Mexico

1. General trends

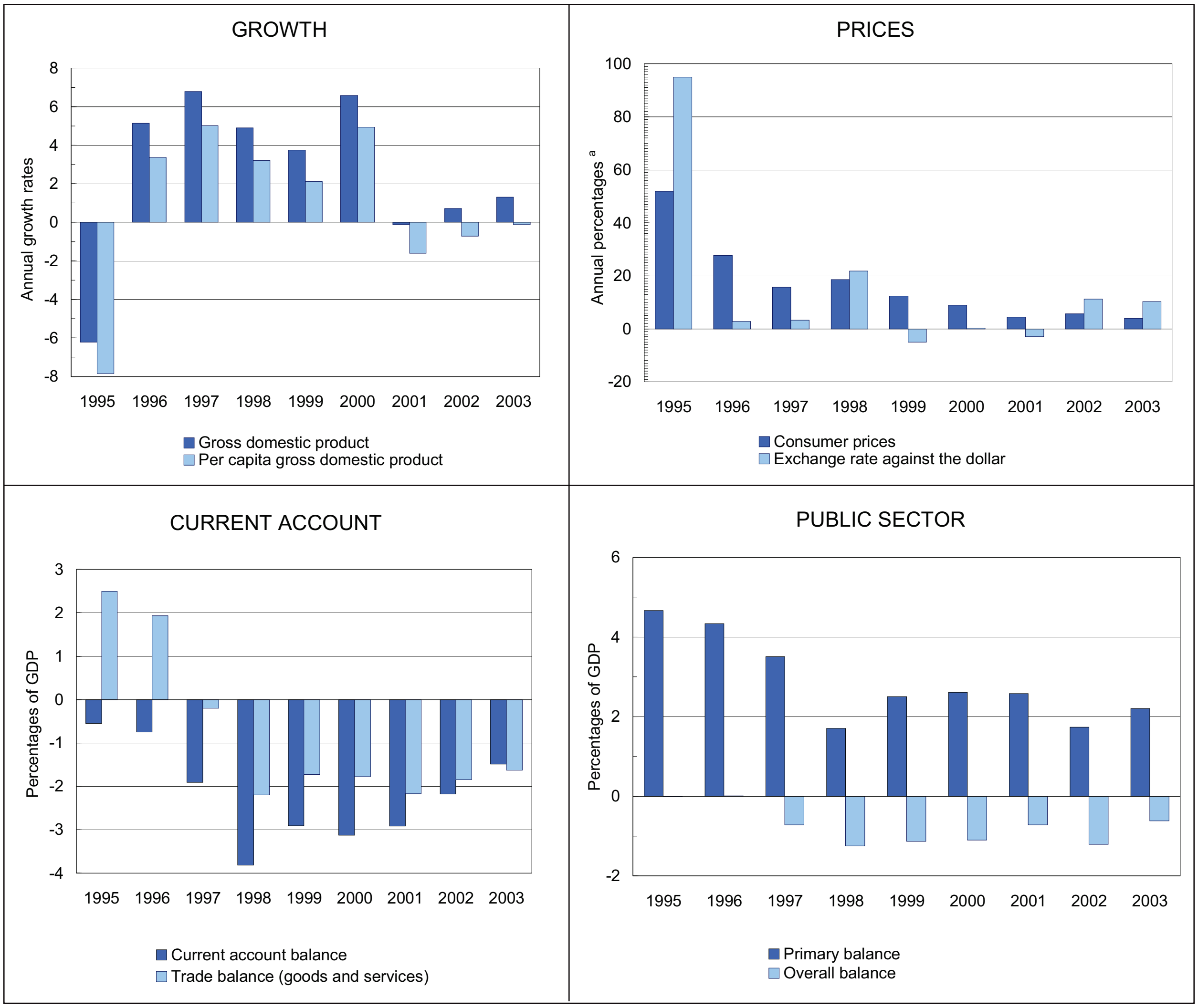
In 2003 the Mexican economy grew by 1.3% and posted a third straight year of declines in per capita GDP and employment. Gross national income was up by 1.5% thanks to the positive effects of the terms of trade and an upturn in remittances from migrants. Exports began to rise in the last quarter of 2003 in response to the expansion of the United States economy, although the increase was modest and uneven across different sectors. There was, however, a robust increase in the value of oil exports owing to high international prices. External demand rose slightly (1.1%), while domestic demand showed little growth (0.5%).

