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The full impact of the peso devaluation on the Mexican economy became apparent in mid-January. Among other things, the government reported high consumer price inflation during the first half of the month, plus a sharp downturn in retail sales and other economic activity. The Banco de Mexico (central bank) reported that inflation during the first half of January (Jan. 1-15) reached 2.3%, representing a huge jump compared with December, when monthly inflation climbed by 0.9%. In fact, the inflation rate for the entire fourth quarter of 1994 had only totalled 2.3%. The jump in consumer prices is of particular concern to the Zedillo administration, since the government had forged an anti-inflation agreement with businesses and labor in early January, which included a limit on the price of consumer products and on salary increases (see SourceMex, 01/04/95). Additionally, the administration had taken other steps to control inflation, such as cracking down on illegal price increases and subsidizing sales of corn to millers in order to keep the price of tortillas from rising.

The Banco de Mexico report, released on Jan. 24, said price increases were highest during the first half of January for such basic goods as milk and eggs, fruit, meat, and medicine, as well as rents, wines and spirits, air and bus fares, gasoline, cars, and newspapers. Although some increases in prices had been anticipated, the actual extent of inflation was not known before the Banco de Mexico report on Jan. 24. In fact, on Jan. 19, Fernando Lerdo de Tejada, head of Mexico's consumer protection agency (Procuraduria Federal del Consumidor, PROFECO), had optimistically reported that prices for most products increased by a smaller rate than originally anticipated during the first half of the month. In the announcement, Lerdo de Tejada praised self-service supermarkets, which he said had resisted increases on domestic products and only raised prices on imported items. Given the rate reported by the Banco de Mexico for early January, however, many analysts now project consumer price inflation this year will be much higher than the Zedillo administration's latest projection of 19%.

Indeed, inflation would have to average about 0.7% for the remaining 15-day periods the rest of the year to achieve the government's 19% target. And, even if the government achieved 19% inflation, it would still represent a huge jump compared with 1994, when the consumer price index only increased by 7%. While the inflation rate remains a strong concern, an equally strong worry is a slowdown now evident in the Mexican economy. The economy has been hard hit by the increased costs of imports, and by the reduction in purchasing power of consumers, who are not expected to keep up with the rise in prices this year. As a result, consumers will generally not be able to afford increases in interest rates, greatly restricting the use of consumer credit. On Jan. 16, the Confederation of Sales Executives (Confederacion de Ejectivos de Venta) reported that sales of basic products between late December and mid-January were down about 10% at the retail level because of the devaluation. Miguel Angel Nogueira, president of the organization, said increased prices had

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also resulted in sharp reductions in sales of such products as cement, steel, and pharmaceutical goods. Additionally, he noted the devaluation had also reduced sales of luxury items by 45%.

At the same time, the devaluation has resulted in a sharp drop in sales for merchants in US cities near the US-Mexico border. According to some estimates, sales along the border have dropped by an average of 20% or more since mid-December. In downtown El Paso, Texas, a local merchants' association reports sales have dropped by 30% to 40% since late December.

"Unless the exchange rate becomes more stable, we will be facing very hard times in the next several months," said Paul Lazovick, a businessman in downtown El Paso. Charles Haltman, general manager at a J.C. Penney store in El Paso, also told the official news agency Notimex that a large number of clients from Mexico have canceled layaway purchases and have asked for a return of their deposits. On the other hand, however, sales have picked up in Mexican cities near the US-Mexico border, where retailers have reported an increase in shoppers from the US side who are taking advantage of the strengthened purchasing power of the US dollar to achieve bargain prices in Mexico.

The devaluation has also attracted an increase in Guatemalan shoppers to Mexico. According to Guatemala's Economy Minister Eduardo Gonzalez, during a one-week period in early January customs authorities along the land borders with Guatemala confiscated the equivalent of US $15,000 in clothing, cigarettes, and other contraband products illegally entering Guatemala from Mexico. Customs authorities also reported an increase in legal purchases by Guatemalan citizens of such items as fuel, soap, basic grains, and other foodstuffs. In addition to the impact on the retail sector, the devaluation appears to be taking a toll on large industrial sectors. During January, three other automobile manufacturers Ford, Nissan, and Mercedes Benz announced plans to suspend operations at assembly plants in Mexico during January, in anticipation of reduced consumer demand. In all three cases, the automobile manufacturers explained the closure as necessary to reduce production and keep inventories from growing. Consumer demand for automobiles has begun to plunge because of high interest rates, increased costs of production due to higher costs for imports and a reduction in consumer purchasing power.

