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Mexico's Economy in 1998 and 1999

Although Mexico's economy was subject to a series of external shocks throughout 1998, authorities responded with the proper fiscal and monetary policies to contain the adverse effects of these developments. The net outcome for the country was lower-than-expected growth and higher-than-expected inflation.

Mexico's economy in the second half of the 1990s has experienced some dramatic moments, which essentially started with an unexpected peso devaluation in December 1994. This was followed in 1995 by the most severe economic crisis Mexico has witnessed since the 1930s. Yet, later that year a recovery was already under way, which solidified in 1996 and 1997. Then, in 1998, Mexico was hit by several external shocks that pushed the economy into lower-than-expected growth and higher-than-expected inflation. This article examines Mexico's 1998 economic performance and discusses this year's outlook.

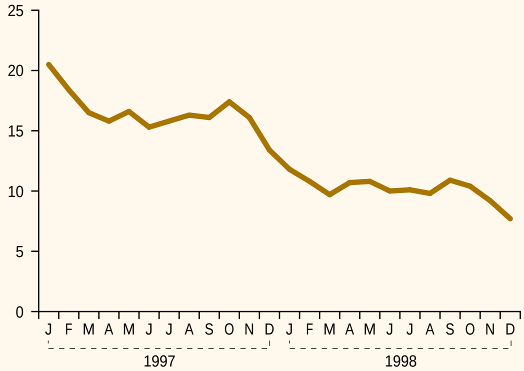
KEY MACROECONOMIC INDICATORS IN 1998

Three external shocks impacted Mexico's economy in 1998. First, as a result of the Asian financial crisis, which started in 1997 and continued into 1998, other emerging economies such as Mexico's saw their capital inflows reduced through the so-called contagion effect. Second, the price of oil dropped sharply in international markets throughout the year (*Chart 1*), which affected Mexico's public finances since oil revenues represent about a third of total government revenues. Finally, Russia's debt default in August sent shock waves throughout emerging economies as international investors once again withdrew from these countries. Mexico was not immune to this new round of contagion effects, suffering a downturn in its capital inflows. Chart 2 shows the decreased portfolio investments received by Mexico and other selected regions in 1998 relative to the previous two years.

Despite this adverse external environment, Mexico emerged in 1998 with healthy 4.8-percent gross domestic product (GDP) growth (*Chart 3*). Though this rate was lower than original expectations of over 5 percent, it still placed Mexico among the fastest growing economies in 1998. Of the 34 countries listed in Table 1, only

Chart 1
Average Export Price of Mexican Oil, 1997–98

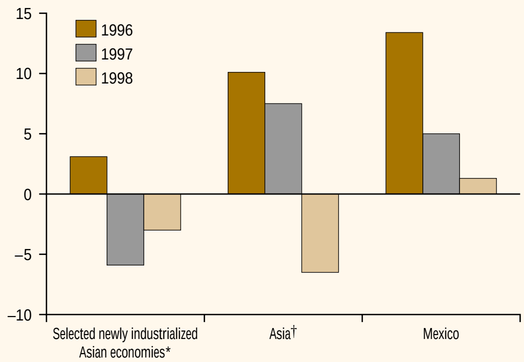
U.S. dollars per barrel



SOURCE: Instituto Nacional de Estadística, Geografía e Informática with data from Petróleos Mexicanos.

Chart 2
Portfolio Investment in Selected Regions, 1996–98

Billions of U.S. dollars

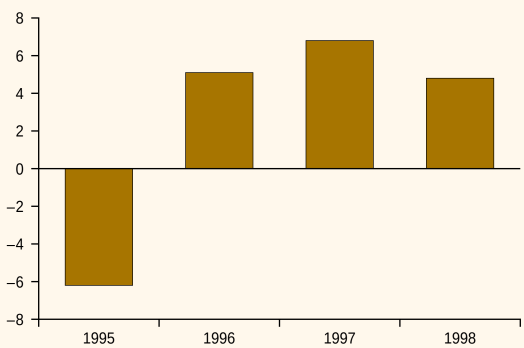


* Korea, Singapore and Taiwan.
† Includes China, Indonesia, Malaysia, Philippines and Thailand, among others.

SOURCE: International Monetary Fund.

Chart 3
Real GDP, 1995–98

Percent, annual rates



SOURCE OF PRIMARY DATA: Instituto Nacional de Estadística, Geografía e Informática.

