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Update analysis on the international crisis and its impact on the Mexican Economy

Análise atual da crise internacional e seu impacto na economia mexicana

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RESUMO: O objetivo deste estudo é analisar o estado atual da economia mexicana em face da crise internacional. Duas perguntas são feitas: a crise internacional acabou? A economia mexicana é forte e resiliente o suficiente para enfrentar a crise na zona do euro? A primeira dessas questões é respondida na parte 1. A resposta à segunda questão é discutida na segunda parte deste estudo. Também é examinado o grande número de problemas de curto, médio e longo prazo que a economia mexicana terá que enfrentar em 2012 e talvez 2013.
PALAVRAS-CHAVE: crise internacional; economia mexicana; zona do euro; países emergentes; restrições externas ao crescimento.

ABSTRACT: The aim of this study is to analyze the current state of the Mexican economy in the face of the International crisis. Two questions are asked: Is the International crisis over? Is the Mexican economy strong and resilient enough to face the crisis in the Eurozone? The first of these questions is answered in part 1. The answer to the second question is discussed in the second part of this study. Also examined are the large number of short, medium and long term problems that the Mexican economy will have to face in 2012 and perhaps 2013.
KEYWORDS: International crisis; Mexican Economy; Eurozone; Emerging Countries; External Restrictions to Growth.
JEL Classification: 01.

INTERNATIONAL FINANCIAL CRISIS

In the 1970s the Mexican singer José José popularized the song "What is past is past." The lyrics of the chorus are sung as follows "the past, now past no longer

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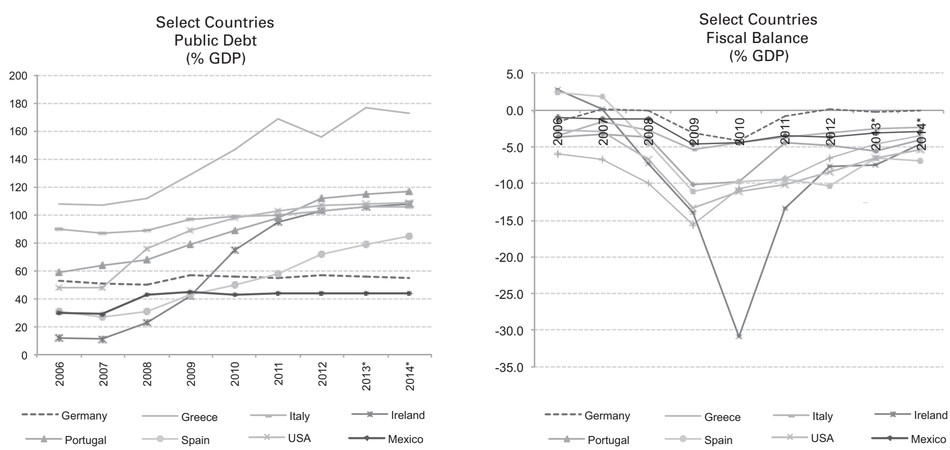
interests me." In 2008, the year in which the international crisis began, it was predicted that the recovery of the most affected countries, such as Spain, would begin in 2009. Negative factors, such as the high rates of unemployment would be a thing of the past. The recovery would confirm what José referred to: the past… is past. Recent fluctuations and the forthcoming recession in the eurozone countries in 2013 prompt the question: Has the past really past? The answer is simply: no. Negative aspects of the crisis, which began in 2008, are still with us. According to Figure 1, significant foreign debt and vast fiscal deficit remain unresolved problems in several of the eurozone countries. Fiscal revenues dropped owing to the reduced growth of GDP, however levels of public spending were maintained. Consequently, debt and fiscal deficit disappeared. According to the trend registered in Figure 1, the group of countries that most rapidly increased their debt as a share of GDP in 2008 and 2010 are Greece, followed by Ireland, then Portugal and Spain. The forecasts for these countries predict stability and no debt reduction until 2014. According to the deficit trend shown in Figure 1 from 2008 to the end of 2012, Ireland has the highest fiscal deficit in relation to GDP, followed by Greece, the United States, Spain and Portugal. According to the forecasts, these countries will not stabilize their fiscal balances or achieve a deficit of around -5% until 2014.

