

Macroeconomic Challenges for Mexico and the World

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EGADE-ITESM
May, 2010

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- Assessment of economic and financial damages in 2009
- Strengths of the Mexican Economy after 2009
- Weaknesses of the Mexican Economy after 2009
- Medium term macroeconomic challenges for Mexico and the World.
- Necessary actions in the short run
- Conclusions

Damage assessment, 2009

- The sudden drop in external revenue due to the financial crisis in USA and other developed countries.

- Petroleum revenues (-19,973 MUSD) (39.4%)
- Family remittances (-4,016 MUSD) (16.0%)
- Manufacturing exports (25,416.3 MUSD) (11.8%)
- Tourism revenue (-1,958.7 MUSD) (16.2%)
- FDI (-3,761 MUSD) (73.7%)
- External financial sources closed to Mexican firms (4mmd)

Loss of 55.1 mmd
(6.0% GDP)

GDP fell 6.5% in
2009

- Shutdown of economic activity (service sector) due to the influenza virus A1H1 contingency in april and may of 2009.

Damage assessment, 2009

- The latter caused, among other effects:
 - 558 mil jobs (IMSS) were lost from October 2008 to December 2009.
 - The Open Unemployment Rate increased to more than 6% of the Economic Active Population between July and September 2009 (Feb 2010, 5.21%)
 - Private consumption reduced by 6.1%*
 - Private investment fell 10.1%*
 - Banking credit to the private sector -6.3%**
 - Delinquency rate for credit cards of 7.8% (Feb 2010)
 - Tax collection (Income tax -10.5% e Value Added Tax -17.8%) (***)
 - Sales of new vehicles (-26.4%) ****

