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On Feb. 21, President Ernesto Zedillo's administration, facing heavy pressure from the US, agreed to a set of fundamental economic reforms that focus on curbing inflation. The measures, however, threaten to throw Mexico into a severe recession, further straining the government's already uneasy relationship with the business sector. The agreement with the US over economic reforms was reached after five days of difficult and intense negotiations between Mexican Finance Secretary Guillermo Ortiz Martinez and US Treasury Secretary Robert Rubin. The accord forms part of the conditions attached to the package of US$20 billion in loan guarantees that the US promised to provide for Mexico to help weather the economic crisis caused by the devaluation of the peso.

The US loan guarantees are a basic component of a US$50 billion international rescue package for the Mexican economy announced in late January (see SourceMex, 02/01/95). The package also includes US$10 billion in loan guarantees from the European-based Bank of International Settlements (BIS) and US$20 billion from the International Monetary Fund (IMF). US President Bill Clinton's administration, along with the BIS and the IMF, have demanded that Mexico take steps to restore confidence to private investors by propping up the peso and curbing inflation, which reached a whopping 3.8% in January (see other article in this issue of SourceMex). As part of the agreement announced on Feb. 21, the US is demanding that the Zedillo administration run a budget surplus of 0.5% during 1995.

The government must also expedite the privatization of remaining state-run enterprises, and it must modify state monetary policy by charging interest rates above the rate of inflation in order to sop up excess liquidity from the economy. In fact, the day before the agreement was announced the Banco de Mexico had already ordered an increase in short-term interest rates to 50%, representing a jump of 10 percentage points. The sharp increase in interest rates, in turn, should attract more foreign investors into Mexican government bonds (Tesobonos) and certificates (Cetes). Ironically, an overdependence on this type of soft investment under former president Carlos Salinas de Gortari's administration was cited as one of the major causes of the devaluation of the peso in late December (see SourceMex, 01/04/95). Meanwhile, even if the measures reinforce confidence among foreign investors, the higher interest rates could cause a severe recession in Mexico.

According to private economists, many companies will not be able to afford to stay in business and will have to either cease operations or sharply curtail operations, causing a huge increase in the already high jobless rate. Economists warn that a severe recession, in turn, could encourage further social unrest in Mexico, increase illegal immigration to the US, and further undermine President Zedillo's already weak political position. In fact, other clauses contained in the Feb. 21 agreement are likely to aggravate social tensions even more, such as the Zedillo administration's agreement to deposit a portion of the country's earnings from crude oil exports in the US Federal Reserve as collateral for the loan guarantees. Mexican officials, for their part, acknowledge they are concerned

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about the threat of a recession this year, but said the tough economic measures were justified to prevent a much more difficult economic situation in the long term. "The conditions Mexico is facing are very difficult," said a top aide to Finance Secretary Ortiz. "But there is no other way out." Beyond the threat of a recession, many business executives in Mexico are disenchanted with what they perceive as a lack of economic leadership on the part of Zedillo.

During January and February, leaders of a number of business organizations called special press conferences to highlight the President's short-sighted economic policies. A prime example was a press conference in Mexico City on Feb. 8 in which the leaders of the clothing industry chamber (Camara Nacional de la Industria del Vestido, CNIV) and a marketing executives organization (Confederacion Mexicana de Ejecutivos de Venta) met with reporters to demand that Zedillo present a coherent and very specific economic plan by the end of the first quarter to deal with the impact of the devaluation. In his statement, CNIV director David Maauad suggested that a major problem appeared to be a glaring lack of coordination among the various cabinet departments that deal with economic policy.

Similar statements were made throughout the month by national and local leaders of such organizations as the manufacturer's business chamber (Camara Nacional de la Industria de Transformacion, Canacintra) and the powerful business coordinating council (Consejo Coordinador Empresarial, CCE). In many instances, the business leaders warned that serious problems could surface beyond the lack of funds for day-to-day operations. One leader in San Luis Potosi state noted that the loss of earnings due to the devaluation may prevent many businesses from making normal contributions to social security and retirement programs for workers.

In addition to high interest rates, another strong criticism levied against Zedillo is the President's decision to allow the peso to float relative to the US dollar rather than designating a fixed level. This has been a special concern for companies involved in the export-import business, since the recent wide swings in the value of the peso have created difficulties for many to set prices or formalize contracts for imports of raw materials. Some organizations, frustrated by the Zedillo administration's lack of concrete economic growth strategy, have threatened to take matters into their own hands. For example, the Monterrey chapter of Canacintra which represents manufacturing companies in the northern industrial state of Nuevo Leon has told the government that its members will withhold payment of taxes on payrolls and income unless the government soon produces a very specific recovery plan.

Another very public action was taken by Jalisco-based conglomerate Grupo Sidek, which on Feb. 15 announced plans to suspend payments on US$19.5 million in debt to domestic and international banks. The action by Sidek a highly successful company with ventures in steel production, tourism, and real estate created strong concerns that other Mexican firms would also default on their loans, which would have a negative effect on both the Mexican and the US economies. According to some estimates, at least 100 large companies in Mexico are facing difficulties in meeting short-term obligations totaling US$18 billion. "This is the tip of the iceberg. What can you expect after a company like Sidek, which is a good company, declares suspension of payments?" an analyst at the Mexican Stock Exchange (BMV) told the Associated Press on Feb. 15, after the market's main index (Indice de Precios de Cotizacion, IPC) declined by about 6.4%. Indeed, the Sidek situation had

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a ripple effect on the market during that session, causing declines in bank stocks such as Banacci (Banamex's holding company), which fell 14% in value that day.

