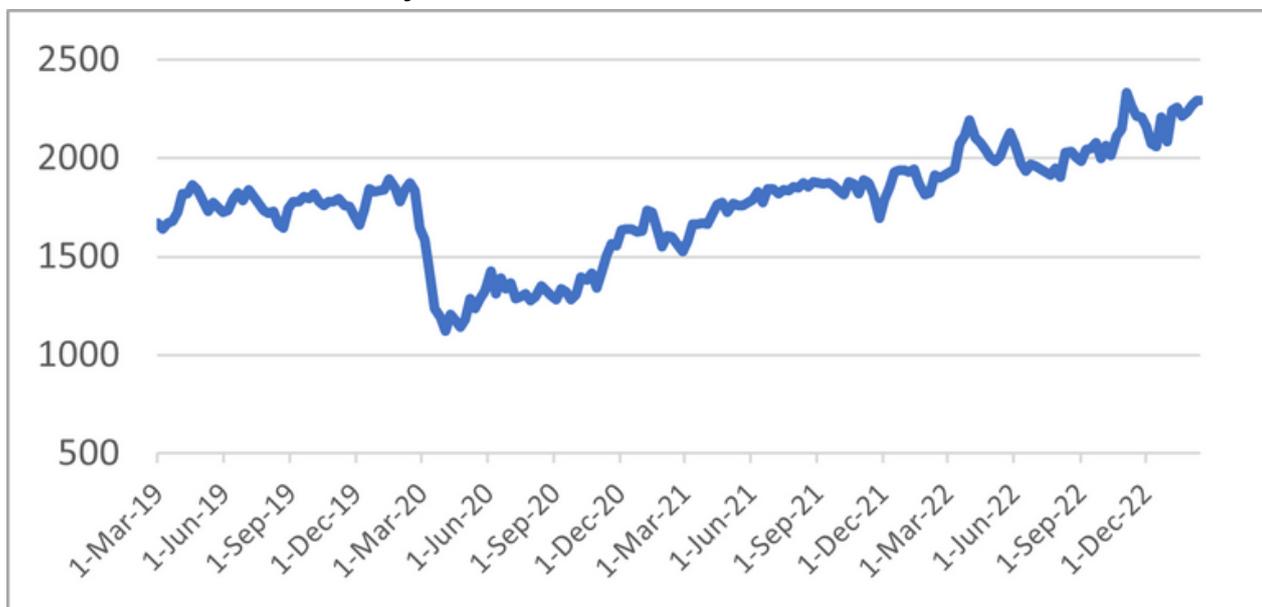
Currently Mexico is trading at historically low valuations equivalent to a 25% discount to the 15-year average P/E<sup>(9)</sup>, despite the relatively stable macroeconomic environment, which reinforces our positive view of the country. Although Mexico will enter a crucial political cycle in 2024, we don't expect a material impact on markets from politics this year. From a top-down perspective, we see the risk of a hard landing in the US economy as a more significant potential headwind for local equities. On top of that, persistent inflation could lead to an even tighter monetary policy. However, the Mexican economy will likely experience a soft landing as we don't foresee any significant macroeconomic excesses or imbalances. With the prospect of decreasing inflation, the central bank will likely be able to stop monetary tightening and potentially reduce rates in 2H23 or 1H24. In the medium term, Mexico continues to be well placed, offering an attractive opportunity, relative to other emerging market countries. UEM remains excited by its investments in Mexico and the potential returns they offer in this dynamic market.

## MSCI Mexico P/E versus MSCI Emerging Markets



Source: Factset, 2023.

## BMV IPC Index in the last five years (GBP Terms)



Source: Factset, 2023.

## Eduardo Greca

16 February, 2023

Source Data: ICM Limited, Bloomberg.

[1] Factset, 2023

[2] IMF - Global Debt Database. <https://www.imf.org/external/datamapper/datasets/GDD>

[3] Macro Trends. Retrieved from <https://www.macrotrends.net/countries/MEX/mexico/trade-gdp-ratio>

[4] Banxico. Retrieved from <https://www.banxico.org.mx/SieInternet/consultarDirectorioInternetAction.do?sector=1&accion=consultarDirectorioCuadros&locale=en>

[5] Santander, 2023. Nearshoring.

[6] US Bureau of Economic Analysis. <https://view.officeapps.live.com/op/view.aspx?src=https%3A%2F%2Fwww.bea.gov%2Fsites%2Fdefault%2Ffiles%2F2022-12%2Ftrad-geo-time-series-1022.xlsx&wdOrigin=BROWSELINK>

[7] OECD. <https://data.oecd.org/emp/hours-worked.htm>

[8] Santander, How Would Mexico's Pension Reform Benefit its Financial System?, 2023

[9] Factset, 2023

\*Total return is calculated based on undiluted Net Asset Value, plus dividends reinvested and adjusted for the exercise of warrants and subscription shares

## Risk Warning

The information presented on this document is solely for information purposes and is not intended to be, and should not be construed as, an offer or recommendation to deal in Utilico Emerging Markets Trust plc ("UEM"). Investments in UEM are subject to investment risks, and the value of investments and the income derived from them may fall as well as rise and investors may not get back the principal amount invested. Past performance is not indicative of future performance. Investors should read the prospectus along with the supplement(s) and seek relevant professional advice before making any investment decision. The information presented has been obtained from sources believed to be reliable, but no representation or warranty is given or may be implied that they are accurate or complete. UEM is managed by ICM Limited and ICM Investment Management Limited. The Investment Managers reserve the right to make any amendments to the information at any time, without notice. Issued by ICM Investment Management Limited (registered in England: 08421482), which is authorised and regulated by the Financial Conduct Authority (FRN: 630094). The information in the title banner is as at 31 January, 2023 and approved by ICM Limited.

## Utilico Emerging Markets Trust plc | Registered Office

The Cottage, Ridge Court, The Ridge, Epsom Surrey, KT18 7EP, United Kingdom

Company registration number: 11102129

[www.uemtrust.co.uk](http://www.uemtrust.co.uk)

**Subscribe to our newsletter on [uemtrust.co.uk](http://uemtrust.co.uk)**