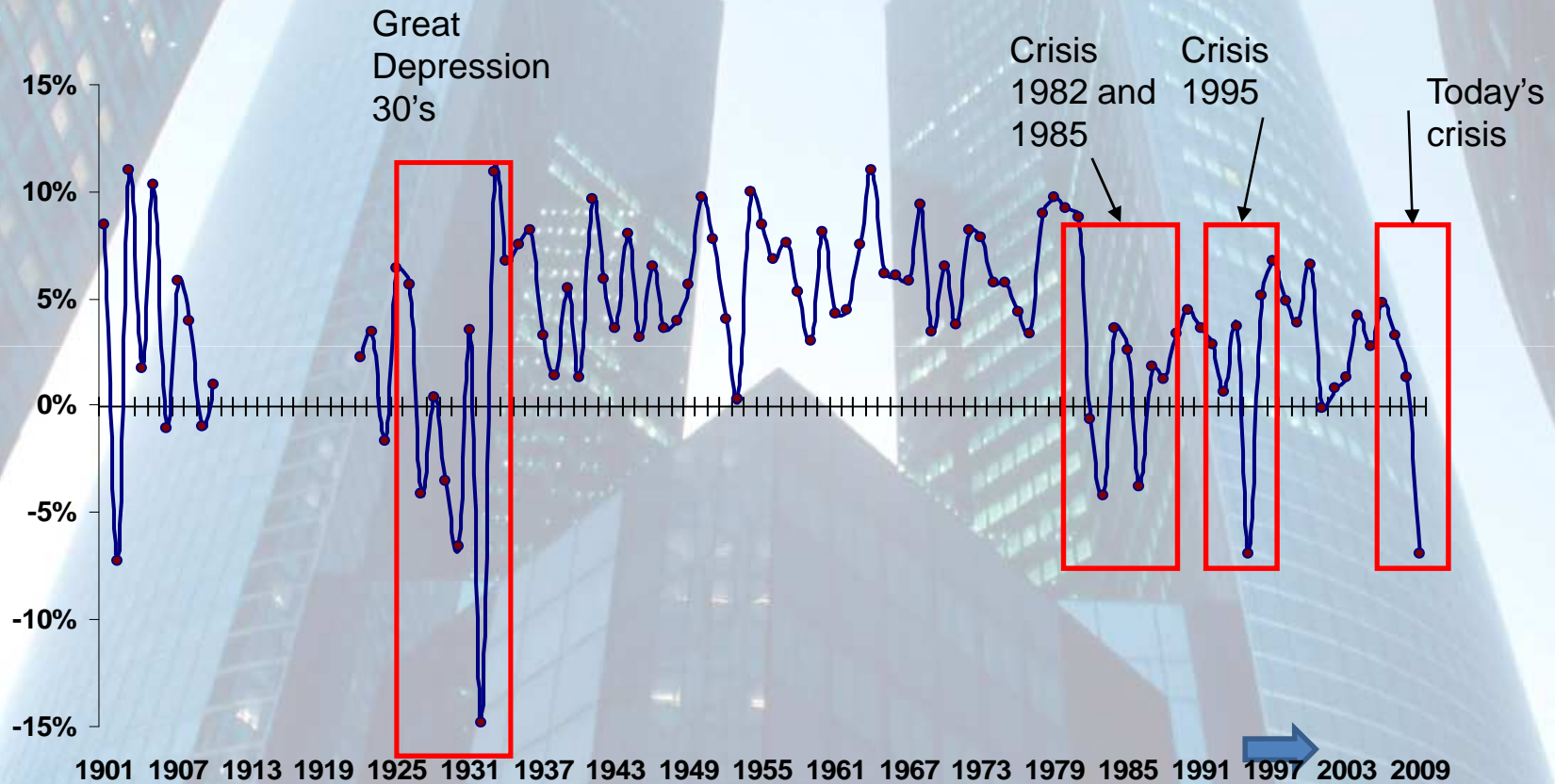
*2009/2008

** Febraury 2010/Febraury 2009

*** Noviembre 2010/Noviembre 2009

**** Diciembre 2010/diciembre 2009

A Century of Economic Growth in Mexico

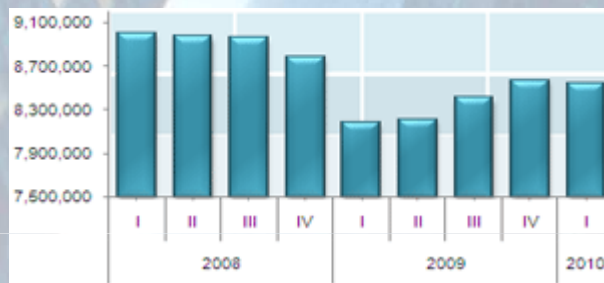


Fuente: INEGI

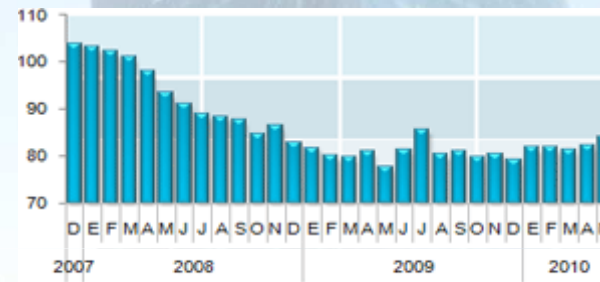
Nevertheless, the economic recovery is already starting:

- According to different indicators, the recession reached bottom in the second semester of the year and a slight reaction in the productive sectors.

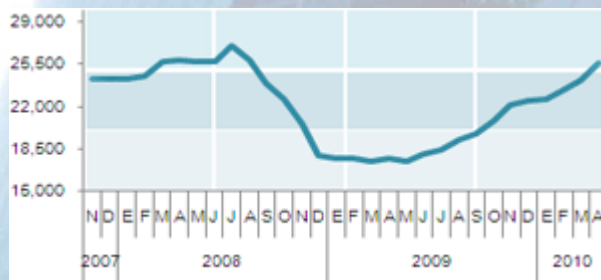
Real GDP
(Million pesos 2003)



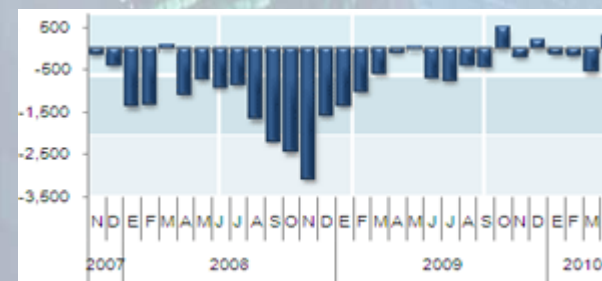
Consumer Trust Index
2003=100



Total Exports
Million dollars



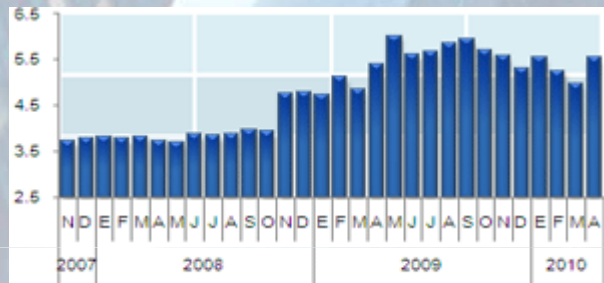
Trade Balance
Million dollars



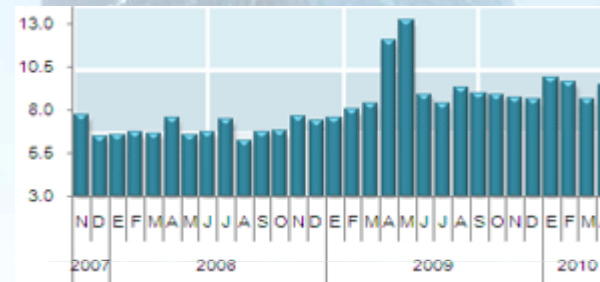
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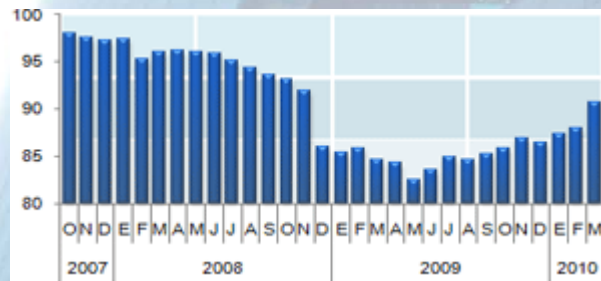
Open Unemployment Rate
(% EAP)



