

Comments on the Banco de México's Annual Report (1993)

Miguel A. Ortega *

The Banco de México's annual report is undoubtedly one of the most important documents on the behavior of the Mexican economy.

I therefore consider it relevant to offer some comments and observations on the bank's 1993 report.

Because it is issued by the country's central bank, the document presents a record of the overall course of the economy—in particular that of some macro variables and, very specifically, Mexico's financial position. These comments will concentrate on the first two aspects of the report, as they seem most important for observing the country's overall situation and its short-term prospects.

Perhaps I should begin by explaining that the Banco de México is not responsible for Mexico's economic policy. Through its monetary and financial activities, however, the bank does help the federal government achieve the goals it has set for itself. With its recently acquired autonomy, its mandate is now, "above all, to bring about stability in the purchasing power of the peso."

It is important to clarify this point, so that comments made here will not be interpreted as a criticism of the bank. It reports on what has taken place and on how it used the instruments at its disposal to contribute to the goals set.

Another pertinent clarification is that, from January 1 until now, some unfortunate occurrences have taken place in Mexico which are already influencing the economy and will have a negative impact on the bank's relatively optimistic forecasts for 1994. As this observation is made in defense of the institution, it is also only fair to say that the report is as revealing for what it says as for what it leaves unsaid, as we shall now see.

Fighting inflation

The basic aim of President Carlos Salinas' economic policy has been to fight inflation. The understanding is

that "price stability is merely an intermediate—albeit essential—objective in economic policy strategy, which is oriented toward achieving more basic goals: economic growth at a satisfactory and sustainable pace, accompanied by higher income levels and a more equitable income distribution."

It should be stressed that the amendment to the Constitution which grants autonomy to the central bank "is motivated by the need to avoid the ills that inflation brings with it..., namely: its regressive impact on income distribution; ...its negative impact on savings and investment; and the gradual stagnation of the economy."

“The report is as revealing for what it says as for what it leaves unsaid”

These concepts are in line with orthodox economic policy but, unfortunately, have not been ratified by the behavior of the Mexican economy. Indeed—as noted previously (*Voices of Mexico* 26)—as the fight against inflation went forward, all the indicators that the bank stated should have registered an improvement continued to decline instead. This was particularly the case with those relating to economic growth, employment and income distribution.

This has given rise to a debate on whether the policies adopted are the right ones, as well as on these policies' extremely high cost/benefit ratio. Although the bank's conclusion that "high, sustainable rates of economic growth are only possible if inflation is kept low" is debatable, it is certain that Mexico's economic history in the last five years proves that fighting inflation is not the sole condition for

* Political analyst.

achieving this growth. Moreover, if it is not accompanied by other measures it may have exactly the opposite effect (see table).

Insufficient flexibility vis à vis lowered expectations on inflation

A part of the report that has caused a good deal of comment is its stress on the “insufficient flexibility vis à vis lowered expectations on inflation” as a factor discouraging production and employment.

The document says that “another factor that contributed to the slowdown of the economy was the disparity between 1993’s real inflation rate and the higher rate

predicted by economic agents. This discrepancy was the reason why real interest rates for many debtors ended up higher than those anticipated when their loan was taken out. Similarly, a considerable number of businesses were affected by the fact that real wages also rose more than what had originally been projected, as it was predicted that inflation would be higher than what it actually was.”

It is somewhat difficult to interpret this concept, since it would mean—if one were to apply the argument the other way around—that production and employment benefit when real inflation is higher than predicted. This, of course, would imply a contradiction: that it is better to fall short of one’s goals than to surpass them.

The foreign trade sector

As one of the positive aspects of the “structural change” policy that has been implemented, the document stresses “the remarkable growth in Mexico’s non-oil exports.” The report repeatedly refers to the “favorable performance of sales abroad” and a “remarkable dynamism in exports and a drop in the growth of imports.” According to the bank, the reasons for such “dynamism” are “the benefits brought by structural change” and “that the country has now achieved a satisfactory level of competitiveness.”

However, there is more here than meets the eye; these statements should be qualified to a certain extent.

The document says that “in 1993, sales to the American continent grew considerably, by 15.8%.... In contrast, those to

MEXICO Inflation, Growth and Unemployment 1989-1993

	Inflation ¹ %	Growth of GDP ² %	Unemployment ³ %
1989	19.7	3.3	2.9
1990	29.9	4.5	2.7
1991	18.8	3.6	2.7
1992	11.9	2.8	2.8
1993	8.0	0.4	3.4

¹ Source: Banco de México

² Source: Banco de México and INEGI.

