

Mexico

Mexico's GDP shrank from 3.2% in 2007 to an estimated 1.8% in 2008 owing to the general weakening of domestic demand coupled with a steep decline in export growth, especially in the second semester. A slightly restrictive monetary policy limited the supply of credit during the first part of the year, reining in private consumption. The expansion of the real wage bill slowed, remittances from migrant workers decreased, and the gradual worsening of the international financial crisis lowered expectations in general, which had a negative effect on investment. Annual inflation is expected to reach 6% in 2008 on the back of the rise in international food prices and domestic electricity and housing prices. The fiscal balance will remain close to equilibrium; the current account deficit of the balance of payments is estimated to reach about 1.5% of GDP, twice the size of the deficit posted in 2007.

The manufacturing industry suffered the effects of the slowdown in demand in the United States market, which absorbs 80% of Mexico's exports, most of which are manufactures. The trade deficit widened thanks to buoyant imports, especially gasoline, cereals (whose import values were driven up by high international prices), machinery and electrical material imports.

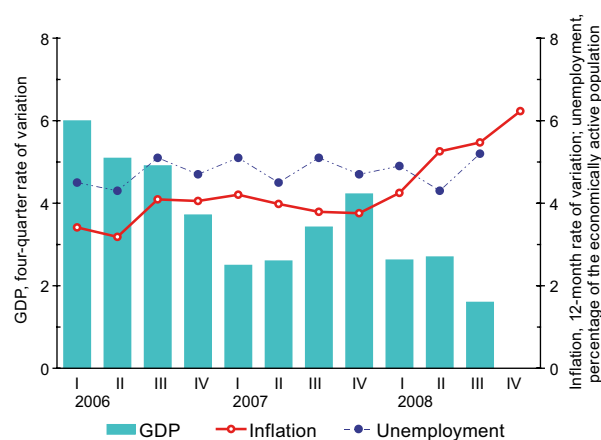
The Mexican economy will slow down further in 2009. The government measures being taken to mitigate the impact on the financial and the real sector will help ensure liquidity and stimulate production. Nonetheless, GDP growth is projected to fall to less than half that recorded in 2008 as a result of declining manufacturing exports, a depressed domestic market, less credit and reduced inflows of foreign direct investment and remittances from Mexicans working abroad.

Public-sector revenues rose 11.5% in real terms between January and September thanks to the increase in both oil income (19.7%) and non-oil income (7.2%). Oil revenue was boosted by the relatively high prices obtained for petroleum exports and domestic gas sales. The favourable impact of these prices was partially offset, however, by the drop in production volumes and crude oil exports and the rise in petroleum imports. Non-oil tax revenues expanded 11.3% mainly thanks to higher receipts of income tax, VAT and the special tax on production, services and imports. The collection of the flat-rate business tax that came into force in 2008 also increased non-oil revenues.

Higher-than-expected receipts made it possible to step up public-sector budget spending between January and September by 13.2%: current non-financial expenditure increased 13.8% and capital expenditures 25.5%. Physical investment expanded to account for 15.9% of programmed spending. Public-sector borrowing requirements are expected to reach 2% of GDP, slightly more than in 2007.

In order to soften the impact of the slowdown of the world economy, the government launched a growth

MEXICO: GDP, INFLATION AND UNEMPLOYMENT



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

and employment stimulation programme, which aims to use public resources representing about 1% of GDP to stimulate the economy. The programme consists of five lines of action: the expansion and reallocation of public expenditure to promote infrastructure spending in particular; procedural changes to streamline public spending, particularly in infrastructure, and to avoid under-implementation; the construction of a refinery; an extraordinary support programme for small and medium-sized enterprises; and the simplification of procedures for foreign trade and customs operations to ensure access for more products and at better prices and to make it easier to establish companies in Mexico.

In the second semester, the Ministry of Finance and Public Credit announced the acquisition of US\$ 8 billion of international reserves from the central bank to ensure the liquidity of the national treasury and cover the government's operating expenses in the ensuing months. Up to September 2008, US\$ 3.649 billion in external liabilities were amortized. That same month, net external public debt stood at 2.9% of GDP for 2008, while net internal public debt reached 15.5% of GDP.

In the wake of falling crude oil prices, the government performed a number of hedging operations in financial markets in the second semester of 2008 at a total cost of US\$ 1.5 billion and using a base price of US\$ 70 per barrel of Mexican crude. If prices in 2009 average close to those in force in November 2008, (less than US\$ 40 per barrel), the federal government will receive compensation of US\$ 9.553 billion, enough to avoid having to make adjustments to the national budget.

The central bank had to deal with a number of issues in 2008. High international prices for certain food items, commodities and energy products drove up inflation, and the interest rate was therefore raised three times between June and August by 25 basis points, finally targeting an interbank rate of 8.25%. From September on, however, private consumption and employment levels worsened, and food, energy and other commodity prices began to drop, so the bank decided to leave the interest rate at 8.25%. Although interest rates were nominally higher in 2008 than in 2007, the episodes of inflation during the year meant that they were lower in real terms. The average real interest rate of the 28-day Federation Treasury Certificates (CETES) was 2.3% for January-October 2008 compared with 4.2% for the same period in 2007.