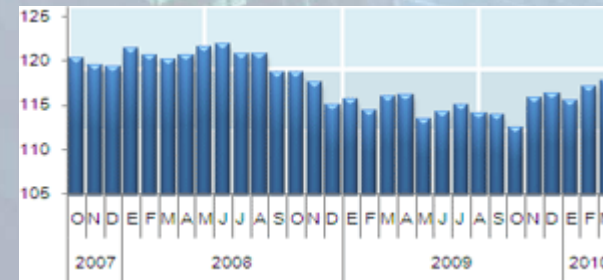
Subemployment Rate
(% EAP)



Hours worked in manufacturing
Index 1993=100

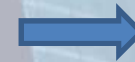


Entrepreneur Opinion from the Manufacturing
Sector
Orders (Points)



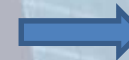
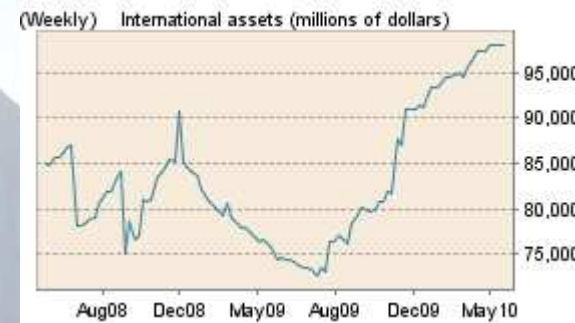
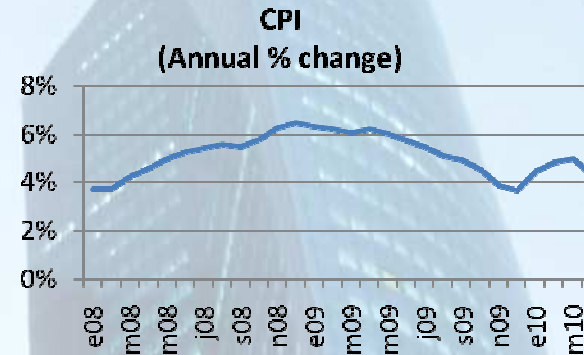
Strengths after the 2009 crisis

- Low inflation 3.45% (4.27% April 2010)
- High level of international reserves (97.9 mmd 28/05/2010)
- Properly capitalized banking system (17.3% total risk March 2010)
- Mexican Stock Market returned to the pre-crisis level
- Manufacturing sector is recovering, following the USA economy.
- Money demand was not reduced during 2009



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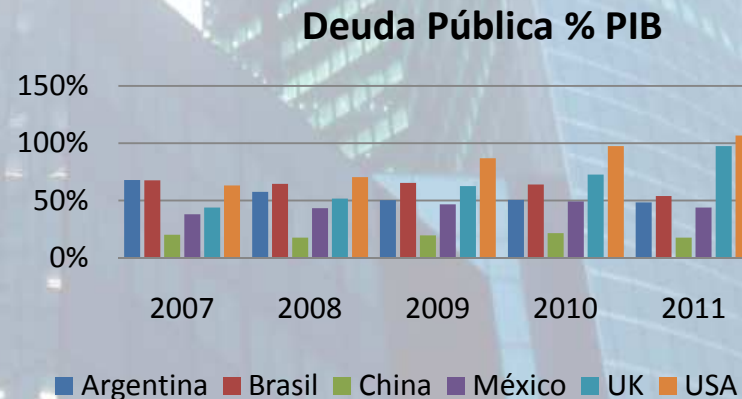


Strengths after the 2009 crisis

- The flexible exchange rate absorbed the external shock (financial crisis in USA) and the adjustment was not transmitted to the price level.
- The level of public debt is low compared to international levels.