In contract to the international picture, Mexico has had stable levels of debt during this period and a fiscal deficit close to 0%. According to forecasts, similar levels will be registered in forthcoming years.

Figure 1
External Conditions

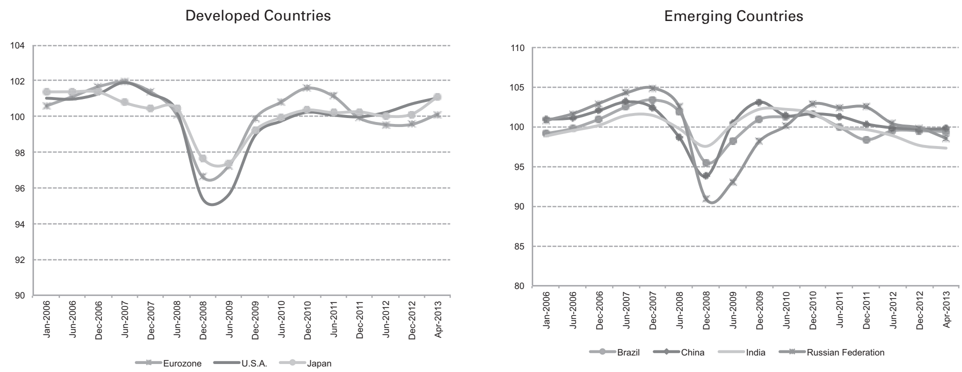


Source: prepared by the authors on Fiscal Monitor data of International Monetary Fund (IMF)
*Projections

The crisis has not disappeared, in fact it has spread and it not only affecting developed countries, but also emerging countries. According to the trend for January 2006 to June 2013, the lead indicators shown in Figure 2 reveal that the crisis between 2008 and 2009 in the United States, the eurozone and Japan had major repercussions for Brazil and the Russian Federation and less so for China and India.

The brief period of recovery for the United States, the eurozone and Japan between January and June 2010 also influenced emerging countries. China and India recovered more quickly and to a greater extent than Brazil and Russia. It appeared that the crisis had been overcome, but this was not so.

Figure 2
Composing Leading Indicatores: Jan 2006 - Apr 2013



Source: prepared by the authors on basis of Organization for Economic Cooperation and Development (OECD).

The indicators dropped again for the United States, Japanese and the eurozone economies from June 2011. The eurozone was worst affected by this new period of recession. Various analysts concur that these indicators continued to drop in 2012 and that the eurozone continued to be the most affected. Although the United States show a relative improvement from June 2012 to April 2013, its performance could be affected by the fall in the Eurozone, which in turn could adversely affect the Mexican economy. Consequently, the key issue for the Mexican economy in 2013 is the extent to which the eurozone might fall and the repercussions this could have for the U.S. economy.

Emerging economies have also felt the recent reduction in economic activity in developed countries. India, Brazil and Russian have suffered most from the adverse effects, while stagnation in China negatively influences manufacturing exports in Mexico.

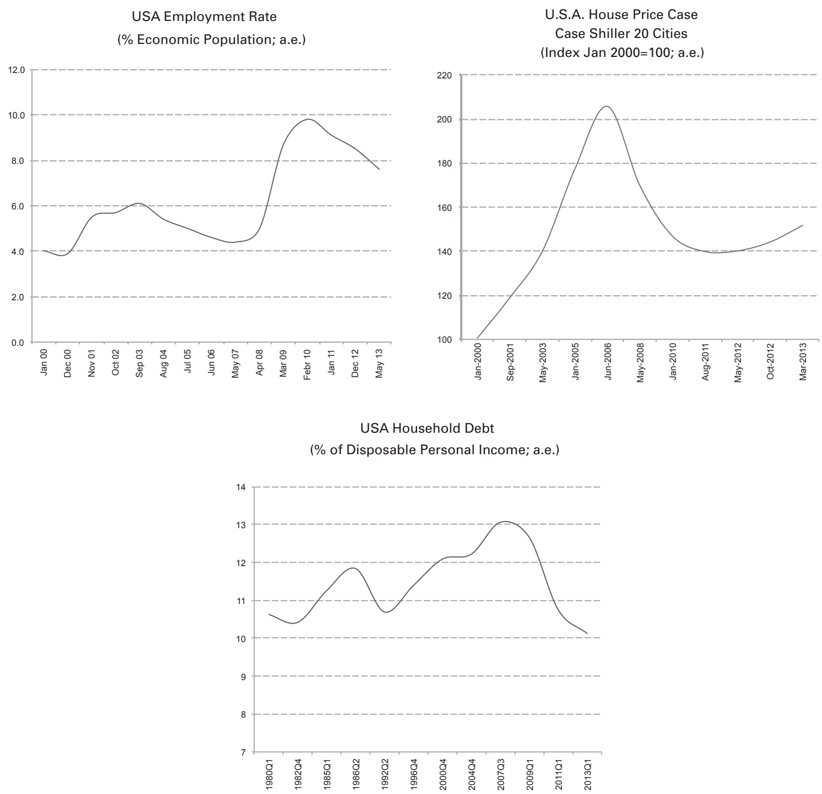
Figure 3 shows that despite the negative situation facing the global economy, the U.S. economy is beginning to show signs of recovery. The unemployment rate begins to fall from February 2010 to October 2013, falling from 9.8% to 7.6% respectively. Unemployment is still higher than in 2007. This reflects the fact that recovery in the United States remains slow.