The real exchange rate appreciated slightly during the first three quarters of 2008, both in terms of the bilateral rate with the United States dollar and the effective exchange rate. In October 2008, however, the value of the Mexican peso plummeted against the dollar owing to various derivative operations carried out by companies established in Mexico. The central bank was forced to intervene to

MEXICO: MAIN ECONOMIC INDICATORS

	2006	2007	2008 ^a
Annual growth rates			
Gross domestic product	4.8	3.2	1.8
Per capita gross domestic product	3.7	2.0	0.6
Consumer prices	4.1	3.8	6.2 ^b
Average real wage ^c	0.4	1.0	0.7 ^d
Money (M1)	15.1	11.7	8.9 ^e
Real effective exchange rate ^f	0.0	0.6	-0.3 ^g
Terms of trade	0.5	0.9	2.8
Annual average percentages			
Urban unemployment rate	4.6	4.8	4.9 ^h
Public sector			
overall balance / GDP	0.1	0.0	0.0
Nominal deposit interest rate	6.1	6.0	6.7 ⁱ
Nominal lending interest rate	7.5	7.6	8.3 ^j
Millions of dollars			
Exports of goods and services	266 146	289 492	323 703
Imports of goods and services	278 015	305 506	345 689
Current account	-2 231	-5 813	-15 136
Capital and financial account	1 228	16 099	17 636
Overall balance	-1 003	10 286	2 500

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

^a Preliminary estimates.

^b Twelve-month variation to November 2008.

^c Manufacturing sector.

^d Estimate based on data from January to September.

^e Twelve-month variation to October 2008.

^f A negative rate indicates an appreciation of the currency in real terms.

^g Year-on-year average variation, January to October.

^h Estimate based on data from January to October.

ⁱ Average from January to November, annualized.

^j Average from January to October, annualized.

prevent an overreaction triggering more inflation. By November, 14% of reserves had been auctioned off in a move to prop up the peso. Between July and the end of November 2008, the average exchange rate of the peso rose from 10.2 to 13.0 pesos per dollar, and at the end of October, the bilateral real exchange rate was almost 15% lower than at the end of the same month in 2007.

In October 2008, the Mexican congress approved a first set of energy reforms aimed at improving the efficiency of Petróleos Mexicanos (PEMEX), the parastatal oil company. The company was granted greater autonomy in its decision-making regarding project investment and the allocation of resources for maintenance and operations.

The downturn in the Mexican economy, especially during the last two quarters of the year, was triggered by the recession in the United States. The modest increase recorded in annual GDP in 2008 is the combined result of growth in the agricultural sector and services (especially basic services) and the stagnation, particularly from May onwards, of industrial activity, a trend that worsened towards the last quarter of the year. Growth in the services

sector also waned towards the end of 2008 as private consumption growth fell even lower. The weak performance of the industrial sector reflects a significant contraction of mining activity, limited growth in the manufacturing sector and a sharp drop in construction activity.

Manufacturing started to decline in August 2008 and is expected to continue to do so until the end of the year. Automobile production was down in July and August but increased 5.1% in September compared with the same month the previous year. Automobile exports fell in July-September compared with the same period in 2007.

Despite slower economic growth, open unemployment remained at about 4% of the economically active population in January-September, a similar level to that recorded in 2007, thanks to the absorption of some of the workforce by the informal sector. The number of people affiliated to the Mexican Social Security Institute (IMSS) increased at a slower pace and rose by barely 0.9% in October 2008 compared with the same month the previous year. The worst employment trends were detected in the processing and construction industries (4.6% and 2.2% fewer jobs, respectively).

The slowdown in the world economy, and particularly in the United States, put the brakes on export growth in Mexico as well. Exports remained buoyant up to the end

of the first semester, but falling oil prices and the drop in demand in the United States market curbed Mexican sales dramatically. In January-September, the growth of goods exports diminished drastically to only 1.6%, compared with the same period of the previous year. Sales to the United States shrank 1.3%.¹ In current dollars, sales kept increasing until the third quarter but were clearly trending downwards. Automobile exports recorded the second largest drop after petroleum exports, which were also down compared with the first semester.

Import values rose 15.4% in the first three quarters owing in part to high oil and grain prices and increased machinery and electrical material purchases. In real terms, import growth far outpaced export growth. The trade deficit therefore widened by US\$ 1 billion since the end of 2007 to stand at US\$ 8.38 billion in September 2008. Excluding oil, the trade deficit exceeded US\$ 50 billion in the same period.

The economic-financial crisis in the United States had a severe impact on remittance flows to Mexico. Up to September 2008, the accumulated value of these flows was US\$ 17.526 billion (3.7% less than in 2007). Foreign direct investment is expected to reach US\$ 18 billion in 2008. Most of this investment will be in the manufacturing industry, financial services and trade.

¹ Estimates based on current deflated figures for the export prices index (see INEGI).