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Government and private forecasters have released fairly optimistic projections for the Mexican economy for the rest of the year, but these predictions may unravel because of the sluggish pattern in the US economy that is tied to high oil prices and because of growing domestic political uncertainties. The administration's optimistic view of the economy is reflected in the latest report from Banco de Mexico (central bank), which raised its projections for the country's annual GDP to a range between 3.75% and 4.25% growth this year. This compares with its previous forecast ranging between 3.5% and 4%.

The recovery was already apparent in the first quarter of the year, when the administration reported a GDP growth of 3% for the three-month period (see SourceMex, 2004-05-05). The central bank said its new projection was based on increased manufacturing activity. "There is still unused capacity in the economy that may imply more growth without inflation," said Manuel Ramos Francia, head of economic research at the bank.

Some jobs created in short term

Conflicting trends in the manufacturing sector suggest the recovery may still be weak. In late June, the government's statistics agency Instituto Nacional de Estadisticas, Geografia e Informatica (INEGI) reported that the number of workers employed in manufacturing as of April was down about 2.6% from the same month in 2003.

The maquiladora industry, however, recently reported a recovery in jobs after experiencing a slowdown in recent years. In a report published in late June, the Consejo Nacional de la Industria Maquiladora de Exportacion (CNIME) said the industry created 52,623 jobs in January-May 2004. This is in stark contrast to recent years, when the maquiladora sector reported sharp employment declines (see SourceMex, 2002-07-17 and 2003-10-22). The rebound in jobs at maquiladora plants coincides with a slight improvement in the country's overall employment picture.

A report published by the Secretaria de Trabajo y Prevision Social (STPS) said 12.47 million workers were registered to obtain social security benefits through the Instituto Mexicano del Seguro Social (IMSS) as of July, the highest level of the year. The STPS said the enrollment figures were still below the high of 12.77 million recorded in November 2000, when GDP growth reached 6.9% (see SourceMex, 2001-02-21).

Even with the positive job figures released by President Vicente Fox's government, skeptics say the administration on balance has failed to promote policies that produce jobs. Critics point to INEGI statistics, which indicate that more than 612,000 jobs have been lost since Fox took office in December 2000. Furthermore, an analysis published by the Camara Nacional de la Industria de la

Transformacion (CANACINTRA) criticized the Fox government for failing to support small and medium-sized businesses and forcing many workers into the informal economy.

The report said that more than one-third of Mexico's economically active population (EAP) make a living as street vendors or through other activities in the informal economy. Still, analysts point to other factors that they say are signs of a stable economy, including the strong performance of the stock market (Bolsa Mexicana de Valores, BMV) and the relative stability of the Mexican peso versus the US dollar.

Some private forecasters such as the bond-rating agency Moody's are also optimistic about the performance of the Mexican economy during the remainder of 2004. A Moody's report published in early August raised projections for Mexico's 2004 GDP growth to 3.9%. In the report, Moody's said Mexico's economic recovery is "solidly on course," attributing its optimistic forecast to monetary stability, the ability of the Fox government to maintain strict fiscal discipline, and a favorable impact from the North American Free Trade Agreement (NAFTA).

The GDP projections are tempered somewhat by a slightly higher-than-anticipated increase in consumer prices in the early part of the year. The Banco de Mexico reported the consumer price index (indice nacional de precios al consumidor, INPC) rose by 0.26% in July, bringing accumulated inflation for January-July to about 1.9%. Some analysts say they now doubt that the Fox government will attain its target of 4% annual inflation in 2004. "The 4% goal is very difficult to achieve," said Hector Nieto, a financial analyst for the copper producer Grupo Mexico. "It's very important to keep inflation under control, but even if we see 4.5% or 5%, those are still very manageable rates."

High oil prices a double-edged sword

The increase in inflation is attributed in part to high prices for fuel, electricity, and housing. For example, the price of liquefied petroleum gas (LPG), one of the more popular heating and cooking options in Mexico, increased by almost 9.8% in January-August relative to the same period in 2003, said the Secretaria de Economia (SE). Similarly, some commercial and residential users have faced an increase of 4% in expenditures for electricity and natural gas since the beginning of the year.

The increase in energy costs, particularly oil and gasoline, has been a double-edged sword for Mexico. Some analysts expect strong global oil prices to increase Mexico's oil-export revenues by about US$2.8 billion beyond projected levels for this year. The average price for Mexican crude oil surpassed US$35 per barrel on Aug. 9. Prices have not been this high since 1990, said Ignacio Cedillo Bravo, an analyst at Bursametrica in Mexico City.

Through late July, Mexican crude oil had sold at an average of US$29 per barrel, much higher than the US$20 annual average that Congress and the administration used to determine the 2004 budget (see SourceMex, 2004-01-07). "Prices are responding to the strong demand of our principal market, which is still the US," said Bernardo de la Garza, crude-oil commercial director for P.M.I Comercio Internacional SA, the company that manages most of the state-run oil company PEMEX's supply contracts abroad. "There will not be a substantial change in prices in the rest of the year." The federal government plans to use some of the excess revenues to boost budget allocations to state

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governments by about 8.2 billion pesos (US$718 million) this year, said Alejandro Werner, planning director at the Secretaria de Hacienda y Credito Publico (SHCP).