According to the *Case-Shiller* index applied to twenty U.S cities, housing prices have dropped considerably. However, since January 2010, this trend has leveled out (see Figure 3).

Historically, performance in the Housing Sector has had repercussions for the

U.S. economy, but so has an increase in consumer income. Another variable that must therefore be taken into account in this study is the financial situation of housing. The percentage household debt owed reduced from the beginning of 2009 to first quarter 2013 (see Figure 3).

Figure 3



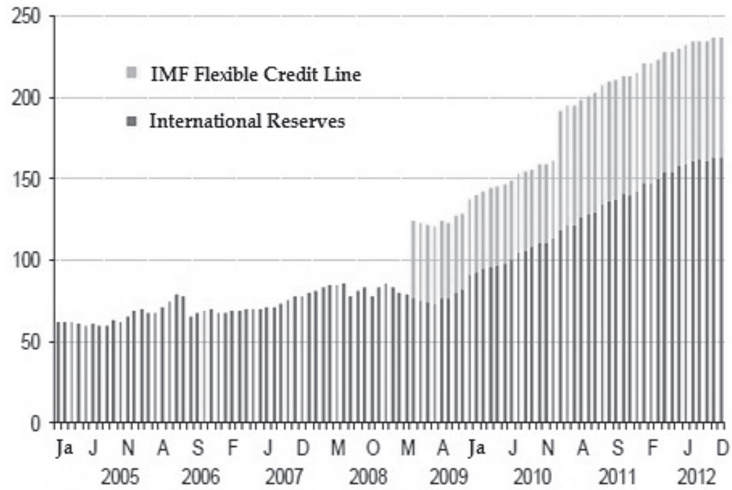
Although there have been improvements in the United States, the eurozone's economy is still weak, particularly in Greece, Portugal, Spain, Ireland and Italy. The perceived risk has risen considerably in these countries. According to the indicators that measure credit risk, Portugal, Spain and Italy are the countries that present the highest risk (BANXICO, 2013, p. 24). For Mexico, Spain's credit risk is a worrying factor given that a good number of her banks belong to Spanish corporations.

MEXICO TODAY. STRONG AND RESILIENT?

Positive features

The Mexican economy presents both positive and negative features in an international context. The first positive feature relates to the levels of international reserves from the end of 2009. Mexico's reserves have been increasing and a credit line has been maintained with the IMF (see Figure 4). The amount of reserves accrued recently is very different to the end of 2007. Before the 2008-2009 crisis, reserves hovered at around 80,000 million dollars. The reserves and debt figure for 2012 is slightly above 240,000 million dollars. This represents a significant resource for facing global adversity, particularly given that Mexican exports are expected to decline and imports to rise in 2013, and consequently the current account deficit to increase.

Figure 4: International Reserves



Source: Bank of Mexico and International Monetary Fund.

Rising international oil prices and a positive forecast for the future is another positive feature of the Mexican economy. From 2004 to 2008 the international price of oil rose steadily. During the 2008-2009 crisis, the international price of oil dropped 40 dollars a barrel, but it rose in December 2012 to more 90 dollars a barrel (see Figure 5).

