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LADB Staff

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Mexico's Economic Growth Stronger than Anticipated in First Half of 1997

by LADB Staff

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In mid-August, the Secretaria de Hacienda y Credito Publico (SHCP) reported Mexico's GDP growth for the second quarter of 1997 at 8.8%. As a result, GDP growth for the January-June semester reached 7%. GDP growth for both the second quarter and first half of the year were higher than anticipated by most economists. For example, a forecast published in early August by the Centro de Estudios Economicos del Sector Privado (CEESP) had projected growth for January-June at 5.5% to 6%. Similarly, a survey conducted by Dow Jones news service among 10 major brokerage houses showed projections between 5.5% and 6.7% for the April- June quarter. The relatively strong performance in the first semester increases the likelihood that President Ernesto Zedillo's administration will meet or surpass its target of 4% annual growth in 1997 (see SourceMex, 10/30/96).

Noteworthy growth reported in most economic sectors

The SHCP report noted particularly strong performances in the industrial, agricultural, construction, and service sectors during the second quarter of the year. According to the SHCP, the industrial sector recorded 11.2% growth in the April-June quarter and 8.8% during the semester. The SHCP said companies involved in the manufacture of capital goods, durable goods, and components recorded the strongest output.

The agricultural sector, which had experienced a prolonged slump, recorded a 10.4% growth rate in the second quarter and 5.8% growth in the January-June period. "The growth in agriculture was influenced by larger harvests of corn, wheat, beans, chile peppers, lemons, apples, and other products," the SHCP report said.

The construction sector grew 9.1% during the second quarter. According to Jorge Carrillo of Casa de Bolsa Value in Mexico City, the strong performance in construction was particularly significant since it was one of the sectors most affected by the devaluation of the peso. "In any economy, if the construction industry is hurting, chances are the rest of the economy is hurting," Carrillo told the Dallas Morning News. "And if it grows, so does the rest of the economy."

The SHCP said the service sector recorded growth rates of 7.7% in the April-June quarter and 6.3% during the first semester. The services category, which accounts for 64% of Mexico's GDP, includes financial services, real estate, entertainment, hotels, transportation, and retailing. The hotel, entertainment, and transportation sectors all reported strong activity, but economists said the most encouraging trend is the recovery in the retail sector. "We're seeing evidence that the 90-million-person Mexican consumer market is finally coming back to life," economist Lawrence Goodman of Salomon Bros. told the Los Angeles Times.

Indeed, increased retail activity has provided support for President Zedillo to oppose proposals by the opposition Partido Accion Nacional (PAN) and Partido de la Revolucion Democratica (PRD)

to lower the value-added tax (impuesto al valor agregado, IVA) to 10% or less. The opposition is expected to push for the IVA reduction in the upcoming session of Congress (see SourceMex, 07/23/97 and 08/13/97).

Still, some economists questioned whether the statistics on increased retail activity are an accurate measure of recovery in purchasing power. According to economic consultant Jonathan Heath of the Mexico City-based Macro Asesoría Económica, retail statistics only reflect economic activity among a small number of Mexicans. As a result, PRD legislators and some labor and business leaders suggest that, in addition to a reduction in the IVA, larger salary increases are needed to help reactivate consumption among the poorest segments of the population.

For his part, political analyst Sergio Sarmiento expressed concern that the rapid growth rate in the first half of the year created risks in the long term. "The growth may not be sustained if the government does not take steps to shore up productive infrastructure," said Sarmiento. "We may be faced with bottlenecks that could result in higher inflation and other economic risks."

President Zedillo cautioned against taking the statistics as a definitive sign of recovery in the Mexican economy. According to Zedillo, the 7% growth during the first semester is insufficient to improve the living conditions of most Mexicans. The president pledged to pursue programs that create jobs and promote social welfare.

Strong peso creates concern about further growth prospects

Others expressed concern that Mexico will be hard pressed to maintain strong economic performance in the second half of the year if the peso remains overvalued. Following a sharp decline in late February and early March, the peso has since gained steadily. The peso had reached about 7.73 pesos per US\$1.00 by mid-August, compared with 8.03 pesos per US\$1.00 on March 5. Some business organizations, such as the Cámara Nacional de la Industria de Transformación (CANACINTRA), expressed concern that the peso's strength would limit Mexican exports and encourage increased imports, which would eventually change Mexico's trade surplus into a trade deficit.

According to some economists, the most significant problem with the strengthening of the peso is that its value relative to the dollar did not correspond with inflation trends in the two countries, which created a competitive advantage for US companies. Accumulated inflation in Mexico reached 8.7% during the first semester, compared with 0.7% accumulated inflation in the US. Still, the strengthening peso appears to have had little impact on Mexico's trade balance in June, which was reported as a surprisingly high surplus of US\$182 million. Exports that month totaled US\$9.229 billion, while imports amounted to US\$9.047 billion.

The strong peso has had both a beneficial and negative impact on Mexican industry. On one hand, some manufacturers must compete with cheaper imports, particularly consumer goods. On the other hand, many companies are paying less to import capital goods and other products needed to expand their operations and boost productivity. Moreover, a stronger peso provides an advantage for companies that need to pay dollar-denominated debt. Some economists say the strong peso is a consequence of increased foreign investment in Mexico.

Still, many are concerned that much of the capital inflow is in indirect investments, which raises the risk of an abrupt devaluation. "This is hot money," analyst Paco Caballero of Indosuez Banque told the newspaper *The News*. "If investors decide to leave the country, there will be a lot of pressure on currency markets."

To a certain extent, the Zedillo administration has attempted to reduce overreliance on foreign capital by promoting domestic savings, particularly through the new retirement savings program (Programa de Administradoras de Fondos del Retiro, AFORE).

Many business leaders applauded moves by the Banco de Mexico (central bank) in early August to keep the peso from increasing in strength through purchases of dollars on the Mexican currency markets. They urged the central bank to continue to take steps to gradually bring the peso back to its true value relative to the dollar. "What we want to see is an adjustment in the exchange rate to reverse this tendency of overvaluation," said Javier Prieto, president of the northeast chapter of the Consejo Nacional del Comercio Exterior (CONACEX).

Economists and business leaders generally agree that a "comfortable" level for the Mexican currency is above 8.00 pesos per US\$1.00. Some economic forecasting organizations, such as the CEESP, project the value of the Mexican currency falling to about 8.39 pesos per US\$1.00 by the end of 1997. Another organization, the Instituto Mexicano de Ejecutivos de Finanzas (IMEF), suggested a further weakening of the currency to about 8.50 pesos per US\$1.00 by the end of the year. (Sources: *Reuter*, 07/23/97, 08/05/97, 08/18/97; *El Financiero Internacional*, 08/18/97; *The News*, *La Jornada*, 07/24/97, 08/05/97, 08/19/97; *Christian Science Monitor*, 08/19/97; *Excelsior*, 07/24/97, 07/31/97, 08/08/97, 08/18/97; *Novedades*, 07/24/97, 08/04/97, 08/05/97, 08/15/97, 08/19/97, 08/20/97; *El Universal*, 08/06/97, 08/07/97, 08/20/97; *El Economista*, *El Diario de Yucatan*, 08/20/97)

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