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China's Currency Decision to Have Little Impact on Mexico's Textile Sector

by LADB Staff
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China's recent decision to revalue its currency could bring some benefits for the Mexican textile and electronics industries, which could become more competitive against Chinese exports of these products. The extent of those benefits is expected to be minimal, however. In mid-July, China announced that it would let the yuan fluctuate against a basket of currencies, resulting in a 2.1% increase versus the US dollar. A stronger yuan will increase the cost of Chinese products, thereby eliminating some of the competitive advantage that China had gained in recent years against products from other countries.

The Chinese decision is partly a response to criticisms that the country has kept its currency artificially low to give its products an edge on world markets. "This is good for Mexico because it will allow for more equal competition with China," said economist Gerardo Cruz of the Instituto Mexicano de Ejecutivos de Finanzas (IMEF). President Vicente Fox's administration also said the move was beneficial, not only enhancing Mexico's competitive position but also creating a more stable global currency market. "China's decision to move to a more flexible [foreign exchange] regime is good news," said Alejandro Werner Wainfield, who heads the economic-planning division at the Secretaria de Hacienda y Credito Publico (SHCP).

Currency revaluation far less than expected
The extent by which Mexican manufacturers will benefit from the Chinese decision is up for debate. This is because the Chinese currency revaluation was far less than most economists had anticipated. "Experts were hoping the revaluation would be between 10% and 15%," Cruz said. The Mexican textile industry, in particular, is skeptical about the Chinese currency decision. "This [increase] is very small," said Tony Kuri Alam, president of the Camara Nacional de la Industria del Vestido (CNIV). "[China] wants to compete in a free market but with absolute government controls over its currency." Kuri said the yuan should be revalued by 40% to create a level playing field.

Because of lower labor costs, weak currency, and other factors, China has surpassed Mexico as the top source of US imports during the past two years. Mexican products accounted for only 10% of US imports in January-May of this year, compared with a 14% market share for China. Until 2003, Mexico had a bigger market share than China. Mexican exports to the US actually increased by almost 9% in the first five months of this year relative to a year ago, but this was largely a function of the high price of crude oil, which has been rising for the past couple of years (see SourceMex, 2005-02-16).

In contrast, China's exports to the US increased by almost 28% in January-May Mexican exports of manufactured products to the US, including those from maquiladora plants, continue to be displaced by China and other Asian countries, economists noted. Strong peso hinders Mexican exports The Chinese currency situation is not the major factor affecting the unfavorable competitive
position of Mexican exporters this year, but rather the continuing strength of the peso in relation to the US dollar.

The Mexican currency is close to a two-year high, hovering near 10.60 pesos per US$1.00. Analysts say the peso has received a boost from a strong Mexican economy. Earlier this year, the Banco de Mexico (central bank) projected Mexico's GDP growth at 3.5% to 4% this year, but has adjusted the projection to between 3.25% and 3.75%. The reduction in the GDP forecast is related to the loss of competitiveness for the Mexican export sector relative to China. "There are two reasons" for the reduced estimate in GDP growth, said Manuel Ramos Francia, the chief economist at Banco de Mexico. "The US economy is showing lower rates of growth, and Mexican exports have lost US market share."

The Consejo Coordinador Empresarial (CCE) said high interest rates are also contributing to a slowdown in economic activity in Mexico, which also explains the central bank's decision to lower its forecast slightly. The Centro de Estudios Economicos del Sector Privado (CEESP) is maintaining its forecast of GDP growth at about 3.9%, however, because forecasts for other economic fundamentals, such as consumer-price inflation, remain unchanged. "We will end this year with GDP growth at close to 4%," said the CEESP. "Annual inflation is going to be close to the projected level of about 3%.

Economists say the Mexican peso has also received a boost from the steady flow of remittances from Mexican expatriates in the US and other countries. The Banco de Mexico estimates that remittances will reach US$20 billion this year, compared with about US$17 billion in 2004 (see SourceMex, 2005-01-12). Remittances have been increasing steadily during the past decade, with the total sent back by expatriates amounting to only about US$5.9 billion as recently as 1999 (see SourceMex, 2000-04-12). Analysts also attribute the strength of the peso to the steady influx of foreign direct investment (FDI) into the Mexican economy this year. The Secretaria de Economia (SE) expects FDI to total about US$17.6 billion by the end of 2005, compared with about US$16.6 billion in 2004.