Table 1
1998 World Economic Growth

	GDP growth (percent)
World output	2.4
Developed countries	2.1
Developing countries	3.0
Selected Countries	
Argentina	4.3
Brazil	.2
Canada	3.0
Chile	3.8
China	7.8
Colombia	1.8
Czech Republic	–2.2
France	3.1
Germany	2.8
Greece	3.7
Hong Kong	–5.3
India	5.6
Indonesia	–13.6
Ireland	9.0
Israel	2.0
Italy	1.4
Japan	–2.8
Korea	–5.5
Malaysia	–7.5
Mexico	**4.8**
Netherlands	3.7
Peru	1.5
Philippines	1.0
Poland	4.8
Portugal	3.9
Russia	–4.8
Singapore	1.5
Spain	3.8
Switzerland	2.1
Taiwan	4.9
Thailand	–8.0
United Kingdom	2.3
United States	3.9
Venezuela	.6

SOURCE: International Monetary Fund.

four—Ireland, China, India and Taiwan—outperformed Mexico in GDP growth last year.

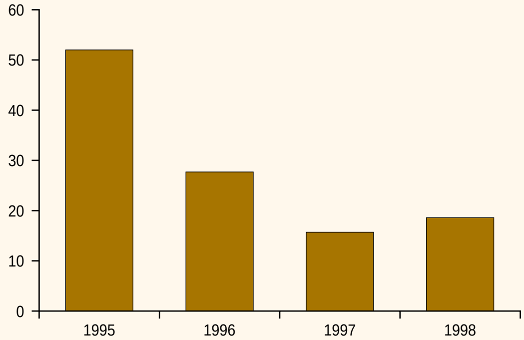
On the inflation front, Mexico finished the year with a higher-than-expected rate of 18.6 percent. Despite the Mexican authorities' efforts to keep inflation down by following the appropriate fiscal and monetary policies, they were unable to fully control the negative effects of contagion on this indicator. Last year's inflation was not only higher than the previous year's, it also exceeded the government's 1998 target of 12 percent (*Chart 4*).

The 1998 performance of other key macroeconomic indicators was as follows:

- **Interest Rates.** Both the 28-day *Cetes* rate and the average interbank interest rate (TIIP) were higher in 1998 than in 1997. As Chart 5 shows,

Chart 4
Inflation, 1995–98

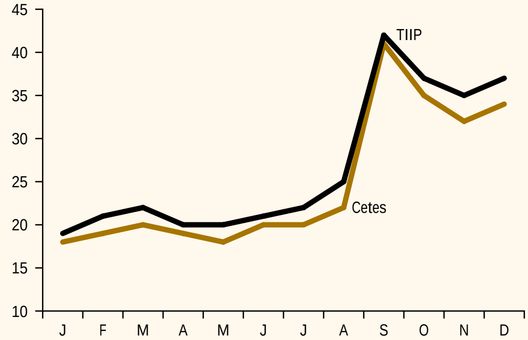
Percent, annual rates



SOURCE OF PRIMARY DATA: Banco de México.

Chart 5
Interest Rates, 1998

Percent, monthly averages



SOURCE: Instituto Nacional de Estadística, Geografía e Informática with data from Banco de México and Bolsa Mexicana de Valores.

both benchmark interest rates hovered around 20 percent for the first seven months of the year. Mexican interest rates surged in response to Russia's August debt moratorium and spiked in September to 41 percent. During the last quarter, however, interest rates eased from their September peak. The *Cetes* and TIIP rates averaged 24.7 percent and 26.7 percent, respectively, in 1998, up from 19.8 percent and 21.2 percent in 1997.

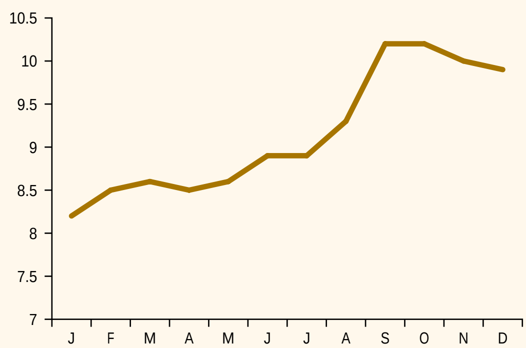
• **Exchange Rate.** As with interest rates, Russia's debt default was a key element in the performance of the peso–dollar exchange rate in 1998. Moreover, the two other external factors—the declining price of oil and the lingering effects of the Asian crisis—contributed to the volatility exhibited by this indicator for most of 1998. While the exchange rate averaged 8.2 pesos per dollar in January, it lost ground during the following months and slipped considerably in August (*Chart 6*). Though the exchange rate stabilized thereafter, the year-end rate equaled 9.9 pesos per dollar, a depreciation of 22 percent relative to year-end 1997.