Although the higher fiscal revenue from oil afforded the authorities considerable leeway to increase public spending, particularly on investment (22.4%), total gross fixed capital formation shrank for the third year in a row (-0.4%), thus compromising the economy's competitiveness gains. What growth there was in GDP was propelled by an increase in private consumption, which, in turn, was fuelled by credit. The maquila industry continued to shed jobs, albeit more slowly than it had in the preceding biennium, eliminating a total of 230,000 jobs between 2000 and 2003. Informal activities expanded and workers continued to emigrate to other countries, with the result that family remittances grew by 35.2% to reach US$ 13.266 billion. This figure represented 96.6% of current transfers, or 2.1% of GDP, and was US$ 2.5 billion higher than the level of foreign direct investment (FDI) inflows, which were lower than at any point since 1996.

The main financial indicators pointed to a relatively better and more stable situation, thanks to low inflation and low international interest rates. Weak demand for imports brought the deficit on the balance-of-payments current account down to 1.5% of GDP, its lowest level since 1996. Inflation (3.98%) was within the range expected by the Banco de México, and the public-sector deficit stood at 0.6% of GDP. The fiscal situation remained fragile, however, in view of the high cost of the liabilities assumed by the government and its dependence on oil revenues.

The economy has shown signs of recovery in 2004 despite risk factors in the external environment such as higher international interest rates, the negative impact of oil prices on the global economy and competition from Asian products, especially Chinese ones, in the United States market. GDP is expected to grow by about 4% in 2004 in view of the acceleration of external and domestic demand in the first few months of the year; output growth in the first quarter was 3.7%, the highest rate posted since the last quarter of 2000. Inflation is likely to reach 4%, while the public-sector deficit will probably amount to 0.3% of GDP.

Figure 1
MEXICO: MAIN ECONOMIC INDICATORS



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] December-December variation.

2. Economic policy

In 2004 economic policy has continued to be guided by the objectives and principles applied since the 1994-1995 crisis: fiscal discipline and monetary stringency in the context of a floating exchange rate. The core objective is once again to reduce inflation to levels similar to those posted in the United States and Canada, Mexico's main trading partners.

(a) Fiscal policy

In 2004 fiscal policy has continued to be geared to meeting the established target (a deficit of 0.3% of GDP). In the first half of the year public revenues continued to benefit from the rapid growth of oil earnings, which accounted for about one third of the total. In the first four months of the year public finances showed a surplus that was 18.9% higher in real terms than the one posted in the same period of 2003. This was due to the growth in oil revenue (12.3%) and in non-oil tax revenue (5.5%); particularly significant in this regard were VAT and income tax receipts, which rose by 8.5% and 5.8% in real terms, respectively, over their levels in the year-earlier period. Total public-sector spending grew by 3.6% in real terms in relation to the 2003 figure.

In 2003 the fiscal deficit target was achieved thanks to high oil prices, which boosted oil revenues by 24.6% in real terms. Non-oil revenues also expanded, by 4.3%. The overall rise in income amounted to 10.3% and total income was equivalent to 23.7% of GDP (1.3 points above the programmed amount). Tax collection was up by 5.4% in real terms owing to higher VAT receipts (11.4%). This was due to the boom in private consumption triggered by a change in the method of paying this tax as from March 2002, as well as efforts to tighten controls. Non-tax revenue, on the other hand, fell by 18.3%.

The higher level of income made it possible to increase public spending (by 7.7% in real terms) without significantly affecting compliance with the fiscal target. The rise in spending not related to interest payments was due to substantial hikes in spending on current operations (11.9%) and on physical capital (16%), especially infrastructure. The upturn in current expenditure was influenced by increases in spending on personal services, pensions and operating expenses for basic services and by spending associated with the electoral process.

The public sector's financing needs, which encompass all of its activities, regardless of whether they are implemented by public or private entities, amounted to 2.7% of GDP, or 3.4% excluding non-recurrent revenues.[1]

In view of low international interest rates, external liabilities (including Mexico's remaining Brady bonds) were paid off ahead of time and new debt was incurred on better terms. According to the Ministry of Finance and Public Credit, in 2003 net public debt amounted to 26% of GDP, which was 1.6 percentage points higher than the 2002 percentage. This was partly due to the peso's depreciation against the dollar and the increase in domestic debt.

Despite the increase in tax revenue, the low tax burden (11% of GDP) continues to be one of the economy's key structural problems, and a comprehensive tax reform is required in order to solve it. The reform should raise tax revenues as a proportion of GDP, reduce their dependence on oil earnings and move towards the design of public budgets with medium- and long-term time frames.

