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According to published reports, a total of US$2 billion in foreign investment was withdrawn from Mexico during the last two weeks of September and the first week of October because of new uncertainties about the Mexican political and economic climate. A study conducted by Grupo Financiero Ixe and published in the daily newspaper La Jornada said the flight of US$2 billion in foreign capital was a direct result of sharp declines in the value of the peso and the Mexican Stock Exchange (BMV), which in turn reflected growing uncertainty about the direction of Mexico's economy. Indeed, in late September the peso declined to one of its lowest points for this year, falling to 6.55 per US$1.00, before recovering slightly. The peso took a downward turn again during the first week of October, dropping to 6.61 per US$1.00 on Oct. 2, due to continuing uncertainty in the financial markets.

According to some market analysts, the immediate explanation for the decline in the peso in late September was a surge in demand and tight supplies of dollars in Mexico. The surge in demand was mostly from Mexican banks who were attempting to boost their dollar positions at the end of September and aggressive buying from other companies that needed to meet upcoming foreign debt obligations. A lack of foreign participation in the foreign exchange market tightened the supply of dollars to meet the increased demand, which in turn helped boost the value of the dollar relative to the peso. A sharp decline in the BMV's main index (Indice de Precios y Cotizaciones, IPC) during the last week of September also created concerns among foreign investors. The IPC dropped to 2,381 points on Sep. 26, or about 240 points below the highest point of the year on Sep. 8. The IPC recovered briefly on Sep. 28 to about 2,402 points.

Many market analysts attributed the short-lived recovery in late September to the fact that the market losses had created a "bargain" for stock purchases and not to a change in the fundamental factors in the economy. Additionally, statements from International Monetary Fund (IMF) officials that Mexico will reach all its economic and financial goals for this year also helped fuel positive sentiment in the market. Indeed, speculative buying increased in the markets after IMF officials praised Mexico's ability to overcome this year's crisis as a "spectacular" performance. Furthermore, the IMF officials said Mexico would be able to resume economic growth and reduce inflation by the end of the year.

The IMF and the US government were instrumental in keeping Mexico from defaulting on its debt obligations by providing an economic rescue package of US$50 billion. Mexico used the funds to pay maturing short-term securities. In fact, during the last week of September, reports were circulating that President Ernesto Zedillo was scheduled to announce the repayment of about US$1 billion of the US portion of the loans during a visit to Washington in mid-October. US officials would not confirm the rumor, but US Treasury Secretary Robert Rubin told reporters that Mexico has now paid

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more than US$200 million in interest on the US loans. Notwithstanding the positive US and IMF assessments, many economists disagreed with the long-term prognosis for the Mexican economy.

"People are worried about the economy and political stability, and that's why we're seeing such volatility," said one trader. Indeed, during the first week of October, the market resumed its losses, fueled by rumors that the Banco de Mexico (central bank) governor Miguel Mancera Aguayo had resigned. The rumors triggered a decline of 100 points in the BMV's IPC to 2,291 points on Oct. 2, one of lowest points for this year. "In only six months, the Mexican economy has suffered a seven-year setback," said a front-page article in the daily business newspaper El Financiero. According to El Financiero, few investors appear prepared to increase holdings in Mexico until they see concrete signs of an economic turnaround. A major concern among traders and investors is that the economic recovery promised by the Zedillo administration for the second half of the year is not imminent. "It is not clear that inflation and interest rates are on their way down," said the private sector's economic studies center (Centro de Estudios Economicos del Sector Privado, CEESP). "On the contrary, we run the risk that both (inflation and interest rates) could increase again."

In recent weeks, Finance Secretary Guillermo Ortiz and other members of the Zedillo administration have issued frequent statements indicating that Mexico's economic crisis has hit bottom after a GDP decline of 10.8% in the second quarter, and that economic growth is due to resume by the fourth quarter of the year. "The government can continue to place emphasis on macroeconomic indicators, which will certainly make the administration look good, but there are other statistics that reflect what is happening in the real economy," read an article in the financial magazine Expansion, published by Grupo Expansion. In the article, the magazine said the increase in unemployment to record levels has created a situation that will be very difficult to reverse.

"The sense of desperation is very palpable in the streets of our country," read the article. "It will be very difficult to return to an economy where employment is stable." According to the latest official statistics released by the Zedillo administration, about 2.5 million persons were unemployed as of the middle of this year. In mid-September, the government statistics agency (Instituto Nacional de Estadistica, Geografia e Informatica, INEGI) reported that 7.3% of the country's economically active population (EAP) was unemployed during July (see SourceMex, 09/27/95).

