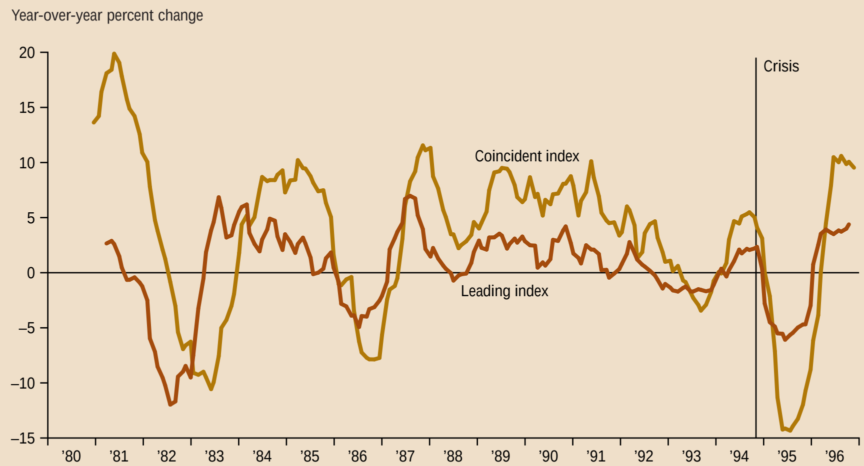
The Mexican Economy Snaps Back

Mexico's 1995 economic plunge was one of the most rapid in the nation's history, but the turnaround was also quick. Overall output is almost back to the pre-crisis peak, but the particular stresses and strains of this comeback make it look different from past rebounds.

Mexico's recession and now burgeoning recovery have played out differently in the various sectors of the economy. Output in all sectors fell during the crisis, but the construction and wholesale and retail trade sectors were the hardest hit. Manufacturing also experienced a large decline; however, it benefited from a huge jump in exports. By the last half of 1995, all sectors had experienced a dramatic turnaround, with manufacturing leading the way. Even so, wage softness and a very slowly rebounding consumer sector remain problems. The availability of international financial markets to large companies, together with restricted credit for smaller and middle-sized firms as a result of troubles in Mexico's domestic banking system, has meant that the larger firms seem to be getting the lion's share of the growth.

Chart 2
Mexican Economic Indexes Show Recovery



The Nonfinancial Economy

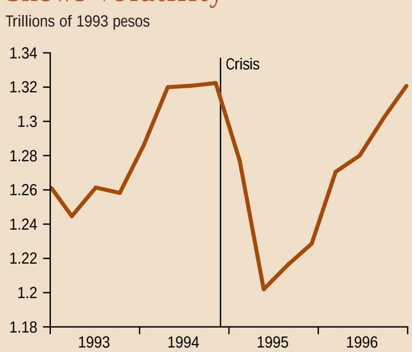
Although real gross domestic product (GDP) fell 6.9 percent in 1995, it rose 5.1 percent in 1996 (*Chart 1*). The Federal Reserve Bank of Dallas does not forecast Mexican GDP growth for 1997 over 1996, but a consensus of private forecasters is that it will expand by about 4.5 percent. The index of leading economic indicators for Mexico, originally constructed at the Federal Reserve Bank of Dallas, shows increases throughout 1996. This pattern suggests expansion at least into the second quarter of 1997 (*Chart 2*).

Although overall output in Mexico is just now approaching its pre-crisis peak, industrial production had reached its previous peak by the middle of last year. This recovery was substantially more rapid than what occurred after Mexico's 1982 crisis, as can be seen in Chart 3. Chart 3 depicts the progress of industrial production on a month-by-month basis after the 1982 and 1994 economic crises. After the 1982 peak, industrial production took three years to reach its previous peak. This time, it took only 18 months.

Because of a dramatic increase in exports, manufacturing never suffered as much as the rest of the economy. But like most of the Mexican economy, manufacturing output dipped substantially during the first two quarters of 1995 (*Chart 4*).

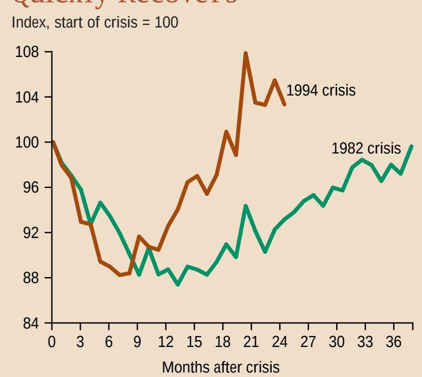
Trade liberalizations that began in the late 1980s had moved Mexican manufacturers into international competition. However, the failure of the