In October 2003 members of the federal executive and legislative branches, state governors and representatives of local legislatures and municipal councils gathered for a National Fiscal Convention. The aim was to forge a consensus among the three levels of government (federal, state and municipal) on fiscal reform, with a view to increasing tax collection, strengthening the fiscal autonomy of government entities, improving resource distribution and raising public investment.

The debates in this forum, which concluded on 16 August 2004, covered the issues of public spending, revenue, debt, public assets, modernization and streamlining of financial management, intergovernmental cooperation and coordination and fiscal transparency, supervision and accountability. The reform proposal agreed upon by the participants will be submitted to the Mexican Congress for consideration and adoption.

(b) Monetary policy

In 2004 the Banco de México has continued to implement a monetary policy geared to achieving 3% inflation by establishing a long-term inflation target (set at 3% starting in 2003) with a one-point fluctuation range around the target and by announcing monetary policy decisions on predetermined dates.

The main monetary policy instrument is the so-called *corto*, which indirectly affects nominal interest rates. The *corto* involves the establishment of a daily target level for commercial banks' current account balances at the Banco de México (since April 2003 the target has referred to daily balances instead of cumulative monthly balances). Its main function is to provide market signals, as its level is equivalent to a small fraction of the money market.

In the first quarter of 2003 the Banco de México applied a tight monetary policy, but the economy's listlessness paved the way for looser monetary management, which took the form of a downturn in interest rates for the rest of the year. In the first half of 2004 the *corto* was raised three times: in February (from 25 million to 29 million pesos per day), March (to 33

1 Non-recurrent revenues consist of exceptional income such as profits of the Banco de México or privatization proceeds.

Table 1
MEXICO: MAIN ECONOMIC INDICATORS

	1995	1996	1997	1998	1999	2000	2001	2002	2003 [a]
	Annual growth rates [b]								
Gross domestic product	-6.2	5.1	6.8	4.9	3.7	6.6	-0.1	0.7	1.3
Per capita gross domestic product	-7.8	3.4	5.0	3.2	2.1	4.9	-1.6	-0.7	-0.1
Gross domestic product, by sector									
Agriculture, livestock, hunting, forestry and fishing	0.9	3.6	0.2	0.8	3.6	0.6	3.5	0.3	3.9
Mining	-2.7	8.1	4.5	2.7	-2.1	3.8	1.5	0.4	3.7
Manufacturing	-4.9	10.8	9.9	7.4	4.2	6.9	-3.8	-0.7	-2.0
Electricity, gas and water	2.1	4.6	5.2	1.9	7.9	1.0	4.7	0.4	1.1
Construction	-23.5	9.8	9.3	4.2	5.0	4.2	-5.7	1.3	3.4
Wholesale and retail commerce, restaurants and hotels	-15.5	4.8	10.7	5.6	3.1	12.2	-1.2	0.0	1.3
Transport, storage and communications	-4.9	8.0	9.9	6.7	7.8	9.1	3.8	1.9	3.3
Financial institutions, insurance, real estate and business services	-0.3	0.6	3.7	4.6	3.6	5.5	4.5	4.3	4.3
Community, social and personal services	-2.3	1.0	3.3	2.9	2.1	2.9	-0.3	0.5	0.5
Gross domestic product, by type of expenditure									
Consumption	-8.4	1.8	6.0	5.0	4.4	7.4	1.9	1.2	2.9
General government	-1.3	-0.7	2.9	2.3	4.7	2.4	-2.0	0.1	2.5
Private	-9.5	2.2	6.5	5.4	4.3	8.2	2.5	1.3	3.0
Gross domestic investment	-35.0	25.6	24.9	9.9	4.0	11.4	-3.8	-0.9	-8.1
Exports (goods and services)	30.2	18.2	10.7	12.1	12.4	16.4	-3.8	1.5	1.1
Imports (goods and services)	-15.0	22.9	22.7	16.6	14.1	21.5	-1.6	1.4	-1.0
	Percentages of GDP								
Investment and saving [c]									
Gross domestic investment	19.8	23.1	25.9	24.3	23.5	23.8	20.9	20.2	18.2
National saving	19.3	22.4	24.0	20.5	20.5	20.6	18.0	18.1	16.7
External saving	0.5	0.7	1.9	3.8	2.9	3.1	2.9	2.1	1.5
	Millions of dollars								
Balance of payments									
Current account balance	-1 576	-2 500	-7 666	-16 073	-13 999	-18 188	-18 195	-14 082	-9 298
Merchandise trade balance	7 089	6 533	623	-7 915	-5 584	-8 003	-9 954	-7 916	-5 690
Exports, f.o.b.	79 542	96 002	110 431	117 459	136 391	166 455	158 443	160 763	164 860
Imports, f.o.b.	72 453	89 469	109 808	125 374	141 975	174 458	168 396	168 679	170 551
Services trade balance	64	-94	-1 433	-1 350	-2 737	-2 323	-3 558	-4 048	-4 497
Income balance	-12 689	-13 473	-12 106	-12 820	-11 992	-14 856	-14 021	-12 386	-12 838
Net current transfers	3 960	4 534	5 250	6 012	6 313	6 994	9 338	10 268	13 727
Capital and financial balance [d]	-14 735	4 448	28 126	12 572	18 249	25 314	25 520	21 172	18 736
Net foreign direct investment	9 526	9 186	12 831	11 897	13 055	16 075	22 372	13 845	9 393
Financial capital [e]	-24 261	-4 738	15 295	675	5 194	9 239	3 148	7 327	9 343
Overall balance	-16 312	1 948	20 460	-3 501	4 250	7 126	7 325	7 090	9 438
Variation in reserve assets [f]	-9 648	-1 805	-10 513	-2 118	-596	-2 862	-7 325	-7 090	-9 438
Other financing [g]	25 960	-144	-9 948	5 619	-3 654	-4 265	0	0	0
Other external-sector indicators									
Real effective exchange rate (index: 2000=100) [h]	151.3	135.9	118.6	118.4	108.2	100.0	94.3	94.0	104.6
Terms of trade for goods (index: 1997=100)	96.1	98.8	100.0	96.5	98.4	103.2	103.2	103.7	104.7
Net resource transfer (% of GDP)	-0.5	-2.8	1.5	1.3	0.5	1.1	1.8	1.4	0.9
Total gross external debt (billions of dollars)	166	157	149	160	166	149	145	140	140
Total gross external debt (% of GDP)	57.8	47.2	37.1	38.0	34.6	25.6	23.2	21.6	22.4
Net profits and interest (% of exports) [i]	4.8	3.8	3.1	4.1	2.4	4.0	3.8	2.6	2.7

