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Trump's Tariffs and Mexico's Economic Exposure

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Executive Summary

- Mexico faces 25% U.S. tariffs on nearly all exports not covered by USMCA, with no exemption from the recent 90-day pause—unlike some other trade partners.
- Trump has tied tariff relief to non-trade demands, including migration control and anti-drug efforts, placing Mexico under both economic and political pressure.
- The tariffs could trigger a 1% GDP contraction in Mexico, which lacks the fiscal space to respond with stimulus measures.
- Much of Mexico's export activity is conducted by U.S.-based multinationals like Ford and GM, so the earnings hit to Mexican firms may be muted despite macroeconomic stress.
- Half of Mexico's exports to the U.S. don't qualify under USMCA; around $50 billion worth may never qualify, facing full tariffs unless companies restructure supply chains.
- A sharp peso depreciation, strong U.S. consumer demand, and deeply integrated supply chains help soften—but not eliminate—the blow.
- As Mexico's largest export sector, autos could lose $12–18 billion. Mexico is seeking to reclassify more production as U.S.-origin to minimize tariff exposure.
- High reliance on imported inputs in electronics, price sensitivity, and fierce global competition make these sectors especially exposed to tariff shocks.
- Trump's tariffs and Sheinbaum's pivot toward Washington have strained China-Mexico relations. A major BYD plant is on hold, and new Chinese investment has slowed.
- Despite efforts to realign trade policy and defend key sectors, Mexico's economy remains vulnerable to both Washington's political whims and global supply chain shifts.

Key Picture: Mexico Exports by Countries

Source: UN COMTRADE

Introduction

A trade war involving the United States, Canada, and Mexico began on February 1, 2025, when U.S. President Donald Trump signed orders imposing near-universal tariffs on goods from the two countries. The executive order introduced 25% tariffs on all imports from Mexico and nearly all Canadian imports, with oil, energy, and potash taxed at 10%. While media focus has largely remained on Canada, Mexico faces a unique blend of trade, security, and diplomatic pressure. Despite Trump's recent announcement of a 90-day pause on some tariffs, a White House official clarified that this exemption does not apply to Mexico or Canada. The 25% tariffs on goods not covered under the USMCA remain in place, as do the 10% levies on energy and potash.

These tariffs are not just economic tools. Trump tied the measures to broader political demands on migration and drug enforcement. On February 3, President Sheinbaum of Mexico negotiated a one-month delay of tariff implementation in exchange for deploying 10,000 National Guard troops to the U.S.-Mexico border. In return, the U.S. promised to take measures to reduce arms smuggling into Mexico. However, such gestures have not resulted in broader relief.

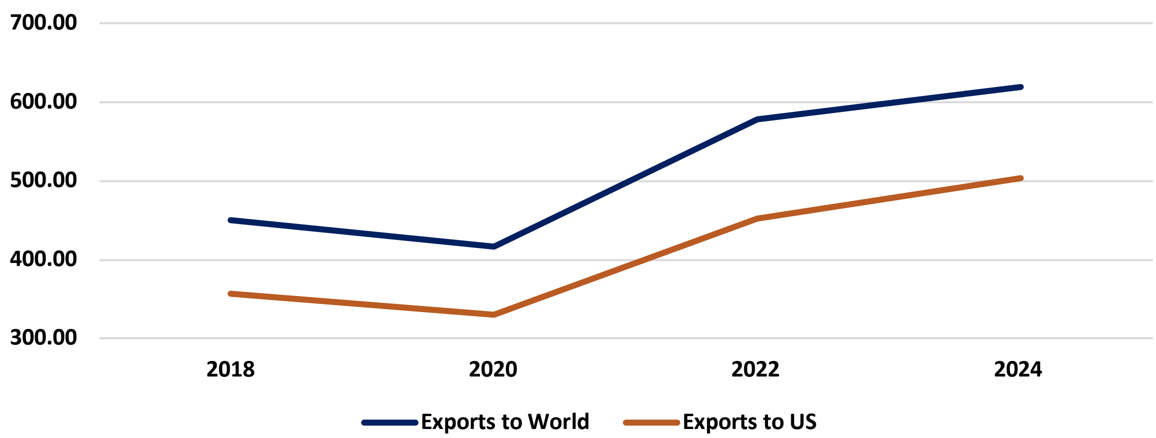
Additionally, Trump imposed 25% tariffs on steel and aluminum imports from all countries—including Mexico—effective March 12. These industries are key to Mexico's export economy and face a compounded burden from the protectionist turn in Washington.

