

USMCA – Resolution on auto sector rules of origin is positive for Mexico and Canada

- Yesterday, the panel in charge of the solution of the dispute regarding rules of origin in the auto sector published a ruling with their final report
- In it, they stated that essential parts of a vehicle (e.g. engine, transmission, bodywork) will be considered as originating fully from the region once they comply with a minimum regional content of 75%
- We must remember that this was the position held both by Mexico and Canada, contrasting with the US which argued that only the percentage of regional content from the inputs for said parts should be considered
- This ruling is relevant considering that around 24% of Mexico's exports to the US correspond to the vehicles sector
- The result should support the domestic auto industry and could trigger higher local and foreign appetite in the sector, boosting investment as soon as 2023

Favorable outcome for Mexico and Canada in the auto sector. Yesterday, the panel in charge of dispute settlement –under chapter 31 of the USMCA– issued a ruling on rules of origin for regional value content in the auto sector. The panel stated that the percentage of content for essential parts¹ can be counted as 100%, as long as inputs used for their production fulfill with 75% of raw materials and labor from the region. On the contrary, the US argued that the percentage that these parts should contribute would be tied to the original value of raw materials and labor used in the fabrication. The ruling is based on the interpretation of differences in terms of the structure and description of essential parts, which being somewhat ambiguous, favor the stance held by Mexico and Canada. This resolution is important as it increases the likelihood that exports from our country to the US and Canada can be made free of duties due to their compliance with said rules of origin.

Parties' reactions. Mexico's Ministry of Economy stated that, in coming days, the country will start a dialogue and cooperation process with the other countries to comply with the final report. Canada's Trade Minister, Mary Ng, signaled that Canada *"...is glad to see that the dispute settlement mechanisms in place are supporting our rights and obligations negotiated in USMCA..."*. Finally, the speaker of the Office of the US Trade Representative, Adam Hodge, said that they are disappointed with the decision, and that they *"...are reviewing the report and considering next steps..."*. Meanwhile, the US Chamber of Commerce *"...welcomes this ruling and the certainty it will provide for industry..."* on top of *"...we urge the administration to quickly implement the panel ruling..."*. Finally, *United Steelworkers* stated that the decision hurts workers across North America. Locally, the *Business Coordinating Council* (CCE in Spanish) and the *Confederation of Mexican Industrial Chambers* (CONCAMIN in Spanish) have given very favorable comments on the matter.

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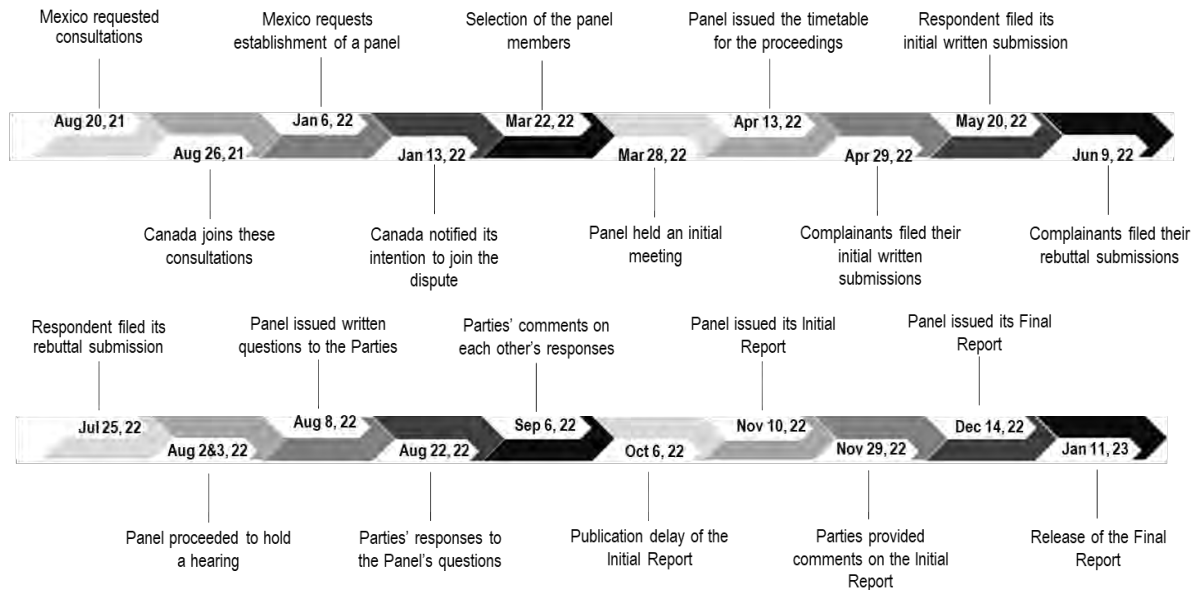


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¹ There are seven essential parts, these being: (1) Engines; (2) transmission; (3) body and chassis; (4) axle; (5) suspension; (6) steering; and (7) lithium battery (for EVs).

The process ends almost 16 months after the consultation request. Mexico made this request to the US on August 20th, 2021, with Canada stating their intent to take part in it on the 26th of the same month. After this, the consultation period took place on September 24th of the same year. Given that a solution was not reached, Mexico requested the establishment of a panel on January 6th, 2022, with Canada joining the dispute seven days later. The panel was formed based on Chapter 31 of USMCA. The main hearings took place on August 2nd and 3rd, with the initial support being published on November 10th. After comments from the involved parties, the panel issued its final report on December 14th, which was released to the public on January 11th, 2023.