Table 1 (concluded)

	1995	1996	1997	1998	1999	2000	2001	2002	2003 [a]
				Average annual rates					
Employment									
Labour force participation rate [j]	55.4	55.4	56.2	56.5	55.8	56.3	55.6	55.1	55.6
Open unemployment rate [k]	6.2	5.5	3.7	3.2	2.5	2.2	2.5	2.7	3.2
Visible underemployment rate [k]	16.4	16.0	14.8	12.2	11.3	11.7	11.1	10.0	10.5
				Annual percentages					
Prices									
Variation in consumer prices (December-December)	52.0	27.7	15.7	18.6	12.3	9.0	4.4	5.7	4.0
Variation in the national producer prices index	59.5	25.3	10.5	17.5	12.5	6.4	1.3	9.2	6.8
Variation in nominal exchange rate (December-December)	95.0	2.8	3.3	21.8	-5.0	0.3	-2.9	11.2	10.3
Variation in average real wage	-12.6	-9.9	-0.6	2.8	1.5	6.0	6.7	1.7	1.4
Nominal deposit rate [l]	...	...	20.0	21.6	20.9	14.6	11.0	6.2	5.1
Nominal lending rate [m]	...	...	22.1	25.1	23.7	16.9	12.8	8.2	6.9
				Percentages of GDP					
Public sector									
Budgetary revenues	22.8	23.0	23.0	20.3	20.8	21.6	21.8	22.2	23.7
Programmable current spending	12.1	12.0	12.8	12.4	12.5	13.0	13.3	13.8	14.9
Primary balance	4.7	4.3	3.5	1.7	2.5	2.6	2.6	1.7	2.2
Overall balance	0.0	0.0	-0.7	-1.2	-1.1	-1.1	-0.7	-1.2	-0.6
Net public debt [n]	30.1	25.0	20.3	20.9	21.1	17.8	18.5	20.1	21.1
Domestic	-0.6	2.8	6.2	7.4	10.6	9.2	12.3	15.4	17.4
External	30.6	22.2	14.2	13.5	10.6	8.6	6.2	4.7	3.7
Money and credit [o]									
Domestic credit [p]	39.8	26.6	36.8	39.8	37.2	37.0	37.9	37.6	38.6
To the public sector	9.0	6.7	15.0	16.6	17.1	19.1	20.4	20.1	21.1
To the private sector	30.8	19.9	21.8	23.3	20.0	17.8	17.5	17.4	17.5
Liquidity (M3)	37.4	35.0	36.3	38.0	40.1	40.1	44.0	46.6	48.4
Money stock and local-currency deposits (M2)	33.6	33.8	35.0	36.7	38.7	38.7	42.6	45.0	46.9
Foreign-currency deposits	3.7	1.3	1.3	1.3	1.4	1.4	1.5	1.6	1.4

