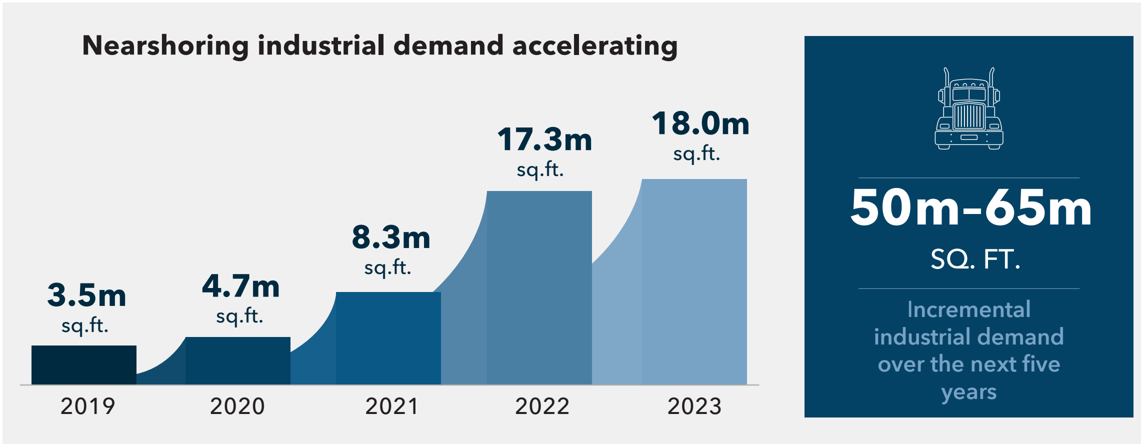
Ares Real Estate

Deglobalization and the rise of Mexico in today's supply chain

Executive summary



Source: Ares Management. Forward-looking statements are not reliable indicators of future events and no guarantee or assurance is given that such activities will occur as expected or at all.

The global economy is undergoing a massive transformation as the United States and China begin to decouple after decades of economic integration. As trade patterns have shifted, Mexico has emerged as a clear winner, offering highly skilled labor at attractive wages, close geographical proximity to the United States, and a recently renegotiated free trade agreement. By our estimates, nearly one-fifth of all U.S. imports diverted from China have moved to Mexico, increasing the country's market share of U.S. imports by 200 basis points since 2018 and making them the largest trading partner with the United States.[1] While we believe trends around nearshoring are still in early stages, already Mexico has experienced 52 million square feet of industrial demand from nearshoring tenants since 2019 — amounting to almost 8 percent of Mexico's industrial stock.[2] During the next five years, we believe nearshoring could add 50 million to 65 million square feet of incremental industrial demand.[3]

Shifting trade patterns

In the decades following World War II, improvements in transportation technology and a sharp decline in tariffs allowed for rapid expansion of global trade.

This era of increased globalization ended, however, with the 2016 election of Donald Trump, who largely campaigned on a protectionist economic platform. From 2018 to 2020, the average U.S. tariff on Chinese imports increased from 3 percent to 19 percent.[4] By the end of Trump's term, tariffs were in place on 66 percent of goods imported from China (based on pre-trade war values).

At the same time the Trump administration was escalating the trade war with China, it was reinforcing trade ties with Mexico and Canada, culminating in the signing of the United States–Mexico–Canada Agreement (USMC) on Dec.,10, 2019. The USMC primarily served to modernize the North American Free Trade Agreement (NAFTA), with a key provision increasing the regional value content (RVC) requirements for autos to 75.0 percent, from 62.5 percent under NAFTA.[5]

The Biden administration has also embraced a protectionist industrial policy, although President Biden has largely favored subsidies to stimulate domestic manufacturing. Notably, the Biden administration passed the CHIPS Act and Inflation Reduction Act to support U.S. domestic manufacturing in semiconductors, electric vehicles and the broader green supply chain. In total, these initiatives have generated more than $860 billion in business investments in the United States.[6] Finally, the Biden administration recently announced new tariffs on $18 billion of imports from China.

In addition to rising geopolitical tensions between the United States and China, China is no longer the lowest cost producer. When China entered the World Trade Organization in 2000, its GDP per capita was just 14 percent of Mexico's. As of 2022, China's GDP per capita had increased to 118 percent of Mexico's.[7] In response to surging production costs in China, companies have been searching for alternative countries to reduce costs.

Finally, the past four years have seen numerous disruptions to global trade flows — from a global pandemic that shut down production centers and saw containers stuck at distant ports, to a drought in the Panama Canal, and attacks by the Houthis on container ships in the Red Sea. Maritime trade, which was cheap and reliable for most of the post–WWII period, has instead seen more volatile shipping times as well as higher transport costs.

In total, these events have forced supply-chain managers to focus on creating more resilient procurement networks and manage geopolitical risks within those networks. Mexico offers an attractive solution to these problems due to its proximity to the United States. Under normal conditions, goods take 11 days to travel across the Pacific Ocean from Shanghai to Los Angeles, and then another 21-hour drive to a major inland hub, such as Dallas. In contrast, Monterrey is just a 10-hour drive to Dallas.

Mexico's growing role in the U.S. supply chain

With rising geopolitical tensions between the United States and China, surging production costs in China, reduced reliability and higher costs to maritime shipping, Mexico is emerging as an extremely attractive location for higher-skilled manufacturing. Even prior to the trade war, Mexico was the second-largest trading partner of the United States, with U.S. trade accounting for 80 percent of Mexico's overall exports. The U.S.-Mexico trading relationship has strengthened even further since the start of the trade war.

