

THE MEXICAN ECONOMY IN  
THE INTERNATIONAL CRISIS

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## INTRODUCTION

*"The Mexican government, Mexican companies and the Mexican banking system are not dependent on foreign credit, and consequently the volatility is not spreading directly to our markets."*

*Statement by Mexican Treasury Secretary Agustín Carstens, during a visit to Washington (September 29, 2008)*

### **A 'tsunami' expected at pawn shops**

*So far in 2008, one out of every four families, on the average, has conducted a transaction at the Nacional Monte de Piedad (National Pawn Shop). However, this charitable institution anticipates that 2009 will bring a 'tsunami' of people arriving at its doors, with some valuable object to pawn. The institution assured it has the capacity to attend to a greater number of families, and added that it will finish up this year with a total of 22 million transactions. It grants loans in amounts ranging from 30 pesos up to thousands of pesos.*

*The majority of those taking out loans are from low-income sectors, and pawn primarily jewelry and watches, but also artwork and cars.*

*(El Universal, December 2008).*

The term *crisis* is used commonly to refer not only to difficulties experienced, but also to opportunities. Derived from the Greek *krisis* (decision), it is understood, therefore, that a crucial moment implies the possibility of making decisions that will put an end to inertia.

It seems that breaking through inertia is a necessary step in response to the disastrous situation for major companies, the principal States and the predominant theories of recent decades. In the case of Mexico, the current situation is not simply a reproduction of the crises of 1976, 1982, 1987 and 1994, since it is not accompanied by major devaluations and rampant inflation. However, this does not make it any less serious. The current crisis is essentially impacting employment, the sustainability of micro and small companies, working conditions in the economic apparatus overall (including workers in major corporations), State finances, social security and the possibilities for refuge for international economic refugees seeking work, and it leads to increased polarization in the concentration of wealth.

With regard to the term *recession*, the most frequently used concept indicates that this phenomenon occurs when the economy has suffered a drop in production for at least two consecutive quarter compared to the same period the previous year. In the United States this was not the case at the

end of 2007 or the beginning of 2008, but it was nearly so. Without more detailed calculations, we can say that the US economy was technically not in a recession, but at a growth rate of 0.6 percent it was at the point of crossing over. In fact technical discussion began at that time on whether or not the US economy had indeed entered into a recession. In November 2008, on the basis of an econometric model that included financial, production and employment variables, the National Bureau of Economic Research (NBER) retrospectively made the official declaration that the United States had been in a recession since the beginning of 2008.<sup>1</sup>

In Mexico, up until the beginning of the current government administration, it was thought that the major national achievement was having established macroeconomic stability, expressed in considerable reductions in inflation, exchange rate instability, fiscal deficit and foreign deficit. It was said up to the beginning of 2008 that Mexico was economically protected against crises (given the major accumulation of monetary reserves in foreign currency) and that actions causing a fiscal deficit (expressed as populist spending) or any effort toward a more active State role would constitute a threat to the country.

At the beginning of 2009 a recession has not yet been declared in Mexico. In fact, economic deceleration is evident, although some growth was registered in the GDP for the first three quarters of 2008, with 2.6 percent, 2.7 percent and 1.6 percent respectively.<sup>2</sup> Nevertheless, the situation is very tenuous, as observable in a number of indicators, including consumer confidence indexes, manufacturing sector performance, the global economic activity indicator (a monthly proxy for the GDP), prices, decreased ability to pay credit card debt, stock market performance, the foreign deficit and loss of jobs. In other words, if we look to a broader understanding of the concept of recession – as utilized in the declaration of a recession in the United States – we might also perceive a recession occurring in Mexico.

In terms of changes in public policies, we are hardly seeing any discourse in business sectors in 2009 that questions generating public deficit in order to rescue private businesses. Nor did we see in 2008 any group having significant economic or political power questioning the auctioning of foreign currency by the Bank of Mexico or the resulting loss of international reserves and "financial strength." Inflation was more than 50 percent higher than expected (6.5 percent versus 3.8 percent). The foreign deficit increased substantially and this tendency will continue with increased velocity in 2009.

In monetary matters, pressures related to parity may increase, with a combination of foreign and domestic impacts. From a perspective of the "real exchange rate," equilibrium

parity in the balance of payments should be less than 13 pesos to the US-Dollar. Nevertheless, given the need for foreign currency on the part of Mexican business corporations with debts in dollars, the slight rise in inflation and the considerable drop in oil revenue, when the current "price insurance" expires (at 70 US-Dollars a barrel) and as production continues to fall due to dwindling oil fields, we can expect serious difficulties overall in the exchange rate toward the end of 2009.