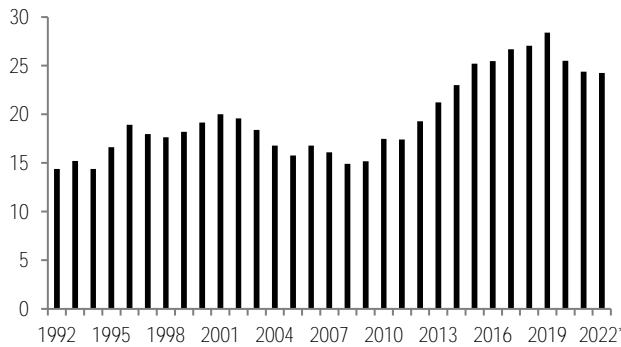
Dispute settlement process for the auto sector



Source: Banorte with data from the USTR

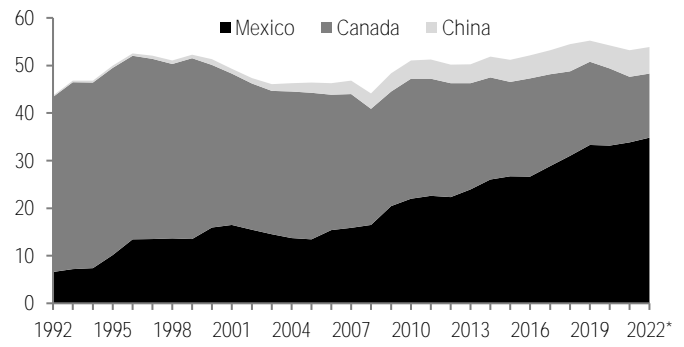
Good news for the Mexican auto industry. According to the *US Census Bureau*, about 24% of Mexico's exports to the US are vehicles –which includes finished cars and auto parts–, highlighting the strong importance of the sector for the domestic economy. Since 1992, this percentage has shown a clear upward trend, reaching a high in 2019, with subsequent figures impacted by the pandemic and the lack of supplies (see chart below, left). In said year (2019), the total value of these exports from our country to the US reached US\$101.1 billion, while in 2021 they came in at US\$93.8 billion. Also relevant, Mexico has a meaningful position in total US vehicle imports, with around 35% in market share. Canada contributes with another 14%, while China does not have a meaningful percentage (6%), as seen in the chart below on the right.

Mexico: Vehicle exports as a share of total exports sent to the US %



*Note: Figures for 2022 contemplate data until November
Source: Banorte with figures from the US Census Bureau

US: Vehicle imports by country %



*Note: Figures for 2022 contemplate data until November
Source: Banorte with figures from the US Census Bureau

On the other hand, the *Mexican Association of the Automotive Industry* (AMIA, for its acronym in Spanish) expects the sector’s recovery to continue in 2023, anticipating 6.6% production growth, reaching a total around 7.5% lower than its pre-pandemic level. In the same line, the *National Auto Parts Industry* (INA) estimates 7.2% growth in auto part exports this year, despite anticipating that the semiconductor shortage will continue.

This ruling provides certainty to both established companies and new investments, the latter highly relevant in the context of nearshoring. Among the companies that have announced new investments in the sector or in related products, we highlight: (1) Tesla, with an investment of US\$1 billion on an auto parts plant in Nuevo León; (2) GM, with a total conversion of its Ramos Arizpe plant to one that will exclusively assemble electric vehicles in the medium-term; (3) Kia, with a total budget of \$408 million planned between 2022 and 2024, of which \$67 million have already been spent; (4) BMW, with €800 million (US\$862 million) in San Luis Potosí to produce electric vehicles; (5) Nissan plans to spend more than US\$700 million by 2025 on its operations in our country; (6) Ternium (metals), with a planned expenditure of US\$1 billion to expand its product portfolio at its plant in Pesquería, Nuevo León; (7) Cuprum (metals) with US\$100 million in aluminum products; (8) Faurecia (seats and interiors), spending US\$147 million to expand its Nuevo León plant. In addition, Nuevo Leon’s Minister of Economy, Iván Rivas, mentioned that two Asian companies have shown interest in establishing lithium battery factories in said state. These are just a few examples of the strong dynamism that the sector keeps showing, which would ensure not only continued industry growth, but also its evolution to capitalize growing interest in electric vehicles.

Higher dynamism for the automotive sector. In our opinion, the ruling not only grants legal certainty to automotive production in the region, but it will also allow renewed dynamism in new investments. In this sense, our vision for the short- and medium-term is positive, with these investments allowing an extension of this industry’s recovery, which remains in a complex backdrop. We remain attentive to other factors such as inventory management, possible technical stoppages due to input shortages –mainly semiconductors– and labor disputes within the USMCA framework as lingering concerns in this sector.

In our view, the implications of this ruling will be favorable for GDP as early as 2023. Moreover, this should help offset, at least partially, for the signs of a global economic slowdown.

On North American trade relations, we continue focused on the energy sector's consultation process and the possible controversy related to transgenic corn within the USMCA framework. On the former, Minister of Economy Raquel Buenrostro recently said that there's good disposition between the parties to find a resolution. This has already meant an extension of the consultation period (with a third round) to avoid the establishment of a panel. On the latter, early in December last year, the Minister stated that "*...there is a series of misinformation and interpretation of the decree...*" assuring that rules regarding corn imports for industrial use and forage have been left unchanged. In this context, we highlight that these disputes are common in any trade agreement. However, USMCA's resolution mechanisms have been successful, which we believe is very favorable for the private sector's relocation and investment strategies.

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