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Slow U.S. Recovery Could Limit Growth in Mexico’s Economy in Short Term, but Reforms Could Boost Long-Term Prospects

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When President Enrique Peña Nieto’s took office, he immediately entered into an agreement with the opposition parties in Congress to promote deep reforms that would set the foundation for long-term economic growth (SourceMex, Dec. 5, 2012). Some of those reforms have already been approved or are under consideration, including an overhaul of the public-education system (SourceMex, Dec. 12, 2012) and expansion of the telecommunications sector (SourceMex, March 27, 2013). But some of the reforms that matter most, an overhaul of the tax code and significant changes to energy policy (particularly the state-run oil company PEMEX), have yet to be considered.

Without the reforms, Mexico is expected to grow between 3.5% and 4% in each of the next two years, but economists believe the GDP growth rate could be even higher if Peña Nieto and the Mexican Congress are able to push through the energy, tax, and telecommunications reforms. The changes in the telecommunications sector have been approved in the Chamber of Deputies but await debate in the Senate. A major effect of the reforms would be to eliminate many restrictions on domestic and foreign investment, which would bring the capital needed for growth in these sectors. Barbara Kotschswar, an economist at the Washington-based Peterson Institute for International Economics (IIE), said the potential is there for Mexico to surpass Brazil as Latin America’s preferred destination for foreign investors.

"[Mexico] is viewed very favorably overseas and has gained a place among the most promising countries," Jonathan Heath, a private consultant in Mexico City, wrote in the Mexico City daily newspaper Reforma.

But Heath notes that optimism is more guarded in Mexico because high expectations have been dashed before. "Our most important growth engine—exports of non-petroleum manufactured products—demonstrated a very sluggish pattern in December and January, while the figures for the auto industry were apathetic in February," said Heath. "Production from the manufacturing sector advanced a mere 0.05% in January relative to the previous month, and annual growth reached a mere 2%.

Others concurred that the weakness in the manufacturing sector would limit growth for the entire year. In its most recent survey of private economists and analysts, the Banco de México (central bank) said the average of projections declined to 3.46%, compared with a previous average of 3.54%.

The projections by the economists surveyed by the central bank coincided with other private forecasts. "We are keeping our growth projection at 3.2% for 2013, which is lower than the 3.9% growth rate reported in 2012," said Sergio Martín Moreno, an economist at HSBC in Mexico.

As a result of the sluggish economy, job growth in Mexico remains slow. The survey showed that businesses remained cautious about hiring new workers in March, with only 7% of survey
participants indicating that they hired new employees and another 4% reporting a reduction in their work force. "In general terms, the rate of job creation was moderate and much slower than the previous month," Martín Moreno told the Notimex news agency.

One reason for the weakness in the manufacturing sector is the sluggish demand for Mexican goods in the US market, with Mexico's exports of manufactured goods in February down 1.5% relative to a year ago, the Instituto Nacional de Estadística y Geografía (INEGI) reported at the end of March.

**Decline in remittances hurts Mexican economy**

The weak US economy has also affected one of Mexico's top sources of foreign exchange: remittances from expatriates. A recent report from Mexico's central bank, also known as Banxico, said remittances have declined for eight consecutive months. In February, remittances amounted to US$1.59 billion, just short of the projected US$1.71 billion, said the central bank.

But remittances have been falling steadily since July 2012, partly because of weakness in the US construction sector, which employs many Mexican expatriates. As a result, total remittances in 2012 were only US$22.4 billion, on par with the US$22.7 billion in funds that expatriates sent to Mexico in 2011 (SourceMex, Feb. 22, 2012). But remittances have been trending lower in the past five years because of the sluggish US economy. The amounts for 2011 and 2012 compare with the record-high remittances of about US$26.1 billion in 2007.

The declines are linked directly to the downturn in the US economy, which has not yet recovered fully from the collapse of the mortgage market in 2008. That economic downturn has had a major negative impact on the global economy, including Mexico (SourceMex, Aug. 22, 2007, and Feb. 6, 2008). Because of the mortgage crisis, remittances fell for 17 consecutive months in 2008, 2009, and 2010 (SourceMex, April 14, 2010).

"This reduction [in remittances] is a clear indication that the earnings of our fellow Mexicans are falling in the US and that they are making surviving a priority rather than sending money to their relatives back home," Enrique Quintana, an economist at Universidad Nacional Autónoma de México (UNAM) wrote in a guest piece in the Mexico City daily newspaper Reforma.