Indirect foreign investment has also boosted the peso, as strong demand for peso-denominated securities emerged because of the high interest rates offered by the Banco de Mexico. The central bank increased rates in the first quarter of the year to bring inflation down, following a higher-than-expected consumer price index (indice nacional de precios al consumidor, INPC) of 4.5% in January. Economists see little chance of peso devaluation Economists say the strength of the peso this year has brought back some memories of 1994, when the Mexican currency was overvalued by about 10% to 20% (see SourceMex, 1994-08-17).

A combination of depleted foreign reserves and high interest rates forced former President Ernesto Zedillo (1994-2000) to devalue the peso at the end of the year, sending the economy into a tailspin (see SourceMex, 1995-01-04). The economic downturn forced the US and multilateral institutions to develop a special financial package to rescue the Mexican economy (see SourceMex, 1995-03-08). Still, analysts say there are no serious concerns about the threat of a devaluation this year. One reason is that foreign reserves reached a record-high US$62 billion in March of this year and have continued close to that level all year.
The Fox government is attempting to shield the economy from any contingencies not only by maintaining a high level of reserves, but also shoring up the banking system, Werner said. Furthermore, said the Banco de Mexico, the Mexican currency is expected to weaken by the end of the year perhaps to about 11.20 pesos per US$1.00 because of an expected economic slowdown in the second half the year. This projection differs only slightly from private forecasts, which put the Mexican currency at 11.12 pesos per US$1.00 by December.

The central bank said interest rates are expected to increase in the US toward the end of the year, which would have the effect of limiting growth in the US. This will directly affect Mexico, which still depends heavily on the US economy.

**Entrepreneur offers plan to back peso with silver**

Reassurances from the Fox administration and the central bank have not fully quelled concerns about a devaluation, with a handful of business leaders suggesting that the government begin to link the peso to silver. The chief proponent of this measure is Hugo Salinas Price, who has proposed that Mexico reintroduce silver coins as legal currency, which would provide solid backing for the peso.

Salinas Price has teamed up with the Asociacion Civica Pro Plata to promote the plan, which would create the libertad, a one-ounce silver coin that would have no nominal value engraved upon it. Instead, the new coin would be valued according to the price of silver as a commodity, with its worth determined daily by the Banco de Mexico. "The idea was born from the need to protect the currency," said Price, founder of retailer Elektra, which forms part of the influential conglomerate Grupo Salinas. The conglomerate is led by Salinas Price’s son Ricardo Salinas Pliego and also includes Banco Azteca and television network TV Azteca.

Salinas said the libertad would be protected from losing value because losses on commodity markets would be compensated for by central bank valuations. "Devaluations occur when citizens lose confidence in the value of their currency and exchange their money for dollars or other foreign currencies," said a Web site created by the Asociacion Civica Pro Plata. "With silver, the currency does not lose its value, which eliminates the need to flee to another currency."

Some federal legislators have warmed up to Salinas Price's proposal, partly because of its positive effect on the Mexican silver industry. In March, the Senate approved an initiative supporting the plan to create the libertad coins, but a similar measure was later rejected by the finance committee (Comision de Hacienda y Credito Publico) in the lower house. The committee rejection did not stop Deputy Fernando Guzman Pelaez of the center-right Partido Accion Nacional (PAN) from bringing the measure to the full Chamber of Deputies, which has yet to take up the initiative. "We see this as a viable initiative," said Guzman, who gained support from six other deputies from various parties. "It would bring a new vitality to the state economies."

Critics say the plan is flawed because it would create extreme limitations on monetary policy. "I am inclined to think that this will not pass [Congress]," analyst Rafael Urquia of Banamex Accival brokerage in Mexico City told Reuters before the finance committee vote in March. "I would like to think that the legislators sitting on economic committees have some common sense." The Banco de Mexico has also come out against the plan, calling it anachronistic. (Sources: Asociacion Civica
Mexicana Pro Plata, www.plata.com.mx; Dow Jones news service, 03/08/05; Bloomberg news service, 03/16/05; El Economista, 05/24/05; Los Angeles Times, 07/15/05; El Universal, 07/26/05; The Herald-Mexico City, 03/09/05, 07/22/05, 07/28/05, 08/02/05; Reuters, 03/14/05, 08/02/05; El Economista, 08/03/05; El Financiero, 05/03/05, 05/05/05, 05/10/05, 05/12/05, 07/04/05, 07/06/05, 07/29/05, 08/01/05, 08/02-04/05; La Jornada, 06/23/05, 08/04/05; La Cronica de Hoy, 07/19/05, 07/28/05, 07/29/05, 08/01/05, 08/04/05)

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