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Preliminary figures. [b] Based on figures in local currency at constant 1993 prices. [c] Based on figures in local currency at current prices. [d] Includes errors and omissions. [e] Refers to the capital and financial balance (including errors and omissions), minus net foreign direct investment. [f] A minus sign (-) denotes an increase in reserves. [g] Includes the use of IMF credit and loans and exceptional financing. [h] Annual average, weighted by the value of merchandise exports and imports. [i] Refers to net investment income as a percentage of exports of goods and services as shown on the balance of payments. [j] Economically active population as a percentage of the working-age population; urban areas. [k] Unemployment and underemployment rates are percentages of the economically active population; urban areas. [l] Weighted average for term deposits in commercial banks. [m] Lending rate published by the International Monetary Fund. [n] Refers to (consolidated) net debt reported by the Banco de México. [o] The monetary figures are annual averages. [p] Refers to net credit extended to the public and private sectors by commercial banks and other financial and banking institutions.

million) and April (to 37 million). These increases were in response to higher prices for goods and services such as meat, gasoline, urban transport and water contributions (all of which are classified as components of non-core inflation)[2] and to expectations of inflation generated by wage adjustments at the beginning of the year and the prospect of higher external interest rates. Core inflation has remained practically constant for the past 18 months.

The benchmark interest rate (on 28-day treasury bills (CETES)) fell from an annual average of 7.09% in 2002 to 6.23% in 2003. The downward trend continued in January and February 2004, but the rate began to rise in March owing to expectations of higher international rates.

2 Non-core inflation comprises the subindex of goods and services with administered and negotiated prices, education services and agricultural products.

Table 2
MEXICO: MAIN QUARTERLY INDICATORS

	2002				2003 [a]				2004 [a]	
	I	II	III	IV	I	II	III	IV	I	II
Gross domestic product (variation from same quarter of preceding year) [b]	-2.4	1.9	1.6	1.9	2.5	0.1	0.6	2.0	3.7	...
Merchandise exports, f.o.b. (millions of dollars)	36 496	41 551	41 434	41 281	39 108	40 484	41 451	43 880	43 295	...
Merchandise imports, c.i.f. (millions of dollars)	38 122	42 978	42 925	44 655	39 189	41 891	42 972	46 493	43 718	...
International reserves (millions of dollars)	42 229	42 723	44 981	46 099	51 096	52 899	51 418	56 086	58 406	58 407
Real effective exchange rate (index: 2000=100) [c]	88.9	92.5	96.6	97.9	104.5	101.5	104.3	108.1	105.9	110.0
Urban unemployment rate	2.8	2.6	2.9	2.5	2.8	3.0	3.8	3.5	3.9	3.6
Consumer prices (12-month percentage variation)	4.7	4.9	4.9	5.7	5.6	4.3	4.0	4.0	4.2	4.4
Average nominal exchange rate (new pesos per dollar)	9.12	9.45	9.89	10.17	10.82	10.45	10.73	11.19	11.00	11.39
Average real wage (variation from same quarter of preceding year)	3.7	2.5	0.8	0.0	1.2	1.4	2.5	0.7	1.2	...
Nominal interest rates (annualized percentages)										
Deposit rate [d]	6.5	5.8	6.1	6.4	6.9	5.4	3.9	4.3	4.5	5.0
Lending rate [e]	8.3	7.7	8.1	8.7	9.8	6.9	5.1	5.9	6.0	6.2
Interbank interest rate	8.5	7.7	8.1	8.4	9.7	6.7	5.1	7.0	5.9	6.6
Sovereign bond spread (basis points)	250.0	321.0	434.0	324.0	294.0	229.0	209.0	190.0	179.0	213.0
Stock price index (in dollars, June 1997=100)	104.4	88.7	93.7	87.1	105.3	110.7	123.6	148.5	141.1	105.3
Domestic credit (variation from same quarter of preceding year) [f]	2.3	6.4	8.1	16.8	13.6	8.9	10.7	9.2	11.1	11.2 [g]
Non-performing loans as a percentage of total loans [h]	5.0	5.0	4.8	4.6	4.6	4.2	3.7	3.2	3.2	...