In summary, the situation for Mexico in 2009 is expected to be particularly negative: the Gross Domestic Product will drop; there will be less secure employment; inflation will continue to be elevated; income distribution will deteriorate; remittances from migrants will diminish; both fiscal and foreign financial equilibrium will collapse; international reserves will diminish; and the peso will become weaker as Mexico faces abrupt changes in the international scene.

In this article we will briefly outline some thoughts on the economic and political effects in Mexico from the crisis, Mexico's positioning in this regard, and the possible consequences for Mexico from a new international financial architecture.

## I. IMPACT OF THE CRISIS ON MEXICO

The current crisis has brought varying effects for different social classes, regions and sectors of economic activity. It is difficult to compare the current situation with previous crises, since it is neither a sudden, generalized circumstance of a macro-devaluation of the national currency. Political impacts will also be different, since this is the first major crisis in a context not characterized by single-party hegemonic control over executive and legislative public powers, nor is there a clear dominance of any one party at the state and municipal government levels.

### Economic Impact

The Mexican economy is more dependent on the US economy than any other economy in the world: more than 80 percent of Mexico's exports go to the United States; most imports and foreign investment come from the United States; the technology used in Mexico comes primarily from the United States; the US-Dollar is used to indicate value and is the currency used in the major investments in Mexico. Given these conditions, it is impossible for Mexico to maintain any distance from the situation in the United States.

We can expect the crisis especially to lead to a decline in the country's production and in some of its components (private consumption, investment and exports). The drop in production will lead directly to a drop in formal employment and in greater competition in the labor market – which will facilitate

an increase in more volatile and precarious working conditions. This situation will be aggravated by the decreased possibilities for employment for Mexican migrant workers in the United States – which will diminish the exodus to that country and lead to the eventual return of Mexican workers who migrated there in previous years.

The balance of payments will be especially impacted by the reduction in exports provoked by the drop in oil prices (especially when the export price insurance, contracted by the Mexican Treasury Ministry, expires), by the decrease in remittances from Mexican migrants working in the United States, and by the reduction in traditional exports, primarily from maquiladoras.

With regard to inflation, it may possibly be less than in 2008, however prices will continue to increase, due to the peso's depreciation and Mexico's continued high interest rates – which will impact production costs and the capacity of Mexican credit card holders to make payments on their credit card debt.

Lastly, in terms of exchange rate parity, risks arise from three factors: i) an increased deficit in the current account in the balance of payments; ii) dwindling oil fields and the drop in oil prices; iii) Mexican private companies' difficulties in paying their foreign loans, and, consequently, the use of national reserves of foreign currency to assist these companies.

Together, these circumstances have already led to the deterioration of a set of macroeconomic indicators:

- Projections for growth in the Mexican economy during 2009 range between a 0.3 percent growth in the GDP and a negative 1.8 percent rate, as announced by the Bank of Mexico in January 2008.
- The Global Economic Activity Indicator (*Indicador Global de Actividad Económica* – IGAE), a monthly proxy for the GDP, indicated a level for October 2008. That is 0.9 percent below the rate recorded for October 2007.
- At the end of 2008 the Consumer Confidence Index was at the lowest level recorded since 2001, the year this index was first calculated. In fact, it is 22.1 percent lower than the level recorded in August 2007.
- Since September 2007, all the monthly variations in the index of personnel employed in the manufacturing sector have seen negative numbers. In October 2008, this index dropped to 2.8 percent of the rate recorded in the same month of 2007 – which was, in turn, 0.7 percent below the rate for that month in 2006. Real average remunerations for an hour of work are also below the levels for the previous year, and are, in fact, 7.1 percent below the levels for 1993 – the reference year for INEGI information.

