Suspension of tariffs: is the USD/MXN breathing?

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- **Trump imposed tariffs of 25.0% on Mexico and Canada, although he postponed that measure after the efforts of these two countries to stop fentanyl trafficking and illegal immigration.**
- **Trump's protectionist trade policy would cause an immediate inflationary rebound in the US and a significant economic slowdown in Mexico in the medium term.**
- **Based on the suspension of tariffs, we anticipate a range for the USD/MXN exchange rate of $20.10 - $20.95, but possible rebounds to $21.46 in case of a reactivation of tariff policies.**

Announcement of tariffs and subsequent pause

Last Saturday, Donald Trump announced the imposition of tariffs of 25.0% on imports from Mexico and Canada as of February 4, derived from concerns related to fentanyl trafficking and illegal immigration. However, before they went into effect, **Trump decided to pause these measures for a month**, citing the efforts announced by Mexico and Canada. President Sheinbaum deployed 10,000 National Guard troops to the northern border, while Prime Minister Trudeau presented a $1.3 billion border plan. After this, the peso completely reversed the losses against the dollar and the exchange rate stabilized around $20.40 (compared to $21.28 reached the previous day).

Tariffs would have been catastrophic

We believe that the likelihood that the 25.0% tariffs on Mexico would be long-lasting was low, given the severe economic repercussions for both countries. **For the US**, the measure would have generated an **inflationary rebound**, since Mexico represents 15.4% of its total imports. This would have led the Fed to stop the cuts in its benchmark interest rate or even raise it, affecting the economic growth of that country. **For Mexico, in the short term, the impact would have been moderate**, as exports would have remained relatively stable. Since the U.S. cannot quickly substitute products manufactured in Mexico and considering the strong U.S. labor market, U.S. consumers may have absorbed some of the additional cost of the tariffs. However, as supply chains tightened and companies looked for alternatives to be more profitable, Mexican exports would be affected, causing a significant **economic slowdown in the medium and long term**.

Vision for USDMXN

Considering the movements observed before the announcement of a pause in tariff policies between the US and Mexico, as well as technical indicators, **we anticipate a period of lower volatility** for the exchange rate (USD/MXN), prior to knowing the decision on March 1. Prior to that date, we foresee a **fluctuation range between $20.10 and $20.95**, but we keep our attention on the development of economic figures in Mexico and the US, which may add volatility to the parity in the short term. Additionally, considering the possible reactivation of the 25.0% tariffs from the US to Mexico, we estimate a reaction from the markets higher than that registered with the announcement of February 1 (maximum depreciation of -2.95%), pointing to the resistances of $21.45 and $21.80. As long as an environment of uncertainty prevails in the short term, we expect the dollar to maintain an upward trend thanks to the strength against its main peers and the restrictive expectations of the Fed's monetary policy in 2025.

Trump effect on USD/MXN (01/31 to 02/03)

Source: Authors' elaboration with information from Refinitiv.

14.5% of the U.S. trade deficit is explained by Mexico.

Tariffs: Deterioration of Comparative Advantage

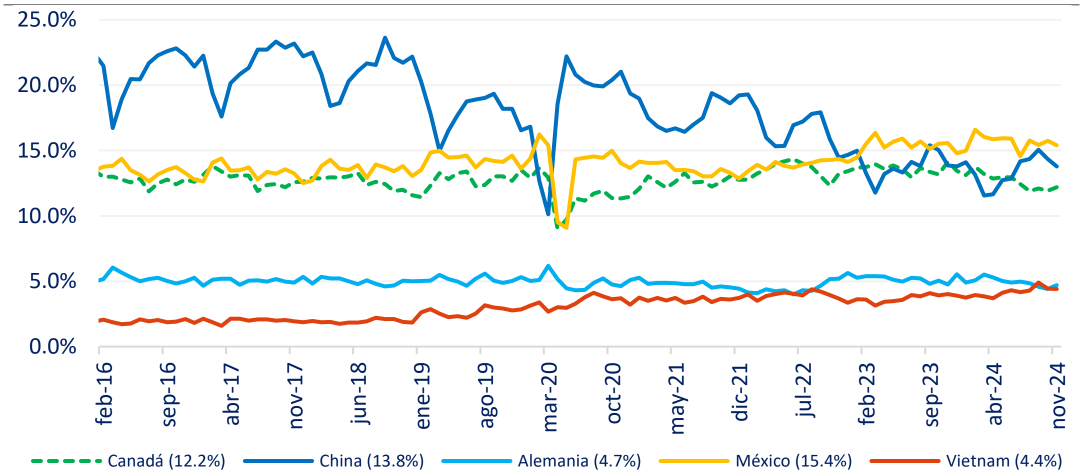
The imposition of new tariffs aligns with Trump's protectionist vision in his trade policy. Although the president justifies these measures to stimulate the economy through a stronger national industry, the results would have the **opposite effect**. The increase in import costs would directly impact essential inputs for U.S. manufacturing, especially in the automotive, technology and energy sectors, reducing the competitiveness of their companies. Since U.S. manufacturing production is not self-sufficient, due to a lack of industrial capacity, the vast majority of companies would be forced to continue importing from Mexico, at least in the short term, with no viable alternatives to replace such supply chains. In addition, possible retaliation from Mexico and Canada would have serious repercussions on the U.S. export sector, contributing to the economic deterioration of that country.