The 25% tariff on all U.S. imports from Mexico, which takes effect today, is likely to push Mexico's economy into recession if maintained. A GDP contraction of around 1% this year is a realistic scenario. Unlike Canada and China—also hit by new tariffs—Mexico lacks the fiscal capacity to cushion the blow. Even if a deal eventually lifts the tariff, the persistent threat of U.S. trade restrictions will continue to undermine business confidence and investment, weighing on future growth.

Tariff Exposure in Mexico's Trade Structure

At first glance, the scale of exposure is daunting. Exports account for nearly one-third of Mexico's GDP, and roughly 80% of those exports are destined for the United States (**Key Picture**). A 25% tariff on more than half of that flow would seem like a recipe for recession.

Figure 1: Mexican Exports to the World and the US



Source: UN COMTRADE

A significant portion of Mexico's export activity is not driven by domestically owned firms but by U.S.-based multinational corporations operating within Mexican territory. The automotive sector—Mexico's largest export category—is dominated by companies such as Ford and General Motors, both of which are headquartered in the United States and listed on U.S. stock exchanges. These firms utilize Mexico as a cost-effective manufacturing base, yet the associated profits and equity ownership remain external to the Mexican economy.

According to U.S. government data and trade experts, approximately half of Mexico's exports to the United States last year did not qualify under the USMCA trade agreement and are thus exposed to the full 25% tariff recently imposed by President Donald Trump. While most of these goods could meet USMCA requirements with additional documentation, around 10%—valued at roughly $50 billion—are unlikely to comply, leaving firms facing a stark choice: restructure supply chains or gamble on the durability of the tariffs.

Although Trump recently agreed to temporarily exempt USMCA-compliant goods following two days of market volatility, Mexico's economy ministry warns that a substantial portion of exports may still fall short of North American content requirements. As a result, many Mexican products now face steeper tariffs than Chinese imports, which are subject to a lower 20% rate—deepening the uncertainty surrounding Mexico's trade outlook.

Roughly half of Mexico's $505.9 billion in exports to the U.S. last year bypassed USMCA compliance due to the complexity and expense of verifying North American content. About 40% of exports—worth around $200 billion—entered duty-free regardless, as they faced no tariffs (e.g., medical devices, beer, tequila), eliminating the incentive for paperwork. The remaining 10%, including autos, electronics, and oil, did face tariffs, but these were low enough that firms often opted to pay rather than comply.

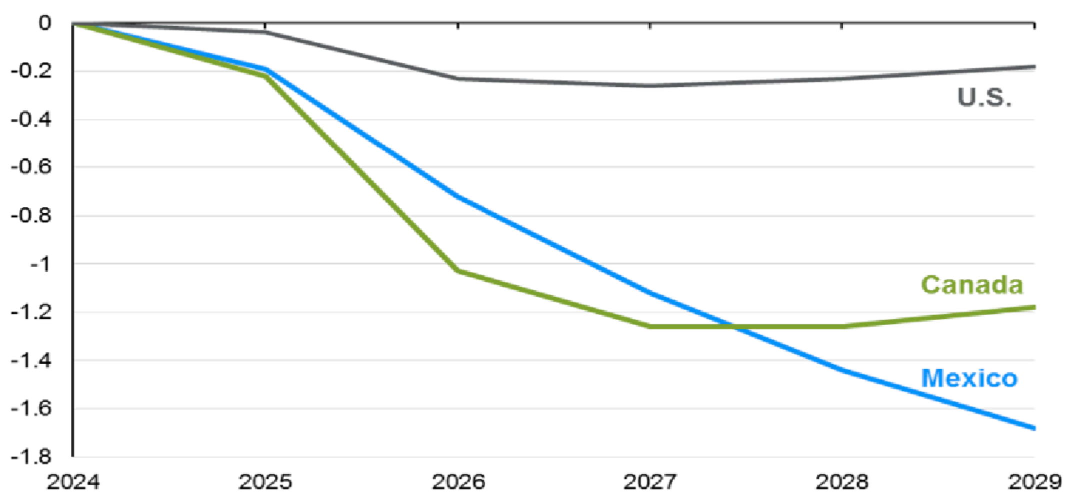
Trump's new 25% tariff has upended that logic, forcing companies to assess whether their products meet USMCA criteria or can be adapted to do so. Mexico's economy ministry estimates that 85–90% of exports could qualify by next month. But the rules remain complex for key sectors: 8.2% of vehicles and 20.4% of auto parts exported to the U.S. do not currently comply. Electronics face particularly tough thresholds, with over 50% of components required to originate in North America—an unlikely scenario given the reliance on Asian suppliers.