However, labor unions and private economists suggest that the government's reporting methods do not present the full picture. They contend that as low as 8 million and as high as 9 million members of the EAP are unemployed, while at least another 8 million are underemployed. Another major concern among domestic and foreign investors is that the government may not be able to negotiate new anti-inflation agreements with the labor and business sectors. Representatives of labor and business organizations have threatened to withdraw from the current agreement (Pacto para el Bienestar, la Estabilidad y el Crecimiento, PABEC) unless the Zedillo administration makes significant changes in its economic policies. The administration's disagreements with labor unions gained prominence in late September, when leaders of the (Confederacion de Trabajadores de Mexico, CTM) and the workers congress (Congreso del Trabajo, CT) threatened to leave the PABEC after the government for the third time this year approved an increase in the price of tortillas (see SourceMex, 09/27/95).

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CTM leader Fidel Velazquez told reporters that the latest hike in tortilla prices is symptomatic of the government's new attitude of not consulting with workers about price increases for basic goods. He told reporters that the union's position is that any new anti-inflation agreement would have to have enforceable mechanisms prohibiting the government from raising prices unilaterally. Business leaders, for their part, have also requested a "redefinition" of the PABEC and a change in direction for the administration's economic policies. Among other things, members of the business sector are demanding increased direct support for small- and medium-sized businesses, tax breaks, and concerted efforts to alleviate poverty.

"The pressures facing Mexico have reached a limit and we now run the risk of an unraveling of society," said the leader of one organization. Meantime, many domestic and foreign investors are anticipating a continuation of poor earnings reports for most Mexican companies. "The stock market had been rising gradually over the past two or three months in anticipation of good earnings reports during the third quarter of the year," said financial analyst Jonathan Heath of the Mexico City-based consulting firm Macro Asesoria Economica. "When investors saw that companies were not going to fare as well as anticipated, they started selling their stocks."

Only those companies with extensive export operations are expected to show relatively healthy bottom lines, as the devaluation of the peso has markedly improved Mexico's trade balance. For example, the trade surplus for January-July totaled US$3.67 billion, based in part on an increase of 32% in exports from a year ago (see SourceMex, 09/20/95). Many business executives remain skeptical about the Zedillo administration's assessments that the economic decline has been halted and that a gradual recovery is imminent. The government has not yet released an estimate for growth in the third quarter of the year, but Finance Secretary Guillermo Ortiz recently projected a decline of 5% in the GDP for the entire year.

According to Jaime Arias Hernandez, a columnist for the daily newspaper Excelsior, the Zedillo administration may be right in suggesting that Mexico has managed to halt its economic decline. "But one cannot honestly say that growth has actually begun," said Arias, who pointed to key factors in the economy, such as the continuation of unemployment, the continued deterioration of retail sales, and especially the lack of automobile sales. "Domestic demand for automobiles in the first eight months of the year is down by an accumulated 80% from last year," said Arias. "All the signs are that the economic recovery will have to wait for a longer period. In fact, the third quarter of the year should be considered as lost, although the decline in economic growth will be smaller than in the second quarter." According to Hector Larios, president of the business coordinating council (Consejo Coordinador Empresarial, CCE), the country will need more than three years to emerge from the recession. Larios urged the Zedillo administration to take more decisive steps to reactivate the economy, including efforts to attract domestic and foreign investment.

In fact, representatives of at least 10 sectors indicated that their situation has not improved much in the third quarter of the year. The automotive, auto parts, steel, pharmaceutical, plastics, restaurants, food, publishing, footwear, and retail sectors have all reported declines ranging between 10% and 70% so far this year. Those companies with export operations have been able to reduce losses, while those with primarily domestic sales are the ones in most trouble. In the auto parts sector, domestic sales of new parts have fallen by 70% this year, while sales of used replacement parts have dropped by 30%. The pharmaceutical industry reports a similar trend, with sales down by 12% to 14%.

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According to Peter Reinartz of Ciba Geigy de Mexico, tight incomes may have reduced doctors visits by as much as 50%, which in turn has reduced demand for medicines. For his part, Jose Manuel Delgado Tellez of the restaurant industry chamber (Camara Nacional de la Industria Restaurantera, CANIRAC) said sales by restaurants this year have fallen by 30% to 40%. As for the steel and iron industry, the larger companies have been able to survive the crisis with few problems by reorienting a larger portion of their production to the export market, while smaller and medium-sized companies, which rely heavily on the domestic market, are facing liquidity problems.

Representatives of chambers for retailers, publishers, food producers, and plastics manufacturers also reported similar results, according to a survey conducted by the daily newspaper La Jornada. (Sources: Associated Press, 09/25/95, 09/28/95, 09/29/95; El Diario de Yucatan, 09/29/95; Agence France-Presse, 09/07/95, 09/19/95, 09/25/95, 09/27/95, 09/28/95, 10/01/95, 10/02/95; Notimex, Reuter, 09/28/95, 10/02/95; El Financerio International, 10/02/95; Reforma, Excelsior 09/28/95, 09/29/95, 10/03/95; La Jornada, 09/28, 10/02/95, 10/03/95)

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