The downward trend in remittances has had a major negative impact on communities in Mexico that depend on funds sent by relatives in the US. Remittances have fallen in 28 of Mexico's 32 states since 2007, but a recent Banxico report says eight states in particular—México, Veracruz, Hidalgo, Chiapas, Guerrero, Guanajuato, Michoacán, and Puebla—have seen significant declines in the past five years.

"In the last five years, the states that depend most on remittances received 38% fewer funds from expatriates," said Reforma, citing the Banxico report. "This is a consequence of the US economic crisis, which has had an impact across our country."

A study by BBVA Bancomer indicates that remittances account for almost 10% of GDP in some of the states that depend the most on money sent by relatives in other countries, primarily the US. "So far this year, we have seen remittances drop by 9%," said Luis Carlos Chávez Zavala, Michoacán's secretary for migrant affairs. "This is a trend that we have not seen since 2007." But the situation in Michoacán is less dire than in other states like Chiapas and Veracruz, where remittances have fallen by 30% in the last five years.
The impact varies from community to community. While the larger and medium-sized cities in Mexico have diversified sources of revenue and are able to withstand the decline in remittances, this is not the case for many small communities and towns that have come to depend on money sent back from expatriates who work in the US. And studies have shown that most people emigrating to the US come from smaller rural communities (SourceMex, March 3, 2004, and Sept. 17, 2008).

In many instances, the reduced amount of money arriving from overseas has halted small construction projects. For example, many communities like Chilcuautla in Hidalgo state have reported a huge drop-off in sales of construction and electrical materials. And there are municipalities like Charo in Michoacán where 80% of the families have at least one relative who has emigrated to the US and whose livelihood depends on the money sent from abroad. "In some communities, families are asking the city government to lend them money to bury a relative, pay for a visit to the doctor, or cover their utility bill," Sergio Arredondo, secretary general of the Federación de Nacional de Municipios de México (FENAMM), told Reforma.

What lies ahead?

There is some concern in Mexico about the prospect of reductions in government spending in the US, which could threaten a US economic recovery, thus hurting the Mexican economy. The concerns lie in the inability of the US Congress and President Barack Obama’s administration to reach agreement on specific spending caps to comply with the Budget Control Act of 2011, which triggered the sequester—automatic across-the-board reductions—on March 1, 2013.

Some economic experts in Mexico believe the slowdown in the US economy could have repercussions for this year’s growth rate, particularly affecting remittances. Economist Antonio Castro of Capem-Oxford Economic Forecasting estimated that remittances for 2013 could decline to about US$19.9 billion from the estimated US$22.4 billion for 2012. This, he said, could limit GDP growth in Mexico in 2013 to 2.9% instead of the projections of 3.3% or higher.

"There will also be an impact on employment, since only 560,000 new jobs would be created in Mexico this year rather than the earlier projections of 680,000 jobs," Castro told the Mexico City daily newspaper Excelsior.

But others are more optimistic about the medium- and longer-term forecasts for the US economy, even with the reduced government spending. If the US recovers and achieves sustained growth in the second half of the year, then Mexico would reap the benefits, the Centro de Estudios Económicos del Sector Privado (CEESP) said in a recent report. The CEESP, which is projecting a GDP growth of 4% in Mexico for 2013, said the US industrial sector has shown some dynamism in the first few months of 2013 despite the threat of US government spending cuts, which bodes well for Mexican exports to the northern neighbor.

The CEESP is also basing its optimism on the potential approval of telecommunications, energy, and tax reforms in Mexico "We have already noted that each reform by itself is important, but together they would generate an environment where businesses and people can develop more efficiently," said the CEESP.

"What is more likely is that the US economy is going to recover because of its flexibility," said UNAM’s Quintana. "This means that remittances are surely going to grow. We don’t know when this is going to happen, but it is going to happen."
There is great uncertainty about the impact of the immigration-reform proposals under discussion in the US Congress on remittances. In the long term, the reforms could provide some stability for undocumented workers seeking to legalize their status in the US. The initiative also proposes the creation of guest-worker programs in certain areas such as agriculture, which help grow the pool of money available for expatriates to send back to Mexico.

But the proposals also seek to secure the borders and tighten enforcement of immigration laws, which could result in an increase in deportations in the near term. This, in turn, would have the effect of reducing remittances further. "We believe there could be an increase in the number of people deported back to Mexico," said Mariana Rodríguez Mier y Terán, deputy interior secretary for human rights for the Tamaulipas state government. But Rodríguez Mier y Terán acknowledged her comments were speculative, since the US Congress has yet to approve any immigration reforms.

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