

Mexico

Recent Developments, Structural Reforms, and Future Challenges

In recent years, the Mexican government has implemented a series of economic reforms to strengthen the country's fundamentals and increase its ability to cope with external shocks. Because of the progress that has been made, the government is confident that Mexico will be able to leave recent crises behind and start the new millennium with a stable and growing economy.

José Angel Gurría

DURING 1999, as a result of applying sound economic policies, Mexico achieved, and in some cases surpassed, the government's main macroeconomic targets (Tables 1 and 2). The economy grew 3.6 percent, exceeding the 3 percent rate anticipated at the beginning of the year, as both domestic and external demand for goods and services increased. Economic growth has led to the continuing creation of jobs and a sharp reduction in unemployment rates. During the first 11 months of 1999, the total number of workers registered by the Mexican Social Security Institute increased by more than 870,000, and the open unemployment rate fell to its lowest level since 1985.

Fiscal discipline continues to be the cornerstone of President Ernesto Zedillo's economic strategy. Prudent fiscal policy has contributed to the achievement of macroeconomic stability and increased domestic savings. Since it met the fiscal deficit target for 1999, equivalent to 1.25 percent of GDP, the government was able to lower the ratio of net public debt to GDP to 25.3 percent in 1999 from 27.9 percent at the end of 1998. Moreover, Mexico's public-debt-management policy has continued to be

consistent with the strengthening of the economy. Market amortizations of the public sector's external debt for the last quarter of 1999 and the year 2000 as a whole amount to \$2.3 billion.

Another important achievement in recent years has been the reduction in inflation. The consumer price index increased 12.32 percent in 1999, below the 13 percent target established at the beginning of the year. On the external side, non-oil exports have continued to show a positive trend, growing 15.0 percent in 1999. Additionally, the trade balance reflected the increase in international oil prices. In 1999, Mexico's current account deficit amounted to \$13.0 billion, or 2.8 percent of GDP, and foreign direct investment reached \$10.7 billion, or 76.6 percent of the current account deficit.

In addition, the flexible exchange rate regime has helped Mexico to absorb external shocks in an orderly manner and has shown less volatility than expected. Thus, during 1999, the peso appreciated 3.6 percent with respect to the U.S. dollar.

Economic strategy for 2000

During 2000, Mexico will continue to take a prudent policy stance in view of the



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Table 1
Strengthening of the Mexican economy: Selected indicators

	1993	1994	1998	1999 ¹
Savings as percent of GDP ²				
Total	21.0	21.7	24.4	23.9
Domestic	15.2	14.7	20.5	21.0
External	5.8	7.0	3.8	2.9
Current account deficit				
Million dollars	23,399.2	29,662.0	15,957.7	13,965.1
Percent of GDP	5.8	7.0	3.8	2.9
Foreign direct investment				
Million dollars	4,388.8	10,972.5	10,237.5	10,700.0
Percent of current account deficit	18.8	37.0	64.2	76.6
Public foreign net debt				
Million dollars	69,362.1	76,889.9	82,222.1	83,251.1 ³
Percent of GDP	16.1	26.8	19.6	16.3 ³
Public sector foreign interest payments/total exports				
Percent	9.3	8.8	5.4	5.0 ⁴
Government securities held by residents abroad				
Million dollars	21,877.9	19,575.9	2,476.2	2,136.5 ⁵
Public sector external debt market amortizations for the next year ⁶				
Million dollars	12,776.2	20,017.9	1,624.6	2,482.4 ⁴
Average maturity of government securities				
Number of days	285.0	306.4	421.2	561.2 ⁷
International net reserves				
Million dollars	24,537.5	6,148.2	30,139.8	30,733.5 ⁷
M2/international net reserves	6.3	17.4	6.0	7.4 ⁸
M3/international net reserves	7.2	20.5	6.1	7.5 ⁸

Sources: Mexico, Department of Finance and Public Credit; National Institute for Statistics, Geography, and Informatics; and Bank of Mexico.

¹ Estimated figures, except where otherwise indicated.

² In 1998, the figures may not add to the total shown because of rounding.

³ As of October 30.

⁴ As of third quarter.

⁵ As of December 29.

⁶ Includes dollar-indexed *Tesobonos* maturing in 1995.

⁷ As of December 30.

⁸ As of November 30.

possibility of a slowdown in the U.S. economy. The Mexican government has also taken steps to ensure that it can cope with external shocks and that upcoming national elections can take place in a stable economic environment.

The economic strategy for 2000 has been designed to maintain the positive trends in economic growth and job creation, continue to reduce inflation, increase social spending, and achieve an orderly transition into the next administration. To ensure that these objectives are met, the Mexican government firmly intends to maintain sound public finances and continue the structural reform process.

