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THEDIALOGUE

FEATURED Q&A

Why Has It Been So Hard to Advance Mexico's Economy?

Mexico's Central Bank headquarters in Mexico City. // File Photo: Alonso21-commonswiki.

Q Mexico's economy in the second quarter contracted for the first time on a quarterly basis since 2013, Mexico's National Statistics Institute said July 29, although it grew 2.4 percent year-on-year in that period. Was the contraction in the second quarter a one-off event, or does it foreshadow economic weakness ahead? What are the bright spots in Mexico's economy, and what are the biggest headwinds? To what extent are some parts of Mexico lagging behind economically, and what should the government do to address those disparities?

A Tapen Sinha, professor of risk management at the Instituto Tecnológico Autónomo de México: "The beginning of 2016 looked good for Mexico. It seemed that the oil price had touched the bottom. Exports were up, remittances were steady and tourists were coming in at a steady clip. All of these factors are the main drivers for Mexican GDP growth. Then, two unexpected things happened. First, the prospect of Donald Trump becoming the president of the United States came into focus. The anti-Mexico rhetoric of Trump in the form of undocumented immigrants would be targeted if he is elected got louder. If these Mexicans are deported, it would directly hit remittances. In addition, if NAFTA is renegotiated under a Trump presidency, it would also adversely affect Mexico, as most of Mexican foreign trade takes place with the United States. The financial market started taking bets against the Mexican peso (the so-called Trump Hedge). In addition, the unexpected passage of the 'Brexit' also hit Mexico, as the Mexican peso is used as a proxy for all developing countries. Banco de

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TODAY'S NEWS

POLITICAL

Venezuela Misses Mercosur Deadline: Brazil

Brazil's foreign ministry said Saturday that Venezuela will not be taking over the rotating presidency of the Mercosur trade bloc because it failed to meet Friday's deadline to comply with membership requirements on human rights and other criteria.

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ECONOMIC

Labor Costs Going Up for Auto Makers in Mexico

The trend threatens to reduce the country's low-cost incentive for businesses to locate and expand manufacturing operations there.

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ECONOMIC

Inflation Rate in Argentina Slows

Although inflation slowed in July by more than economists had predicted, plans by Argentine Energy Minister Juan José Aranguren to quadruple gas tariffs for most consumers, and boost those for electricity six-fold, could spark higher inflation in months ahead.

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Aranguren // File Photo: Government of Argentina

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POLITICAL NEWS

Venezuela Misses Mercosur Presidency Deadline: Brazil

Brazil's foreign ministry said Saturday that Venezuela will not be taking over the rotating presidency of the Mercosur trade bloc because it failed to meet Friday's deadline to comply with membership requirements on human rights and other criteria, ABC News reported. "The Brazilian government regrets that Venezuela has not been successful ... in their efforts to fulfill compliance with the commitments made when signing the accession protocol to join Mercosur," the ministry said in a statement posted on its Web site. Venezuela, which agreed to join the bloc in 2006, was scheduled to assume the

Serra // File Photo: Government of Brazil.

group's presidency for six months starting at the beginning of August. But Brazil, Argentina and Paraguay, three of the founding Mercosur countries that have had right-of-center presidents assume power recently, have pushed back. Brazil's foreign ministry, led by José Serra, said it would confer with other members and consider international law in taking next steps with the presidency. In related news, a Venezuelan appeals court on Friday upheld the nearly 14-year prison sentence imposed on opposition leader Leopoldo López for inciting violence, the Associated Press reported. The news came after three weeks of deliberation. López has denied that he incited violence, and international human rights groups have made his release from prison a top priority. Street rallies demonstrating both for and against the Maduro administration in 2014 left three people dead and dozens injured.

ECONOMIC NEWS

Labor Costs Going Up Sharply For Auto Makers in Mexico

Mexican auto manufacturers and parts suppliers have been poaching workers and paying bonuses and other perks as a short supply of qualified workers has begun to increase labor costs measurably, The Wall Street Journal reported Sunday. The trend threatens to reduce the country's low-cost incentive for businesses to locate there or expand manufacturing operations, according to the report. At some plants, wages have risen by double-digit percentages in recent years—a period when global car companies have announced billions of dollars in new capacity investments in Mexico. In related news, the mayor of Mexico City, Miguel Ángel Mancera, on Sunday called on other mayors to join him in a campaign to raise the minimum wage across the country, El Universal reported. A member of the left-of-center Party of the Democratic Revolution, or PRD, Mancera met in Michoacán with local PRD chair Carlos Torres Piña and other officials to discuss plans to get more mayors to sign onto a "living wage" declaration. Average salaries in Michoacán were about 15 percent lower than national averages in 2015, Mexico's economy ministry said in a report.

