

SMARTER PERSPECTIVE: TARIFFS

Navigating the New Reality: US-Mexico Trade Relations and the Road to the 2026 USMCA Review

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February 2026—With the mandatory USMCA review just five months away, we are reexamining the tariff tensions between the United States and Mexico and asking the critical question: were these measures a permanent shift in trade policy, or a negotiating tactic designed to achieve larger outcomes.

The relationship between the United States and Mexico continues to be deeply intertwined, both economically and politically. Mexico remains the United States' largest trading partner, and the country has solidified its position as the world's leading exporter of auto parts and vehicles. Yet this interdependence now operates within a fundamentally altered landscape. One characterized by selective tariff enforcement, ongoing legal challenges, and intensive preparations for what promises to be a consequential renegotiation of the trade framework that governs North American commerce.

What Has Changed

A year ago in the spring of 2025, the Trump administration announced multiple tariff measures targeting Mexican imports, yet few had been fully implemented. Much of the rhetoric was being used to foster cooperation on immigration and fentanyl enforcement while positioning the U.S. government to negotiate new features in the USMCA.

The most significant development has been the emergence of a two-tier system for Mexican exports. Goods that comply

with USMCA rules of origin continue to enter the United States duty-free, while non-compliant goods face a 25% tariff. According to data from the Penn Wharton Budget Model, this has triggered a dramatic shift in importer behavior: as of October 2025, approximately 89% of imports from Mexico now claim USMCA tariff exemption, up from roughly 50% before the tariff regime took effect. This surge reflects importers aggressively restructuring their supply chains and documentation to secure duty-free status.¹

However, certain sectors have not been spared. Steel and aluminum imports from Mexico face a 50% tariff following an increase in June 2025—a measure that contributed to a 60% decline in Mexican steel exports to the United States in April of that year.² The automotive sector, which sits at the heart of the US-Mexico trade relationship, operates under particularly complex rules that merit careful examination.

The Automotive Sector

For businesses involved in the automotive industry, including those we serve at Hilco Global Mexico, understanding the current tariff structure is essential. The sector exemplifies both the challenges and the vitality of the evolving trade relationship.

Under current rules, automobiles and auto parts face a 25% tariff, but this applies only to the non-U.S. content of vehicles assembled in Mexico.³ For manufacturers with high domestic content, this provides

meaningful relief. However, the complexity of calculating regional value content, combined with ongoing disputes over interpretation of the rules, has created significant uncertainty for automakers and their suppliers.

This uncertainty is compounded by unresolved tensions stemming from a January 2023 USMCA arbitration panel decision regarding how "core parts" factor into a vehicle's regional content calculation. The United States lost that case, with Mexico and Canada successfully arguing for more flexible interpretation of the rules. According to the Congressional Research Service, some U.S. stakeholders, particularly labor groups, have expressed concerns that the ruling undermines efforts to strengthen the domestic auto industry.⁴ This dispute is widely expected to resurface during the 2026 review.

Between January and July 2025, U.S. imports of trucks, buses, and specialty vehicles totaled \$32.41 billion, with Mexico as the leading exporter at \$25.86 billion, though this represented a 13.8% year-over-year decline.² The data underscores both Mexico's continued dominance in the sector and the real impact that tariff uncertainty has had on trade volumes.

Looking ahead, the automotive rules of origin will almost certainly be a central focus of the USMCA renegotiation. U.S. Trade Representative Jamieson Greer has indicated that the administration seeks to tighten rules of origin not only for

automobiles but across industrial goods more broadly. According to Greer's report to Congress, "strengthening rules of origin for industrial goods is necessary to ensure that the benefits of trade in these products flow substantially to the Parties."⁵

For automotive manufacturers and their supply chain partners, this identifies a clear direction: the pressure to demonstrate genuine North American content will intensify, and businesses that cannot meet stricter requirements may find themselves on the wrong side of tariff impacts.

The China Factor

The true driver behind many of these policy moves appears to be the broader U.S. strategy to shield North America from China's economic influence.

Chinese investment in Mexico has continued to grow, with estimates ranging widely from \$3 billion to over \$20 billion, according to the Baker Institute at Rice University. More significantly, Chinese car companies now account for approximately 30% of new car sales in Mexico—a figure that U.S. officials are monitoring closely. The influx of highly subsidized Chinese vehicles, including models manufactured by BYD and other state-backed enterprises, has put pressure on established automakers assembling smaller, less expensive cars in Mexico, such as Volkswagen, Kia, and Nissan.⁶

This dynamic is reshaping the USMCA discussion. The Center for Strategic and International Studies (CSIS) notes that a "critical focus of the 2026 USMCA review will likely involve the 'China question'—that is, how North America should respond to the perceived challenges posed by China's growing role in regional supply chains." U.S. officials have clearly signaled their intent to use the review to bring Mexico's and Canada's policies on China more in line with Washington's approach.⁷

