

MEXICO

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USMCA REVIEW: MEXICO'S INDUSTRIAL HEADACHE

Mexico's economic outlook remains modest. It is characterised by a slowdown in private consumption and investment still held back by uncertainty and a lack of new infrastructure projects. Exports, the main drivers of economic activity, have benefited from the US regionalisation strategy, but the USMCA renegotiation is introducing new constraints. The US is tightening the conditions for accessing its market, threatening the competitiveness of the manufacturing sector, which remains dependent on Asian inputs. At the same time, rising public debt, continued support for Pemex and falling oil revenues are drastically reducing fiscal margins, exacerbating the country's economic challenges.

GROWTH REMAINS SLUGGISH

The outlook for the Mexican economy is not showing any significant improvement. Growth will remain close to 1%, which is well below its potential (2%). Following a disappointing first quarter (+0.2% q/q in Q1, after +1.7% in Q4 2025), monthly economic data suggest sluggish growth in the second quarter, with a marked slowdown in domestic demand and generally disappointing industrial performance.

In real terms, private investment fell by 5% year-on-year in Q1, marking its seventh consecutive quarterly drop since 2023. This contraction reflects persistent structural constraints (unreliable energy and water supplies, and security instability) and a climate of uncertainty exacerbated by recent institutional reforms, including to the judicial system. The latter is currently being implemented, but several unclear provisions are raising doubts about the independence of the judiciary. On top of this institutional instability is the uncertainty surrounding the renewal of the USMCA and global geopolitical tensions. All of this may be driving investors' wait-and-see approach. Furthermore, the difficult transition from the major infrastructure projects launched by the previous government (the Tren Maya and the Dos Bocas refinery, now completed) and the lack of new projects (as part of the government's fiscal-consolidation policy) are adversely affecting public-investment spending.

Furthermore, private consumption is showing signs of losing momentum, against a backdrop of a less buoyant labour market. The unemployment rate remains low (2.8% in May) and the employment rate continues to rise, but job creation is concentrated almost exclusively in the informal sector. The decline in remittances from workers abroad is also contributing to the slowdown in private consumption. Remittances fell both in volume terms — following the implementation of the US government's restrictive immigration policies — and in value terms, due to the appreciation of the peso throughout the second half of 2025 and the first few months of 2026. Remittances in dollars have picked up slightly in recent months. However, they continue to fall in real peso terms, leading to a significant decline in the purchasing power of households for which they are intended.

STRONG EXPORTS: FALSE COMFORT

The export sector remains the mainstay of the economy. Total exports have risen every month since the start of the year, posting year-on-year growth of 30% in value terms in May. It should be noted that nearly 85% of Mexico's total exports are destined for the United States.

Economic forecasts

	2022	2023	2024	2025	2026e	2027e
Real GDP growth, %	3.9	3.2	1.5	0.5	1.1	2.0
Inflation, CPI, year average, %	7.9	5.6	4.2	3.8	4.0	3.7
Budget balance / GDP, %	-4.3	-3.3	-5.1	-3.9	-3.8	-3.8
Public debt / GDP, %	46.9	46.5	49.1	51.5	53.1	54.0
Current account balance / GDP, %	-1.2	-0.3	-0.9	-0.4	-0.6	-0.5
External debt / GDP, %	41.9	33.3	31.0	32.0	33.0	33.1
Forex reserves, USD bn	194.0	207.0	221.0	239.0	245.0	258.0
Forex reserves, in months of imports	4.8	4.1	4.3	4.5	4.2	4.1

TABLE 1

e: ESTIMATES & FORECASTS
SOURCE: BNP PARIBAS ECONOMIC RESEARCH

Informal employment weighs on consumption

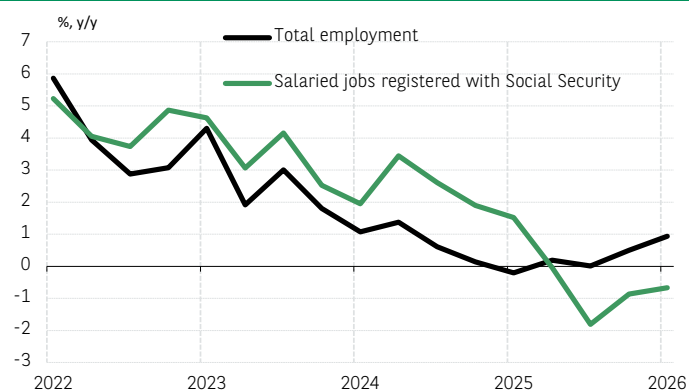


CHART 1

SOURCE: INEGI, ENOE

The performance of the automotive sector (25% of total manufacturing exports) has been mixed. Although vehicles complying with the USMCA's rules of origin continue to enjoy preferential access to the US market, they are now subject to a 25% tariff on their non-US content. This measure has weighed on automotive exports since the end of 2025 and throughout the first quarter of 2026. Data for April and May show a slight rebound, which may not prove to be sustainable.