Losing access to the U.S. market is not an option. Firms are now reshaping supply chains to meet USMCA origin rules—even at higher costs.

Tariff Impact on Mexico

At first glance, a tariff of this magnitude risks tipping Mexico into recession. Projections of a 1% GDP contraction this year are not far-fetched (**Figure 3**), especially considering the country's limited fiscal room for stimulus, unlike Canada or China, which are also facing new U.S. trade restrictions. However, three factors—exchange rate movements, the resilience of the U.S. consumer, and supply chain rigidity—may help absorb part of the shock.

Figure 3: Impact of Tariffs on the Economies (Real GDP growth, projected % change from baseline forecast, 2024-2029)



Source: Peterson Institute for International Economics

Mitigating Factors

One key mitigating factor is the sharp depreciation of the Mexican peso. In 2024, the peso fell by 23% against the U.S. dollar, dropping from 16.97 to 20.82 MXN/USD. This currency shift makes Mexican exports cheaper in dollar terms, softening the blow of the 25% tariffs. A product that cost $100 last year, for example, now effectively costs just $77 when priced in pesos. This means nearly the entire tariff is offset—at least nominally—by currency movements. But the benefit is not uniform. The peso's decline also raises the cost of imported inputs, potentially squeezing margins in sectors that rely on foreign intermediate goods, such as advanced manufacturing or electronics. The relief is real, but uneven.

Another buffer is the strength of U.S. consumer demand. The U.S. economy grew by 2.5% in 2024, with spending remaining robust across sectors closely tied to Mexican exports—automobiles, electronics, and fresh produce. Many of these goods are inelastic in demand, meaning buyers are relatively insensitive to price increases. If American consumers absorb even half the tariff cost, the resulting drop in demand may be modest.

Still, not all sectors are safe. In more price-sensitive categories, like textiles and apparel, even small increases can prompt substitution or offshoring. Mexico's export composition will therefore play a key role in how much damage is ultimately done.

Finally, geography and integration matter. Mexico's proximity to the United States and its deep embedding in cross-border supply chains provide a kind of built-in defense. U.S. manufacturers, particularly in the automotive and electronics industries, depend on Mexican inputs that cannot be easily or quickly replaced. Relocating supply chains to Asia or even within the U.S. would be expensive and time-consuming.

According to recent estimates, as much as 70% of Mexico's supply chains are "sticky" and unlikely to shift within one to two years. This inertia sustains demand for Mexican goods, even in the face of rising trade barriers.

Sectoral Pain Points: Who's Most Exposed?

While mitigating factors such as currency depreciation and supply chain rigidity offer some cushion, the sectoral breakdown tells a more sobering story. Some of Mexico's most vital industries—those tightly bound to U.S. demand—remain highly vulnerable to the new tariff regime.