- The annual inflation goal established by Mexico's Central Bank (Bank of Mexico) is a range of 3 to 4 percent. However, the inflation rate for 2008 was 6.5 percent – with effects that varied greatly according to the income level. The increase in prices was 5.97 percent for economic levels with an income above six minimum wages, while it was 8.1 percent for households with incomes of less than three minimum wages (the minimum wage in Mexico is equivalent to approximately 83 euros per month).
- In these circumstances, the Bank of Mexico has maintained a policy of high interest rates, with the aim of making the country attractive for foreign investment (primarily US investment) in the money market. The interest rate for 28-day Treasury Certificates (reference rate) was maintained at levels between 7 and 8 percent during 2008, with an annual rate of 8 percent at the year's end. Especially worth mentioning here is the focus on obtaining real positive returns in relation to inflation, unlike the policy applied in the United States.
- The exchange rate depreciated about 18.3 percent in 2008, from 11.03 pesos to the US-Dollar at the end of 1997 (cash exchange rate) to 13.05 pesos to the US-Dollar at the end of 2008. It is important to mention here that as of the end of January 2009, the exchange rate had reached 14.25 pesos to the US-Dollar, signifying a depreciation of 9.2 percent with respect to the end of 2008, or an accumulated depreciation of 29.2 percent since the end of 2007.
- The trade balance deteriorated by 67 percent, with the trade deficit increasing from US \$10.074 billion in 2007 to US \$16.838 billion in 2008.
- Effects on the stock market have been as serious as those in the United States. On October 18, 2007 the IPC price index for the Mexican Stock Market reached a record of 32,851 points. A year later, on October 27, 2008, the IPC had dropped to 16,481 points, representing a 50 percent loss in stock market value. Nevertheless, a strong recuperation was obtained in the Mexican Stock Market after that, with a peak of 23,482 points on January 5, 2009 – representing an overall recuperation of 28.5 percent in relation to the October 27, 2008 level. Still, extremely volatile conditions have continued, and by January 26, the IPC had already once again lost 15.8 percent of its value, with respect to its October 27, 2008 level.

In summary, increasing deterioration is characterizing the real economic sphere and the equilibriums previously achieved in the financial sphere have been lost. These results will likely lead to a considerable increase in poverty and more intense polarization in income distribution in the near future.

### Likely Political Consequences

The crisis has arrived during a period characterized by a very serious breakdown in the Mexican society. This time it is not a matter of considering the impacts of the economic crisis in the context of a society functioning under a certain set of social norms, but we must look at the repercussions in a society in which profound insecurity has become a daily reality. This insecurity is expressed in drug trafficking, disputes between drug cartels, assaults, kidnappings and murders, the repeated infiltration of illegal activities (especially drug trafficking) among public authorities and especially those in charge of combating public insecurity – and in general the violence that has become part of everyday life. In Mexico the intensity of the international economic crisis has arrived in already dangerous terrain.

These conditions weaken a political system and all of its institutions. The credibility of police officers, legislators and political parties is constantly deteriorating – diminishing the possibilities for generating an operational strategy capable of effectively reorienting the functioning of economic and political systems towards the objectives of efficiency, sustainability, fairness and justice.

In 2009 Mexico will hold federal elections for National Congressional seats, as well as state and municipal-level elections. The most likely scenario will consist of especially high voter abstention, and a re-composition of political forces in the National Congress in favor of the Institutional Revolutionary Party (*Partido Revolucionario Institucional* – PRI). The PRI, which lost presidential elections in 2000, had governed the country as a *political party* since 1929. At this time there is no evidence that the PRI has undergone a significant renovation process. Its eventual electoral success will reflect the social disenchantment created by the lack of socially and economically favorable results from the two federal administrations led by the National Action Party (*Partido Acción Nacional* – PAN), and the chaos reigning in the various leftist and center-leftist alternatives, deriving from internal disputes for power, especially within the Party of the Democratic Revolution (*Partido de la Revolución Democrática* – PRD).

The political impact of the economic crisis is not only to be limited to electoral matters and the distribution of power among political parties. We must also consider the increasing lack of confidence in politics, in the capabilities and political will of elected representatives and officials to take the decisions that will actually make it possible to maintain social cohesion and to achieve at least an acceptable level of economic functioning.

With this panorama there are increasing risks of an intensification of all types of illegal activities, but primarily drug trafficking, human trafficking to the United States, and trafficking of weapons, stolen merchandise, biodiversity, archeological treasures, human organs, etc. In addition, the increasing ostentatious expression of extreme wealth reveals social polarization and reflects a high concentration of income (the Gini index on current household income is approximately 0.5), intensifying the perceptions of injustice in an already critical context.

Given the lack of social cohesion and the lack of acknowledgement of norms and institutions, economic deterioration may lead to the search for more risky, desperate individual and collective solutions. Consequently, an urgent task is to establish mechanisms for re-legitimizing public powers.

