

Mexico's Energy Reform

Impact of Mexico's Deregulation and Liberalization of the Fuels Market

Mexico's Energy Reform paved the way to a liberalized market to ensure the adequate production and supply of fuel to meet future requirements. This report analyzes the Mexican fuels and vehicles market under these reforms, evaluating the structure of regulations, demand for fuel, fuel distribution system, retail infrastructure and the composition of the vehicles market. In addition, it provides valuable comparative analysis of similar structures within the United States and examines the nature of the energy relationship between the two nations.

FUEL MARKET REGULATIONS

The Energy Reform allowed private ventures to participate in many sectors of the fuels market that had previously been reserved for state-owned companies. To govern this new market, it revised the structure of its regulatory system vesting most authority within three bodies: the Energy Regulatory Commission's (CRE) main responsibility is to ensure competitive market conditions; the Security, Energy and Environment Agency (ASAE) oversees environmental and safety regulation and the Ministry of Energy (SENER) defines the overall energy policy and import and export permits. However, applicable regulations are often emitted and enforced by several regulatory bodies, complicating coordinated goals and compliance.

With specific respect to fuel regulations, Mexican fuel quality requirements are consistent with other nations since they were based on those from the U.S. and the European Union, except with regards to biofuels and sulfur controls. Fuel efficiency and emissions requirements can be compared to those in America and both countries have similar governing hierarchies. However, the United States creates its own regulatory priorities whereas Mexico has been strongly pushing the adherence to international treaties in terms of emissions and global warming and pushes local governments in its effort to combat toxic emissions from vehicles.

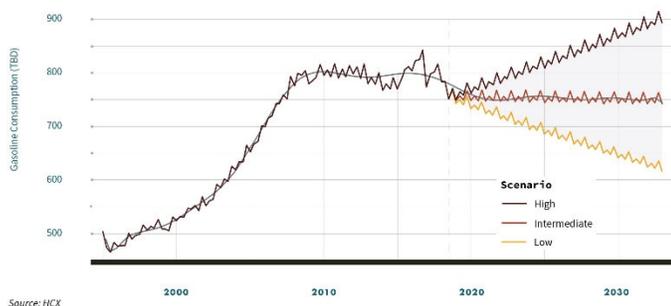
PRESENT AND FUTURE DEMAND FOR FUELS

Fuel imports remain the most important way to satisfy the demand for fuels, since refinery production is down nearly 50% in the past six years. Gasoline and diesel combine for 96.14% of fuel demand. The remaining is distributed among natural gas and propane. Fuel consumption in 2018 was 763 TBD for gasoline and 293 TBD for diesel. Shares by each fuel have remained almost constant in the 2008-2018 period. To project future demand, three scenarios were developed based upon average variables of the past ten year (intermediate scenario), then plus and minus 1%.

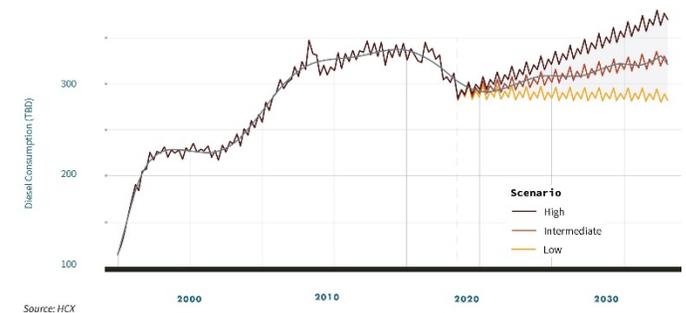
FUELS DISTRIBUTION INFRASTRUCTURE

Currently, the transport, storage, and distribution infrastructure facilities are primarily owned by PEMEX Logística, the Federal Commission of Electricity (CFE), and new storage and distribution facilities owned by private companies. As of October 2018, 62 storage projects have been announced in 22 states of the country, which will yield a 50% increase in current terminal capacity. These expansions, combined with CFE's project to release their storage infrastructure to improve the total capacity in Mexico, will allow Mexico to accomplish the minimum inventory objectives established for the year 2020, and the expansions are expected to continue growing as the market expands in the following years. On average, only 43% of the pipeline's operating capacity is used, although pipelines connecting the large metropolitan areas are used at full capacity. The gross storage capacity is enough to supply the demand for pipeline connected terminals.

