

MEXICO LOOKS TO SLOW GROWTH AMID RELATIVE STABILITY

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Mexico has entered a new phase in its economic history: macroeconomic stability with subpar growth. The accomplishments of the Fox administration have been, first, to become the administration; second, to achieve the first presidential transition in a quarter of a century unaccompanied by macro-devaluation and runaway inflation; and, third, to successfully manage economic policy so that macroeconomic stability can be assumed to be the norm.

The inability of Mexico's governing class to implement the structural and institutional reforms the country needs if it is to become more competitive is a well-known story, and one not likely to change between now and Dec. 1, 2006, when Fox's successor assumes office. Providing that the present economic policy-making team remains in control, between now and the end of the Fox sexenio the trends described below will characterize the economy.

Growth in the second half of the sexenio will be much better than in the first half, but average only about half the 7 percent rates Fox promised when he was campaigning. Outside variables, like oil prices and the growth rate of the U.S. manufacturing sector, will be critical determinants of Mexican growth. Job creation will continue to be a major difficulty, one with social and political as well as economic implications.

Inflation should stay below 5 percent, but stronger demand and the peso's depreciation last year will make it difficult to bring inflation down to 3 percent. Nominal interest rates should be higher in the remainder of the sexenio than in 2002, when they frequently posted historical lows of less than 5 percent. This is due to three reasons. First, inflation will probably be higher. Second, U.S. interest rates will be higher, probably beginning this summer. Third, as the Mexican presidential election approaches, investors will demand a higher "uncertainty premium."

Trade and current account deficits will be larger. The structure of Mexico's trade means that higher growth rates translate into larger trade account deficits. That will be accentuated by the inevitable decline of oil prices. In Mexico, the size of the trade account deficit drives the size of the current account deficit. Even though these deficits will be larger, they should remain a manageable percentage of GDP.

Mexico's capital account surplus is likely to decline. Financing the current account deficit should not be an issue, since foreign direct investment (FDI) should finance at least three-fifths of the current account deficit. This year, the Spanish bank BBVA's intention to pay \$4.1 billion (U.S. dollars) for the 41 percent of Bancomer it does not yet own should boost FDI, as well as finance the year's current account deficit. In future years, however, FDI is likely to decline unless there are other such mega-acquisitions.

The peso is likely to decline modestly, and volatility will increase in the run-up to state elections this year and next. The economic fundamentals do not warrant a macro-devaluation. Any serious presidential candidate shares an interest in macroeconomic stability and will be loath to do anything that could precipitate a crisis. Nonetheless, don't be surprised to see the peso weaken as the July 2006 presidential election draws near.

Macroeconomic stability with 5–7 percent growth rates is not an impossible dream for Mexico. It requires economic and political reforms that are not likely to be made until a new president assumes office. In the end, Mexico's economic problem is a political one.

— Dr. Deborah L. Riner

American Chamber of Commerce of Mexico

2004 MEXICO CONSENSUS ECONOMIC FORECAST

	Annual Percent Change 2004 from 2003						Annual Average		
	GDP 1993 Peso	Private Con- sumption	Government Con- sumption	Total Invest- ment	Exports	Imports	Consumer Price Index	Exchange Rate	CETES 28 Day
AMERICAN CHAMBER	2.9	2.7	1.0	2.0	3.1	4.7	4.5	11.180	5.9
BANAMEX	4.0	3.9	2.0	4.7	4.3	6.2	3.7	10.630	6.4
BANCOMER	2.5	2.1	2.2	0.1	3.3	6.0	3.9	11.270	5.7
CTR. FOR ECON. FORECASTING	3.5	3.8	3.5	3.5	6.9	8.4	3.8	11.357	6.2
CONSULTORES ECONOMICOS									
ESPECIALIZADOS	3.3	3.5	1.6	5.5	5.2	6.4	4.7	11.200	6.2
GRUPO FINANCIERO INVERLAT	3.1	3.1	2.4	2.9	4.3	5.4	4.5	11.310	6.9
LATIN SOURCE MEXICO	3.3	3.7	1.5	5.5	4.2	6.0	4.0	11.220	5.7
CONSENSUS — THIS QUARTER	3.2	3.3	2.0	3.5	4.5	6.2	4.2	11.167	6.1
— LAST QUARTER	3.5	3.4	2.1	4.7	5.5	7.2	3.9	11.104	6.2

2005 MEXICO CONSENSUS ECONOMIC FORECAST

	Annual Percent Change 2005 from 2004						Annual Average		
	GDP 1993 Peso	Private Con- sumption	Government Con- sumption	Total Invest- ment	Exports	Imports	Consumer Price Index	Exchange Rate	CETES 28 Day
AMERICAN CHAMBER	3.3	3.0	2.1	1.9	2.1	3.9	4.0	12.000	6.5
BANAMEX									
BANCOMER	3.3	3.1	-1.2	1.7	7.0	9.0	3.5	11.670	7.2
CTR. FOR ECON. FORECASTING	4.5	4.6	4.2	6.0	8.7	9.9	3.5	11.740	6.6
CONSULTORES ECONOMICOS									
ESPECIALIZADOS	4.5	4.4	3.1	6.1	5.9	7.0	4.3	11.670	7.7
GRUPO FINANCIERO INVERLAT	4.4	4.7	3.0	9.0	5.4	9.2	4.2	11.980	7.6
LATIN SOURCE MEXICO	3.5	3.8	-0.4	5.7	6.5	8.2	3.7	11.620	6.2
CONSENSUS — THIS QUARTER	3.9	3.9	1.8	5.1	5.9	7.9	3.9	11.780	7.0
— LAST QUARTER	4.4	4.1	2.8	5.7	7.6	8.9	4.0	11.189	8.4

HISTORICAL DATA

Source: INEGI	GDP – 1993 Pesos (billions)	Private Consumption 1993 Pesos (billions)	Government Consumption 1993 Pesos (billions)	Total Investment 1993 Pesos (billions)	Exports (Trade Bal.) US Dollars (millions)	Imports (Trade Bal.) US Dollars (millions)	Consumer Price Index June 02=100 Dec./Dec.	Exchange Rate Pesos/Dollars (annual av.)	CETES 28 Day (annual av.)
2003	1,634.2	1,198.6	155.4	354.6	165.1	170.7	106.9	10.717	6.4
<i>Percent Change</i>	1.4	2.0	1.5	-1.7	2.7	1.2	3.9	9.3	-10.9
2002	1,611.7	1,175.1	153.1	360.8	160.8	168.7	102.9	9.803	7.18
<i>Percent Change</i>	0.9	1.3	-1.3	1.2	1.5	0.2	5.7	4.6	-36.5
2001	1,597.2	1,160.5	155.0	356.5	158.4	168.4	97.4	9.371	11.31
<i>Percent Change</i>	-0.3	2.4	-1.2	-5.8	-4.8	-3.5	4.4	-1.7	-26.3
2000	1,602.3	1,133.8	157.0	378.6	166.5	174.5	93.2	9.535	15.36
<i>Percent Change</i>	6.6	7.6	2.0	11.4	22.0	22.9	9.0	-1.0	-28.3
1999	1,503.5	1,053.5	153.8	339.9	136.4	142.0	85.6	9.630	21.43
<i>Percent Change</i>	3.7	3.9	4.7	4.0	16.1	13.2	12.3	3.6	-13.3
1998	1,449.3	1,013.8	146.9	327.0	117.5	125.4	76.2	9.293	24.73
<i>Percent Change</i>	4.9	5.3	2.3	9.9	7.7	14.2	18.6	16.3	25.0

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