• **Budget Deficit.** Mexico's 1998 budget deficit target, announced at the beginning of the year, was 1.25 percent of GDP. Given this tight fiscal policy objective, Mexico was forced to cut its budget three times during the year in response to the reduction in public oil revenues brought about by the plummeting oil prices. Mexico was successful in controlling its public finances last year: the actual budget deficit was 1.24 percent of GDP.

• **Employment and Unemployment.** Employment grew 8 percent in 1998, equaling the 1997 rate and surpassing the 1996 rate (*Chart 7*). Employment has been rising since Mexico's 1995 economic crisis, when it declined more than 4

Chart 6
Exchange Rate, 1998

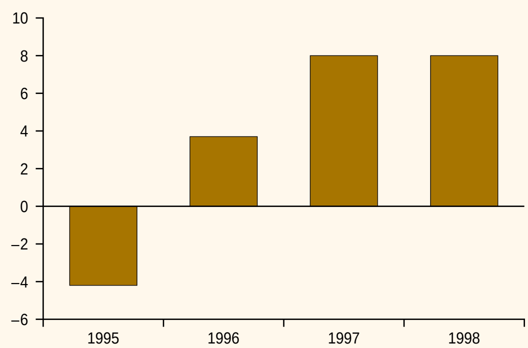
Pesos per U.S. dollar, monthly averages



SOURCE: Instituto Nacional de Estadística, Geografía e Informática with data from Banco de México.

Chart 7
Employment, 1995–98

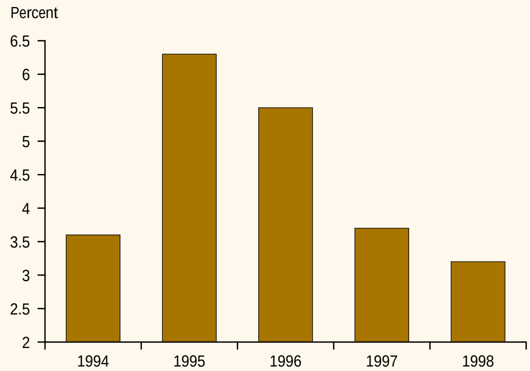
Percent, annual rates



SOURCE: Instituto Nacional de Estadística, Geografía e Informática with data from Instituto Mexicano del Seguro Social.

Chart 8

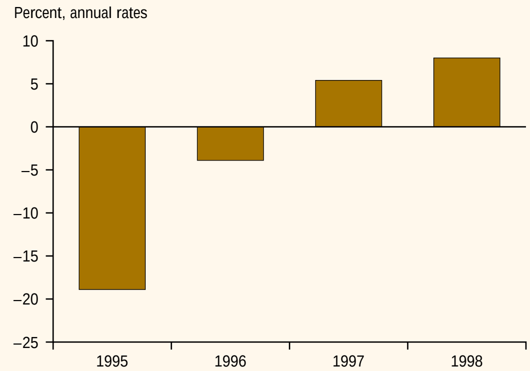
Open Unemployment Rate, 1994–98



SOURCE OF PRIMARY DATA: Instituto Nacional de Estadística, Geografía e Informática.

Chart 9

Retail Sales, 1995–98



SOURCE OF PRIMARY DATA: Instituto Nacional de Estadística, Geografía e Informática.

percent. Conversely, Mexico's open unemployment rate has come down since 1995. Last year, the rate fell to 3.2 percent, below the 1997 rate as well as the rate prevailing before the 1995 crisis (*Chart 8*). Although this is certainly good news for Mexico, it should be kept in mind that these figures pertain to a narrow definition of unemployment. Other measures depict a higher unemployment and underemployment picture, though even these indicators have improved since 1995 (*see box titled "Mexican Unemployment Measures"*).

