

Mexico

The Mexican economy posted growth of 4.8%, the highest rate since 2000, with all the components of aggregate demand rising strongly. Consumption was up by 6%, investment by 9% and exports by over 10%, driven by the motor vehicle sector which, in turn, powered the largest expansion in employment in six years and helped to narrow the balance-of-payment current account deficit (0.3% of GDP). Domestic demand received impetus from growth in credit to the private sector, migrant remittances and the upturn in employment, although real wages scarcely varied. The high petroleum price helped to keep the fiscal deficit low (0.3% of GDP), despite increased spending on concluding infrastructure works and on the presidential, legislative and state elections held in July. The close-run presidential elections and the difficult period that followed generated only a very slight financial volatility towards mid-year, with no major repercussions on the economy.

In 2007 Mexico's exports are expected to be affected by the slowing of the United States economy. Output growth and employment will slacken, so production growth will be driven by the domestic market, which will continue to be spurred by remittances and credit. GDP will expand by about 3.8%, inflation will come in at around 4% and the fiscal accounts will be close to balance.

The new government faces some broad challenges. In the short term, it must work to soften the impact on the Mexican economy of the United States slowdown, while dealing with competition from China in that market. The main challenges for the medium and long terms are to achieve a higher rate of economic growth and lay the foundations for sustainable economic expansion, increase formal job creation and reduce poverty, marginalization and income inequality. In order to move towards those objectives the government will have to formulate suitable public policies and put in place reforms on antitrust, fiscal, energy and labour affairs, among other matters. The government will need to devise a strategy for the complex task of consensus-building in Congress, which emerged from the legislative elections with a highly pluralistic make-up and showed some difficulty in achieving dialogue during the transition.

For the third year running, fiscal policy benefited from the high price for petroleum on international markets and, as a result, the heavy spending on infrastructure and on the electoral process did not affect the achievement of the fiscal target or the amortization of public debt.

Public revenues rose by 14% in real terms between January and September, owing largely to oil surpluses of over two percentage points of GDP (a price of US\$ 36.5 per barrel was estimated at the start of the year, compared with the observed price of US\$ 54.5). Oil income rose by 15% and represented 36.7% of all public revenues. Non-petroleum revenues climbed by 13.5%, thanks to increased receipts from value-added tax (VAT), income tax and import duties (15.4%), as well as the revenues of State-owned enterprises (9.3%), especially higher energy sales by the Federal Electricity Commission (CFE) and social security contributions.

The larger revenues underpinned an increase in public spending (12.6% in real terms between January and September), much of which went to personal services. These, in turn, increased 5.4% owing to wage rises in State-owned enterprises. Physical investment rose by 22.8% and represented 16.5% of programmable spending. Operating expenditure, which includes payments corresponding to Projects with a Deferred Impact on Public Expenditure

Recording (PIDIREGAS), as well as health services, education programmes and elections-related outlays, rose by 13.7%.

The public sector borrowing requirement, which encompasses all activities regardless of whether they are implemented by public or private agencies, stood at 0.8% of GDP, thus continuing the downward trend observed in the last few years. Mexico needs to expand its narrow tax base (10% of GDP) and reduce the reliance of its public revenues on oil income.

The federal government bought international reserves to pay maturing external debt to the tune of US\$ 12.451 billion. This helped to bring the external debt stock down to 4.9% of GDP in September. Contrasting with debt reduction undertaken by the banking system and other financial institutions, domestic public liabilities increased as they were incurred to replace external debt and came to represent 14.4% of GDP up to September, 1.3 percentage points up on 2005.

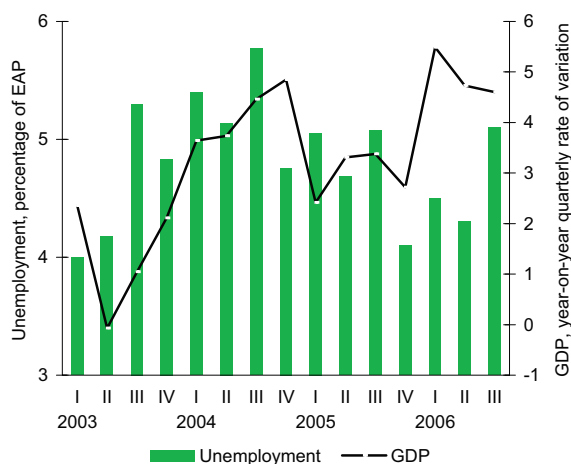
Monetary policy continued to be aimed at keeping inflation at around 3%. Thanks to global financial stability and the control of inflation in the first few months of the year, the “corto” (a compulsory level for commercial bank balances in the central bank) was kept unchanged and the monetary stance was maintained after a slight easing in April 2006, when the central bank set the anchor rate at 7%. The nominal lending rate¹ decreased from 8.6% at the end of 2005 to 7.3% in 2006.

The foreign-exchange market experienced episodes of volatility, caused by expectations of an international liquidity squeeze, combined with the domestic political situation. The dollar exchange rate reached 11.5 pesos before the elections, but returned to its previous levels of around 11 pesos thereafter. The nominal exchange rate was practically unchanged with respect to 2005 (10.9 pesos to the dollar), indicating an insignificant annual variation in the real exchange rate.

