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A recent surge in interest rates could have negative repercussions for several sectors of the Mexican economy during the rest of this year and into next year. In mid- September, the short-term interest rates set by the Banco de Mexico (central bank) hovered near 50%, which brought interest rates on credit cards and other consumer loans close to 70%.

The central bank eventually lowered the short-term rates, but the reductions were deemed insufficient to prevent a slowdown in key sectors of the economy in the last quarter of the year. The central bank had set interest rates high to protect the Mexican peso from the global financial crisis, caused by problems in the Asian, Russian, and Brazilian markets. Guillermo Ortiz Martinez, the Banco de Mexico's chief governor, said the high rates were intended to keep inflation in check and discourage speculation against the peso.

On Sept. 18, the central bank set the rate for 28-day Treasury Certificates (Certificados de Tesoreria, CETES) at 47.8%. The CETES rate was lowered to 38.7% and then to 34.45% on Sept. 29, the day the US Federal Reserve dropped US interest rates. But rates were expected to remain relatively high because of continuing instability in global financial markets.

Some analysts questioned whether the high interest rates were the best policy in the long term. "The central bank is walking a fine line to defend the peso," said Patrick Boucher, an analyst for Banco Santander. Jaime Collazo, president of the Instituto Mexicano de Ejecutivos de Finanzas (IMEF), said the central bank may be placing the economy at risk if short-term interest rates are allowed to remain high. According to Collazo, CETES rates will have to come down to 20% to 25% by the end of October to avert a major economic slowdown and prevent a surge in inflation.

Some economists fear continued high rates could result in a massive default on loans, reduced investment, and weak consumer spending, which could have a negative impact on economic growth. "Mexico has to generate 1.2 million jobs a year just to keep static," one economist told the daily newspaper The News. "If growth goes below 3%, we're in a recession." In any case, economists contend the government's targets of 12% inflation and GDP growth of 4.5% to 5% are unrealistic. "Interest rates may eventually decline from current levels, but they are likely to remain high for the rest of the year," said analyst Mario Correa of the Inverlat brokerage company in Mexico City.

Construction, auto industries face uncertain fourth quarter

The high interest rates will negatively affect most sectors of the economy, but some of the more-visible effects should be evident in the construction and automotive sectors. Jose Mercado Atri, a vice president with the Camara Mexicana de la Industria de la Construccion (CMIC), said high interest rates will limit construction of new homes to 190,000 units during 1998, far short of the

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700,000 homes needed to keep pace with population growth. Since 1994, bankers have been very selective in approving housing loans, said Mercado.

However, the recent surge in interest rates makes it almost impossible for anyone to obtain a mortgage loan. "I do not expect banks to resume mortgage loans until short-term interest rates drop back to 20%," said Mercado. High interest rates have also translated to higher costs for construction materials.

At a recent forum in Mexico City, CMIC president Ricardo Platt Garcia said costs have increased by 15% for cement and 8% for steel in recent months, which will further hamper construction activity. Construction activity is also hampered by the steady weakening of the peso against the US dollar and three federal budget cuts this year, said Mauricio Jessurum Solomou, president of the INSIS consulting company.

As a result of the budget reductions in January, March, and July, the government has postponed or canceled construction projects (see SourceMex, 01/21/98, 03/25/98, and 07/15/98). Jessurum Solomou said the construction industry will probably contract by 3% to 4% this year. But the sector's problems extend back to the devaluation of the peso in late 1994. "This slowdown is three-and-a-half years old," said Carlos Alanis of GAM Construction, a builder of low-income housing.

Similarly, the automotive sector is expected to feel the repercussions from high interest rates in the last four months of this year. The projected reduction in sales in September- December will dampen an otherwise strong year for domestic- automobile dealers. In mid-September, the Asociacion Mexicana de la Industria Automotriz (AMIA) reported domestic sales of motor vehicles during January-August at almost 305,000 units, an increase of about 45% from the same period in 1997.

But economists say high interest rates will dry up financing for automobile loans in the coming months, which is expected to bring domestic sales to a near standstill through the end of the year. "The second half of the year will be extremely poor because domestic sales will not increase," said Adalberto Gonzalez of consultants Grupo de Economistas Asociados (GEA). "We are going to have to revise our forecasts for domestic sales of motor vehicles from our original projection of 42% growth," said CAPEM economist Cesar Castro.

Some automobile companies have already reduced their projections for the year. For example, Ford de Mexico has lowered its sales expectations for 1998 to 115,000 units from its previous projection of 123,000 units. The Asociacion Mexicana de Distribuidores de Automotores (AMDA) has not yet altered its domestic-sales projection of 610,000 units in 1998. Still, the association's preliminary estimate projects sales to decline to 570,000 units in 1999.

The weak demand in the automobile sector is expected to affect other related sectors such as auto parts. Guillermo Navarro Sada, a member of Asociacion de Mayoristas de Partes Automotrices del Norte (AMPANAC), said almost one-third of the auto-parts manufacturers in Nuevo Leon state could go bankrupt because of the reduced sales of motor vehicles the rest of this year and into 1999. "The large and medium-sized companies will be able to adjust their marketing strategies," said Navarro Sada. "But the smaller operations will go out of business." (Sources: Excelsior, 09/21/98,

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09/23/98; Reuters, 09/17/98, 09/22/98, 09/29/98; El Financiero International, 09/14/98, 09/21/98, 09/28/98; El Economista, 09/15/98, 09/28/98, 09/29/98, 09/30/98; El Universal, 09/17/98, 09/18/98, 09/21/98, 09/23/98, 09/24/98, 09/29/98, 09/30/98; The News, 09/18/98, 09/30/98; Novedades, 09/28/98, 09/30/98)

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