



Posted on April 20, 2023

Nearshoring and Latin America

After the pandemic, the term “nearshoring” became popular in the media. Given the potential implications of this phenomenon on the Latin American region, it is worth exploring it in more detail. Forbes describes nearshoring as a *“tactic that allows companies to move their operations to the closest country with a qualified workforce and reduced cost of living without the time difference.”* (Maritza Diaz, Forbes, 2021). In essence, nearshoring is a form of offshoring, but with different goals in mind.

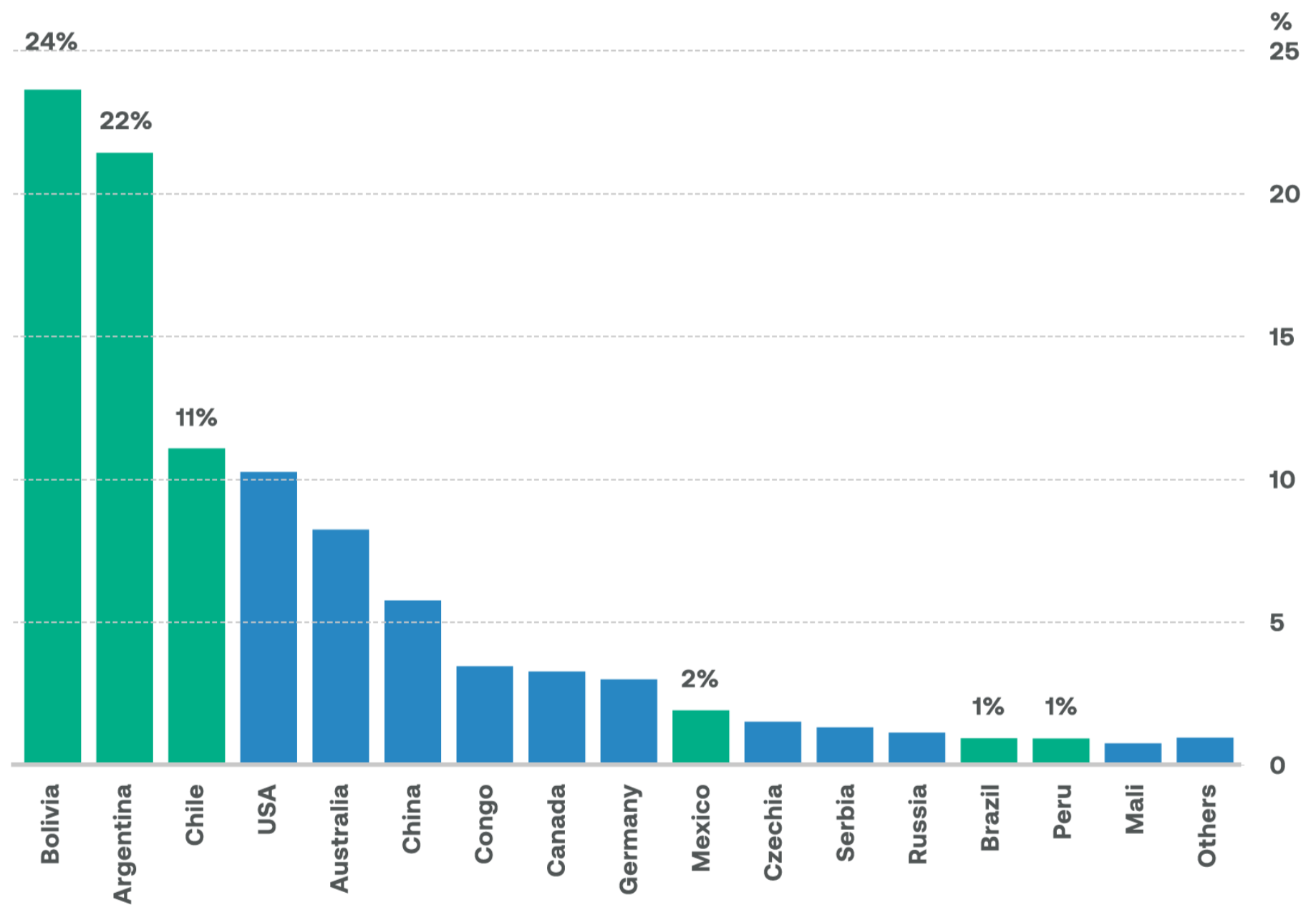
Offshoring became popular in the 1980’s as many companies relocated their production facilities to countries such as China, India, and Bangladesh, as relatively lower labor costs reduced manufacturing expenses and increased profit margins. Eventually, this trend grew to encompass the relocation of service facilities. However, offshoring presented two main problems, namely geographic distances, and time zone differentials. Vastly different time zones meant that colleagues in the same company would have to work very different hours, with some working through the night to provide the support or services needed by their teammates or end clients. Most impactful were the geographic distances that had to be traversed in order to ship materials and finished products halfway around the world. This dynamic became painfully evident during the Covid-19 Pandemic.

