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Government Releases Surprisingly Small GDP Decline for First Quarter 1995

by LADB Staff

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In mid-May, the Finance Secretariat (SHCP) reported a surprisingly small decline of 0.6% in Mexico's GDP for January-March, raising concerns that the report does not reflect the true extent of the impact of the devaluation of the peso and the resulting economic crisis. Indeed, in early March President Ernesto Zedillo's administration had projected a GDP decline of 1.1% for the first quarter.

More recent estimates by private economists projected declines of 2% to 2.8% for the first quarter. Many of these private forecasts were released a few days before the SHCP announced the GDP figures for the first quarter. For example, Grupo Vector, in a report issued in mid-May, said the extremely poor performance of Mexico's retail and manufacturing sectors during January-March left economists no choice but to forecast a significant drop in GDP for the first quarter of the year. Vector projected a decline of 2.8%. Similarly, in mid-May Grupo Financiero Bancomer (GFB) also issued a report estimating a decline of 2% or more in Mexico's GDP in the first quarter of the year. GFB said the performance of the Mexican economy in first quarter was particularly affected by a lack of liquidity, high interest rates, and a sharp drop in public spending, all recessive factors. The GFB report said these factors combined with low wages, a reduction in the workforce, and a heavy increase in private debt to "create a significant drop in consumption and investment," which will extend throughout the year.

Meantime, according to several economists, the smaller- than-expected decline reported by the SHCP may be more the result of the government's record-keeping methods than any underlying strength in the economy. For example, analyst Gray Newman of the Mexico City-based brokerage company Interacciones told Reuter that the government's practice of comparing GDP statistics relative to the same period a year ago, rather than to the previous quarter, appeared to have some bearing on the surprisingly small decline of 0.6%. In January-March of 1994, the SHCP reported a relatively small rise of 0.7% in the country's GDP. Furthermore, Gray and other analysts noted that momentum from the fourth quarter of 1994 appeared to spill over into January. "You can't turn off an economy overnight like a television set," he said.

Finance Secretary Guillermo Ortiz himself admitted that the statistics for GDP in the first quarter of this year may present a misleading picture of the Mexican economy. He predicted that SHCP reports for the second and third quarters will show a sharp decline in the country's economy. "I think unemployment and economic contraction will get worse before they get better, which will have negative social consequences," said Ortiz, in a speech in mid-May to the Center for Strategic and International Studies (CSIS), a Washington-based think tank. Ortiz told the CSIS audience that the greatest challenge for the Zedillo administration in the coming months will be to expand a "social safety net" to prevent unemployment from getting out of hand and to foster conditions for a gradual economic recovery towards the end of the year. Ortiz did not mention a specific forecast for the second and third quarters, nor did he say whether the Zedillo administration was prepared to revise downward its earlier forecast for a 3.9% decline in GDP for the April-June quarter of this year.

In forecasts issued earlier this year, the Zedillo administration had projected a decline of 2% in GDP for this year, with a sharp recovery at the end of the year helping offset some of the negative growth in the second and third quarters. In contrast, Mexico reported a GDP growth of 3.5% in 1994. In forecasts issued shortly after Zedillo took office, the government had originally forecast GDP growth of 4% this year, but was forced to revise that projection after the peso devaluation in late December, which resulted in a sharp increase in inflation and a drastic rise in interest rates. Many economists now expect the government to eventually issue a revision for the overall decline of 2% for this year, possibly even a drastic reduction. For example, the economic analysis organization Centro de Estudios Economicos del Sector Privado (CEESP), has projected a GDP decline of 5.6% for the entire year, along with an inflation rate of 52% (compared with the government's latest official forecast of 42%). "The nature and severity of the fiscal and monetary policies adopted by the government will continue to abruptly contract economic activity," said the study.

The CEESP said the country's economic decline during most of this year will result in the continuation of such negative trends as increased unemployment, restricted purchasing power, and a decline in the productivity and financial stability of many companies. Other financial analysis companies have projected smaller declines, although still much larger than the 2% drop forecast by the administration. For example, Grupo Serfin in mid-May forecast a GDP contraction of 4.8% this year, while Ciemex- WEFA in early May put Mexico's GDP decline for 1995 at 4.1%. Both forecasts cited sharp declines in the manufacturing and retailing sector as reasons for their forecasts. Meantime, the 0.6% decline in GDP reported by the SHCP for the January-March period was the first for those three months since 1987.

According to the SHCP report, the decline was led by the textile and construction sectors, which reported contractions of 10.2% and 7.3%, respectively. A sharp decline of 4% was also reported in the retail sector, which includes restaurant sales. On the other hand, the SHCP said that the sharp declines in these sectors was almost offset by gains in other areas that are export oriented, such as basic metals which surged 10.1% because of a sharp rise in steel and iron sales to overseas customers and a 6.3% rise in the energy sector, which includes petroleum. The SHCP also reported 2% growth in the agriculture and fisheries sector. In comparison, this sector experienced a decline of 2.5% during in the first quarter of 1994. In the manufacturing category, which overall increased by 0.4%, the SHCP reported growth in five out of nine categories.

In addition to the devaluation of the peso and high interest rates, the decline in economic activity has been attributed in part to an increase in the value-added tax (Impuesto al Valor Agregado, IVA). The increase, which took effect April 1, pushed the rate from 10% to 15% (see SourceMex, 03/15/95 and 04/12/95). During May, controversy arose over reports that the Zedillo administration was about to raise the IVA by another three percentage points to 18%. According to Deputy Alejandro Diaz of the opposition National Action Party (PAN), Finance Secretary Ortiz raised this possibility at a meeting with legislators on May 10. According to Diaz, Ortiz raised the question whether deputies and senators would support an increase in the IVA in exchange for reductions in other taxes. The proposal created a stir in the legislature, forcing members of all parties including Ortiz's own Institutional Revolutionary Party (PRI) to denounce the proposal, especially since the last increase to 15% had only been in effect for a few weeks. "The administration's lack of sensibility to the extreme

discontent in the country about our current economic situation has reached such extremes that the Finance Secretary dares to suggest another increase in the IVA," said Diaz.

In response to the controversy created by Ortiz's statements, members of the PAN announced plans to introduce legislation to reduce the IVA to about 7%. This plan was overwhelmingly supported by the other major opposition party, the Democratic Revolution Party (PRD). PAN deputies and senators said a reduction in the IVA would have beneficial effects across the board, promoting an increase in the purchasing power of lower-income Mexicans, protecting small and medium-sized businesses, and addressing the growing problem of unemployment. On the other hand, members of the PRI rejected this proposal, accusing the PAN of "political opportunism." For example, Sen. Carlos Sales, chairman of the Senate Finance Committee (Comision de Hacienda), said the proposal represented an effort by the PAN to drum up support ahead of upcoming gubernatorial elections in Guanajuato and Yucatan states.

For his part, Finance Secretary Ortiz denied that an increase in the IVA was ever seriously considered by the Zedillo administration. He said any statements came in the context of informal discussions at a working meeting, in which the administration was seeking feedback and input from various groups regarding the steps taken by the government to address the economic crisis. (Sources: El Norte, 05/08/95; El Financiero Internacional, 05/15/95; Wall Street Journal, 05/16/95; Reuter, 05/16/95, 05/17/95; Associated Press, 05/17/95; Reforma, 05/18/95, 05/19/95; La Jornada, 05/15/95, 05/18/95, 05/19/95; Agence France-Presse, Inter Press Service, New York Times, 05/18/95; Notimex, 05/18/95, 05/19/95)

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