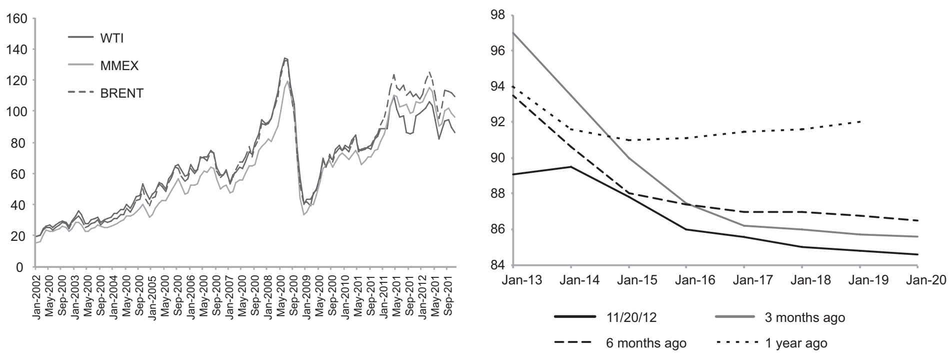
Forecasts indicate that prices for 2013 to 2020 will remain high (see Figure 5). Consequently, the share of fiscal revenue from oil will not be affected by an unfavorable international environment in 2013.

In contrast to the situation in 2011 and 2012 for the weaker economies of the Eurozone, a recession in 2013 will not severely affect federal government finances within the Mexican economy. The forecast of percentage fiscal deficit in 2013 is less than in 2012 (see Figure 1). A more precise figure, including Mexican Petroleum (PEMEX) investment is around -2.4%, whereas in 2011, the figure was -2.5% (ECLAC, 2012a, p. 75). Furthermore, the expenditure budget approved for 2013 remains conservative given the negative environment expected in 2013, when a deficit equivalent to 0.0% of GDP is forecasted (-2.0% if PEMEX investment is taken into account) (SHCP, 2013, p. 74). Furthermore, although the end of 2012 inflation rose to 4.3% is expected in the medium term it will be 3.6%.

Figure 5: Oil Prices

Observed

Futures of WTI



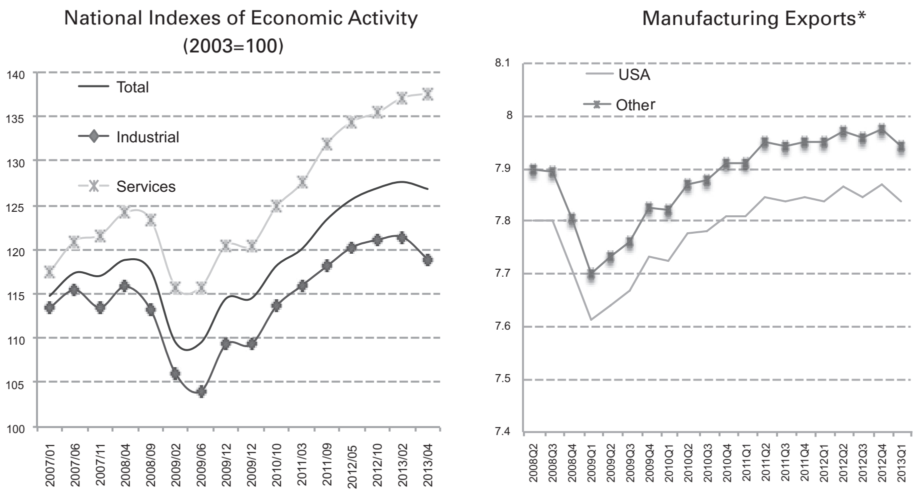
Source: prepared by the authors on basis of Energy Information Administration (EIA) and Centro de Estudios de las Finanzas Públicas of Mexican Congress

Another positive feature of the Mexican economy is the exchange rate's flexibility when faced with external shocks. In fact, Mexico, together with Brazil, Colombia and Chile reduced pressure on the exchange rate at the most difficult point of the crisis, quickly correcting the overvaluation of their currencies (Ocampo, 2009, p. 30). Variations in the exchange rate would enable accounts to be adjusted should an adverse situation affect the balance of payments, enabling the Mexican economy to recover quickly from crisis, an advantage that weaker economies such as Spain do not have. A devaluation in Spain could make exports more competitive and reactivate the economy more quickly. However the way things currently stand for the Spanish economy, this is not possible. New government measures seek to influence production costs in the same way as a devaluation: by reducing internal production costs. We shall see if this is possible in forthcoming months.