Since 2018, nonenergy imports from Mexico have increased by 46 percent, or $146 billion, pushing Mexico's market share of nonenergy imports from 14 percent to 16 percent.[8]

In total, this increase in market share amounts to an additional $64 billion in trade, with the bulk of that increase coming from trade previously done with China. Furthermore, we estimate for every 1 percentage point China loses in market share, Mexico stands to gain $6 billion in additional exports, or an increase of 1.3 percent.

Finally, we estimate that every $2.5 billion in additional exports generates approximately 1 million square feet in additional industrial demand. This means a 10 percent increase in exports generates nearly 18 million square feet of industrial demand, or 2.6 percent of the total stock.[9]

Mexico plays a particularly important role in the U.S. auto supply chain, with 22 percent of imported passenger vehicles (by value) and 75 percent of freight vehicles sourced from Mexico. Meanwhile, 41 percent of auto-part imports come from Mexico. Additionally, Mexico accounts for 27 percent of U.S. computer imports and 31 percent of medical equipment imports. Finally, the country has seen strong market share growth in electronics, particularly televisions (up 9 percentage points from 2018), and electronic boards and panels (up 5 percentage points from 2018).[10]

Driven by the need to recalibrate supply chains in the face of geopolitical tensions, shipping disruptions and rising production costs in China, international corporations are increasingly looking to expand into new markets, and Mexico has been one of the biggest winners of this shift. From 2018 to 2022, 830 new foreign firms have opened in Mexico.[11]

Furthermore, these new firms have taken up 52 million square feet of industrial real estate (7.5 percent of total stock), with new demand hitting 18 million square feet in 2023 alone.[12]

Companies headquartered in China have accounted for the largest share of nearshoring demand since 2019, with 40 percent of the total, followed by U.S.-based companies at 22 percent.[13] Additionally, many of these new investments are coming from the automotive industry, which already enjoys deep historical ties to the United States and benefits from a large existing workforce.

Outlook[14]

During the next five years, we estimate Mexico could see an additional 50 million to 65 million square feet of industrial demand from nearshoring.

As stated earlier, we estimate an additional $2.5 billion of exports generates 1 million square feet of industrial demand. Using as a baseline that U.S. consumption increases by 4 percent per year, and that imports increase at a similar pace, we expect about 40 million square feet of demand from trend growth. Additionally, we anticipate that China will lose another 5 percentage points to 10 percentage points of market share during the next five years as supply chains continue to recalibrate, and geopolitical tensions remain high. If China loses 5 percentage points of market share, we project that would boost Mexico's imports by $30 billion, which would add another 12 million square feet, bringing the total to 52 million square feet. In the scenario where China loses 10 percentage points of market share, Mexico could add a total of 63 million square feet. We would also note this estimate may prove conservative as nearshoring demand in Mexico has averaged 17.5 million square feet during the past two years. If this trend were to continue, that would amount to 88 million square feet during the next five years.

Additionally, the increase in manufacturing activity in Mexico will likely generate indirect demand for industrial space as local employment and wages increase, boosting domestic consumption. The increase in warehouse space from domestic spending is likely to be further bolstered by a growing share of spending on ecommerce, which requires more industrial space than traditional retail. Between 2024 and 2029, ecommerce spending is projected to increase at an annual rate of 11.3 percent — making Mexico's ecommerce market one of the fastest growing globally.[15]

Endnotes: [1] Based on the views of Ares Real Estate as of Sept. 30, 2024, unless otherwise noted. As such, our views are subject to change at any time; [2] CBRE, "Nearshoring In Mexico: Demand in the Industrial Real Estate Market", February 2024; [3] Forward-looking statements are not reliable indicators of future events, and no guarantee or assurance is given that such activities will occur as expected or at all; [4] Peterson Institute for International Economics, Chad P. Bown, "US-China Trade War Tariffs: An Up-to-Date Chart", as of September 2023; [5] U.S. Department of Commerce International Trade Administration; [6] White House press release, May 14, 2024; [7] International Monetary Fund, as of September 2023; [8] U.S. Census Bureau, data as of June 2024; [9] Based on the views of the Ares Real Estate as of Sept. 30, 2024, unless otherwise noted. As such, our views are subject to change at any time; [10] U.S. Census Bureau, data as of June 2024; [11] BBVA Research, as of 2023; [12] CBRE, data as of 2024; [13] CBRE, data as of 2024; [14] As of Oct. 1, 2024. Projections and forward-looking statements are not reliable indicators of future events, and no guarantee or assurance is given that such activities will occur as expected or at all; [15] Statista Market Insights, data as of June 2024

ABOUT ARES REAL ESTATE

Ares Real Estate manages comprehensive public and private, equity and debt strategies, with approximately $51.5 billion of assets under management as of June 30, 2024. Backed by a vertically integrated platform, demonstrated track record, tenured team, thematic investment approach, access to proprietary deal flow and synergies with the broader Ares platform, we are able to identify and execute on attractive opportunities with compelling risk-reward profiles.

We maintain a time-tested and consistent approach across our equity and debt strategies focusing on major property types and adjacent sectors that have value-creation opportunities, located in liquid markets with diversified economies.

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