Source: Banco de México



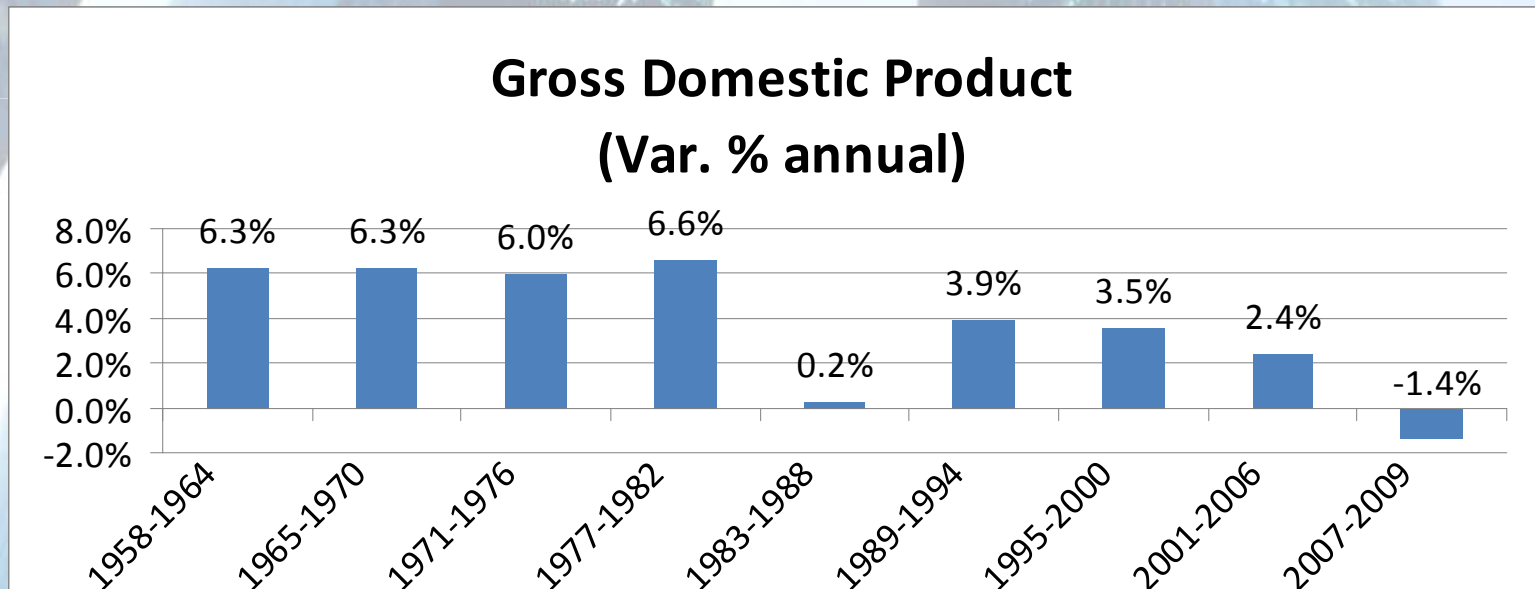
Source: International Monetary Fund

Weaknesses of the Mexican Economy after 2009

- Fiscal vulnerability due to the petroleum market
- Excessive dependence to the USA economy
- Low inflation is mainly explained by:
 - Weakness of the domestic economy
 - Subsidies (gasoline)
- The exchange market is vulnerable to the volatile foreign portfolio investment. →
- There is inflexibility in public expenditure despite the reduction in public revenues (from petroleum)

Medium term macroeconomic challenges

- The lack of structural reforms during 13 years of conflicts between the Executive and Legislative powers has provoked a stagnation in economic growth:



Source: INEGI

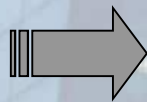
Medium term macroeconomic challenges

1/2 Energy Reform



- We will become petroleum importer (2013 - 2015)
- We will lose an important source of public revenue (petroleum exports represented 1.7% of GDP in 2009)

1/2 Fiscal Reform



- Public budget focused on petroleum sales
- High fiscal burden for captive contributors
- Public revenues are diminished by the regime of zero VAT for medicines, food, exception for some services and other special regimes