Negative features

Despite the positive aspects hitherto discussed, the question remains: Is the Mexican economy stronger and more resilient than it was in 2008? The answer is that despite the positive signs the Mexican economy shows in 2013, it is still not as strong or resilient as it was in 2008. Two less positive features serve to illustrate our answer. The first is that although economic activity continues, it lacks momentum. Although the national indexes of economic activity (INAE) rose in general, it began to slow down in the industrial and services sectors from February 2012 (see Figure 6).

Figure 6
Evolution of Mexican Economy



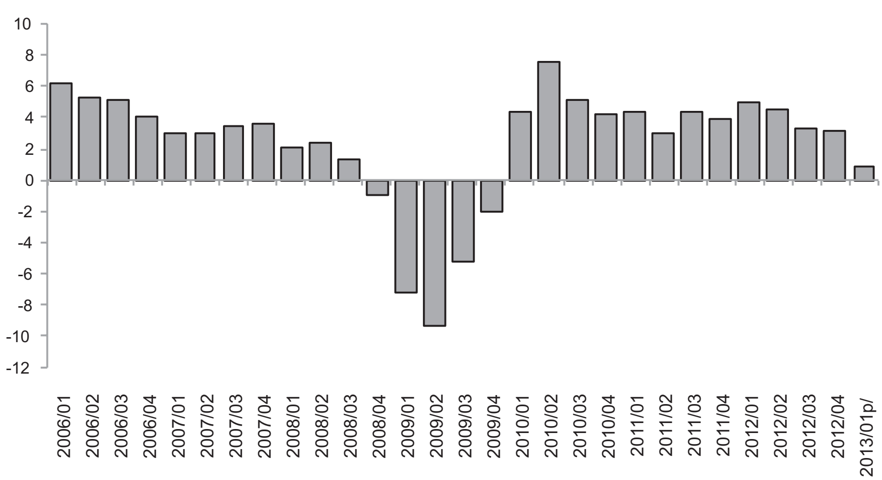
Source: Instituto Nacional de Estadística Geografía e Informática (INEGI).

Source: Trade Map, United Nations Conference of Trade and Development (UNCTAD).
*In logarithms.

Manufacturing exports to the United States and other countries have begun to decline. This has had repercussions on the Mexican manufacturing exports.

It is hoped that the real GDP growth rate for the first quarter of 2013 will be lower compared with the rates registered since the Mexican economy recovered from one of its worst crises in history (see Figure 7).

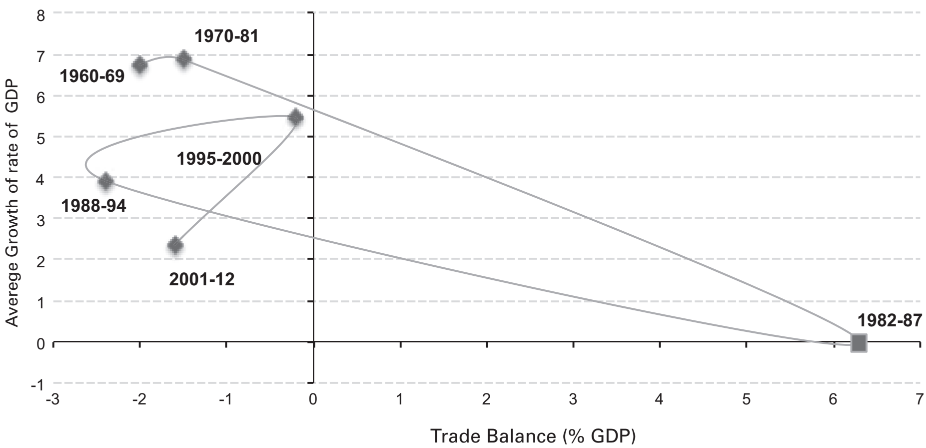
Figure 7
Growth of Real GDP in Mexico



Source: Instituto de Estadística Geografía e Informática (INEGI).
p: preliminary data

The second negative aspect is the existence of external restrictions to growth. For four decades, whenever there has been growth in the Mexican economy, the current account deficit has increased. This reduces or disappears if the growth rate reduces (see Figure 8).