Ironically, the high oil prices that have given the government surplus revenues to spend at home could also halt the country's projected economic recovery. "High oil prices are mostly not good for Mexico," economist Pedro Tuesta of US-based 4Cast told Bloomberg news service. "If oil prices hurt the US, it hurts Mexico." The US reported a 3% annual growth rate from April through June, the slowest expansion in more than a year.

US government sources said rising energy prices caused the weakest pace of consumer spending in three years. "There are strong possibilities that the US will moderate its growth, which would cause the Mexican economy to also experience slower growth," the Centro de Estudios Economicos del Sector Privado (CEESP) said in a recent report. The CEESP noted that Mexico still depends on the US for 80% of its exports.

Additionally, Mexico's economic performance is hampered by its inability to make a major dent in its rate of extreme poverty. A report released by the World Bank in late July said 20.3% of the Mexican population remains in extreme poverty, although the rate has dropped by about four percentage points from 2000. A major reason for the decline, said the bank, has been the increase in remittances sent from the US by expatriates and not the government's anti-poverty programs.

The report noted that the bulk of the government's expenditures on health care, education, and retirement benefits primarily help households with monthly incomes above 30,000 pesos (US$2,629). Fox, political parties wrestle with key reforms While there has been no major political instability, major infighting among the parties on several fronts has created a level of uncertainty in Mexico that could eventually affect economic growth. The most direct impact of political infighting is the inability of the Fox administration and Congress to sit down and hammer out agreements on reforms to the energy sector, the labor code, and the tax system.

Most legislators agree on the need for reforms in these areas, but the extent of the changes has polarized the two opposing factions. One faction comprises the majority of members of the former Partido Revolucionario Institucional (PRI) and the center-left Partido de la Revolucion Democratica (PRD) and the other includes Fox's conservative Partido Accion Nacional (PAN) and a minority of PRI legislators. The energy reforms are especially contentious, with Fox's proposals to attract private investment into electricity, natural gas, and oil exploration receiving strong opposition (see SourceMex, 2003-10-08 and 2004-01-28).

Some controversy is also evident on tax reform, especially differences on collection (see SourceMex, 2004-01-07). Legislators realize that Mexico's tax base is only 12% of GDP, forcing the government to rely excessively on oil-export revenues to fund the Treasury. The administration and the various political parties were hoping to reach some compromise through the national tax convention (Convencion Nacional Hacendaria, CNH), which was expected to issue a recommendation this summer (see SourceMex, 2004-02-11).

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The CNH had been scheduled to present recommendations in July, but the report has been delayed. The willingness of the various parties to enter into dialogue on tax reform is misleading because the various parties remain deeply polarized regarding other contentious issues. Political conflicts raise some concerns The cooperating parties are not the same on all the issues. For example, the PAN and the PRD are united in their dispute with the PRI regarding the Aug. 1 Oaxaca election. Gabino Cue, who represented a coalition comprising his Partido Convergencia por la Democracia (PCD), the PRD, and the PAN lost the race to a PRI candidate by two percentage points in one of the tightest state elections in recent history (see SourceMex, 2004-08-04).

The tight numbers have created strong animosities between the PRI and the coalition, with Cue presenting a formal challenge before electoral authorities. The coalition candidate alleges that the PRI resorted to illegal campaign activities, including outright fraud, to win the election. The PAN and the PRD have also come together on the decision of the Fox government to prosecute former President Luis Echeverria Alvarez (1970-1976) for his role in repressing student demonstrators in 1971. A court recently ruled that Echeverria could not be prosecuted because of the statute of limitations (see SourceMex, 2004-07-21).

Special Prosecutor Ignacio Carrillo Prieto has appealed this decision to Mexico's highest court (Suprema Corte de Justicia de la Nacion, SCJN). Conversely, the PAN and a majority of the PRI initially supported an effort to bring Mexico's City PRD Mayor Andres Manuel Lopez Obrador to trial for violating the Constitution (See SourceMex, 2004-05-26). The PRI delegation in the Chamber of Deputies, however, is reconsidering its initial commitment to back a trial against the Mexico City mayor. In any case, Lopez Obrador has vowed to fight the charges, alleging that the PAN and the PRI have embarked on a campaign to discredit him and prevent a possible presidential run.

The Mexico City mayor has not declared his candidacy for the 2006 election, but is widely expected to seek the PRD nomination. The PAN-PRI coalition has also come together to support comprehensive reform to the social security system to save it from bankruptcy. The changes include a reduction in the generous benefits to the social security workers union (Sindicato de Trabajadores del Seguro Social, SNTSS). The PRD and the Partido del Trabajo (PT) joined forces to oppose these changes, saying they could set a dangerous precedent for labor rights (see SourceMex, 2004-07-28). With the backing of the PAN and the majority of the PRI, the Senate and the Chamber of Deputies both voted overwhelmingly in favor of the reforms in early August. The SNTSS, with the support of the independent Union Nacional de Trabajadores (UNT), has threatened to call a national strike on Sept. 1, the day President Fox is scheduled to give his state-of-the union address.