## II. MEXICO'S POSITIONING IN RESPONSE TO THE CRISIS: POSSIBLE POSTURES IN RELATION TO G-20

Public information regarding Mexico's posture in response to the crisis has been focused on domestic anti-crisis measures. It is not clear whether Mexico has a clear policy indicating the posture it will assume in international forums organized to re-design international financial architecture.

### Domestic Anti-Crisis Policies

In terms of domestic strategies, five basic lines of action are being pursued:

- Assistance for employment and workers: Expanding the government's temporary employment program; establishing an assistance program for companies in order to prevent layoffs (through assistance related to workers' payroll); allowing workers to withdraw larger amounts of money from their pension funds; extending the period of medical coverage through Social Security for workers who have lost their jobs to six months, and expanding financing for the National Employment Service (training and job pools).
- Assistance to families freezing gasoline prices (previously subject to weekly increases); reducing prices for propane gas by 10 percent; generating a program for converting electric home appliances with the aim of saving energy; and increasing the public budget for granting loans to buy homes.
- Assistance for competitiveness: Reducing the price of electricity; promoting government purchases from small and medium-sized supplier companies; providing more technical assistance to micro, small and medium-sized companies; creating more loans for companies; and promoting the acquisition of locally-produced goods.

- Investment in infrastructure to enhance competitiveness and provide employment: increasing the budget for general construction of federal infrastructure, for investment in the national Pemex oil company and for state-level investment; granting loans to assist companies in the construction of their own facilities.
- Transparent, efficient and timely public spending: enhancing the transparency and speed with which public expenditures are made; and maintaining the government budget without spending in cuts, despite the drop in oil prices, given the contract for exchange rate coverage negotiated by the federal government.

These lines of action indicate decisions that are positive in a number of aspects, however they do not necessarily correspond to an anti-crisis strategy, since they should occur independently of crises. For example, responsible public spending should take place with or without a crisis.

Also, those who question these measures point to a resulting increase in the fiscal deficit, with costs estimated at 90 billion pesos (approximately five billion Euros). Mexico's Treasury Ministry states, nevertheless, that there will be no deficit, because of the oil surplus, successful fiscal revenue raising in 2008, and savings in administrative spending in the public sector.

Thirdly, the measures may actually be conflictive and their pertinence questionable. Expanding mechanisms for small companies to access credit, in the context of a reduced demand, may imply a process that increases debt, but does not generate more sales, given the narrowing market and decreased taxes on imports (to avoid an increase in inflation). In addition there is some uncertainty as to whether the majority of small companies will be able to benefit from the government purchases program in the current context. Also, if an important aspect of employment policy is to strengthen workers' training, with a focus on enhancing human capital, this implies adapting workers' skills to the needs expressed by the demand. It is necessary to question the possible results from this focus in a context in which the demand for labor is drastically declining.

Nevertheless, the decisions to increase government purchases from small companies and to support productive programs are positive. As well, placing a freeze on fuel prices and reducing electricity prices will help to stop inflation.

### International Positioning

Although Mexico has been invited to participate in the G20 meetings, a clear discussion or presentation of what is or should be Mexico's position in international debates is not

evident in the public information available. In any case, we can predict that the Mexican government will align its posture with that maintained by its officials and former officials holding positions of authority in important international entities, such as the OECD, headed by José Ángel Gurría, former Mexican Treasury Secretary, and the Bank for International Settlements, headed by Guillermo Ortíz, current Bank of Mexico president.

The postures consistently assumed by both Gurría and Ortíz endorse active policies for promoting the market and for restrictive, autonomous monetary policy. In this sense the Bank of Mexico's posture has been contrary to that maintained by the US Federal Reserve, especially with regard to interest rates. We can expect the Mexican government to call for greater control over currency issuance and over the handling of the public deficit, and to criticize international debt overhang. In other words we can expect a demand for the implementation of restrictive monetary policies in industrialized countries, similar to those implemented in many debtor countries after the economic crises of the 1980s and 1990s. This would limit policies that favor financial bailouts and promote consumer spending by lowering interest rates – policies that have been those prevailing in recent months.

In terms of fiscal policy we can expect a posture of relative facilitation of the use of public credit for investment purposes, as long as there is oversight by international entities, such as the World Bank or the Inter-American Development Bank (IADB), and as long as the debtor State has the capacity for repayment. In this framework, we will see a posture that continues to promote a public sector role in providing incentive for private investment.