Argentine Inflation Slows in July

Argentina's inflation rate in July eased to 2 percent, a slower rate of growth than expected and a figure that is less than half of what it was two months before, Reuters reported Friday. The country's state statistics agency, INDEC, which has been reorganized this year after criticism of its data's integrity under the previous administration, had reported 3.1 percent inflation for June and 4.2 percent for May, when it issued its first consumer price report since President Mauricio Macri took office in December. The Macri administration has not yet released an-

NEWS BRIEFS

Massive Turnout Across Peru to Protest Violence Against Women

More than 50,000 people marched in Peru's capital of Lima and eight other cities on Saturday to protest violence against woman and what they say is the indifference of the judicial system, the Associated Press reported. President Pedro Pablo Kuczynski took part in the march, along with first lady Nancy Lange. Several high-profile cases of men being given light sentences for violent crimes against women have stoked public outrage on the issue.

U.S. Offers Dominican Republic Assistance in Embraer Bribery Case

The U.S. ambassador to the Dominican Republic, James W. Brewster, on Friday said Washington will help Dominican Republic prosecutors with their probe into money laundering and high-level crime allegations involving Brazilian aircraft maker Embraer, Dominican Today reported. Last week officials arrested a former defense minister and three others for allegedly accepting $3.5 million in bribes from Embraer in exchange for placing a $94 million order for its Super Tucano aircraft.

LATAM Airlines Profit Falls as Economies Lag

LATAM Airlines, formed in the merger of Chile's LAN and Brazil's TAM in 2012, said Friday that profits would continue to prove difficult to achieve amid slow economic activity in its main markets in Latin America, Reuters reported. The company disappointed investors with a $92 million second-quarter net loss last week. Roberto Alvo, the airline's vice president of planning, told reporters in a conference call Friday that Brazil still has "a long way to go to get back to pre-crisis levels," despite seeing "timid" signs of recovery in South America's largest economy in recent weeks.

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nualized consumer price data or an economic growth forecast for this year, however. Despite the slower inflation rate last month, consumers are bracing for higher inflation to come as Macri's government unwinds more than a decade of price and currency controls. Argentina's energy minister, Juan José Aranguren, said earlier this year he would try to reduce by half the $16 billion in energy subsidies the government pays out each year by quadrupling gas tariffs for most consumers and boosting those for electricity six-fold, the Economist reported recently. Two courts have blocked the tariff rises, and the final decision now rests with the supreme court, which is expected to rule on the matter later this month.

Venezuela, Colombia Open Their Border on a Limited Basis

Colombia and Venezuela on Saturday began implementing plans to gradually reopen several "provisional" border crossing points for pedestrians for the first time in nearly a year, making good on promises announced last Thursday to allow goods such as food and medicines to once again begin flowing, Agence France-Presse reported. More than 54,000 people entered Colombia on Saturday, 81 percent of them returning to their place of origin, immigration authorities in Bogotá said. A total of six border

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crossings were opened in the Venezuelan states of Táchira, Apure, Zulia and Amazonas. The crossings were for the most part calm and orderly, Prensa Latina reported. For now, the border will remain open only 15 hours per day. Vehicles of any sort remain prohibited from crossing. Measuring more than 1,000 miles long, the border has long been plagued by narcotics and contraband smuggling, one of the reasons President Nicolas Maduro of Venezuela cited for last year's closing. In related news, Maduro raised Venezuela's minimum wage 50 percent last week, Bloomberg News reported, a measure that takes effect Sept. 1 for all workers earning minimum wage and all public employees, members of the armed forces and pensioners. He also increased the amount of food vouchers. The increase does not nearly keep up with unofficial rates of inflation, however, which international economists say is rising by more than 700 percent annually.

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México was left with little choice but to raise the interest rate in two bouts to reduce the market volatility of the peso. That action slowed the Mexican economy down. However, the negative GDP growth was unexpected. Still, for the rest of the year, the prospect of economic growth is still positive. If in the following quarter the economy still shows signs of weakness, Mexico's central bank will still have the luxury of reducing the interest rate from the current 4.25 percent later this year."