The process of remonetization led to a year-on-year expansion of 12.9% in real terms in the monetary base in September. The money stock (M1) expanded at a higher rate (11.7%) than the broad monetary aggregates. This was partly due to the falling opportunity cost of maintaining liquid financial assets. The annual interest rate on 28-day Treasury Certificates came down from 7.88% in January to 7.05% in October. The effects of this drop were seen in a 2.4% drop in residents' bank deposits (a component of M2).

Total financing for the non-bank private sector was up by 16.2% in real year-on-year terms in September

Figure 1
MEXICO: GROSS DOMESTIC PRODUCT AND UNEMPLOYMENT



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

2006. The fastest-growing segments were mortgage and consumer loans, which surged by 75% and 46%, respectively. Corporate credit rose by 15.6%, mainly in the sectors of services and construction.

The Banco de México continued to use the mechanism for slowing the accumulation of international reserves and US\$ 6.886 billion were sold up to mid-November. The reserve stock registered a net variation of US\$ 74 million and reached US\$ 68.595 billion. This result also reflected the Ministry of Finance and Public Credit's above-mentioned purchase of US\$ 12.451 billion to prepay external debt.

The economy expanded by 4.9% between January and September and the annual figure is expected to be 4.8%. Gross fixed capital formation expanded strongly in the public and the private sector alike, thanks in part to reconstruction work to repair damage caused by Hurricanes Wilma and Stan in the south-east of Mexico at the end of 2005.

The expansion of production was driven by manufacturing and services, which posted growth rates of 5.3% and 5.1%, respectively, between January and September. Activity in metal products, machinery and equipment rose by 12.3%, powered mainly by goods linked to external demand, such as motor vehicles and motor vehicle parts, machinery and electronic equipment, and optical and medical apparatuses. The other branches of activity all expanded, except textiles, which registered a contraction of 2.6%.

¹ Refers to the cost of corporate borrowing, represented by the yield on corporate bonds issued on the money market.

The expansion in the motor vehicle industry was the result of the manufacture of new models, following large investments by vehicle assembly firms to modernize and build up productive capacity. From January to October vehicle production increased 28%, driven by exports, which were up 37% and contrasted with the 4% growth rate in production for the domestic market.

Growth in services was due to factors such as spending on communications during the electoral process, the expansion of telecommunications and an upturn in consumption and investment in tourist areas in the south-east of the country following Hurricanes Wilma and Stan. The expansion of manufactures, construction and consumption was reflected in increased activity in banking services, rentals and financial intermediation.

The impetus created by export growth and motor vehicle production helped to boost job creation, although the nationwide open unemployment rate barely came down, standing at 3.6% of the economically active population (EAP) between January and September 2006. The underemployed represented 8.2% of the EAP and 11.4 million people (26.8% of the employed population) were in informal employment. Formal job creation amounted to around 800,000 posts (according to the number of new registrations with the Mexican Social Security Institute), which was one of the highest figures since 1998 and represented an increase of 7%.

In the first three quarters inflation held steady within the range set by the monetary authority, with moderate fluctuations in the prices of fruit and vegetables and adjustments to administered prices at the start of the year. The rise in the prices of milk, premium gasoline and diesel as of November 2006 is likely to place inflation above 4% at the end of the year.

Despite signs of slacker demand in the United States market, external trade expanded at rates not seen since 2000. From January to September the value of merchandise exports climbed by 20%, reflecting both petroleum and non-petroleum exports (33.8% and 17.5%, respectively). As far as imports (up 17.9%) are concerned, intermediate and capital goods rose at similar rates (around 17%) reflecting, in the latter

Table 1
MEXICO: MAIN ECONOMIC INDICATORS

	2004	2005	2006 ^a
Annual growth rates			
Gross domestic product	4.2	3.0	4.8
Consumer prices	5.2	3.3	4.1 ^b
Average real wage ^c	0.2	-0.1	0.8 ^d
Money (M1)	13.9	11.2	15.5 ^e
Real effective exchange rate ^f	4.7	-3.1	-0.3 ^e
Terms of trade	2.9	1.9	3.9
Annual average percentages			
Urban unemployment rate	5.3	4.7	4.6 ^g
Public sector			
overall balance/GDP	-1.0	-0.8	0.3
Nominal deposit rate	5.4	7.6	6.1 ^h
Nominal lending rate	7.2	9.9	7.7 ⁱ
Millions of dollars			
Exports of goods and services	201 954	230 299	268 701
Imports of goods and services	215 372	242 599	282 223
Current account	-6 682	-5 039	-2 651
Capital and financial account	10 740	12 203	3 151
Overall balance	4 058	7 164	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 2006.

^c Manufacturing industry.

^d Estimate based on data from January to September.

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

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

^g Estimate based on data from January to October.

^h Average from January to November, annualized.

ⁱ Average from January to May, annualized.

case, investment by the motor vehicle industry in 2005-2006. Rising private spending drove consumer goods imports (23.5%).

The performance of the external sector was associated with the increase (for the first time since 2002) in the share accounted for by Mexican exports in the United States' total imports, from 10.1% in January-September 2005 to 10.6% a year later. China's percentage share of the United States import market increased from 14.3% to 14.8% in the same period.

The volume of incoming family remittances has multiplied five-fold in the last 10 years. Up to September 2006 remittances represented US\$ 17.443 billion and are projected to end the year at around US\$ 24.0 billion, or 20% more than in 2005. Foreign direct investment is estimated at US\$ 17.0 billion. The balance-of-payments current account deficit will have reached 0.3% of GDP at the end of 2006.