The Sidek situation was short-lived, however, since company executives on Feb. 17 announced that the conglomerate has suspended the decision to withhold payments on its loans after reaching a separate restructuring agreement with banks. As part of the announcement, Sidek said the company had made a payment of US$29.5 million on its Eurocommercial debt that week. On the other hand, Sidek's decision to resume payments created concern that the company may indeed cut back operations, including layoffs, to make up for a lack of revenues from real estate sales, which provide the bulk of the company's short-term cash flow. The real estate market is especially vulnerable to high interest rates. Analyst Carlos Laboy, a Latin American specialist for the New York-based financial company Bear Stearns, suggested the Sidek action represented a warning to the Zedillo administration to establish a more coherent monetary policy.

The devaluation has forced many large companies to make other difficult business decisions. For example, in early February, Grupo Alfa announced plans to reduce its participation in a US$1 billion joint venture with the US company AT&T to bid for long-distance concessions. The Mexican government is scheduled to open the long-distance market to competition by the beginning of 1997. Alfa officials said the company is seeking other businesses in Mexico to join in the partnership, although Alfa would like to remain the lead partner on the Mexican side. In other adverse business developments, giant enterprises such as Televisa have already eliminated some jobs. Televisa has also suspended previous plans to expand this year, and it will sell off "non-essential operations."

Similarly, construction and engineering companies, which thrived in the late 1980's and early 1990's because of ex- president Salinas de Gortari's programs to expand infrastructure, have now been forced to downsize their operations and even reduce their workforces. For example, industry giant Grupo ICA in the last several weeks has laid off about 11,000 workers out of a total workforce of 32,000. One of the greatest problems faced by engineering and construction companies is the increasing cost of raw materials, many of which must be imported. According to the construction industry chamber (CNIC), costs have risen by 40% for steel, 60% for copper tubing, and 50% for electrical conductors as a result of the devaluation. Construction and engineering companies will also be affected by President Zedillo's commitment to reduce government spending in order to appease the US and multilateral financial institutions. Indeed, in early February, the Communications and Transportation Secretariat (SCT) lowered its projection of highway construction for this year to 3,000 kilometers, from the originally planned 6,000 km., because of the devaluation.

Automobile manufacturers are also greatly affected by the devaluation because they rely in varying degrees on imported parts, the cost of which has greatly increased. For example, Volkswagen officials report that 70% of the materials used in the assembly of the Jetta and Golf models are imported, forcing the company to reduce production of those units. The company uses a greater domestic content for the Volkswagen Beetle and other models, and therefore does not face the same increase in production costs for those cars. Still, Volkswagen and other automobile companies are facing a significant slowdown in domestic sales of all models of cars due to the reduced purchasing power of consumers.

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To compensate for slow sales, at least four of the five major automobile companies operating in Mexico have announced a temporary suspension of operations to prevent a buildup of inventory. Volkswagen, which already suspended production for two weeks in January because of the devaluation, has scheduled two other work stoppages during the first and last weeks of March, to compensate for slow sales and prevent a buildup of inventories. During these two periods, the 1,000 employees of Volkswagen, located mostly at the company's assembly plant in Puebla, will receive one-half of their normal salary. For its part, General Motors in early February announced both a salary increase and a temporary suspension of operations. Union sources said they were able to negotiate a salary increase of 8%, plus benefits equivalent to a hike of another 6.5%. The company, however, plans five separate work stoppages between February and May to compensate for a slowdown in domestic sales caused by the devaluation, although the company did not specify the exact dates for the suspension of operations.

Similarly, bus and truck manufacturer Grupo Dina early this month announced plans to suspend operations for a total of 60 days this year. Company officials said the 60-day suspension could be shortened if market conditions improve. On the other hand, if conditions worsen, the company is also considering the possibility of eliminating some jobs. Meanwhile, on a brighter note, a handful of enterprises that established a foothold in the export market may be able to weather the impact of the devaluation due to increased revenues from sales to overseas customers. For example, the giant cement manufacturer Cemex recently announced plans to export 1.2 million metric tons of cement to Asian markets during 1995. Shipments of another 600,000 MT to that region are possible, especially since demand for cement is strong due to rebuilding of the earthquake-devastated city of Kobe, Japan.

Additionally, in early February the Chihuahua-based tile manufacturer Interceramic inaugurated a new plant in Chihuahua, which will export about 40% of its production to the US and Central America. Moreover, the plant will manufacture a style of tile normally imported from Europe, thus eliminating import costs, which have risen due to the devaluation. A handful of companies have managed to muffle the impact of the devaluation in other ways. For example, Grupo Maseca resisted seeking dollar-denominated loans to expand operations in Mexico. Maseca director Angel Garcia Padilla told the daily newspaper La Jornada that the only loans acquired in dollars were for expansion of foreign operations, such as tortilla factories in the US. (Sources: Proceso, 01/09/95; Notimex, 02/06/95; La Jornada, 02/06/95, 02/08/95, 02/09; Inter Press Service, 02/07/95, 02/08/95; El Financiero International, 01/30/95, 02/06/95, 02/13/95; Agence France- Presse, 02/13/95, 02/15/95; Reuter, 02/15/95, 02/17/94; Deutsche Press Agentur, Inter Press Service, United Press International, 02/16/95; Notimex, 02/06/95, 02/16/95, 02/19/95; Reforma, 02/21/95; Associated Press, 02/16/95, 02/17/95, 02/21/95, 02/22/95; New York Times, 02/16/95, 02/20/95, 02/22/95)

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