U.S. Trade Dependence

U.S. imports reflect the strong trade dependence it maintains with different regions of the world. Specifically, the Asia-Pacific region stands out due to the higher share (26.4%) in U.S. imports, driven mainly by trade with China, Japan and South Korea. Second, the Eurozone continues to play a key role in the supply of manufactured goods and high-tech products. However, by country, **Mexico is positioned as the main supplier of goods to the U.S. (15.4%),** consolidating its role in strategic industries such as automotive and advanced manufacturing. Despite maintaining a trade war, China remains the second-largest supplier of goods (13.8%), while Canada ranks third (12.2%), with a significant weight in the export of raw materials and energy products (considering figures from November 2024). In this context, it highlights the importance of the U.S. economic relationship with its strategic partners and the impact that any change in its tariff policy can generate at the global level.

With cumulative figures from January to November 2024, the U.S. trade deficit with Mexico grew 12.5% annually.

Total U.S. Imports (%) – November 2024



Source: Authors' elaboration with data from the *U.S. Bureau of Economic Analysis.*

USD Rally

In the short to medium term, we anticipate a strong dollar, driven by a combination of macroeconomic factors and the relative weakness of other currencies. From a trade perspective, reducing the U.S. trade deficit may strengthen demand for dollars, especially if retaliation fails to weigh the impact of the new tariffs. In addition, the global environment favors the American currency, as the Eurozone faces weak growth and political crises in its main economies, which keeps the euro under pressure; the pound is affected by political uncertainty and low economic dynamism in the United Kingdom; while the Canadian dollar suffers the blow of the new tariffs. The hegemony of the dollar and the high aversion to global risk could translate into a consolidation of its status as a refuge in the face of commercial uncertainty.

Of the total U.S. imports from Mexico, 33.5% come from the transportation equipment manufacturing sector.

In the last year, Mexico's sovereign risk, measured through the 5-year CDS, has increased 43.0%

USD/MXN volatility

The Mexican peso faces a scenario of high volatility and uncertainty after the announcement of the tariffs, with the USD/MXN reacting immediately to the strengthening of the dollar (2.5% rally) and the perception of greater risk in emerging markets. Despite the negotiations between Mexico and the United States, which paused tariff measures until March 1, the factor of the revision of the USMCA in 2026 persists, which adds uncertainty regarding the stability of the trade relationship with the United States and the controversy in some clauses of the agreement, on the imposition of tariffs. In addition, the increase in the risk premium is reflected in the rise in Mexico's CDS, signaling greater concerns about the sustainability of Mexican public finances in a context of less economic dynamism. Finally, there is a change in market sentiment, reflected in the recovery of speculative net long positions on the peso, in the Chicago market, which had shown a modest increase recently (5,224 contracts vs. -1,544 previously). Pending the imposition of the new tariffs, this trend could be reversed and would imply that net positions would become short (against), increasing the pressure on the exchange rate in the short term.

The Mexican peso closed 2024 with a cumulative depreciation of 22.3% against the dollar.

1 month Implied Volatility USD/MXN

Source: Authors' elaboration with information from Bloomberg.

Monex USD/MXN outlook

Considering the pause of U.S. tariffs on Mexico for a month, we estimate that there will be less volatility in the exchange rate during this period, although the environment of caution persists in the face of any sudden modification of the current agreement. In case **the current narrative** prevails between the two countries, we expect the parity to remain oscillating in a **range of $20.10 to $20.95**, similar to the behavior observed in the last 30 days, while the attention of the markets shifts to the publication of economic figures in Mexico and the US. However, as mentioned above, the strengthening of the dollar against its major counterparts could push the USD/MXN parity towards the immediate resistance of $21.00, limiting the gains of the Mexican peso. Pending the possible imposition of tariffs on March 1, **in case of maintaining 25.0% on Mexican imports**, we anticipate a reaction higher than initially observed (maximum depreciation of -2.95%) and a **first resistance at the level of $21.45, followed by $21.80** (Fibonacci retracement of 141.4% from January 17 to 24). with support at $21.25 (Feb. 2 high). In case both countries manage to maintain the necessary agreements to avoid a trade war, the local currency could be favored towards levels of $20.15 and later validate the 8-week low at $20.01, while responding to macro fundamental factors (interest rates, inflation and GDP).

By the end of 2025, we estimate an exchange rate of $21.00.

Domestic pressure in the US: a key factor for the tariff pause

Donald Trump's decision to temporarily suspend the 25.0% tariffs on imports from Mexico and Canada not only responded to the commitments announced by both countries in terms of border control, but also to strong internal pressure in the US. Various business sectors and legislators expressed their concern about the negative impact that these tariffs would have on the U.S. economy. 43 Democratic congressmen sent a letter to Trump, demanding the immediate suspension of the tariffs, arguing that they "*will devastate Americans already struggling with high prices, destroy jobs, and damage diplomatic relations* [with their closest partners]."

Likewise, the *U.S. Chamber of Commerce* sent a letter to the White House, urging it to reconsider the measure, stressing that such trade barriers "*will increase prices for American families*" and will not solve the problem of fentanyl and illegal immigration. Faced with this scenario of domestic opposition and the possibility of a slowdown in economic growth accompanied by an inflationary rebound, Trump opted to postpone the implementation of the tariffs, although uncertainty persists.

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