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Mexican Economy Grows Slightly in April-June; Rest of Year Uncertain

by LADB Staff

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The Mexican economy showed a little bit of life in the second quarter of the year, but analysts say the up tick will almost certainly be short-lived if the US economy experiences an anticipated slowdown. The Secretaria de Hacienda y Credito Publico (SHCP) reported the country's GDP growth at 2.8% in April-June relative to the same period in 2006. When examining the growth rate in the first quarter of this year, GDP growth was up only a fraction of a percentage point in comparison to the first quarter of 2007.

Analysts said the services sector contributed most to the growth in the second quarter, especially transportation, communications, financial services, retail sales, and restaurants and hotels. Nevertheless, said economist Luis Flores of Ixe Grupo Financiero, Mexico's economic recovery "is occurring at a slower pace and in a more difficult manner than originally anticipated."

The US economy this year is of great concern to Mexico, given the recent volatility that has hit the US financial markets, the result of a crisis in the mortgage-lending sector. The situation, which has had the effect of tightening the amount of money available for loans, has led to higher interest rates. "If the US situation continues to deteriorate, things will get worse" for Mexico, Eugenio Aleman, senior economist at Wells Fargo & Co., told the Los Angeles Times.

Forecasters are already anticipating some slowdown in the US economy in 2007, which could limit Mexico's GDP growth this year. The Mexican government initially forecast GDP growth of 3.6% in its 2007 budget proposal (see SourceMex, 2006-12-13), but later revised the figure downward to a range of 3% to 3.3% (see SourceMex, 2007-05-02). This would represent a sharp decline from the 4.8% growth experienced in 2006.

The uncertainty will also be evident in the Mexican stock exchange (Bolsa Mexicana de Valores, BMV) and other financial markets, which fell sharply on Aug. 17, as a result of a sharp decline on Wall Street that day. The decline was directly linked to the financial problems of US companies involved in activities related to the mortgage crisis. "The volatility in global financial markets will continue in coming weeks because of the mortgage crisis in the US," said Jesus Viveros, a specialist for Bursametrica. Slow

US growth could result in reduced demand for manufactured products like automobiles as well as raw materials like crude oil. The Mexican automobile industry is already experiencing a slowdown because of a slump in sales of vehicles to the US (see SourceMex, 2007-08-15). Meanwhile, reduced US demand for crude oil could further tighten the finances of the state-run oil company PEMEX, which already reported an earnings decline in the first quarter of this year despite relatively high global oil prices (see SourceMex, 2007-05-09).

The Organization of Petroleum Exporting Countries (OPEC) said the mortgage crisis in the US is largely responsible for a recent decline in the price of crude oil in the US to about US\$72 per barrel in mid-August from almost US\$79 just a few weeks earlier. OPEC said the US market situation could "have a negative impact on demand during the second half of the year."

Similar mortgage crisis unlikely in Mexico

The Mexican government and private analysts have ruled out the possibility that a mortgage crisis similar to the one in the US could develop in Mexico because the mortgage-lending practices in the two countries are very different. The problems in the US were a result of the collapse of the subprime market, which grants mortgage loans to borrowers whose credit history is not sufficient to get a conventional mortgage. Lenders attempted to make this practice profitable by reselling loans to investors. The scheme backfired this year when too many borrowers started to default on their loans, which caused the chain reaction that led to the crisis in US financial markets.

In Mexico, the opposite has been the problem, as banks have traditionally charged high interest rates and other fees, discouraging many would-be borrowers (see SourceMex, 2003-03-12, 2006-09-13 and 2007-03-21). Government entities and nonbank financial institutions (Sociedades Financieras de Objeto Limitado, SOFOLES) played a major role in expanding low-income housing during the administration of former President Vicente Fox (see SourceMex, 2005-10-19). "In Mexico, we don't have a subprime market," said Luis Humberto Parra, an officer with the SOFOL Credito y Casa.

Others said the US crisis would not significantly affect the levels of mortgage credit or the availability of homes in Mexico. "If by chance we see a small spike in interest rates, we will also see an adjustment in four or five months," said Eugene Towle, director of the financial services company Sofotec. Towle said the US slowdown could have other effects on Mexico, including reducing the amount of money sent back to the country from expatriates in the US. A weakened US economy could potentially reduce employment levels for immigrants in some sectors, thus cutting down on the level of remittances. Remittances during the first half of the year were already beginning to show some signs of declining because of a crackdown on immigrants and a slowdown in the US construction industry (see SourceMex, 2007-08-15).

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