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Preliminary figures. [b] Based on figures in local currency at constant 1993 prices. [c] Quarterly average, weighted by the value of merchandise exports and imports. [d] Weighted average for 30-day deposits. [e] Average cost of 28-day loans for leading firms in the securities market. [f] Refers to net credit extended to the public and private sectors by commercial banks and other financial and banking institutions. [g] Data for April. [h] Refers to total credit extended by commercial banks.

In real terms, the yield on one-month bank bills has been negative since mid-2001, while CETES began to record negative yields in the fourth quarter of 2003. Lending rates remained very high compared to international rates.

In 2003 the monetary base expanded by 22.6% in real terms, while the money supply grew by 9.1%. The remonetization process has been proceeding, together with a lowering of interest rates and inflation, since the 1995 crisis, when monetary balances fell (M1/GDP). Meanwhile, the growth of the broadest monetary aggregate (M4, which includes all private-sector financial savings) picked up, especially at the end of the year, when it reached 49% of GDP, the highest figure in three decades. There was an increase in the amount of resources raised through both public and private securities, which partly reflected the substitution of domestic for external debt in view of the lower cost of money on the local market. The balance of the Retirement Savings Fund expanded (albeit to a lesser degree than in the past) thanks to a rise in average pensionable remuneration, and currently represents 21% of M4. With regard to credit, bank financing for households and businesses rose by 4.5% in real terms; this increase essentially reflected rapid growth in consumer credit, which exceeded 40%, since housing loans expanded by only 1.2% and business loans fell by 5%. In 2003 there was continued growth in credit from non-bank financial intermediaries, particularly in the mortgage sector, and in "own-brand" credit from retail commercial establishments and motor vehicle distributors.

(c) Exchange-rate policy

Since 1995 the country's exchange-rate policy has been based on a floating currency regime intended to ensure that the exchange rate and the economy as a whole can adjust quickly to domestic and external shocks.

Exchange-rate fluctuations intensified at various times during 2003, especially around the middle of the year. This reversed the process of real appreciation that the peso had experienced since 1996 (except in 1998). In the first quarter international geopolitical uncertainty caused the peso to depreciate, reaching almost 11 pesos to the dollar. This rate declined as uncertainty dissipated and Mexico paid down its sovereign bond debt. Volatility returned at the end of the year, however, triggering another depreciation that brought the exchange rate to 11.3 pesos to the dollar. In nominal terms, the exchange rate's average level in December 2003 showed a 10.3% depreciation in comparison to the December 2002 average; in real terms, the depreciation amounted to 8.1%.

The increase in oil revenues helped to boost international reserves, which reached a level of US$ 55 billion in May and US$ 57.435 billion as of 31 December 2003. To limit quasi-fiscal losses due to the carrying cost inherent in the build-up of reserves, the Banco de México decided to slow down the rate of accumulation by establishing a mechanism for selling dollars to the country's credit institutions on a daily basis, for an amount equivalent to 50% of the net increase in reserves over the previous quarter. The operation began in May 2003 with the sale of US$ 32 million per day; this amount was reduced to US$ 14 million in August and to US$ 6 million in November. In February 2004 it rose to US$ 45 million.

However, the dramatic change, from one quarter to the next, in the amount of dollars sold per day generated considerable uncertainty, and the Banco de México therefore modified the mechanism in May 2004, fixing the level of dollar sales for four successive quarters. One fourth of the total amount to be sold was put on offer in the current quarter, and the rest was distributed equally among the following three quarters. In mid-April international reserves totalled US$ 58.305 billion, and the amount of dollars to be sold per day between May and July was set at US$ 22 million.

In the first half of 2004 there were brief episodes of sharp volatility in the foreign-exchange market. Between January and June the peso depreciated by 5.2% in relation to its level in the year-earlier period and by 3.7% in relation to the annual average, in nominal terms; expectations of further increases in United States interest rates have exacerbated this volatility and raised the projected exchange rate. The dollar is expected to reach 11.59 pesos by the end of the year.

(d) Other policies

After 16 months of talks, in March 2004 Mexico and Japan concluded their negotiations on an economic partnership agreement. This agreement covers market access, services, investment, government procurement, competition policy, dispute settlement and bilateral cooperation. Mexico will immediately eliminate duties on 44% of its industrial-sector tariff fractions, while Japan will eliminate duties on 91%. Mexico will also grant immediate duty-free access for a quantity of motor vehicles equivalent to 5% of the units sold nationwide, and steel not produced in the country will be liberalized. The agreement consolidates the preferences which Japan grants unilaterally to Mexico under the Generalized System of Preferences, and includes quotas for exports of pork, beef, chicken, orange juice and oranges that are much higher than current export levels. Both governments are expected to ratify the agreement by the end of 2004 so that it can enter into force in 2005.