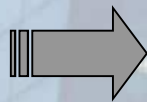
Medium term macroeconomic challenges

1/2 Pension Reform



- IMSS (retired)
- CFE
- PEMEX
- State governments

No Labor Reform

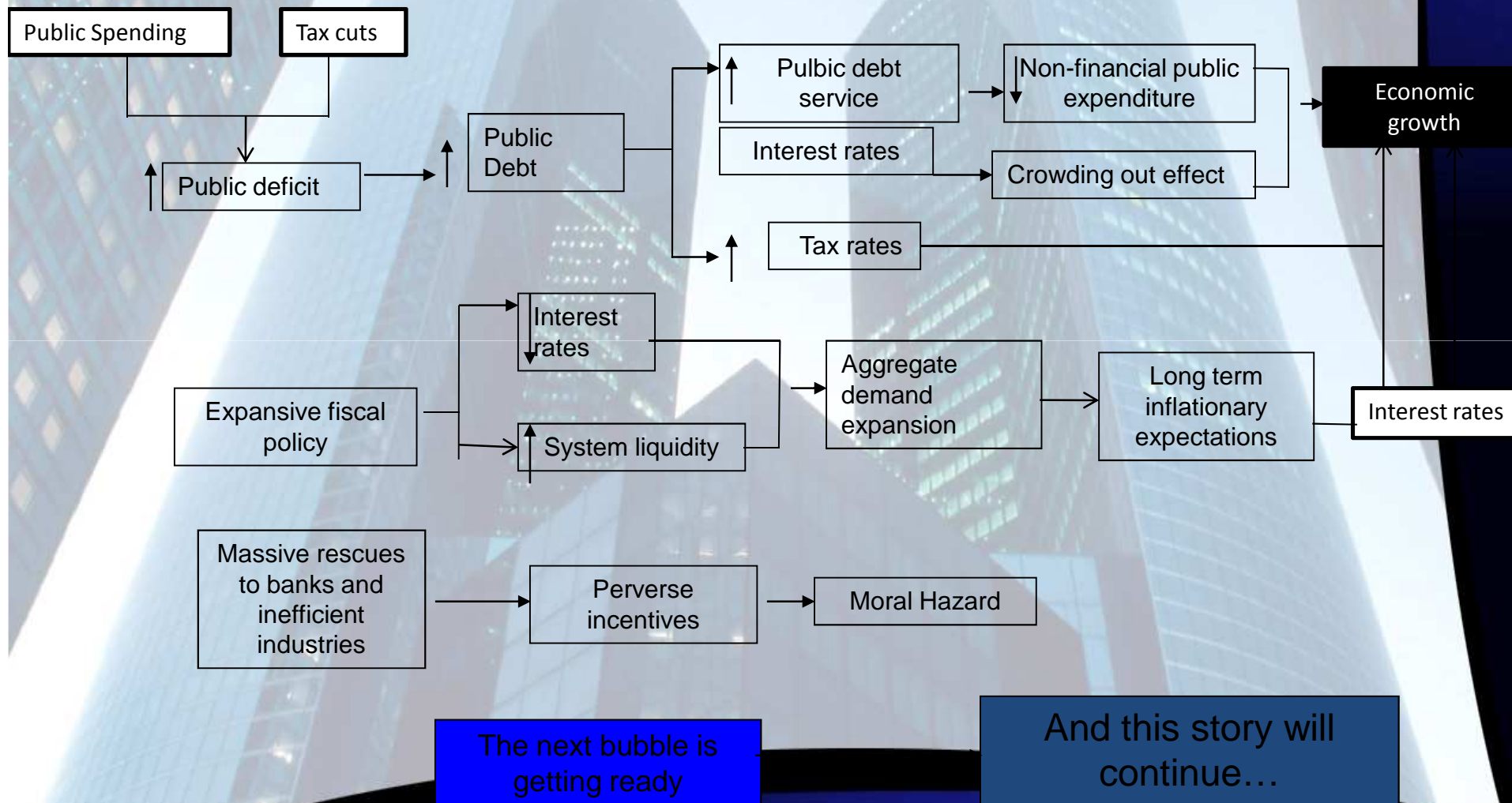


- No incentives to hire new employees
- Reduced opportunity for young and women to participate in labor markets
- High exit and entry costs for Mexican labor market.

Reflections about Mexican future

- Structural problems present at the Mexican economy will explode around 2013-2016
 - How are we supposed to substitute the revenue from petroleum exports?
 - Where are we going to get enough resources to cover the payments for the public pension systems?

The economic policies taken by the governments of developed countries are going to limit the recovery capacity of the world economy and its long run growth.



Worries about the effects of economic stimulus in the USA



Actions to be taken

- Near to the election process of 2012, some political parties have started to realize about the medium run macroeconomic problems.
- This can be one of the reasons why there is a subject brought back to the table after the budget for 2010 was approved:

THE FISCAL REFORM

Actions to be taken

- It should not surprise us that during the discussion of this Fiscal Reform some taboo issues will be analyzed. For example the possibility of including more items to the consumption basket paying VAT.

Actions to be taken

- Medium run (2010-2012)
 - Will exist enough political determination at the PRI to materialize the pending structural reforms?
Will it be too late?
- Long run (2013- α)
 - We are running out of democratic bonus



Conclusions

- ❑ 2009 was the year for the perfect storm.
- ❑ By the second quarter the recession reach bottom and by the end of 2010, the economic activity will get to the 2008 levels.
- ❑ In the medium run, the external environment, the high public deficits and the resulting public debt will cause: inflation, highs interest and tax rates that will compromise the economic recovery after 2013.



Conclusions

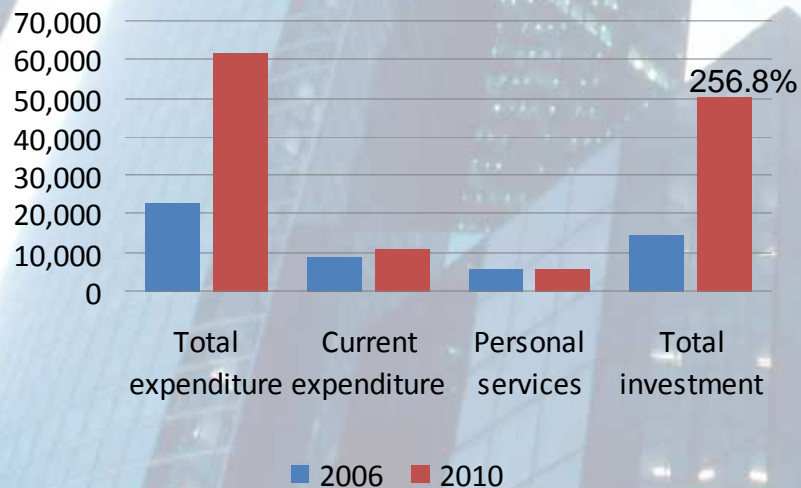
- The lack of growth in Mexico is caused by the supply (the lack of structural reforms to improve competitiveness). Demand is not the problem.
- It is likely that approaching 2012, the legislative power will become more flexible about these reforms.