Proposals under discussion include new restrictions on Chinese investment in North American supply chains, provisions to exclude components made by certain state-linked entities, and potential disqualification of vehicles with significant

Chinese content from USMCA benefits. Senators Dave McCormick and Catherine Cortez Masto have introduced legislation directing USTR to prioritize protecting USMCA from investment by the People's Republic of China during the 2026 review.⁸

Fentanyl trafficking and precursor flows have become intertwined with U.S. trade and security concerns, heightening pressure on both Mexico and China ahead of the 2026 USMCA review. While synthetic opioids remained the leading driver of drug overdose deaths in the U.S. for years, recent provisional CDC data show a historic decline: drug overdose deaths dropped nearly 24% in the 12 months ending September 2024 compared with the prior year, with provisional counts around 76,500 deaths in the year ending April 2025, down from a peak of roughly 110,000 in 2022.⁹ Law enforcement and policy analysis consistently describe a two-country supply chain in which Chinese chemical manufacturers and brokers supply most precursor chemicals, while Mexican transnational criminal organizations produce and traffic finished fentanyl into the United States. Recent moves by China to tighten export controls on key precursor chemicals underscore how control of cross-border supply chains has shifted into geopolitics and trade policy, and why fentanyl enforcement underpins some of the tariff rhetoric and policy leverage being wielded in USMCA negotiations.

For businesses evaluating investment decisions or supply chain strategies, the message is clear: the scrutiny of Chinese-linked content in North American manufacturing is likely to intensify significantly in the coming years.

The Legal Landscape

Adding another layer of complexity to the trade environment is a fundamental legal question now before the U.S. Supreme Court: does the President have the authority to impose broad tariffs under the International Emergency Economic Powers Act (IEEPA)?

On May 28, 2025, the U.S. Court of International Trade unanimously declared that the IEEPA tariffs, including both the

"fentanyl" tariffs targeting Canada, Mexico, and China, and the broader "reciprocal" tariffs, exceed presidential authority and are therefore unlawful. The court held that IEEPA's grant of power to "regulate" imports does not include unlimited authority to impose tariffs of this scope.¹⁰

The U.S. Court of Appeals for the Federal Circuit affirmed this ruling on August 29, 2025, finding that the tariffs "exceed any authority granted to the President by IEEPA to regulate importation."¹⁰ However, the court allowed the administration to appeal to the Supreme Court, meaning the tariffs remain in effect while litigation continues.

The Supreme Court heard oral arguments on November 5, 2025, and a decision is widely expected by mid-2026. According to analysis from Squire Patton Boggs and other trade law specialists, the outcome could have profound implications.¹¹ If the Court strikes down the IEEPA tariffs, importers who have paid duties may be entitled to refunds, estimates suggest \$75-85 billion has been collected from China and \$17-25 billion combined from Mexico and Canada under the challenged measures.¹²

More broadly, the decision will shape the extent of executive authority over trade policy for years to come. Businesses should monitor this case closely and, as the Court of International Trade advised in December 2025, preserve detailed payment records to protect potential refund rights.¹¹

The USMCA Review: What Businesses Need to Know

By July 1, 2026, the United States, Mexico, and Canada must complete the first mandatory joint review of the USMCA under Article 34.7. The parties will then face three options: extend the agreement for another 6 years as-is, approve a revised agreement, or decline to extend—which would trigger a 10-year countdown to the agreement's expiration in 2036.¹³

The United States will almost certainly not agree to extend the agreement without modifications. As White & Case has observed, "the Trump administration will



likely withhold US renewal approval to compel a partial renegotiation of certain commitments through the joint review."¹⁴ The volume of public input underscores the significance of the moment: according to Wipfli, the U.S. Trade Representative received over 1,500 written comments and 170 hearing requests during its consultation period—forcing the agency to expand its public hearings from one day to three.¹⁵

Key issues likely to dominate the negotiations include:

Rules of Origin: The United States is expected to push for higher regional content thresholds across multiple sectors, not just automotive. The goal is to ensure that USMCA benefits flow primarily to North American producers rather than companies using Mexico as a platform to access the U.S. market with goods substantially manufactured elsewhere. Labor Enforcement: U.S. negotiators will likely seek to expand the Rapid Response Labor Mechanism and strengthen enforcement of minimum wage provisions in Mexico.

Digital Trade and Data: Provisions governing cross-border data flows and digital services may be revisited, particularly in light of Canada's now-repealed digital services tax.

Dispute Resolution: The United States may seek to strengthen dispute settlement mechanisms, an area we highlighted in our March 2025 analysis as potentially beneficial for U.S. investors.

Non-Tariff Barriers: The July 2025 tariff suspension was conditioned on Mexico eliminating non-tariff barriers affecting

U.S. products, including regulatory delays, pesticide bans, restrictions in the energy and lithium sectors, and telecom monopolies.