Earlier this month, Volkswagen announced a one-week suspension of its operations at the plant in Puebla, for the same reasons as the three other manufacturers (see SourceMex, 01/18/95). Mercedes Benz suspended operations for virtually the entire month of January, while Ford and Nissan have announced the shutdown of operations for the last full week of January. The Ford plant is located in Hermosillo (Sonora state), while the Nissan operations are located in Cuernavaca (Morelos state) and Aguascalientes. The devaluation has also forced Ford to reduce operations at a plant in Wayne, Michigan, which produces Ford Escorts and Mercury Tracers for shipment to the Mexican market. Nissan officials initially told Agence France-Presse they were optimistic about a potential recovery in demand and that no layoffs were anticipated. "We believe that demand will recover once the peso becomes more stable," a Nissan official told Agence France-Presse. However, on Jan. 23, Nissan Mexicana announced intentions to lay off about 1,000 workers and reduce production during 1995 to 180,000 units from the originally planned 210,000 vehicles. According to Debra Sanchez Fair, a spokeswoman for Nissan in the US, the anti-inflation agreement reached among the Zedillo administration, labor, and business also had a bearing on the Nissan decision to reduce operations. Sanchez Fair claims that a Mexican supplier of parts used by Nissan is demanding a higher price

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for its products than spelled out by the anti-inflation pact. Nissan is refusing to pay the higher price, which has resulted in a shortage of parts and affected assembly operations. The reduced domestic demand for automobiles in Mexico is expected to continue to affect operations of domestic automobile manufacturers, who will either have to adjust their operations to increase exports or reduce output.

According to industry statistics, Mexico's automobile industry exports on average about 36% of its total production. The export advantage created by a cheaper peso in the end may not be that much of an advantage. According to the Journal of Commerce, there are strong concerns among trade executives that Mexican exports will not increase by the same rate as the projected decline in imports, which should still leave Mexico with a relatively high trade deficit this year. In the emergency economic measures announced by Zedillo at the beginning of January, the President said he was hoping to cut the trade and current account deficits to US$14 billion in 1995, compared with US$28 billion during 1994 (see SourceMex, 01/04/95 and 01/11/95). The newspaper said these concerns are supported by recent trends in the shipping industry, where cargo companies report an increase in cancellations of shipments scheduled for Mexican ports, but have not reported a similar rise in bookings for export shipments. In general, Mexican ports handle more imports than exports, which in the long run could reduce business for shipping lines such as Transportes Maritimos Mexicanos (TMM). On the other hand, according to the Journal of Commerce, the one area where shippers could expect increases are in shipments of bulk commodities and agricultural products, as well as minerals, which are produced primarily for export.

Mexican coffee industry officials told the government news agency Notimex that the devaluation of the peso, combined with a reduction in global stocks of coffee, will contribute to a recovery in the coffee sector. Isaac Rodriguez Hernandez, president of the Oaxaca state coffee council, told the official news agency Notimex that roughly 70% of the coffee beans grown in Mexico are exported. He said the new prospects for the coffee industry should boost production in 1995 beyond the 700,000 100-pound coffee bags produced in 1994. (Sources: Journal of Commerce, 01/09/95; La Jornada, 01/08/95, 01/11/95; Inter Press Service, 01/13/95; El Financiero International, 01/16/95; Notimex, 01/16/95, 01/19/95, 01/20/95; El Financiero, 01/20/95; Associated Press, 01/20/95, 01/22/95, 01/23/95; Houston Post, 01/23/95; Agence France-Presse, 01/17/95, 01/20/95, 01/24/94; Reuter, 01/24/95)

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