Ministry of Communications and Transports (SCT)

- Total investment has grown by 256.8% in real terms (2006/2009)
- The road network has increased 2.6% from 2006 to 2009

SCT Budget
(Thousand of millios, pesos Dec 2009)



National Road network
(Thousands of kilometers)



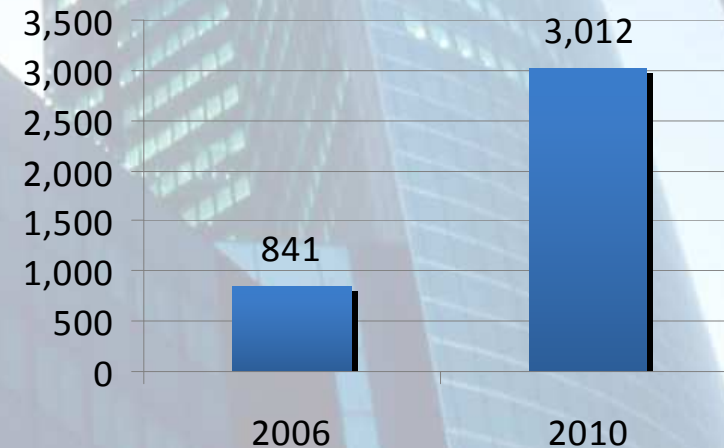
National Sport Commission

- While the budget for the National Public Text Book Commission increased by 11.4% (2006/2009)
- The Budget for the National Sport Commission grew 258% (2006/2010)

**Total Expenditure of the National Public Text Book Commission
(thousand million pesos)**



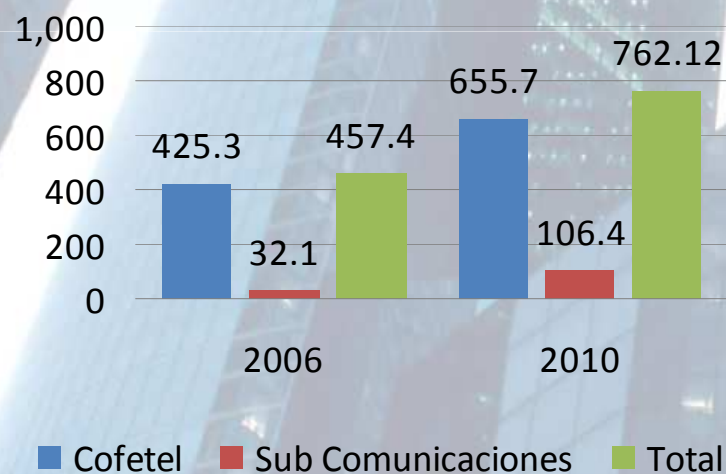
**Total Expenditure of the National Sport Commission
(Thousands of million pesos)**



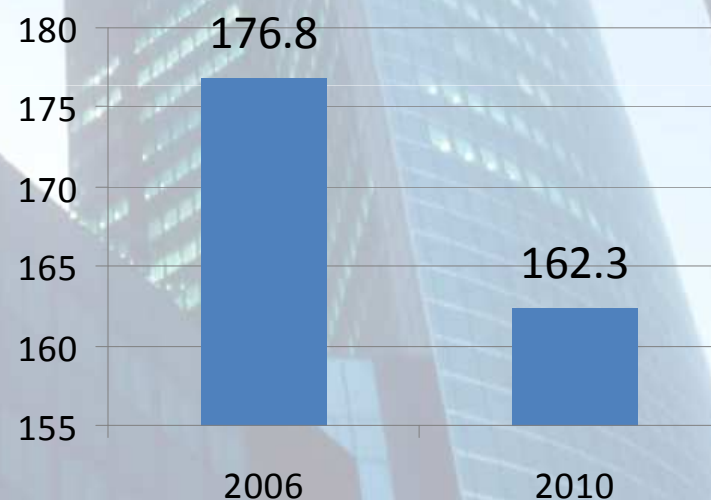
Public Expenditure in Regulatory Institutions

- While the expenditure of the CFT and the Under-Ministry of Communications grew 66% in real terms (2006/2010)
- The total expenditure of Cofeco fell 8.2% in real terms (2006/2010)