• **Consumption and Investment.** Two important components of growth in 1998 were private consumer demand and private investment. Last year, private consumption grew 6.4 percent, consolidating growth of over 6 percent reached in 1997. Boosting consumption in 1998 were employment growth, double-digit salary increases and lower household debt. Total investment last year managed healthy growth of 10.7 percent, thanks to 17-percent growth in private investment. Public investment, as expected, dropped significantly in 1998 (by –20.4 percent) as a result of the impact of lower oil prices on public revenues.

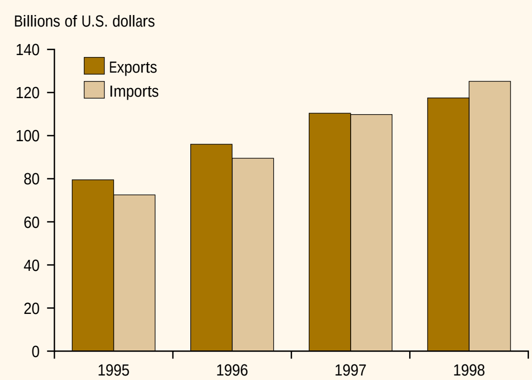
• **Retail Sales.** Last year's retail sales performance reflected the healthy growth in consumption. Retail sales grew 8 percent in 1998, their strongest showing since the 1995 crisis, when they shrank almost 19 percent (*Chart 9*).

• **International Trade.** Mexico recorded a $7.7 billion trade deficit last year, the result of $117.5 billion in exports and $125.2 billion in imports (*Chart 10*). While total export growth slowed substantially in 1998, import growth remained strong. Exports grew only 6.4 percent in 1998, down from 15 percent the previous year. The downturn in this indicator was strongly affected by the drop in the value of oil exports due to depressed oil prices. Exports of manufactured goods, for example, continued strong in 1998, with nearly 12 percent growth. Total merchandise imports, on the other hand, managed double-digit growth of over 14 percent last year. Especially strong were consumption goods imports, which grew over 19 percent and reflected the economy's overall strong consumer demand.

• **Foreign Direct Investment and International Reserves.** Although the external shocks Mexico suffered last year negatively affected its portfolio investment, they did not dampen Mexico's ability to attract long-term foreign direct investment. Foreign direct investment totaled more than $10 billion in 1998 (*Chart 11*), contributing to Mexico's gain in international reserves last year despite the country's volatile short-term capital inflows. International reserves at year-end 1998 were $30.1 billion, an increase of over $2 billion from year-end 1997.

Chart 10

Mexico's Trade, 1995–98



SOURCE OF PRIMARY DATA: Banco de México.

Mexican Unemployment Measures

Mexico's open unemployment rate has a very narrow definition. It is derived from considering as employed anybody who worked at least one hour in the week before the unemployment survey is applied to Mexican households. Therefore, the open unemployment rate would not capture a large portion of the unemployed or underemployed in Mexico.

Other unemployment indicators, however, incorporate broader definitions of unemployment and better reflect Mexico's true unemployment and underemployment conditions. These complementary unemployment rates, together with the open unemployment rate, are defined below.[1]

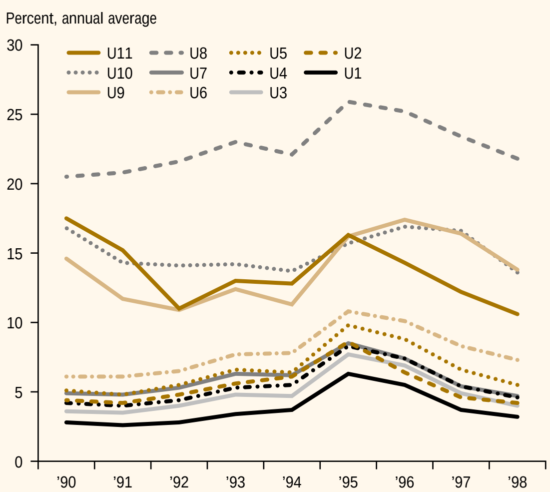
Open unemployment rate (U1). The percentage of openly unemployed people in the economically active population (EAP). The EAP in Mexico includes people 12 years and older who, at the time of the reference survey period, did not work at least one hour during the week, but who were either seeking employment or were trying to become self-employed.