3. The main variables

(a) Economic activity

Economic growth, after remaining at a virtual standstill in the second and third quarters of 2003, began to recover towards the end of the year and accelerated in the initial months of 2004 as exports rose, boosted by faster growth in the United States manufacturing sector. As in the previous three years, the main engine of growth was consumption, which was up by 2.9%; private consumption rose slightly faster (3%) than overall consumption. Gross fixed investment fell for the third straight year (-0.4%) –although the downturn was less severe than it had been in 2001 and 2002– as a substantial improvement in public investment (22.4%) failed to compensate fully for a considerable decline in private investment (-5.7%).

Despite the loss of formal-sector jobs and the low purchasing power afforded by informal-sector employment, private consumption was spurred by an increase in real remuneration in a number of sectors, lower interest rates, easier access to credit (both from commercial banks and from non-bank financial intermediaries and retail chains) and higher inflows of family remittances. Bank credit for private consumption posted real growth of 43.5% in 2003 and of 46.5% in the first four months of 2004 in relation to the year-earlier period.

With regard to investment, there was significant growth in the construction component for the second year running (3.4%), driven by an increase in the number of construction works related to oil, petrochemicals, electricity, transport and housing. Loans for housing started to revive in mid-2003, increasing by 11.9% after four years of decline. However, investment in construction was not dynamic enough to offset the persistent fall in machinery and equipment investment (-3.8%). In the first few months of 2004 this trend reversed itself as investment recovered (growing by 4.7% in the first four months), with investment in machinery and equipment increasing by 4.1% and investment in construction, by 5.2%. Meanwhile, public-sector investment, buoyed by higher oil revenues, continued to focus on strengthening the country's energy, communications, transport, drinking water, sewage and health infrastructure.

In 2003 manufacturing posted a third straight year of decline (-2%), owing in particular to weak United States demand for maquila exports, which account for 47% of all merchandise exports. The drop was considerable in textiles, clothing and leather (-8.9%), printing and publishing (-1.7%) and metal products, machinery and equipment (-5.9%). In the first quarter of 2004, however, manufacturing was already up by 2.8%, although performance is still highly uneven across different sectors.

In the first quarter of 2004 mining, including oil extraction, grew by 6.4%. At the same time, construction expanded by 4.9% and electricity, gas and water, by 1.4%, with the result that the industrial sector as a whole experienced growth of 3.2%, as against 1.9% in the first quarter of 2003.

Automobile production also contracted for a third consecutive year in 2003 (-12.7%), and the downturn continued between January and May 2004 (-8.4%). Financing plans and incentives for car purchases helped to boost domestic sales by 0.3% in 2003; sales of imported units, however, were up by 10%, while sales of domestically produced units plummeted (-11.9%). In 2004 the upward trend in domestic sales continued (with 11.1% growth between January and May), while vehicle production for export dropped by 10.4%.

The number of maquila plants continued to dwindle. At the close of the year there were 2,802 such units (933 fewer than the peak number reached in June 2001). The trend seems to have been changing very gradually since October 2003, closely reflecting the knock-on effect of growth in the United States.

In 2003 the agricultural sector expanded by 3.9%, boosted by abundant rainfall in September, which increased per-hectare yields, and by an upturn in poultry and beef production. The trend continued in the first quarter of 2004, with growth of 4.7%.

Basic services were up by 3.1% in 2003 (and by 8.5% between January and March 2004) owing to the expansion of transport and communications (3.3%), which reflected higher demand for cellular telephone and satellite services and for rail, maritime and road transport services. Financial services, insurance and real estate increased by 4.3%; community, social and personal services, by 0.5%, and commerce, restaurants and hotels, by 1.3%.

(b) Prices, wages and employment

In view of low international inflation, moderate domestic demand and the absence of significant supply shocks since the second quarter of 2003, inflation stood at 3.98%. Non-core inflation, however, began to rise in the initial months of 2004 and triggered an increase in the overall level of prices, which in May was 1.46% higher than the value posted in December 2003, while the level in the period January-May 2004 was 4.29% higher than the level in the year-earlier period. Thus, inflation overshot the Banco de México's annual target of 3%.

Firms continued to adjust their output throughout 2003 in response to the slack demand seen since 2001, and accordingly downsized their workforce. According to data from the Mexican Social Security Institute (IMSS), manufacturing employment fell by 4.1% and agricultural employment, by 3.6%. Sectors catering to the domestic market continued to generate jobs; employment increased by 2.4% in construction and by 1% in commerce.

