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Government Reduces Growth Projections After Recent Storms

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The Mexican government has reduced its growth forecast for 2013 because of the two storm systems that hit Mexico in mid-September, causing significant damage in a large area of the country (SourceMex, Sept. 25, 2013). The Secretaría de Hacienda y Crédito Público (SHCP) now projects GDP growth in 2013 at 1.7%, compared with an earlier estimate of 1.8%. Many private analysts suggest, however, that the SHCP has overstated its economic projections, particularly since the country’s economic performance was already much more sluggish than projected for the first half of the year. In a recent survey by the central bank (Banco de México, Banxico) among private economists, the average of projections for Mexico’s GDP this year was 1.4%.

The economic projections have prompted a debate on whether the tax plan proposed by President Enrique Peña Nieto is what the economy needs to recover.

There is no doubt that the damage from Tropical Storms Ingrid and Manuel caused more damage in Mexico than any storms in recent history. One reason is that the two storms hit at the same time, causing major property losses and at least 157 deaths. The last time that a major event had a widespread economic impact on Mexico was the 2009 outbreak of the H1N1 virus (SourceMex, May 6, 2009). While the negative impact of the storms on the economy is not of the same magnitude as the H1N1 outbreak, there is a similar disruptive effect on economic growth.

Because of the storms, the Peña Nieto administration has reduced its forecast for GDP growth in the third quarter of the year to 1.8% from an earlier projection of 2%. The third-quarter reduction has also prompted the administration to reduce its GDP growth projections for all of 2013 to 1.7%.

Still, the administration believes that the third-quarter downturn will be compensated by an increase in reconstruction-related expenditures, which will have a positive effect on GDP growth in the fourth quarter of the year. The Secretaría de Gobernación (SEGOB) has already announced plans to spend about 12.5 billion pesos (US$948 million) from the disaster assistance fund (Fondo Nacional de Desarrollo Nacional, FONDEN) for reconstruction of highways and infrastructure, business and agricultural loans, and other assistance. In addition, the Peña Nieto government plans to shift another 5 billion pesos (US$379 million) from other programs into reconstruction activities.

While analysts agree that the increased government expenditures will help boost the economy, there is skepticism about the administration’s projections for 1.7% growth for the year. "For the Mexican economy to achieve this average growth rate for the year, the average GDP expansion for the fourth quarter would have to reach at least 2.7%, which appears difficult to attain, if not impossible," columnist Victor Felipe Piz Mirelles wrote in the Mexico City daily business newspaper El Financiero.

Despite the increased expenditures, said Piz Mirelles, Mexico remains in a very weak financial position, with revenues falling and expenditures increasing.
Other factors contribute to lower forecasts

There were already signs that Mexico’s economy was not going to attain the optimistic GDP growth of 3.5% for 2013 that Peña Nieto projected at the start of his administration (SourceMex, Jan. 9, 2013). In a report submitted to the Mexican Senate at the beginning of October, Banxico said the slowdown at the end of 2012 worsened into the first half of 2013. GDP growth averaged 1% in January-June, the smallest economic expansion for that period since 2009, said the report.

Still, Banxico believes that the economy will recover in the long run. "I’m confident the deceleration is temporary," said Agustín Carstens, chief governor at the central bank. He added that Mexico’s "solid macroeconomic pillars" should bring the country out of its slump by early next year.

Banxico said a byproduct of the lower-than-expected growth in the early part of this year was a reduced inflation rate. The accumulated inflation rate for January-June reached only 4.07%, compared with 4.35% during the same six-month period in 2012. Consumer inflation would have dropped even further had it not been for two factors that affected prices: a freeze in March that damaged some vegetable production and a new outbreak of avian influenza in February, which caused egg and poultry prices to jump (SourceMex, Feb. 27, 2013).

Two other factors had some influence on Mexico’s growth rate during the first six months of the year, remittances and tourism, said the Banxico report. On the negative side, remittances sent by expatriates remained stagnant in the first two quarters of the year and into July. Remittances for the first six months of the year amounted to a little more than US$10.7 billion, a decline of about 10% from the same period in 2012. The trend continued in July, when remittances amounted to US$1.84 billion, down about 1.2% from a year ago. There was a slight increase in August, with remittances reaching US$1.9 billion, an increase of slightly more than 1% from a year ago.

