Mexico: Good Macro News; Difficult External Conditions; Bad Micro News

The Trillion Dollar Club
Gary C. Hufbauer and Barbara R. Kotschwar
March 10, 2009
Mexico in the Trillion Dollar Club: PPP GDP (in billions of international dollars)

Source: IMF
Mexico: a decade of sound macro policy

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<tr>
<td>Non-financial public sector balance (% GDP)</td>
<td>-1.2</td>
<td>-1.1</td>
<td>-0.1</td>
<td>0.0</td>
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<td>Current account balance (% GDP)</td>
<td>-3.8</td>
<td>-3.1</td>
<td>-0.7</td>
<td>-2.2</td>
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<td>Inflation (% change y/y)</td>
<td>18.6</td>
<td>9.9</td>
<td>3.3</td>
<td>6.5</td>
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<td>External debt (% GDP)</td>
<td>38.2</td>
<td>28.3</td>
<td>20.4</td>
<td>20.6</td>
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Source: IMF
Mexico has accumulated foreign exchange reserves

Source: Banco de México
Mexico’s potentially rosy economic picture is clouded by the external environment....

Index of Industrial Production 1995-2008 (2000=100)

Source: OECD

Mexico is still closely tied to the US economy
Mexico’s potentially rosy economic picture is clouded by the external environment (cont.)

We are being conservative with our growth projections: EIU estimates a contraction of 2.6%; Banxico of -0.8 to -1.8 percent growth
In late 2008 US imports of Mexican goods started falling, as did Mexico’s purchases of US goods.

Source: USITC
Mexico’s stock market plunged 42 percent in 2008


Change = 42%

Source: Banco de México
Foreign investment has not dried up, but slowed in 2008

Source: Banco de México
Remittances have begun to decline…

Source: Banco de México
Remittances depend on the economic health of a few key US states

**Remittances** are most important to agricultural states. Border states have traditionally been economically strong enough to not send many migrants. This could be affected by the US economic slowdown in states like California, Texas, New York.

Like nearly all emerging markets, the spread on Mexican debt has risen sharply; good fundamentals were no salvation.

*Source: Dallas Fed*
Mexico is absorbing the external shock by allowing the peso to drop.

Source: Banco de México

40 percent devaluation of peso since October 2008; nearly 50 percent since January 2008
Meanwhile, the microeconomic challenges are getting more severe

- Mexico has fallen in its ranking on Transparency International’s Corruption Perceptions index from 51st place in 2001 to 72nd place in 2008
- In the World Economic Forum Global Competitiveness Report Mexico ranked 102 in Public Institutions, behind Pakistan
- Mexico fell from 42nd in the 2008 Doing Business ranking to 56th in 2009
- Mexico fell from 16th in 2005 to 19th place in 2007-8 in AT Kearney’s FDI confidence index
Between January 1, 2007 and December 19, 2008 there were 7,337 drug war deaths in Mexico. The circles portray areas where more than 100 deaths were reported.

Source: LA Times, based on data from the University of San Diego Trans-border Institute
**Whither US policy towards Mexico?**

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Source: CRS (2008); Bailey (2009)

Source: ONDCP
Mexico: resilient so far

- Despite violence, tourism picked up in 2008
  - While overall tourism was up, certain regions, such as Guerrero, show a falling off in travel both from domestic and international travelers
- FDI has continued to flow in, even to regions associated with violence
- Remittances have dropped off but not dried up
- These are statistics to watch in 2009
Mexico: international tourists 2004-2007
(monthly totals)

Source: Secretaría de Turismo
Mexico: US FDI flows into northern border states 2004-2008 (flows by trimester)

Source: Secretaría de Economía
Mexico’s response to the crisis

- Monetary response: Banco de México has intervened to mitigate peso volatility

- Fiscal stimulus:
  - Oct 2008: *Growth and Employment Stimulus Program (PICE)* of $6.9B, about 1% of GDP – largely for use on infrastructure spending
    - In 2008 Mexico hedged oil price at $70/barrel
    - Fiscal reform measures of 2007 should see increased tax collection
  - Jan 2009: *National Agreement on Family Economy and Employment*: $150m to freeze gas prices, lower electricity prices, boost unemployment benefits and increase spending on infrastructure
Like nearly all emerging markets, the spread on Mexican debt has risen sharply; good fundamentals were no salvation.
Mexico is absorbing the external shock by allowing the peso to drop

Peso/dollar exchange rate: October 2008-March 2009

40 percent devaluation of peso since October 2008; nearly 50 percent since January 2008

Source: Banco de México
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Canada’s response to the crisis

- Canada has revised its GDP growth projection down to a contraction of 2.7 percent.
- Canada’s fiscal stimulus (Economic Action Plan) represents 1.9 percent of GDP for the next fiscal year; 1.4 percent for the following year.
- Projected budget deficit of $34 billion this year (2.0 percent GDP); $30 next (1.7 percent of GDP)
What has the US done to help Mexico cope with the financial crisis?

- Federal Reserve: US$30 billion line of credit with the Banco de México, authorized through April 30, 2009, to support confidence
- Mérida Initiative
- NAFTA lives (but trucking still frozen; NADBank still small potatoes)
- Stimulus package: modest expenditure on border infrastructure