**Total Expenditure CFT and Under-Ministry of Communications
(Thousands of million pesos)**

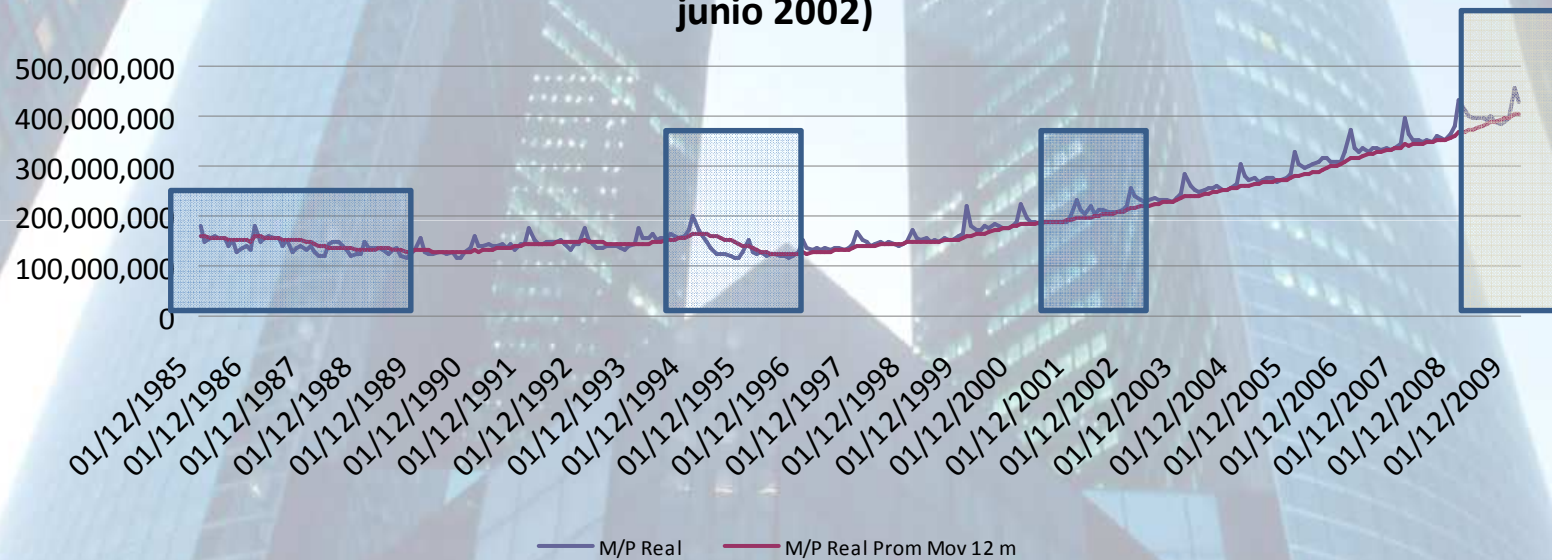


**Total Expenditure Cofeco
(Thousands of millions pesos)**



Coins and bills, real terms

Bills and coins
(Thousands of pesos from 2 q
junio 2002)