Unless remittances increase dramatically during the last four months of the year, the total is likely to fall below the US$22.4 billion received during 2012. Remittances are the second-largest source of foreign exchange for Mexico, surpassed only by oil-export revenues.

There was good news in another important sector for the Mexican economy. The Secretaría de Turismo (SECTUR) reported an increase of 8.5% in the number of tourists arriving in Mexican airports during January-August. The increase is significant, given the continued concerns about safety and crime in Mexico, including in popular resorts like Acapulco (SourceMex, Feb. 13, 2013).

"Security issues—perceived or real—travelers pay attention to, and they can impact travel," Ricardo Suarez, a vice president of acquisitions at Stamford, Connecticut-based Starwood Hotels, said in an interview with the Mexico-based English-language online newspaper The News. "But there is such strong economic growth in the country, it's driving domestic travel and demand from the US and, more recently, also from places like Europe, Russia, and Asia."

A recent SECTUR report showed that 8 million tourists visited Mexico between January and August of this year, compared to 7 million in the same period of 2012. The growth in tourist numbers came primarily from the US, Britain, and other developing countries, with gains in occupancy rates in Mexico surpassing those in other major popular Latin American destinations, said SECTUR.

The importance of tourism to the Mexican economy (SourceMex, Feb. 13, 2013, and July 3, 2013) prompted the government to conduct an emergency evacuation of visitors stranded in Acapulco by Tropical Storm Manuel in September (SourceMex, Sept. 25, 2013).
Will proposed tax reform help or hinder recovery?

In the midst of the recovery efforts, the Peña Nieto government insists that that Mexico’s overall economy remains solid, which will provide a good basis for increased growth once its proposed tax reforms are enacted. The proposal, which aims to increase tax revenues by 1.4% of GDP, would raise certain taxes on the wealthy and close tax loopholes (SourceMex, Sep. 18, 2013).

Finance Secretary Luis Videgaray said the additional revenues obtained from tax increases would allow the government to meet its obligations to society. "We are pushing for a tax reform that gives the state—not only the federal government, but also state and municipal governments—the financial capacity to expand and improve opportunities in education, health, and infrastructure," the finance secretary said in a recent radio interview. "This means we will be supporting an economy that will promote productivity."

But there is some pressure for the administration to revise its tax-reform plan, particularly a proposal to apply the national value-added tax (impuesto al valor agregado, IVA) to the northern states that border the US. At present, the IVA in those states is at 11%, but the rate would be increased to 16% under the Peña Nieto plan.

Some critics warn that the change in tax rate could decimate the maquiladora industry if many of the companies that operate plants along the border decide that remaining in Mexico is not cost-effective. "According to some estimates, an average of 20 companies per month would return to their countries of origin [with a new tax rate]," financial columnist Darío Celis wrote in the Mexico daily newspaper Excélsior. "In three years, more than 800 companies would have abandoned their operations in Mexico, which could translate to the loss of 3 million jobs in the border region."

Celis pointed out that the maquiladora industry already provides a large percentage of the IVA collected by the government. "This is one of the principal source of employment in our country, with more than 12 million direct jobs created," Celis noted.

Others pointed out that the business sector is conflicted about tax reform. "Even though businesses visualize a condition of labor stability and commercial opportunities—even the creation of new enterprises, there is broad concern about some of the economic projections, which have been adjusted downward," columnist Marielena Vega wrote in Excélsior.

Vega said there is concern among leaders of such organizations as the Consejo Coordinador Empresarial (CCE), Confederación de Cámaras Industriales (CONCAMIN), and Confederación de Cámaras Nacionales de Comercio (CONCANACO) that increased taxes on businesses could discourage domestic and foreign investment, which could contributed to a slowdown or even a recession. [Peso-dollar conversions in this article are based on the Interbank rate in effect on Oct. 8, 2013, reported at 13.17 pesos per US$1.00.]

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