Alternative open unemployment rate (U2). The openly unemployed plus those in the economically *inactive* population who have stopped looking for a job and instead decided to stay home or pursue studies, but who were available for employment. Also included in this definition are those people who will be starting a job in the four weeks after the reference survey period.

Real economic pressure rate (U3). The proportion of people in the EAP who were unemployed or who were employed but looking for a second job.

Real preference pressure rate (U4). The openly unemployed and those people in the EAP who were employed but who were seeking to switch jobs.

Mexico's Open Unemployment and Complementary Unemployment Rates, 1990–98



SOURCE OF PRIMARY DATA: Instituto Nacional de Estadística, Geografía e Informática.

General pressure rate (U5). The openly unemployed and those people in the EAP who were seeking either a second job or to switch jobs.

Part-time employment less than 15 hours and unemployment rate (U6). The openly unemployed and those people in the EAP who worked less than 15 hours during the reference week.

Part-time employment due to market conditions and unemployment rate (U7). The openly unemployed and those people in the EAP who, because of market conditions, worked less than 35 hours during the reference week.

Part-time employment less than 35 hours and unemployment rate (U8). The openly unemployed and the proportion of people in the EAP who worked less than 35 hours a week.

Employment at less than the minimum wage and unemployment rate (U9). The openly unemployed and the proportion of people in the EAP who were employed during the reference week but who earned less than the minimum wage.

Critical conditions of employment rate (U10). The proportion of the employed who worked less than 35 hours per week due to market conditions, those who worked more than 35 hours per week but earned less than the minimum wage, and/or those who worked more than 48 hours per week but earned less than two minimum wages.

General rate of employment needs (U11). The proportion of people in the economically active and inactive populations who were openly unemployed during the reference survey period but who were available to work even if they have stopped searching for a job, who will start a job soon, who were employed but were seeking either a second job or to switch jobs, or who worked less than 15 hours during the reference week.

The chart shows the trend in Mexico's open unemployment rate and in its 10 complementary unemployment indicators during 1990–98. All complementary indicators show higher unemployment rates for Mexico throughout the period. Also, though all unemployment indicators rose during the 1995 economic crisis, all also have come down since then so that, in general, it can be said that Mexico's overall unemployment situation has improved since 1995.

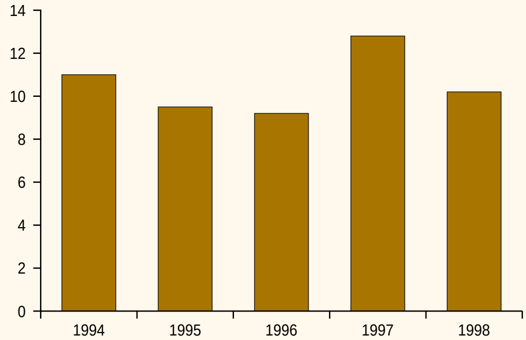
Still, it can be somewhat misleading to talk about a 3.2-percent open unemployment rate in 1998 (U1) when, in the same year, for example, 13.6 percent of the population was either unemployed or underemployed because they worked less than 35 hours per week or earned less than the minimum wage (U10).

[1] The definitions are from Instituto Nacional de Estadística, Geografía e Informática (INEGI), the official source for unemployment data in Mexico. Also, for a comprehensive analysis of unemployment indicators in Mexico, see Susan Fleck and Constance Sorrentino, "Employment and Unemployment in Mexico's Labor Force," *Monthly Labor Review*, Bureau of Labor Statistics, November 1994, pp. 3–31.

Chart 11

Foreign Direct Investment in Mexico, 1994–98

Billions of U.S. dollars

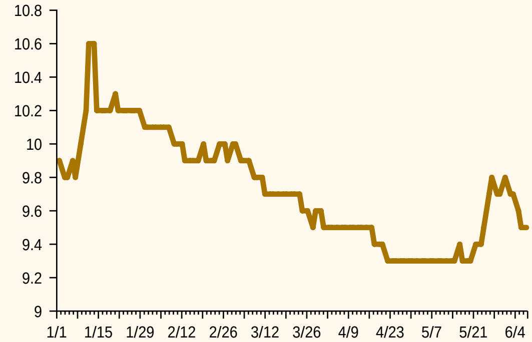


SOURCE OF PRIMARY DATA: Banco de México.

Chart 12

Exchange Rate, 1999

Pesos per U.S. dollar, daily closing values



SOURCE: Bloomberg.