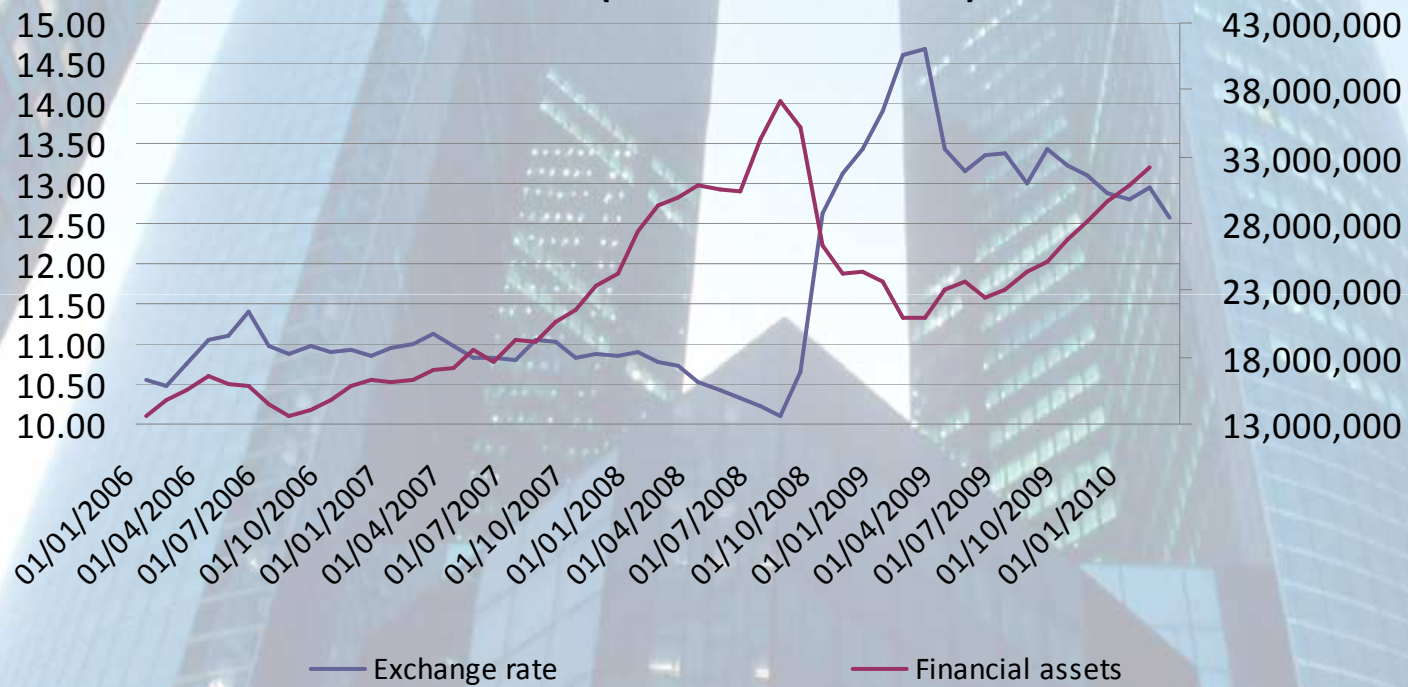


Source: Elaborated with data from Banxico



Exchange rate vs Foreign Portfolio Investment

Exchange rate (peso - dollar) vs Financial Assets hold by foreign citizens (Thousands of dollars)



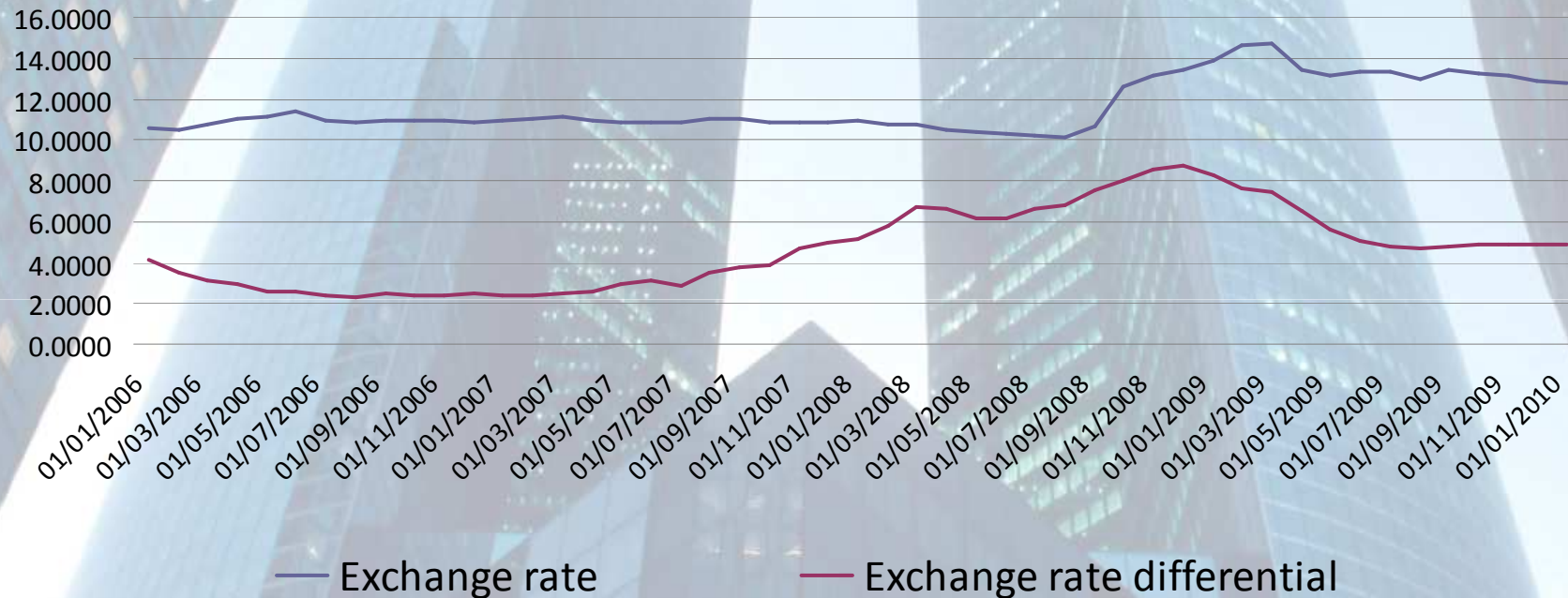
Source: Elaborated by data from Banxico

* Financial Assests owned by non residents (M3)



Exchange rate vs Foreign Portfolio Investment

Exchange rate vs interest rate differential Mexico - USA*



Source: Elaborated with data from Banxico

* Differential between the Mexican TIIIE and the Treasury Bill three months.