Figure 8
External Restriction to Growth in Mexico



Source: prepared by the authors on basis CEPALSTAT data from Economic Commission for Latin America and Caribbean (ECLAC).

The situation from 2001 to 2012, when there is an average growth rate of 2.3% with a trade deficit of more than -1.6% (see Figure 8) could be a bad sign for 2013 and the years to come. If the restrictions continue, the economy will slow down to eliminate the trade deficit.

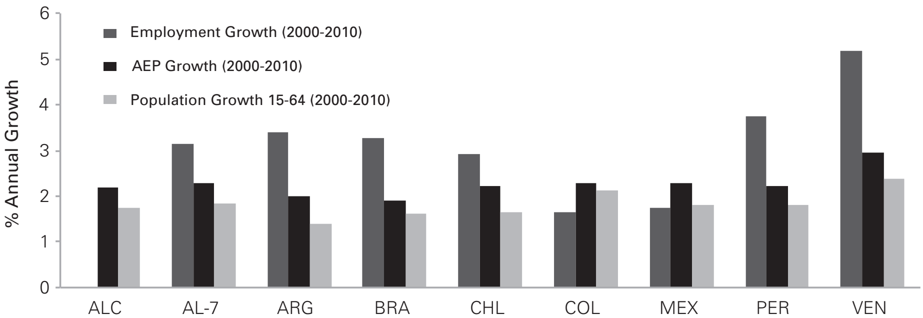
Restrictions to growth have had an effect on the minimum growth of the Mexican economy over the last ten years. The low employment rates that growth has generated, compared to Brazil, Argentina and Venezuela are proof of this (see Figure 9). Added to this is the reduced capacity for employment generation compared to growth of the economically active population (AEP). This is a phenomenon that does not occur in the other countries shown in Figure 9, except for Colombia.

The lack of employment growth is linked to an increase in poverty, inequality and insecurity.

Coinciding with the lack of growth momentum is an increase in poverty. According to Chaves (2011) the number of people living below the breadline has increased since 2008, representing 20% of the total population in 2010. The same can be said for patrimony poverty, which in 2010 represented 50% of the total population.

Another negative aspect is the high level of inequality in our country. The Gini index at market entry in 2008 was around 0.53, and after transfers and taxes 0.49. This figure is in contrast to that of non-Latin American OECD countries. Inequality

Figure 9
Employment Growth, of AEP and Working-Age population



Source: Prepared by the authors on basis CEPALSTAT data from Economic Commission for Latin America and Caribbean (ECLAC).

is significantly less, the Gini Index at market entry in 2008 was 0.45 and 0.34 after transfers and taxes (OECD/ECLAC, 2011, p. 17). The level of inequality has not changed much in 2011, compared with 2008. According to ECLAC, the Gini coefficient is around 0.48 (ECLAC, 2012b, p. 23).

In conclusion, the lack of economic momentum, restrictions to growth, the increase in poverty and high levels of inequality are problems that test the strength and resilience of the Mexican economy before the financial difficulties facing Europe and the global economy.

CONCLUSIONS

The international economic crisis appears to be on its way out, but is far from over. The Mexican Economy has room for maneuver in the short term, but there are challenges to face in the medium and long term. The federal government's view is that the present state of the economy is without doubt capable of facing challenges in 2013. However, researchers, business leaders and international organizations have pointed out medium and long term obstacles. Many have indicated that real growth has been meager in the last thirty years (2.8%), and that for the last thirty years there has been heavy dependency on the fiscal revenue of oil exports. For nearly forty years now, fiscal reform has been needed to resolve the low level of revenue collected from taxation. The tax system is also regressive, gravitating more towards low and medium income, with special measures applicable to high incomes. Levels of public and private investment are insufficient. As a result, infrastructure has deteriorated and machinery and equipment needs modernizing. Monetary policy has succeeded in reducing interest rates. However, this has had a low impact on housing mortgage rates and on companies. The growth model applied to exports has focused exports on a limited number of sectors and has had little impact on other sectors. Finally, underemployment and unemployment is increasingly affecting the highly qualified among the population.

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