The average open unemployment rate rose from 2.7% in 2002 to 3.3% in 2003. In the first four months of 2004 this rate was 3.8%, which exceeded by one percentage point the rate posted in the same period of 2003. The average number of workers insured with IMSS fell by 0.5%, to a total of 12,380,000. Employment in maquila activity continued to decline; maquila jobs have dwindled by about 30% over the past three years, although a modest recovery began to emerge in the first four months of 2004, when employment in the maquila export industry grew by 0.5%. Meanwhile, the informal economy expanded further. This sector generates an estimated 12% of total GDP and employs over 20 million people, or about half the economically active population.

In 2003 real wages in the maquila export industry did not change in relation to their 2002 levels. In manufacturing and commerce, however, real wages rose by 1.4% and 2.7%, respectively. Labour productivity in the maquila sector went down (-0.1%) owing to the more pronounced economic slowdown in the second and third quarters of the year, while in manufacturing and commerce it increased by 1.8% and 3.8%, respectively. As a result of this performance, the unit cost of labour declined in manufacturing (-0.9%) and commerce (-0.8%), but stayed the same in the maquila industry.

(c) The external sector

In 2003 the balance-of-payments current account posted its smallest deficit (US$ 9.298 billion) since 1997. This outcome was influenced by weak growth in imports (1.1%), with downturns in imports of capital goods, inputs for non-oil exports and goods for the domestic market. Non-oil exports stalled and oil exports increased by 28.9%; remittances were up by 35%.

The negative merchandise trade balance shrank to US$ 5.69 billion in 2003. The value of oil exports increased, as the average per-barrel price (US$ 24.79) was US$ 3.21 higher than its 2002 level. The total value of external merchandise sales thus amounted to US$ 164.86 billion, which was just 2.5% higher than the 2002 figure and remained below the peak reached in 2000. The behaviour of non-oil exports reflected increases in sales of agricultural products (20.6%), led by sales of tomatoes, melons, watermelons, other fresh fruits and livestock, and in mining sales (32.8%). These upturns helped to offset the fall in the export value of manufactures (-0.4%), which account for 86.5% of total external sales and thus determine overall export performance. Manufactures exports have been hurt by slow productivity growth and a loss of international competitiveness as a result of persistent declines in investment in machinery and equipment and physical infrastructure. In the United States market, these exports also face growing competition from various Asian producers, especially China. As for the country's imports in 2003, 76% were intermediate goods, 12% were capital goods (whose value went down for the third year in a row) and the remaining 13% were consumer goods. Some 35% of Mexico's total imports were purchased by maquila firms.

Between January and May 2004 export performance improved, with a rise of 12.6% in comparison to the level posted in the year-earlier period. At the same time, imports expanded by 11.9% as production revived; the biggest increase was in purchases of intermediate goods (13.2% in the first four months), while capital goods recovered by 4.6% and consumer goods, by 10.5%. Non-oil exports were up by 12.1%, boosted by increased sales of manufactures (11.7%), agricultural products (14.3%) and extraction-industry exports (94.8%). Oil exports, buoyed by higher prices, increased by 16.7%.

Net remittances from residents abroad were equivalent to 2.1% of GDP, or 79% of the value of crude oil exports, in a continuation of the upward trend observed since 1995. This rise reflects an increase in the number of migrants and better accounting coverage of such transactions. A further upturn has been observed in 2004, as remittances amounted to US$ 6.326 billion in the first five months of the year, which is 25.8% higher than the figure for the same period of 2003. For 2004 as a whole, remittances should reach the US$ 15 billion mark.

The balance-of-payments financial account showed a surplus of US$ 17.683 billion in 2003, which was 21.7% smaller than the 2002 surplus. This outcome reflected a lower level of FDI (-27%) and efforts by both commercial banks and the public sector to pay down the external debt.

Most FDI in 2003 went to the manufacturing industry (47%), followed by financial services (19%), commerce (9%) and transport and communications (5.5%). The United States continued to be the primary source of such investment. In the first quarter of 2004 Mexico received US$ 7.425 billion in FDI, equivalent to 69% of the total received in 2003, as the BBVA bank acquired 40% of the remaining shares in Bancomer; this operation alone represented an inflow of US$ 4.2 billion. Excluding that amount, FDI was 21.6% higher in the first quarter of 2004 than in the year-earlier period, and is expected to total US$ 15 billion for the year as a whole.