GASOLINE CONSUMPTION (2018 - 2022)



DIESEL CONSUMPTION (2018 - 2022)



The main restriction for supply is the actual transport capacity for the interconnected pipeline system. SENER foresees the construction of a pair of pipelines that will allow the system to meet the current demand for fuel transport requirements with 30% of spare capacity available. No other major bottlenecks were found in the Mexican pipeline system. However, the system lacks redundancy and is vulnerable to operational failures.

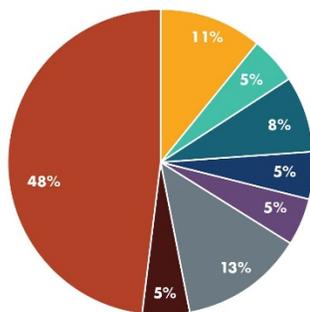
FUEL RETAIL STRUCTURE

Before the Reform, retail activities were one of the few businesses in the energy sector that allowed the participation of private companies, but they had to do so under the PEMEX franchise. As of January 1st, 2016, other brands were allowed to participate in the retail business. By the end of January 2019 there were 12,249 retail sites with permits granted by the CRE and 4,206 (34%) of them use brands different from PEMEX. Most of this growth is concentrated in retail stations that were already operating and decided to move to other franchises.

A main goal of the Energy Reform was to push for the development of a competitive retail structure, increasing the number of service stations and the quality of their service by allowing new competitors with new schemes to enter the market. But the high cost of entry for new competitors, often related to local permitting expenses, have limited the growth of new sites with operators choosing to rebrand instead. This has not created competitive pressures to keep prices down, prompting the government to contemplate additional measures to force competition.

Customer interaction with the fuel retailer remains a priority for the market. While there is no prohibition on self-service, it likely would be unsuccessful as the customer is used to being served without leaving their vehicle. Furthermore, floor personnel give the impression of security, which is a significant factor for clients in Mexico.

SHARE OF RETAIL BRANDS IN MEXICO



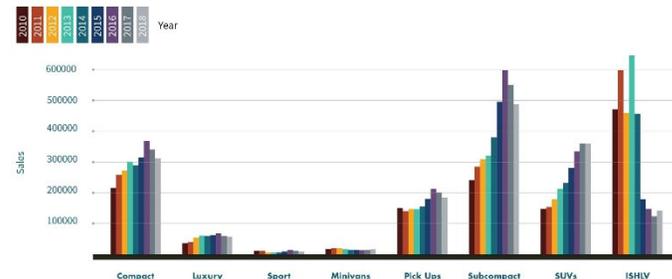
Source: HCX with information from the CRE

DISTRIBUTION OF THE MEXICAN VEHICLE FLEET

The Mexican vehicle fleet grows at a 6.2% average rate and light vehicles are the most common type, representing 68% of the fleet. There are 45,476,133 vehicles circulating in Mexico. The National Auto Parts Industry (INA) estimates that there are 25,559,116 vehicles purchased directly through distributors in Mexico, the rest through other venues. Compact and subcompact vehicles occupy nearly 60% of the current market of vehicles in Mexico with an average growth rate of 5.21%, a trend that's been maintained over the last 13 years. This contrasts with American sales structure, where SUVs occupy the top spot. Used car imports (ISHLV) saw sales drop significantly beginning in 2014. This may be a result of less competitive prices due to a more expensive dollar (most used imported car purchases are of American origin) and tighter controls regarding the quality of these vehicles.

In 2018, slightly more than 1.424 million vehicles were sold in Mexico, compared to a total of 1.535 million vehicles sold in 2017. The average age of vehicles purchased directly through distributors in Mexico is 12.5 years. When including secondhand vehicles purchased mainly from the U.S. and Canada, the average age of the fleet increases to approximately 17 years. This represents a serious problem for the environment since these vehicles have higher emission levels and a large part of them are considered scrap in their country of origin. The average fleet turnover rate is 16.64 years.

SALES OF VEHICLE TYPE (2010 - 2017)



Source: HCX with information from PEMEX and SENER

About the Fuels Institute

Founded by NACS in 2013, the Fuels Institute is a nonprofit tax-exempt social welfare organization under section 501(c)(4) of the Internal Revenue Code. We are dedicated to evaluating issues affecting the vehicles and fuels markets. We commission comprehensive, fact-based research projects that are designed to answer questions, not advocate a specific outcome. Our reports address the interests of industry stakeholders—from business owners making long-term investment decisions to policymakers considering legislation and regulations that affect these markets.

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