In any case it is very unlikely that the Mexican government will present a posture that differs significantly from the predominance of liberal policies favoring the market or that involves a radical transformation of current principles. We can expect, however, a demand for greater coherence between the public policies implemented in industrialized countries and those demanded of emerging economies by international institutions.

### **III. POSSIBLE REPERCUSSIONS FOR MEXICO FROM THE NEW INTERNATIONAL FINANCIAL ARCHITECTURE AND FROM NEW PUBLIC POLICIES IN THE UNITED STATES**

Given the uncertainty prevailing at the international level with regard to the foreseeable financial losses for major financial and industrial corporations, and the sources of financing for resolving fiscal deficits at the international level, it is still too early to have sufficient clarity regarding the basic principles of what will be the new international finan-

cial architecture – to replace the outmoded Bretton Woods agreements – and regarding the new role (strengthened or diminished?) of the international financial institutions derived from Bretton Woods (specifically, the International Monetary Fund and World Bank). At any rate the specific agreements reached will lead to some particular repercussions for the various economic actors in Mexico.

Whatever the case, we can expect more mechanisms for financial regulation at the microeconomic level, both for financial and industrial corporations. The regulatory impact on these corporations will directly impact Mexico, given the extent to which the Mexican financial system is transnationalized. For example, only one of Mexico's major banks has mostly national capital. The resulting impact may have the negative effect of making the operations of these institutions more discreet, reducing their role in dynamizing the economy, but it will also have a positive effect of providing incentives for more stable, less risky financial intermediation processes.

Another potential negative effect may be a further weakening of the peso in relation to currencies other than the US-Dollar, given the peso's strict dependence on the US-Dollar. Practically all of Mexico's reserves are in US dollars, and thus, if the monetary system is recomposed in favor of other currencies or instruments, this will affect Mexico in a similar way as the US-Dollar will be affected.

Nevertheless, a series of positive effects can also be expected if public policies are restructured as a result of the current crisis:

- The narrowing of the foreign market may represent an opportunity to reconsider the importance of the domestic market and the importance of production aimed at satisfying local needs.
- The fact that the crisis is especially notable in the United States may pressure Mexico to diversify its orientation towards international markets, placing more importance on its economic and social relations with Latin America, Europe, Pacific Asia, and eventually, the rest of the world.
- The possible renegotiation of NAFTA, especially in terms of its parallel labor and environmental agreements, may cause a considerable reduction in depredatory foreign investment – or in other words, the type of investment made in Mexico with the aim of avoiding compliance with the essential social and labor rights of workers or with restrictions on environmental deterioration. On the contrary, Mexico may become more attractive for investment that is associated with long-term processes, with more worker involvement in the life of the company, with more productive chaining and more respect for the environment.

- In terms of international migration, a reduction in the exodus of Mexicans to the United States may signify a decline in remittances, but it may also bring the possibility of establishing a policy for reactivating Mexico's agricultural sector, with a focus on satisfying domestic market needs. In order for this to be feasible, a deliberate policy is needed in this regard.
- The current crisis reveals the limitations of market liberalization policies that lack any counterbalancing force and that maintain increasingly lax regulations. Consequently, the crisis makes it necessary to seek unorthodox alternatives, articulated with available domestic resources and with solutions that are appropriate for national circumstances, and at the same time, articulated in line with increasingly interdependent international dynamics.

#### IV. CONCLUSION

The international crisis is causing a severe impact in Mexico – a country where there were already worrisome conditions in terms of the economy, the environment, social cohesion and public security. Consequently, the crisis may contribute to increased political disenchantment among the population.

There are some new measures for confronting the crisis, in line with the main international strategies, however they may have only limited potential. It appears that the Mexican government does not have any proposals for international debate that would involve significant changes in international standards, but rather will only insist that industrialized countries also comply with these standards.

A new international financial architecture will bring varying effects for Mexico, however we may expect that those predominating will be medium and long-term positive effects.

- 1| *According to the National Bureau of Economic Research (NBER), a recession implies a significant drop in economic activity that lasts longer than only a few months and affects employment, personal income, industrial production and manufacturing and retail sales (taken from CNN Expansión, January 8, 2008).*
- 2| INEGI: <http://dgcnesy.inegi.org.mx/cgi-win/bdieintsi.exe/NIVA050010004000700230#ARBOL>.