



Is Mexico the New China?

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When it comes to global manufacturing, Mexico is quickly emerging as the “new” China.

According to corporate consultant [AlixPartners](#), Mexico has leapfrogged China to be ranked as the cheapest country in the world for companies looking to manufacture products for the U.S. market. India is now No. 2, followed by China and then Brazil.

In fact, Mexico’s cost advantages and has become so cheap that even Chinese companies are moving there to capitalize on the trade advantages that come from geographic proximity.

The influx of Chinese manufacturers began early in the decade, as China-based firms in the cellular telephone, television, textile and automobile sectors began to establish [maquiladora](#) operations in Mexico. By 2005, there were 20-25 Chinese manufacturers operating in such Mexican states Chihuahua, Tamaulipas and Baja.

The investments were generally small, but the operations had managed to create nearly 4,000 jobs, Enrique Castro Septien, president of the Consejo Nacional de la Industria Maquiladora de Exportacion (CNIME), told the [SourceMex](#) news portal in a 2005 interview.

China’s push into Mexico became more concentrated, with China-based automakers [Zhongxing Automobile Co.](#), [First Automotive Works](#) (in partnership with Mexican retail/media heavyweight [Grupo Salinas](#)), Geely Automobile Holdings (PINK: [GELYF](#)) and [ChangAn Automobile Group Co. Ltd.](#) (the Chinese partner of Ford Motor Co. (NYSE: [F](#)) and [Suzuki Motor Corp.](#)), all [announced plans to place automaking factories](#) in Mexico.

Not all the plans would come to fruition. But Geely’s plan called for [a three-phase project that would ultimately involve a \\$270 million investment and have a total annual capacity of 300,000 vehicles](#). ChangAn wants to churn out 50,000 vehicles a year. Both companies are taking these steps with the ultimate goal of selling cars to U.S. consumers.

Mexico’s allure as a production site that can serve the U.S. market isn’t limited to China-based suitors. U.S. companies are increasingly realizing that Mexico is a better option than China. Analysts are calling it “nearshoring” or “reverse globalization.” But the

reality is this: With wages on the rise in China, ongoing worries about whipsaw energy and commodity prices, and a dollar-yuan relationship that's destined to get much uglier before it has a chance of improving, manufacturers with an eye on the American market are increasingly realizing that Mexico trumps China in virtually every equation the producers run.

“China was like a recent graduate, hitting the job market for the first time and willing to work for next to nothing,” Mexico-manufacturing consultant German Dominguez told the *Christian Science Monitor* in an interview last year. But now China is experiencing “the perfect storm ... it's making [Mexico – a country that had been the ugly duckling when it came to costs – look a lot better.](#)”

The real eye opener was a 2008 speculative frenzy that sent crude oil prices up to a record level in excess of \$147 a barrel – an escalation that caused shipping prices to soar. Suddenly, the labor cost advantage China enjoyed wasn't enough to overcome the costs of shipping finished goods thousands of miles from Asia to North America. And that reality kick-started the concept of “nearshoring,” concluded an investment research report by Canadian investment bank [CIBC World Markets Inc.](#) (NYSE: [CM](#))

“In a world of triple-digit oil prices, distance costs money,” the CIBC research analysts wrote. “And while trade liberalization and technology may have flattened the world, rising transport prices will once again make it rounder.”

Indeed, four factors are at work here.

Mexico's “Fab Four”

- **The U.S.-Mexico Connection:** There's no question that China's role in the post-financial-crisis world economy will continue to grow in importance. But contrary to the conventional wisdom, U.S. firms still export three times as much to Mexico as they do to China. Mexico gets 75% of its foreign direct investment from the United States, and sends 85% of its exports back across U.S. borders. As China's cost and currency advantages dissipate, the fact that the United States and Mexico are right next to one another makes it logical to keep the factories in this hemisphere – if for no other reason that to shorten the [supply chain](#) and to hold down shipping costs. This is particularly important for companies like Johnson & Johnson (NYSE: [JNJ](#)), Whirlpool Corp. (NYSE: [WHR](#)) and even the beleaguered auto parts maker Delphi Corp. (PINK: [DPHIQ](#)) which are involved in [just-in-time manufacturing](#) that requires parts be delivered only as fast as they are needed.
- **The Lost Cost Advantage:** A decade or more ago, in any discussion of manufactured product costs, Asia was hands-down the low-cost producer. That's a given no more. Recent reports – including the analysis by AlixPartners – show that Asia's production costs are 15% or 20% higher than they were just four years ago. A U.S. Bureau of Labor Statistics report from March reaches the same conclusion. Compensation costs in East Asia – a region that includes China but excludes Japan – rose from 32% of U.S. wages in 2002 to 43% in 2007, the most recent statistics available. And since wages are advancing at a rate of 8% to 9% a year, and many types of taxes are escalating, too, East Asia's overall costs have no doubt escalated even more in the two years since the BLS figures were reported.