1999 PERFORMANCE AND OUTLOOK

The Exchange Rate, Interest Rates and the Price of Oil

Two weeks into 1999, Mexico faced yet another external shock. On January 13, Brazil devalued its currency, the real, by 8 percent; yet by January 15, given the market's negative reaction to this development, Brazil was forced to allow the real to float freely in the exchange rate markets.

The expected contagion on Mexico's financial markets quickly materialized as the peso weakened considerably during those days (*Chart 12*). Interestingly, however, though the contagion this time stemmed from a country within the same region, the negative effects on Mexico were relatively short-lived. Just a week after the Brazilian real's devaluation, the peso regained stability and has strengthened considerably ever since. Thus, after dipping to a rate of 10.6 pesos per dollar on January 14, four months later—on May 14—the exchange rate traded at 9.3 pesos per dollar.

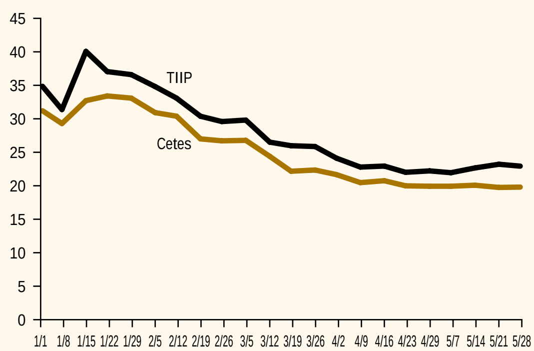
It is apparent that with the Brazilian crisis, international investors differentiated more among emerging markets and, recognizing Mexico's overall solid fundamentals, decided not to exit the country as they had during Russia's debt default in 1998. Hence, rather than spreading, contagion this time was quickly contained. Interest rates in Mexico, for example, followed the same path as the exchange rate—rebounding in mid-January but subsequently declining (*Chart 13*). The rates for *Cetes* and TIIP reached 19.8 and 22.93, respectively, on May 28.

A stabilizing influence on Mexico's economic performance this year has been the oil price recovery. While in January the average export price of Mexican oil averaged $8.61 per barrel, by

Chart 13

Interest Rates, 1999

Percent, weekly averages

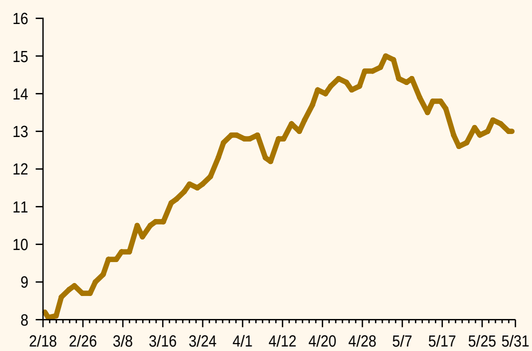


SOURCE: Bloomberg.

Chart 14

Daily Average Export Price of Mexican Oil, 1999

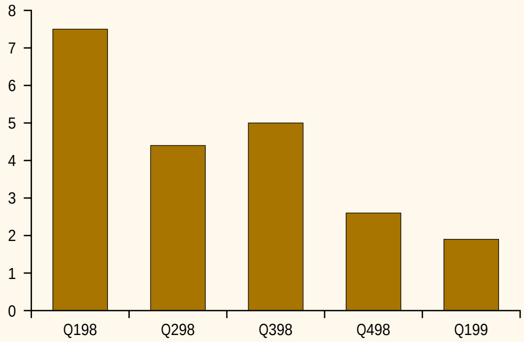
Dollars per barrel



SOURCE: Ministry of Energy with data from Petróleos Mexicanos.

Chart 15
Quarterly Real GDP

Percent, annual rates



SOURCE OF PRIMARY DATA: Instituto Nacional de Estadística, Geografía e Informática.

early May it had gone up to $14.96 per barrel. And though the price has come down somewhat since then, it remains considerably above its level near the start of the year (*Chart 14*). Thus, unlike in 1998, when Mexico was having to adapt its public-finance situation to accommodate a declining oil price, so far this year Mexico has enjoyed a favorable oil-price scenario.