As we can all remember, the world came to a grinding halt during the Pandemic. Most people were working from home or within limited hours. That also meant companies were producing less, and airplanes and ships were transporting less goods. This dynamic put severe pressures on the world’s supply chains of goods and services. As the global economy began to eventually reopen and goods were slowly being produced again, production lines were sometimes forced to stop due to lack of supplies or raw materials required to complete production. Consumers around the world had to wait months for appliances or furniture, as a product manufactured in one country could not be shipped to a different country because of lack of materials or heavy backlogs and bottlenecks in the logistic supply chains. This dynamic was most evident in the supply of semiconductor chips, the infamous “chip shortage”. These experiences made companies in the West keenly aware of their dependence on Asian suppliers, especially on China. Understandably so, this heavy dependence on China posed significant security risks, particularly for the United States. Trade wars between the United States and China had frayed commercial relations between both countries before the Pandemic began. Combined with the supply chain issues experienced in 2020-2021, these dynamics pushed the United States to seek diversification in its supply chain. This is where the concept of nearshoring emerged.

In a move to reduce its dependence on Asia, the United States has been working to bring back manufacturing and services either back to the country (reshoring), or close to it (nearshoring). Some production is being brought back to Canada; however, most of it will likely be relocated to Latin America. In the chart above, we can see the Interamerican Development Bank's estimates for incremental exports expected to arise in the region from the nearshoring movement. The bank expects as much as \$78 billion in incremental exports from the region over the short and medium term. Of this number, it expects approximately 80% to stem from the production of goods, and 20% from the production of services. The automotive, pharmaceutical, textile, and renewable energy industries are expected to see the largest gains. As is evident on the table, Mexico is expected to be the biggest beneficiary in the region, followed by Brazil, Argentina, Colombia, and Chile.

Additional Potential Exports for the Region (in billions of USD)

Source: Interamerican Development Bank, Bloomberg Linea, Insigneo, March 2023



Due to its geographic proximity to the United States, Mexico should prove to be the biggest beneficiary of nearshoring, potentially seeing incremental exports almost five times greater than the next country on the list, Brazil. In Mexico's northern region, cities like Monterrey are already seeing a boost in the technology industry. Local universities, such as Tecnológico de Monterrey, are producing well-trained engineers capable of handling specialized, tech-oriented roles that were previously handled in Asia. Companies such as Tesla, Volkswagen, and BMW continue to expand their presence in the region. We are seeing railway companies such as Canadian Pacific expand their networks from Canada to Mexico in an effort to reduce lead times

and get products to market quickly and efficiently. Banks such as Banorte are investing heavily in Mexico's northern region to support its booming industries. The bank foresees a migration of workers from the south to the north of the country, as opportunities brought about by nearshoring create more employment. In fact, Banorte recently announced it will add 800 jobs in northern Mexico to have the capacity it needs to meet increased demand for mortgages, business loans, and general banking services. An increased need for infrastructure to support increased demand should also lead to job creation, helping the local economy. In fact, the expectation of this dynamic has helped bolster the Mexican Peso, as well as the country's equity markets. We are even seeing the flourishing of new startup companies in the country, such as the logistics company Nowports, that are positioning themselves to benefit from nearshoring trends. Multilateral trade agreements between the United States, Mexico, and Canada should continue to facilitate increased trade between these countries.

“The nearshoring phenomenon has the potential to be a game changer for many countries in Latin American. It is up to these countries to properly embrace this dynamic”

Mexico will not be the only country to reap the benefits of nearshoring. Countries like Brazil, Argentina, and Colombia are also investing in education programs to produce a skilled workforce of engineers and other specialized roles that will enable them to meet the requirements of multinational companies. El Salvador, Guatemala, and Honduras are seeing an increased number of call-centers relocating to their countries. As a result of its stable financial system and friendly business policies, Uruguay is increasingly seeing the expansion of Free Trade Zones. Like Mexico, these countries share similar cultures and democratic values, as well as time zones that are, for the most part, aligned with those of the United States.

There are a few important dynamics that could pose a challenge to the full embrace of nearshoring in the region. The most important is potential political instability. Most governments in the region recognize the benefits that nearshoring could bring to their countries. However, changing political regimes, along with the regulatory changes these could entail, could give pause to companies looking to relocate their operations to the region. Onerous or ambiguous regulatory frameworks could also pose barriers to nearshoring opportunities. Most companies in the United States operate under a regulatory framework, that although sometimes cumbersome, tends to be clearly defined. Ambiguous or seemingly arbitrary frameworks could cause companies to look elsewhere for relocation opportunities. High crime rates, or the perception thereof, is also an important consideration. Companies looking to relocate operations have to send employees from other regions to the host nations. Many times, these companies will choose not to operate in areas with high crime rates to not put their existing employees in danger.

The nearshoring phenomenon has the potential to be a game changer for many countries in Latin American. It is up to these countries to properly embrace this dynamic for the good of their economies, as well as their people.



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