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LADB Staff

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Sharp Decline in Peso Sparks New Concerns About Stability of Mexican Economy

by LADB Staff

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In early November, the peso declined to its lowest level for this year, sparked mainly by concerns about the stability of the Mexican economy. During trading on Nov. 9, the Mexican currency fell to as low as 8.30 nuevo pesos per \$1.00, forcing the Banco de Mexico (central bank) to sell dollars in order to boost the value of the peso. The Central Bank's operations succeeded in bringing the peso back up to about 7.65 nuevo pesos per US\$1.00 on Nov. 10. The previous low for the Mexican currency was set in March, at about 7.8 nuevo pesos per US\$1.00. The decision by the Banco de Mexico to sell dollars created new concerns about a drawdown in the level of Mexico's foreign reserves, which was one of the main factors that led to the devaluation of the peso in December 1994.

The Central Bank attempted to ease these concerns by releasing a statement that only a "modest" level of foreign reserves were used to shore up the peso. According to a recent report from the Central Bank, Mexico's foreign reserves as of the first week of November stood at about US\$13.6 billion. In order to ensure adequate reserves, a number of prominent companies met in early November to discuss the possibility of creating a joint private-government US\$5 billion fund to be used in times of emergency to bolster the peso. Among the leading proponents of this plan are Grupo Alfa, Cemex, Kimberly-Clark, and Grupo Desc.

Alfa's chief executive officer Dionosio Garza attributed the recent sharp declines in the value of the peso to speculative selling and not necessarily to economic factors. "Real measures by the government to solve Mexico's long-term problems have gone unnoticed," said Garza. "We want to stabilize these dramatic swings in the peso to help everybody who does business here." Indeed, President Ernesto Zedillo's administration continues to promise a recovery by 1996, when GDP is forecast to grow to 3% and annual inflation to drop to 20%, compared with the nearly 50% forecast for this year.

On the other hand, some economists believe the instability of the peso is the result of uncertainty about the direction of the Mexican economy. Analysts said investors were still worried about the Zedillo administration's apparently contradictory policy on interest rates. "The markets have seen that there is no magic solution to give us growth right away, and we're stuck in a 'muddling-through' policy," said Jonathan Heath of Mexico City-based Macro Asesoría Económica. Many economists were looking to President Zedillo's budget for 1996, which was announced on Nov. 14, for clues about the direction of the economy. However, the budget, presented by Finance Secretary Guillermo Ortiz to the Chamber of Deputies on Nov. 14, lacked any initiatives to promote economic growth in Mexico, which caused the peso again to decline beyond the rate of 8.00 nuevo pesos per US\$1.00. In turn, that caused the Banco de Mexico to sell dollars in order to shore up the peso to about 7.70 per US\$1.00.

Economists said the biggest disappointment from the budget plan was the lack of proposals to shore up the weakening banking system, which is facing severe pressures from high interest rates. In an interview with the New York Times, financial analyst Jorge Mariscal of Goldman, Sachs & Co. said that despite the recent volatility in the markets, the Zedillo administration can claim some credit for restoring relative stability to the markets following the devaluation of the peso. "This government has been able to bring the patient to a stable condition," he said. "But now the markets are asking when the patient will be able to get up and walk out of the hospital. It's still not clear."

There was also some concern that the central bank is relaxing its tight monetary policy in a bid to drag the economy out of deep recession. However, in presenting the 1996 budget to the Chamber of Deputies, Ortiz emphasized that the Zedillo administration had not changed its policy of allowing the peso to float freely. In the meantime, the short-term economic uncertainty continues to be reflected in the instability of the peso and the Mexican Stock Exchange (BMV). For example, the BMV and the peso both suffered sharp declines in early November due to sensationalist rumors that President Zedillo had been deposed in a military coup. The rumors were based on a report published by AP-Dow Jones on Nov. 3, which quoted a prominent New York financial adviser as saying that the Mexican army had started to take a higher profile position in view of President Zedillo's weakness.

The adviser, however, did not make any direct mention of a military coup. The recent instability in the peso and the BMV has also begun to create new political opposition in the US and Mexico to the Mexican government's policies. For example, in early November, members of the opposition National Action Party (PAN) in the Senate called for the resignation of Miguel Mancera, the Banco de Mexico's chief governor. The PAN senators said Mancera should step down because the policies of the central bank "no longer inspire" confidence in the Mexican economy. Indeed, none of the members of governing Institutional Revolutionary Party (PRI) rose to defend Mancera. "We do not want to contribute to the economic uncertainty by making any statements in this regard," said Sen. Carlos Sales, chair of the Senate finance committee (Comision de Hacienda).

The sharp decline in the peso also attracted new criticisms from US opponents of US President Bill Clinton's bailout of the Mexican economy at the beginning of this year. In that bailout, Clinton provided US\$20 billion from a Treasury Department account, as part of a larger international package of US\$50 billion (see SourceMex, 02/01/95). According to US and Mexican government sources, the Mexican government has already used about US\$12 million of the funds available from the US. Sen. Alfonse D'Amato (R-NY), who has led the opposition to the bailout, charged that the latest decline in the peso created another excuse for Mexico to draw on the US funds. "The Mexican government will use the money in a desperate and useless effort to boost the peso," said D'Amato, who chairs the powerful Senate Banking Committee. (Sources: El Financiero International, 11/06/95; El Norte, 11/07/95; Notimex, 11/08/95, 11/09/95; Excelsior, Siglo 21 (Guadalajara), Deutsche Press Agentur, Reuter, 11/09/95; La Jornada, 11/07/95, 11/09/95, 11/10/95; Reforma, 11/09/95, 11/10/95; New York Times, 11/08/95, 11/09/95, 11/14/95; Associated Press, Dallas Morning News, 11/14/95)

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