The strike is not supported by the major PRI-affiliated unions. The Congreso del Trabajo (CT) has threatened to seek legal action against the SNTSS if the strike results in massive disruptions of electrical power and telephone service. Conflict in Cancun worries tourism industry Some political conflicts are localized but could have wider repercussions, as is the recent case in the resort city of Cancun in Quintana Roo state.

Violent confrontations erupted following the ouster and arrest of Mayor Juan Ignacio Garcia Zalvidea, who was charged with corruption. Garcia, a member of the Partido Verde Ecologista Mexicano (PVEM), was removed from office by the Quintana Roo state legislature because he

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requested a bank loan of US$10.8 million on behalf of the city government without authorization from the city council or the state legislature. The mayor had not specified the purpose of the loan, but reports later surfaced that the mayor had failed to pay a bank debt of 270 million pesos (US$23.6 million) in July of this year.

The nonpayment of the loan caused the international debt company Fitch Ratings to reduce the rating for Cancun to "D" from its previous "A" level. This raised concerns that the Cancun downgrade might affect Quintana Roo's ability to attract investment. "There was an excess in current-account spending," said state tourism secretary Artemio Santos. "It is incomprehensible how a municipality with the wealth and dynamism of Cancun could end up in such a big hole."

This is the second scandal involving the PVEM this year. A videotape surfaced in March of this year showing PVEM leader Sen. Jorge Emilio Gonzalez taking a bribe. Gonzalez offered to use his influence to convince Cancun officials to facilitate a construction permit for a foreign business group in exchange for US$2 million (see SourceMex, 2004-03-10).

Garcia's supporters responded to his arrest by launching an attack on city hall, resulting in violent confrontations with police. The confrontations led the US State Department to issue a travel alert, which raised strong concerns among business owners in Cancun, which relies so extensively on the tourist trade. An estimated 3.3 million tourists, most from the US, visit Cancun annually. The US alert, which was milder than a "warning," forced the Secretaria de Turismo (SECTUR) to issue a statement indicating that the violence was isolated and did not affect areas frequented by tourists. "The tourism infrastructure has not been affected, nor have any tourists been affected by these demonstrations," said Tourism Secretary Rodolfo Elizondo. "Hotels, restaurants and other providers of tourist services are operating normally."

The intervention of SECTUR indicated concerns within the administration about the possible loss of tourist business in Cancun, which would have a negative effect on the country's tourism balance sheet. Tourism, along with oil-export revenues and remittances from expatriates, has kept the Mexican economy afloat in recent years. In the first half of 2004, revenues from tourism, both domestic and international, amounted to US$5.56 billion, a 14% increase from January-June 2003.

The Mexican government, via the Consejo de Promocion Turistica de Mexico (CPTM), has allocated US$6.2 million for a promotional campaign to boost the number of US tourists visiting Mexico in the fourth quarter of the year. The political polarization and the conflicts have created strong concerns within the business community because of their potentially negative impact on foreign investment. In a poll by the Banco de Mexico, respondents listed domestic political uncertainty as the second-most-important factor that could obstruct economic activity in Mexico, after structural reforms. The central bank conducted the poll among 33 private business consulting and analysis groups.

Some have raised concerns that the animosity might delay the approval of the budget for 2005. In April of this year, Fox and the Congress agreed to constitutional reforms that allow earlier approval of the budget to avoid the traditional gridlock that has sent the process into late December (see SourceMex, 2004-04-28).

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PAN Deputy Gustavo Madero Munoz, who chairs the finance committee (Comision de Hacienda) in the lower house, said legislators have pledged not to allow the interparty disputes to affect the approval process for the 2005 budget. "Our challenge in approving the economic package for next year is to find the best way to allocate resources while giving a priority to social spending," said Madero. [Note: Peso-dollar conversions in this article are based on the Interbank rate in effect on Aug. 11, reported at 11.41 pesos per US$1.00] (Sources: The Financial Times-London, 07/18/04; Associated Press, 08/04/04; Bloomberg news service, 08/04/04; The Herald-Mexico City, 07/29/04, 07/30/04, 08/04/04, 08/05/04; Spanish news service EFE, 08/02/04, 08/03/04, 08/05/04; Unomasuno, 07/27/04, 08/09/04; Notimex, 08/04/04, 08/05/04, 08/09/04; Agencia de noticias Proceso, 07/29/04, 08/04/04, 08/10/04; El Universal, 08/04/04, 08/05/04, 08/10/04; El Financiero, 06/29/04, 06/30/04, 07/01/04, 07/02/04, 07/05/04, 07/14/04, 07/29/04, 08/09/04, 08/11/04; La Jornada, 06/30/04, 07/30/04, 08/02/04, 08/06/04, 08/09/04, 08/11/04; La Cronica de Hoy, 07/29/04, 07/30/04, 08/04-06/04, 08/11/04)

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