Mexico, for its part, has adopted what White & Case describes as a "defensive strategy, seeking to preserve market access and reassure investors."¹⁴ President Claudia Sheinbaum has placed defense of the USMCA at the top of her foreign trade agenda, and Finance Minister Marcelo Ebrard has indicated that Mexico seeks a review that "proceeds as quickly as possible, as smoothly as possible."¹⁷

Canada's recently departed Ambassador to the United States, Kirsten Hillman, acknowledged the uncertainty inherent in the process. "It's very difficult to predict," she told *The Globe and Mail* in late January 2026. "This is the first time that we're using this review process. And so there's no history to go on, to know exactly how that's going to run."¹⁸

Mexico's Economic Position

Despite the challenges, Mexico's economy has demonstrated greater resilience than many forecasters anticipated. The International Monetary Fund projected in April 2025 that Mexico would experience a recession, with GDP contracting by 0.3%. The Organisation for Economic Co-operation and Development forecast an even deeper 1.3% decline.¹⁹

In reality, according to the Dallas Federal Reserve, Mexico's economy grew 1.8% during the first half of 2025, surprising analysts who had anticipated contraction. Much of this growth was driven by exporters front-running anticipated tariffs, leading to a temporary surge in shipments.

However, the outlook for the second half of 2025 and into 2026 remains subdued, with consensus forecasts pointing to weak growth as government spending cuts, declining remittances, and persistent trade uncertainty weigh on activity.²⁰

The OECD projects GDP growth of just 0.4% in 2025, recovering modestly to 1.1% in 2026.²¹ BBVA Research forecasts a contraction of 0.4% in 2025 followed by a 1.2% recovery.²² While these projections vary, they share a common theme: Mexico faces a prolonged period of below-potential growth, with the trajectory heavily dependent on the outcome of trade negotiations.

For businesses operating in Mexico, this environment demands careful attention to both macroeconomic conditions and sector-specific dynamics. The surge in USMCA compliance has provided meaningful protection for many exporters, but manufacturers in exposed sectors, particularly those with significant non-North American content in their supply chains, face continued pressure.

Looking Ahead: A Framework for Decision-Making

As the U.S. and Mexico move toward the July 2026 review, businesses must distinguish between political rhetoric and substantive policy shifts. Based on developments over the past year, we offer the following framework:

High Probability of Permanence:

- USMCA tariff exemption for compliant goods (this has been consistently maintained and is foundational to the trade relationship)
- Steel and aluminum tariffs at elevated

- levels (50% rate has been sustained without exemption)
- Automotive tariffs on non-U.S. content (firmly in place, with tightening likely)
 - Stricter rules of origin requirements (bipartisan support; central to U.S. negotiating position)

Moderate Probability:

- USMCA extended with modifications by mid-2026 (most likely outcome, but timing uncertain)
- Supreme Court invalidation of IEEPA tariffs (lower courts unanimous, but outcome not guaranteed)
- New restrictions on Chinese-linked investment and content (strong political momentum, implementation details unclear)

Lower Probability:

- Blanket 25-30% tariffs on all Mexican goods (repeatedly threatened but not implemented; USMCA exemption has held)
- USMCA withdrawal or expiration (economically devastating for all parties; strong business opposition)

Conclusion

The US-Mexico trade relationship has entered a new phase—one characterized not by the wholesale tariff disruption some feared, but by selective pressure, economic realignment, and intensive preparation for what will be the most consequential trade negotiation in North America since the original USMCA talks.

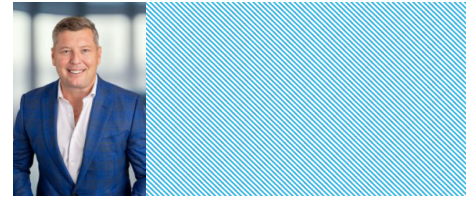
For businesses with operations in Mexico or exposure to cross-border supply chains, the imperative is clear: ensure USMCA compliance, monitor rules of origin requirements closely, assess supply chain exposure to non-North American content, and prepare for a regulatory environment that will likely demand greater transparency and documentation.

The automotive sector, which forms the backbone of US-Mexico trade, will be at the center of these negotiations. Companies that proactively adapt their supply chains, strengthen their compliance infrastructure, and engage with the policy process will be best positioned to navigate the landscape that emerges from the 2026 review.

At Hilco Global Mexico, we continue to monitor these developments closely and stand ready to assist businesses in understanding their exposure, evaluating strategic options, and managing the complexities of operating in this evolving environment. The challenges are significant, but so too are the opportunities for those who approach this moment with clear eyes and sound preparation. We encourage you to reach out to our team to discuss this evolving situation and any questions or concerns you may have about your business or a business in your portfolio. We are here to help.

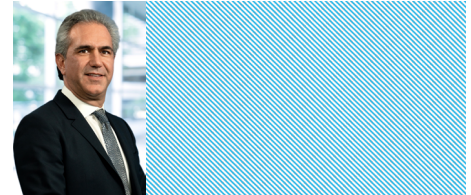
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