Joydeep Mukherji, managing director of Latin American Sovereign Ratings at Standard & Poor's in New York: "The economy will likely expand by little more than 2 percent in 2016 and around 3 percent during 2017-2019, assuming continued stable growth in the United States and a gradual increase in private investment in the energy sector. Real per capita GDP growth during 2011-2015 averaged 1.7 percent, slow for an emerging economy. Even during the global boom years, Mexico's growth lagged behind that of most of its emerging market peers, averaging 3.4 percent during 2004-2008. Despite undertaking more structural reforms than most emerging markets, the growth rate has been disappointing, due in large part to non-economic reasons. Mexico foregos perhaps 1 percent in GDP growth annually because of the impact of crime and violence, according to official estimates. Many years of economic stability have contributed to lower inflation and boosted disposable income, thereby spurring more consumption. However, it has had less of an impact so far in boosting private sector investment. The average growth numbers conceal interesting regional trends. Average GDP growth was 4.5 percent during 2006-2015 in the six fastest growing states (mainly in the north and center of the country), compared with only 0.8 percent for the six slowest growing states (and a national average of 2.4 percent). Clearly, there are substantial parts of the country that have successfully promoted private investment, taken advantage of economic stability and had good access to the U.S. market. This highlights the importance of governance, including at the local level, in boosting growth. The challenge of strengthening the rule of law, improving the level and quality of public services, and creating a consensus on pro-growth policies is more political than economic."

> **"Even during the global boom years, Mexico's growth lagged behind that of most of its emerging market peers."**
>
> **— Joydeep Mukherji**

Alfredo Coutiño, director for Latin America at Moody's Analytics: "Mexico, and likewise the rest of Latin America, faces a common problem with a common root: anemia of growth due to lack of investment. Latin America has been trying to promote growth based on the wrong factor: productivity. It seems that the region has not realized yet that productivity is only a result of invest-

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ment in physical and human capital. The key is to promote the accumulation of capital. Mexico's poor economic performance is a direct result of the low investment-output ratio, which also explains the slow advance in productivity. Mexico's production capacity is limited to a growth rate no higher than 2.5 percent, consistent with the average growth in the past two decades. In fact, during the second quarter of this year, the economy reported a quarterly contraction of 0.3 percent, which is the expression of two things. First, an arithmetic negative effect generated by the high comparison base of the volume of production in the previous quarter. Second, the economy reported a genuine deceleration in the second quarter, as investment has not increased enough due to the prolonging uncertainty and financial volatility. Indeed,

> **"The region has not realized yet that productivity is only a result of investment in physical and human capital."**
>
> **— Alfredo Coutiño**

fiscal and monetary policies have been tightening, but they do not affect growth yet, because they are only moving toward neutrality. Fortunately, Mexico has implemented a bunch of reforms, which will help restore production capacity in the future. Leading sectors will be the ones positively affected by those reforms (energy, telecommunications, financial and construction, among others). Mexico must do two things. First, return to macroeconomic discipline to let the economy perform at its limited capacity but without imbalances. Second, deepen structural changes to increase production capacity and potential growth. This is the only recipe for healthier, higher and more stable growth, and also to start restoring part of the social well-being that's been lost."

Kezia McKeague, director of government relations in the Washington office of the Council of the Americas: "The second-quarter downturn will most likely prove an aberration in Mexico's record of modest growth, but it certainly signals underlying weaknesses in keeping with the government's cautious outlook for 2016. According to National Statistics Institute data, a decline in industrial production—by 1.7 percent from the first quarter—was responsible for much of the GDP contraction, in a reflection of weakened U.S. manufacturing. Moreover, the services sector remained flat, suggesting that domestic consumption, which has been a significant bright spot, may be slowing. In a Banco de México poll in July, private-sector analysts cited weak external demand and global market volatility as the main headwinds facing Mexico's open economy. Many economists also acknowledge that government spending cuts coupled with low oil prices will weigh on growth this year. From my vantage point at a U.S.-based business organization, the government has successfully sustained investor confidence with a fiscal policy geared toward ensuring sustainable debt levels and monetary policy guided by credible inflation targeting. Nevertheless, the Mexican economy is increasingly bifurcated between the north, with cutting-edge manufacturing linked to the United States, and the south, where energy production has fallen and lower-end manufacturing has struggled. As The Economist recently reported, the Peña Nieto administration intends to establish special economic zones to promote investment in five southern states—a potentially interesting model, assuming a convincing business case. In addition, implementation of the government's far-reaching structural reforms will be crucial for achieving more inclusive growth and addressing challenges such as concentrated markets, poor infrastructure, limited access to financing and an uneven educational system."

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