- **The Creeping Currency Crisis**: For the past few years, U.S. elected officials and corporate executives alike have grouched that China keeps its currency artificially low to boost its exports, while also reducing U.S. imports. The U.S. [trade deficit](#) with China has soared, growing by \$20.2 billion in August alone to reach \$143 billion so far this year. The currency debate will be part of the discussion when [U.S. President Barack Obama visits China](#) starting Monday. Because China's yuan has strengthened so much, goods made in China may not be the bargain they once were. Those currency crosscurrents aren't a problem with the U.S. and Mexico, however. As of Monday, the dollar was down about 15% from its March 2009 high. At the same time, however, the Mexican peso had dropped 20% versus the dollar. So while the yuan was getting stronger as the dollar got cheaper, the peso was getting even cheaper versus the dollar.
- **Trade Alliance Central**: Everyone's familiar with the [North American Free Trade Agreement](#) (NAFTA). But not everyone understands the impact that NAFTA has had. It isn't just window-dressing: Mexico's trade with the United States and Canada has tripled since NAFTA was enacted in 1994. What's more, Mexico has 12 free-trade agreements that involve more than 40 countries – more than any other country and enough to cover more than 90% of the country's foreign trade. Its goods can be exported – duty-free – to the United States, Canada, the European Union, most of Central and Latin America, and to Japan.

In the global scheme of things, what I am telling you here probably won't be a game-changer when it comes to China. That country is an economic juggernaut and is a market that U.S. investors cannot afford to ignore. Given China's emerging strength and its increasingly dominant financial position, it's going to have its own consumer markets to service for decades to come.

Two Profit Play Candidates

From a regional standpoint, these developments all show that we're in the earliest stages of what could be an even-closer Mexican/American relationship – enhancing the existing trade partnership in ways that benefit companies on both sides of the border (even companies that hail from other parts of the world).

In the meantime, we'll be watching for signs of a resurgent Mexican manufacturing industry that's ultimately driven by *Chinese* companies – because we know the American companies doing business with them will enjoy the fruits of their labor.

Since this is an early stage opportunity best for investors capable of stomaching some serious volatility, we'll be watching for those Mexican companies likely to benefit from the capital that's being newly deployed in their backyard.

Two of my favorite choices include:

- **Wal Mart de Mexico SAB de CV (OTC ADR: [WMMVY](#))**: Also known as “Walmex,” this retailer has all the advantages of investing in its U.S. counterpart – albeit with a couple of twists. Walmex's third-quarter profits were up 18% and the company just started accepting bank deposits, a service that should boost store traffic. And while the U.S. retail market is highly saturated – which limits growth opportunities – there are still plenty of places to build Walmex stores south of the

- border. After all, somebody has to sell products to all those thousands of workers likely to be involved in the growing maquiladora sector.
- **Coca-Cola FEMSA SAB de CV** (NYSE ADR: [KOF](#)): Things truly do go better with Coke – especially higher wages and an improved lifestyle. According to *Reuters*, [Mexicans now consume more Coca-Cola beverages per capita](#) than any other nation in the world. The company just posted a 25% jump in its third-quarter net earnings, aided by a strong 21% jump in revenue. Coca-Cola FEMSA continues to experience strong growth from its [Oxxo convenience stores](#), and strong beer sales, too. And all three product groups are logical beneficiaries of strong maquiladora development and the growing incomes and rising family wealth that will translate into higher consumer spending in the immediately surrounding areas.

[Editor's Note: Keith Fitz-Gerald is the chief investment strategist for *Money Morning* and *The Money Map Report*. Fitz-Gerald has pulled all his best thoughts together in his new book, "[Fiscal Hangover: How to Profit From the New Global Economy](#)." The reviews are excellent. Investors interested in ordering the book can save \$10 off the cover price at Amazon.com. [Just click here.](#)]