³ Source: Banco de México and INEGI. INEGI’s National Survey on Urban Employment defines the unemployment rate as its proportion in relation to the economically active population, that is, people 12 or older who in the reference period did not work even 1 hour a week, but did look for paid employment or seek to carry out self-employed activity. This methodology is widely considered to underestimate the problem. It does not include underemployment.

the rest of the world fell 16.2%.... Non-oil exports.... to the United States grew by 17.7% ...those to Europe fell 12.9%.”

This means that Mexico’s foreign trade continued to be dangerously concentrated on one market and that the demand from that market determines the variation in Mexican exports. A more detailed analysis should be made of the variables influencing the increase in U.S. purchases of Mexican products, before stating categorically that our competitiveness has increased.

It should also be stressed that the behavior of Mexican exports to the United States in the last four quarters has been identical to that of the U.S. economy (*Reforma*, April 29). (See graph of the summary of the report.)

Conspicuous by its absence from the report is the total amount of the country’s external debt, which, according to the Inter-American Development Bank, has now reached a historic high of about 118 billion dollars. Consequently, “Mexico devoted \$10.5 billion in 1993 to interest payments on its external debt, the largest amount used for this purpose during the present presidential term” (*La Jornada*, April 25).

Another aspect relating to the foreign trade sector that should have received additional comment on the part of the bank is the capital account in the balance of payments.

The report points out that in 1993 the capital-account surplus reached \$30.882 billion, due mainly to an influx of foreign investments (FI) amounting to 33.331 billion. This was made up of 4.9 billion (15%) in direct investment and 28.431 billion (85%) in portfolio investment.

This composition of FI bodes ill. If 85% of the FI entering the country can be considered as speculative or short-term investment, then from the point of view of job creation the benefit that the economy receives is nil. That is what the figures show: an unprecedented surplus in the capital account in this six-year presidential term, with an unemployment rate that is also at a record high.

On the other hand, the high volatility and quantity of portfolio FI have an impact on interest rates. When there is instability in the stock exchange—which has recently been the rule rather than the exception—interest rates rise so as to prevent the flight of this type of capital. These increases in interest rates have grave repercussions on an over-indebted economy, especially on small economic agents who have a real need for financing.

Financial margin and interest rates

What the bank does not say about the margin of financial intermediation is also significant. Recognizing that “it continues to be wide and is one of the factors explaining the relatively [sic] high level that active rates maintain,” the document gives long explanations of why this is so: inefficiencies in the banks (which “are energetically fighting [governmental] institutions”); lack of competitiveness in the financial market; the absence, until recently, of rules and regulations making it possible to have reliable information on potential credit users, etc.

One can only wonder why the Banco de México never mentions the extraordinary profits that banks are making in Mexico, which, according to *The Banker*, have placed Banamex, Bancomer and Banco Mercantil del Norte among the 10 most profitable institutions in the world, in terms of yields (*La Jornada*, July 12, 1993).

Thus, it is difficult to agree with the bank’s claim that “it sought to promote efficiency and competition in the financial market, while protecting users’ interests.” One can only state that the banks have put priority on their own

profitability rather than providing businesses with access to credit—particularly the small and medium-sized businesses that cannot obtain financing abroad.

Small and medium-sized businesses (SMSBs)