Automotive: The Bullseye of the Trade War

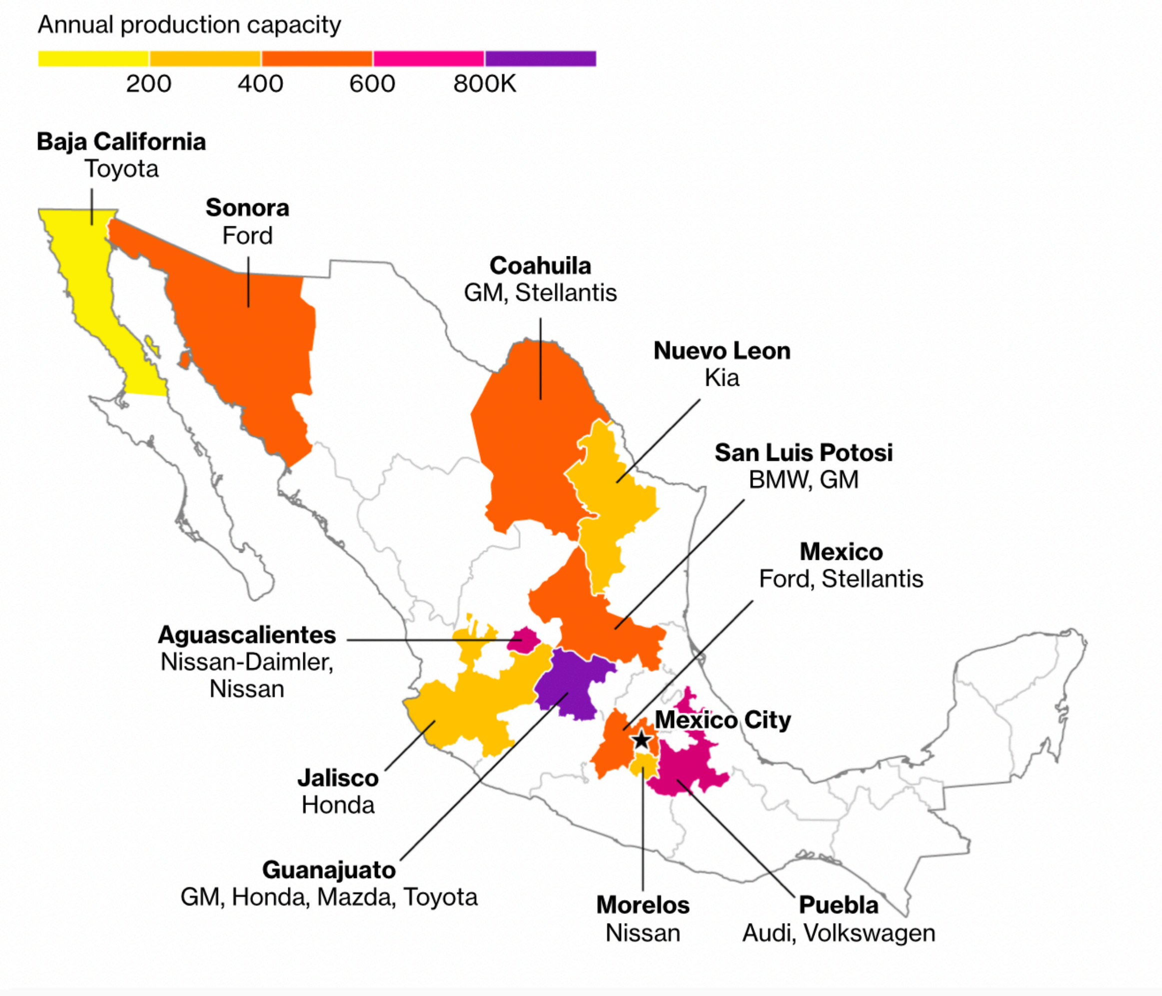
Mexico's automotive industry is the crown jewel of its export economy, accounting for roughly 25% of total shipments abroad. It's also the sector with the most to lose. Without mitigating forces, exports could decline by as much as 15–20%, but due to the peso's depreciation and the rigidity of cross-border supply chains, the expected decline moderates to 8–12%. Still, that translates into a massive potential hit of $12–18 billion. Given its deep integration with U.S. manufacturers, this sector is likely to become the bellwether for Mexico's broader economic trajectory in the months ahead. Analysts from the Anderson Economic Group estimate that the cost of a car assembled with parts from Mexico and Canada could rise by $4,000–$10,000, depending on the model.

In this context, Mexico is seeking to have a greater share of its auto production qualify as U.S.-origin under the USMCA to minimize the impact of President Trump's 25% tariffs, Deputy Economy Minister for Foreign Trade Luis Rosendo Gutierrez said. Gutierrez noted that adjustments in the production process could boost American content and secure tariff deductions. Gutierrez also suggested that the USMCA's 2026 review could be accelerated and called for stronger dispute-resolution mechanisms.

Electronics & Machinery: A Fragile Link

Comprising 16% of Mexico's exports, electronics and machinery are especially exposed due to their high reliance on imported intermediate goods. As the peso falls, the cost of these components rises, squeezing margins even before tariffs bite. Initial projections suggest export drops of 12–18%, though currency effects and supply chain stickiness could reduce the effective impact to 6–10%, equating to losses of $8–14 billion. The long-term risk lies in eroded competitiveness, as higher input costs accumulate across the production cycle.

Figure 4: Mexico Car Plants at Risk



Source: Bloomberg

Agriculture: Resilient but Not Immune

Mexico's agricultural exports—avocados, tomatoes, and other fresh produce—benefit from strong U.S. demand and limited alternatives. As the largest supplier of fresh fruits and vegetables to the U.S., Mexico enjoys a level of insulation. Nonetheless, even modest price increases can cause volatility in food supply chains. Unmitigated, exports could fall by 10–15%, though demand rigidity and favorable exchange rates likely cap the real impact at 4–7%. Still, that's a potential $2–3 billion in losses, concentrated in regions heavily reliant on agricultural production.