Sound public finances. The government will continue to reaffirm its commitment to maintain fiscal discipline. The budget for 2000 establishes a public deficit of 1 percent of GDP; total budgetary income is expected to surpass 20 percent of GDP, while the public sector's expenditure will, in contrast, remain constant, though still above 20 percent of GDP.

Government expenditure for 2000 will continue to focus on the social agenda, particularly on education, health, social security, and poverty reduction. Expenditures on social programs, as well as on efforts to fight extreme poverty, will

significantly increase in real terms.

The government's fiscal stance is expected to lead to a slight reduction in the ratio of net public debt to GDP. Domestic debt management will concentrate on reducing refinancing risk and the sensitivity of the costs of debt to changes in interest rates, as well as on developing a long-term market for government securities denominated in Mexican pesos. The Mexican government will also continue to work toward an efficient refinancing of domestic debt—to improve the market maturities and costs of the relevant securities—as well as a smoothing of the public external debt amortization profile. For 2000 and 2001, external debt market amortizations amount to only \$1.9 billion and \$1.6 billion, respectively. These levels are manageable and consistent with the 2000 budget.

The government's fiscal policy is consistent with monetary and exchange rate policies. In 2000, the Bank of Mexico (the country's central bank) will maintain its commitment to hold the yearly inflation rate to 10 percent. In addition, Mexico will maintain its floating exchange rate regime, which has allowed an orderly adjustment to

external shocks, increased the proportion of long-term capital inflows, reduced the possibilities of speculative attacks, and prevented misalignments of the real exchange rate. Furthermore, the current account deficit is expected to be 3.1 percent of GDP, or \$15.4 billion, and will remain within sustainable levels and consistent with the availability of foreign direct investment. In addition, domestic savings are expected to reach close to 21 percent of GDP in 2000.

Structural reforms. The reforms Mexico has implemented, which have focused on economic and financial liberalization, have enabled the economy to take advantage of the benefits of globalization while minimizing the risks inherent in this process. The reforms—which have included trade and capital account liberalization, increased private sector participation in key sectors of the economy, tax reforms, changes in labor market structure, capital market liberalization, and pension system reforms—have transformed a closed, heavily regulated economy with high government intervention into an open, market-driven economy.

• Since 1985, when it formally joined the General Agreement on Tariffs and Trade, the predecessor of the World Trade

Table 2
Mexico: Macroeconomic framework, 1998–2000

	1998	1999	2000 ¹
Real GDP growth (percent)	4.8	3.6 ²	4.5
Inflation ³	18.6	12.32 ⁴	10.0
Nominal exchange rate			
End of period	9.87	9.51	10.7 ⁵
Interest rate (28-day <i>Cetes</i>)			
Nominal, average	24.8	21.3 ⁴	16.4
Real	7.7	10.1 ⁴	7.0
Current account			
Million dollars	-15,957.7	-13,009.2 ⁶	-15,408.2
Percent of GDP	-3.8	-2.9 ⁶	-3.1
Public sector balance			
Percent of GDP	-1.26	-1.25 ⁶	-1.00
Supporting data			
U.S. GDP			
Real growth (percent)	3.9	3.7 ⁶	2.6
U.S. inflation ³	1.6	2.2 ⁶	2.5
Oil prices (Mexican mix)			
Average price (dollars per barrel)	10.2	15.7 ⁴	16.0
Average production (thousand barrels per day)	1,719	1,554 ⁶	1,525
Foreign interest rate			
LIBOR (percent) ⁷	5.5	5.5 ⁴	6.1

Source: Mexico, Department of Finance and Public Credit.

¹ Projected figures.

² According to analysts' consensus.

³ Percentage increase in consumer price index from December of previous year to December of the specified year.

⁴ As of December 30.

⁵ Because the exchange rate regime is flexible, this figure is not a projection or a goal.

However, it is a reference point used for estimating purposes.

⁶ Estimated.

⁷ For the year 2000, figures for the London interbank offered rate (LIBOR) are based on futures quotation.

Organization, Mexico has undertaken fast and far-reaching trade liberalization measures. These have included, among others, a government-wide deregulation program, a new competition law, the elimination of price controls, and the negotiation of free trade agreements. Mexico has started the year 2000 in a better position within the international arena, owing to eight bilateral trade agreements and the access that they provide to the most important markets in the world: North America and, more recently, the European Union. Mexican foreign policy is geared toward strengthening its participation in the trade liberalization process, particularly with the members of Asia-Pacific Economic Cooperation and with six additional countries of Central and South America.

- The liberalization of the capital account has played a key role in Mexico's efforts to achieve economic and financial integration with the world economy. The government has eliminated restrictions on capital inflows, abolishing limits on commercial borrowing from abroad, foreign investment in Mexican securities, and foreign participation in domestic money markets. Controls on capital outflows have also been abolished.