Even though this year the external environment has not caused the uncertainty it did last year for the Mexican economy, it is not inconceivable that some shocks may still emerge before year-end. One external development that negatively impacted Mexico's financial markets occurred in the latter part of May. Argentina was rumored to be moving toward abandoning its currency board with the U.S. dollar, which caused the peso to weaken to 9.786 on May 27. But, as was the case last year, Mexican authorities are expected to act with the proper fiscal or monetary policies, or both, to contain any negative effects of this or any other external shock.

Other Key Macroeconomic Indicators

First quarter 1999 figures show Mexico's real GDP annual growth at 1.9 percent. Compared with previous quarters, this marks a deceleration in Mexico's growth (*Chart 15*). Industrial production, for example, recorded annual growth of 1.8 percent in the first quarter after advancing 6.6 percent last year. However, fixed capital investment showed a healthy performance in the first three months of 1999, with annual growth of over 3 percent. Moreover, employment in the same period grew at an annual rate of 6.4 percent, while the open unemployment rate averaged 2.9 percent. Maquiladora employment continued strong in the first quarter, with annual growth of 10.4 percent.[1]

On the trade front, although annual growth in both exports and imports was quite slow in January, it picked up in the following months. Export growth surpassed import growth slightly during the first quarter of the year at 6.5 percent and 4.1 percent, respectively.

Retail sales in the first three months of 1999 registered annual growth of just over 1 percent, due largely to stagnant growth in January (0.7 percent) and negative growth in February (–0.1 percent). March, however, showed an important rebound as annual growth in this indicator equaled 2.7 percent.

Finally, monthly inflation has been on a downward trend since the beginning of the year (*Chart 16*). The April rate recorded by the consumer price index was 0.92 percent. The rate in May's first two weeks was 0.24 percent relative to the previous two-week period—the lowest two-week gain since 1994.

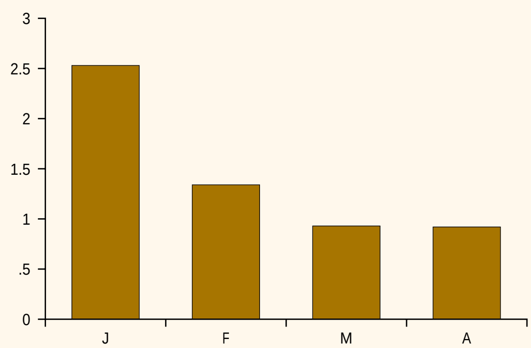
Outlook

Mexico's economic growth in 1999 is expected to be below last year's, while inflation is expected to improve relative to 1998. The official 1999 targets for GDP growth and inflation are 3 percent and 13 percent, respectively. Private-sector forecasts, on the other hand, show lower growth and higher inflation. However, as Table 2 shows, expectations by private-sector analysts have been improving since the beginning of the year as their forecasts in May placed growth higher—and inflation lower—relative to January. Obviously, the Mexican economy's favorable performance in the first five months is increasing analysts' optimism about their year-end outlooks.

In a more regional perspective, of the three biggest economies in Latin America—Brazil,

Chart 16
Inflation, 1999

Percent, monthly Consumer Price Index



SOURCE OF PRIMARY DATA: Banco de México.

Table 2
1999 Mexican Economic Outlook

	Official	Private sector*				
		Jan.	Feb.	Mar.	Apr.	May
Real GDP, annual rate (%)	3.0	2.3	2.4	2.7	2.7	2.9
Inflation, December to December (%)	13.0	16.5	15.8	15.3	15.1	14.5

*Based on Banco de México's monthly survey of 25 to 33 private economic analysis groups.

Mexico and Argentina—only Mexico will record positive growth in 1999. According to the International Monetary Fund, both Brazil and Argentina will be in recession this year, with their economies expected to contract 3.8 percent and 1.5 percent, respectively.

CONCLUSION

Mexico was one of the fastest growing economies last year. Although Mexico's economy was subject to a series of external shocks throughout 1998, authorities responded with the proper fiscal and monetary policies to contain the adverse effects of these developments. The net outcome for the country was lower-than-expected growth and higher-than-expected inflation.

In 1999, Mexico has met with a more favorable set of external conditions. Moreover, authorities continue to pursue sound fiscal and monetary policies. This combination will allow Mexico to continue growing this year under a less inflationary scenario.

—Lucinda Vargas

[1] For a review of the maquiladora industry's performance through 1998, see *Business Frontier*, Issues 3 and 4, 1998.

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