Textiles & Apparel: A Race to the Bottom

If any sector is likely to suffer substitution, it's textiles and apparel. Known for razor-thin margins and extreme price sensitivity, this industry is already under pressure from low-cost competitors in Vietnam, Bangladesh, and China. Tariffs of 25% could push U.S. retailers to shift sourcing away from Mexico almost immediately. A worst-case decline of 20–25% is plausible, with peso depreciation softening the blow to an estimated 12–18%. Still, the potential loss of $1–2 billion may disproportionately affect labor-intensive regions dependent on garment manufacturing.

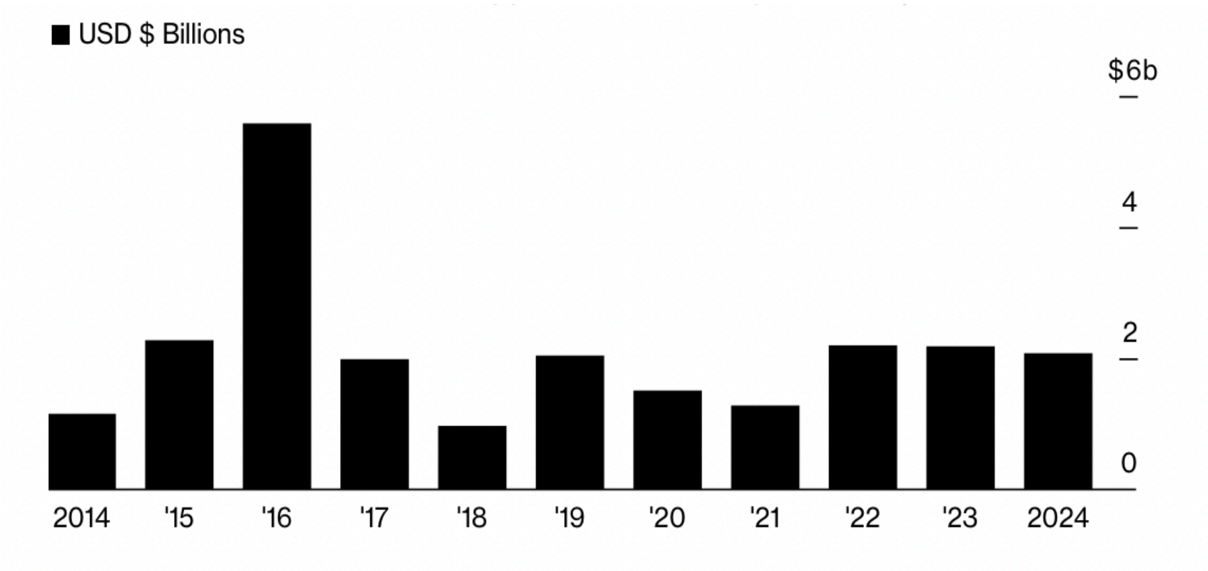
Steel & Aluminum: A Competitive Market

Mexico's metal exports face moderate to high vulnerability. With the U.S. able to source steel and aluminum from other major producers like Canada and Brazil, Mexico's edge is limited. Without policy offsets, exports could fall 15–20%, though a weaker peso might reduce the hit to 8–12%. The result: estimated losses between $3–5 billion. This adds further strain to industries already dealing with squeezed margins and global overcapacity.

Trump's Tariff Threats Are Chilling Chinese Investment in Mexico

Chinese direct investment in Mexico has exceeded $2 billion annually for the past three years—roughly double the level a decade ago, according to the Latin American and Caribbean Academic Network on China. China becomes Mexico's second-largest trade partner (after the U.S.) with annual trade nearing $140 billion.

Figure 5: Chinese Investment in Mexico



Source: Bloomberg

Chinese automaker BYD was poised to open its first factory in Mexico—a $600 million project expected to create 10,000 jobs—but plans have stalled amid Donald Trump's return to the White House and renewed trade tensions. Trump escalated his trade war by announcing new auto tariffs, further straining China-Mexico ties.

Mexico, under President Claudia Sheinbaum, has been appealing to Trump to avoid confrontation, while simultaneously distancing itself from China by tightening scrutiny on Chinese imports. In response, Beijing has grown wary. China's commerce ministry reportedly delayed approval of BYD's plant over fears that sensitive technology might reach the U.S., according to the Financial Times. BYD declined to comment.

Chinese investment may be over, steady growth will continue due to strong demand for Chinese goods and limited local alternatives. Still, tensions are rising.