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Conversely, non-automotive manufacturing exports have grown at a steady pace, reaching 43% y/y in May. In particular, exports of machinery and electrical and electronic equipment (HS headings 84 and 85), driven by strong US demand for these products, have been rising every month since the start of 2026 (33% y/y in May).

This trend cannot be interpreted as a sign of a genuine upmarket move by the Mexican manufacturing industry. Alongside exports, there has been a parallel rise in imports of these same product categories from Asia. Imports directly from China are moving towards stabilising, but imports from other Asian countries (South Korea, Malaysia, Taiwan and Vietnam, in the case of electrical and electronic machinery and equipment) have been growing rapidly since the start of 2025. This trend suggests that Mexico is still primarily positioned in the assembly segments of value chains, while the production of the most sophisticated components remains largely concentrated in Asia. It also points to a diversification of Asian suppliers.

REVIEW OF THE USMCA: THE ISSUES GO BEYOND THE SCOPE OF A TRADE AGREEMENT

1st July marked the official start of the USMCA's "joint review". The United States refused to confirm the automatic extension of the agreement, triggering a period of annual reviews and negotiations that could continue until 2036. The agreement will remain in full force during this period.

During the first official USMCA renegotiation meetings in late May, followed by a second round of talks in mid-June, discussions focused mainly on strengthening rules of origin, particularly in the automotive sector. The United States is proposing to add a requirement for a minimum proportion of content produced on its territory to the current 75% produced within the region. The negotiations also include stricter wage requirements, tariffs imposed on components sourced from outside the region and specific rules introduced for the steel and aluminium sectors. A third round of talks is scheduled for 20 July.

At the same time, critical minerals could be one of the key issues in this review. The aim would be to adapt an agreement designed to promote trade to an environment primarily grappling with the issues of economic security and the energy transition. Discussions are focusing on better coordination of trade policies, stronger rules of origin for products containing critical minerals (batteries and semiconductors), and common mechanisms to secure supplies. With this in mind, the agreement between the United States and Mexico, signed in February 2026, aiming to integrate critical minerals further into North American supply chains, appears to be an important step. If these provisions were incorporated into the USMCA, it would then go beyond the scope of a mere trade agreement to become closer to a genuine common industrial policy. Failing that, the proliferation of bilateral agreements could lead to a more fragmented and less effective framework for reducing North America's dependence on China.

THE EASING CYCLE IS NOW COMPLETE

In May, headline inflation slowed for the third consecutive month, to 3.9% y/y. For the first time since the start of 2026, the inflation rate has fallen below the 4% ceiling set by the Bank of Mexico. Price pressures continued to ease for food, drinks and tobacco.

Regionalisation of trade, but not of supplies

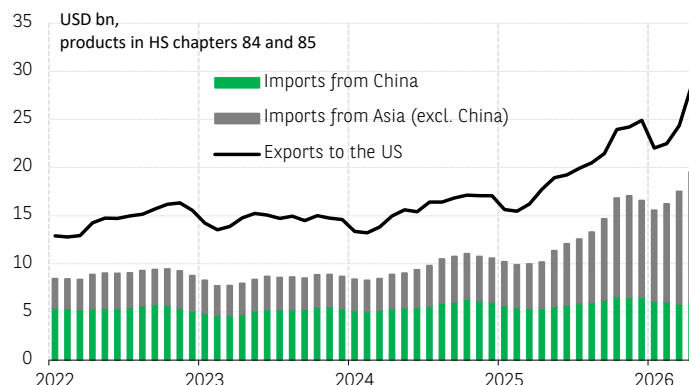


CHART 2

SOURCE: COMTRADE

Core inflation also decelerated in May, to 4.2% y/y. Base effects and upward pressures linked to the FIFA World Cup are preventing a faster slowdown in inflation.

Faced with the risks of second-round effects linked to energy prices and the possibility of a rate rise by the US Federal Reserve, the Bank of Mexico kept its benchmark rate at 6.5% on 25 June, indicating that it would be appropriate to maintain this level in the future.

PUBLIC FINANCES: DIFFICULT FISCAL CONSOLIDATION

Fiscal consolidation, a priority for President Sheinbaum since she took office in 2024, is making progress (3.9% of GDP in 2025, down from 5% in 2024), but the public deficit remains high. The government's overly optimistic growth assumptions, high interest payments (16% of GDP), inflexibility in current expenditure and continued support for Pemex (despite a slight improvement in its results, the company remains dependent on state support due to its high debt, low profitability and significant investment needs) are limiting the improvement in the fiscal situation. Furthermore, the president remains reluctant to implement a wide-ranging tax reform. According to the government, the rise in global energy prices is expected to have a broadly neutral impact on the budget, with higher oil revenues offsetting tax cuts aimed at stabilising prices for end consumers, the fall in production and budgetary transfers to Pemex. We expect the deficit in 2026 to be close to the level seen in 2025, at 3.8% of GDP. As a result, debt is continuing to rise, limiting the government's room for manoeuvre in the face of any new economic shocks.

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