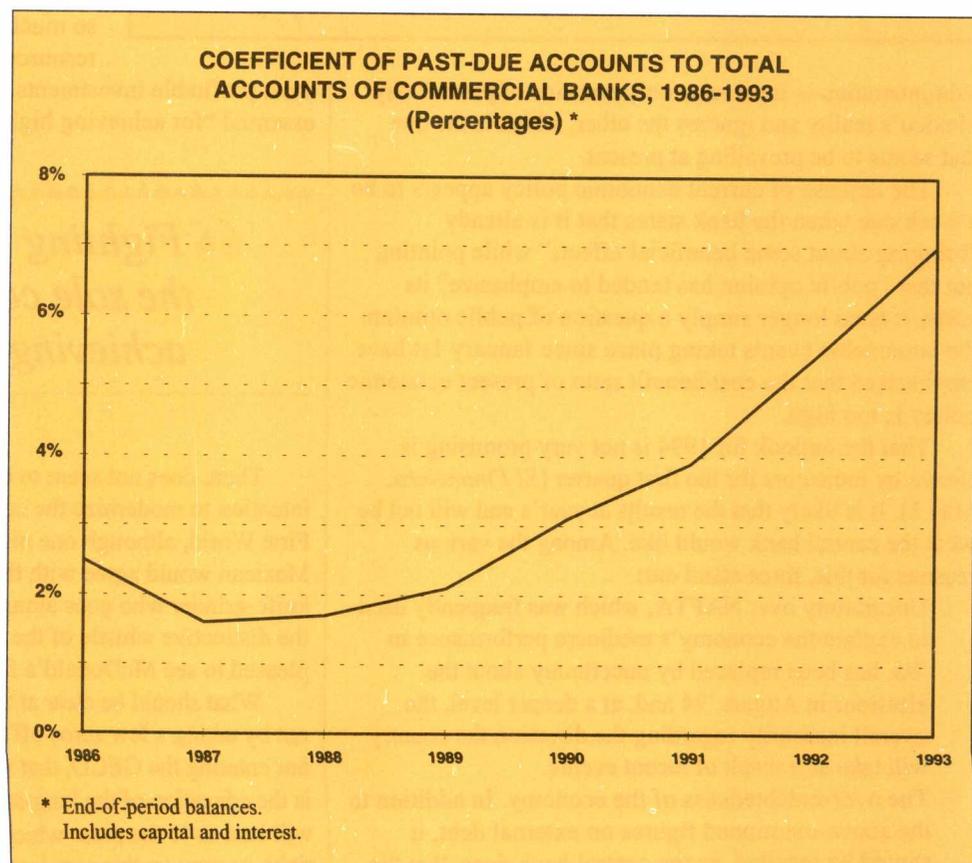
This leads us to point out another remarkable omission in the report: the host of SMSBs that shut down in 1993.

The bank states that “larger businesses and... those which carried out their modernization processes in a timely fashion... actually carried out outstanding productive activity... and increased their labor force.” It also declares that “among the group [of 80 manufacturing firms quoted on the Mexican Stock Exchange] employment remained relatively stable.” Needless to say, these are the largest firms.

The document does not tell us how many SMSBs were affected by the credit policy adopted and by banks’ extraordinary profitability. The veiled criticism of firms that did not “carry out their modernization processes in a timely fashion” also seems unfair. The first requirement for doing so would have been the availability of financing.

Prospects

In my view, the Banco de México’s report is an incomplete document, since—as is characteristic in this



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If you hadn't made so much trouble there'd be a Mc Donald's in the jungle by now.

SI NO SE
HUBIERAN ALEBRESTADO,
¿ESTA HABRÍA UN
MC DONALDS EN LA
SELVA ¿EH?

real terms, from the end of 1988 to the end of 1992, the banks' personal loan portfolio increased 388%." With the prospect of higher interest rates in order to keep speculative foreign capital in Mexico, one can hardly expect a recovery of domestic demand this year.

3. The slimmed-down state apparatus has lost some instruments for the kind of economic direction it is supposed to carry out, and indications are that private enterprise has not yet developed a modern entrepreneurial spirit that would enable it to take the place now allotted to it, apart from generating profits without consideration for the national interest.

A final comment

I fully agree with the importance the central bank gives to education, not so much because the "assigning of resources to education is one of the

most profitable investments," but because it is indeed essential "for achieving higher stages of development."

“Fighting inflation is not the sole condition for achieving growth”

Administration— it presents only one side of present-day Mexico's reality and ignores the other, which is the one that seems to be prevailing at present.

The defense of current economic policy appears to be a weak one when the bank states that it is already "bringing about some beneficial effects" while pointing out that "public opinion has tended to emphasize" its costs. It is no longer simply a question of public opinion: the lamentable events taking place since January 1st have emphasized that the cost/benefit ratio of present economic policy is too high.

That the outlook for 1994 is not very promising is shown by indicators for the first quarter (*El Financiero*, May 3). It is likely that the results at year's end will not be what the central bank would like. Among the various reasons for this, three stand out:

1. Uncertainty over NAFTA, which was frequently used to explain the economy's mediocre performance in '93, has been replaced by uncertainty about the elections in August '94 and, at a deeper level, the overall insecurity regarding the direction the country will take as a result of recent events.
2. The over-indebtedness of the economy. In addition to the above-mentioned figures on external debt, it should be recalled, as the central bank does, that "in

There does not seem to be any disagreement on the intention to modernize the country and bring it into the First World, although one must admit that not every Mexican would agree with the disappearance of the knife-grinder who goes along the streets on his bicycle, or the distinctive whistle of the sweet-potato man's cart, or be pleased to see McDonald's famous M near his home.

What should be clear at this stage of the game is that it is not by taking a few zeros off the peso, nor signing NAFTA, nor entering the OECD, that we will enter the First World. It is the education of the long-suffering Mexican people that will lead us to the place which Mexico can and must, by right, occupy on this new international stage. ✎