- In the early 1980s, the government was a key player in the economy, participating in virtually every sector. Since then, the government's direct participation in economic activities has decreased considerably and is now limited largely to providing public services and an adequate legal framework, guaranteeing competition, and—above all—undertaking social development programs.

- The reform of the tax system is an ongoing process. Every year, the government has taken measures to make tax collection more efficient, transparent, and progressive. Additionally, the government expects to discuss and implement an integral fiscal reform that will allow Mexico to broaden its tax base, improve tax compliance, and reduce the public sector's dependence on oil-related revenues.

- The recent improvements in the Mexican financial system are a key component of the structural reform process. A strong and healthy banking system is needed to increase domestic savings to levels compatible with Mexico's investment needs and to channel those savings, under competitive conditions, to all sectors of the economy.

The most important action taken to date has been the creation of the new Institute for the Protection of Bank Savings (IPAB). The IPAB has assumed the role of the former Banking Fund for the Protection of Savings and is in charge of selling the assets acquired through various governmental banking-support programs and of managing a new deposit insurance scheme. In addition, the Mexican congress has allowed foreign investors to hold a majority share in any Mexican commercial bank, regardless of size. This measure will help to strengthen the banking system's capital base. Furthermore, the senate has recently approved a new corporate bankruptcy law, which is now before the lower house of parliament.

Mexican authorities have also strengthened the regulatory and supervisory framework of the financial system. In that context, the Commission for the Protection of Users of Financial Services was recently created to, among other things, help provide a more solid and extensive financial culture. Moreover, supervisory authorities have geared their efforts toward improving the disclosure of financial information (both public and private) to make it more transparent, timely, and accessible.

- Although Mexican capital markets have grown significantly in recent years, some elements still need to be addressed. Mexico currently does not have a government yield curve for fixed-rate securities with maturities of more than one year and has therefore begun issuing a new fixed-rate, three-year government bond. Furthermore, a futures and options market was established to provide market participants with better risk-management mechanisms while fostering greater depth, liquidity, and stability in the financial markets.

- The country's pension system was reformed in 1997 to establish a fully capitalized scheme and replace the current pay-as-you-go system. The regulatory framework and the supervisory agency for pensions have been strengthened, and pension funds are now managed by private institutions. This reform,

besides representing a major advance in social benefits, has helped to increase domestic long-term savings and to deepen the capital market. These favorable developments, in turn, will increase long-term financing for investment projects.

Achieving a smooth transition

The actions undertaken during the current administration have fundamentally strengthened the economy and promoted productivity increases through structural reforms. As a result, the economy is expanding while inflation is being reduced. In contrast to the unstable situation that prevailed in 1994, current trends in Mexico are sustainable, as is indicated by the following:

- The current account deficit remains moderate (at around 3 percent of GDP, as opposed to nearly 7 percent in 1994) and is consistent with the availability of foreign direct investment.
- International reserves stand at more than \$30 billion, a historic high that compares quite favorably with the 1994 figure of about \$6 billion.
- Domestic savings are estimated to increase to 21.7 percent of GDP in 2000 from 14.7 percent of GDP in 1994.
- Mexico's refinancing needs are moderate in relation to its external debt. The expected ratio of its net public external debt to total exports for 2000 is 55.6 percent, or less than half the 1994 level of 126.3 percent.
- Its current flexible exchange rate regime prevents the accumulation of external imbalances and deters short-term capital inflows. Instead, it encourages long-term capital flows in the form of foreign direct investment and reduces the probability of speculative attacks.

To ensure a smooth transition at the end of the Zedillo administration, the Financial Strengthening Program was

announced in 1999. This program consists of several sources of finance that total \$16.9 billion: \$4.2 billion from the IMF, \$5.2 billion in loans from the World Bank, \$3.5 billion in loans from the Inter-American Development Bank, and \$4 billion in credit lines from the U.S. Export-Import Bank (to finance imports of goods and services from the United States). In addition, the Mexican government has renewed the North American Framework Agreement with Canada and the United States, which provides a credit line totaling \$6.8 billion, through December 2000.

Conclusion

The strong performance of the Mexican economy in the midst of recent global financial turmoil underscores the validity of the consistent and prudent policies it has implemented during the current administration. The guiding principle for policy formulation has been that efforts to achieve sustainable economic growth and job creation require sound policies aimed at enhancing confidence among participants in the Mexican economy and fostering competition in the productive sectors. In the context of continuing structural reforms, Mexico's fiscal, monetary, and exchange rate policies should fully support its efforts to achieve higher and sustainable growth rates.

Past sources of economic vulnerability have been reduced considerably, and the administration has arranged for ready access to substantial financial support to enable it to cope with external shocks or other contingencies. As the new millennium begins, the government has set the stage for a crisis-free transition and permanent improvements in the living conditions of the Mexican people. **F&D**

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