Chart 1
Mexican Real GDP Shows Volatility



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

Chart 3
Mexican Industrial Production Quickly Recovers



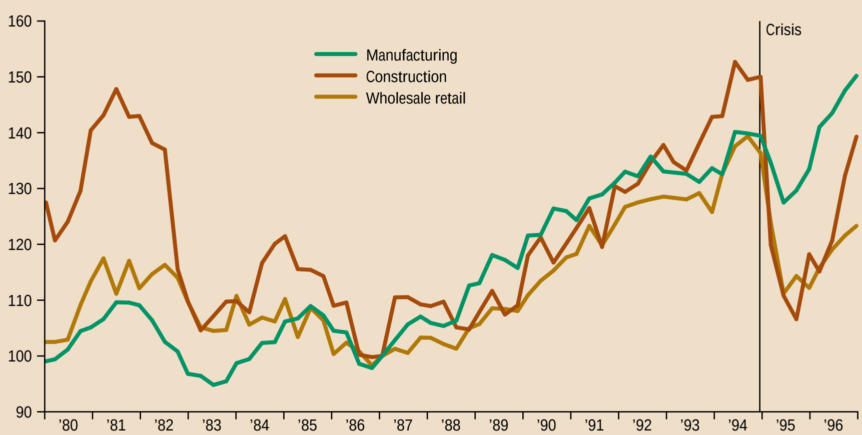
SOURCE OF PRIMARY DATA: INEGI.

exchange rate to adjust for inflation rate differentials between Mexico and the United States made such competition increasingly difficult for Mexican manufacturers. The devaluation of December 1994 realigned prices in dollars sufficiently to trigger large increases in Mexican manufactured exports. As the manufacturing recovery ensued, investments in plant and equipment kept Mexican manufacturers competitive despite the nearly 15 percent appreciation of the real peso/dollar exchange rate in 1996.

This manufacturing rebound has now translated into similar growth throughout the economy. However, the manufacturing sector has surpassed pre-crisis levels, but the construction and wholesale and retail sectors have not. Construction, like many other sectors, did not benefit directly from the export-led boom and fell much more dramatically than manufacturing in the early months of the crisis. Now these sectors have made a dramatic turnaround but have yet to return to pre-crisis levels. Moreover, manufacturing real wages have fallen almost continuously since the economic downturn of 1995 because of the nation's soft labor market.

Chart 4
Mexican GDP: Sectors' Performances Vary

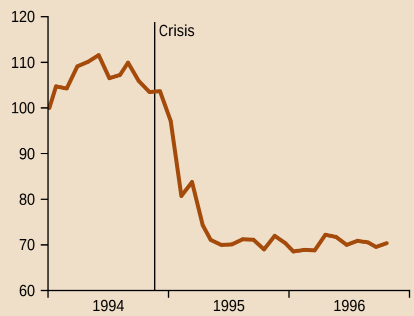
Index, January 1987 = 100



SOURCE OF PRIMARY DATA: INEGI.

Chart 5
Mexican Retail Sales Remain Sluggish

Index, January 1994 = 100



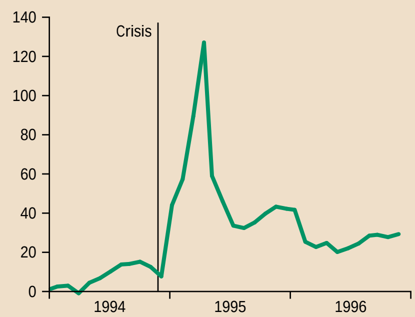
SOURCE OF PRIMARY DATA: INEGI.

Because of the sectoral fragmentation of Mexico's recovery and falling real wages in manufacturing, there has been a very limited rebound in the consumer sector. Retail sales in Mexico are at a serious impasse, as Chart 5 demonstrates. Increases in wholesale and retail production apparently reflect anticipated rather than actual retail sales.

Nevertheless, the groundwork has been laid for long-run stability. The latest figure for monthly inflation, at a seasonally adjusted annual rate of 29.3 percent, is substantially below the 1995 average of 52 percent (*Chart 6*). Consensus expectations are that inflation will fall to 18 percent in 1997.

Chart 6
Mexican Monthly Inflation Is Moderating

Annual percentage



SOURCE OF PRIMARY DATA: INEGI.

Moreover, financial markets behave as if they expect continued growth and stability. Interest rates are falling. Foreign capital is flowing back into Mexico's equities market, and forecasts for Mexican output are almost unanimously positive.

Conclusion

In sum, most of Mexico's ecomony is moving in a positive direction, but the consumption side is lagging. Declining real manufacturing wages in the face of increasing manufacturing productivity suggest that relative returns have shifted toward capital and away from labor. Over time, however, as Mexico fully recovers and all sectors return to pre-crisis levels, demand for labor should pick up and boost wages.

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