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Mexico's 2000 Presidential Election: "Is Economic Crisis on the Horizon?" Again.

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A Common Historical Precedent?

Mexico's last four presidential elections saw devaluations of the peso, recessions and high inflation rates. The 1988 elections didn't experience a peso devaluation, however the economy suffered from slow growth and high inflation rates. Business leaders are bracing for another election year crisis that could occur some time between the July 2nd election and the December 1st, 2000 inauguration.

The repeated economic crises can be attributed to Mexico's president and ruling party, Partido Revolucionario Institutional, PRI, to keep the economy growing during an election year. Since 1976, Mexican governments have increased fiscal spending, loosened monetary policy, and extended loans to the public and private sector in order to win votes. Resulting in high inflation rates, overvalued exchange rates, a drop in international competitiveness, widening current account deficit, capital flight and speculation of an impending devaluation.

During the administrations of Presidents Luis Echeverría, 1970-76 and José López Portillo, 1976-82 the peso was severely overvalued as result of huge government spending and fixed exchange rates. The first year of the Echeverría Administration, the government deficit was barely 0.5% of the GDP [IDB, 1974]. By 1982, the last year of the Portillo Administration, the government deficit reached 15.43% of the GDP [IMF, 1985]. Inflation rose from 5.6% in 1971 to 98.4% in 1982 [Banco de México, 1999]. Despite increases in inflation, the Echeverría Administration maintained a fixed exchange rate of 12.5 pesos per dollar until 1976 while the Portillo Administration allowed for marginal peso devaluations between 1977 and 1982. In both cases, increasing the price of exports and lowering the price of imports provoked a large current account deficit [Federal Reserve Bank of Dallas, 1999].

During the Salinas Administration, 1988-94, government deficits declined from 5% in 1989 to less than 1% of the GDP in 1994 [IMF, 1996]. This was offset in 1993 and 1994, by domestic bank credit that expanded at an annual rate of 19% [IMF, 1996]. This expansion combined with the reduction of NAFTA induced tariffs generated huge current account deficits [U.S. Embassy, 1995]. Salinas, like his predecessors, refused to devalue the peso that was 25% above its value.

The crises of 1976, 1982, and 1994 were precipitated by an overvalued peso generating current account deficits two to four times larger than the level of reserves in Banco de México, Mexico's Central Bank. To finance these huge deficits and avoid devaluation, the Echeverria and Portillo Administrations borrowed large amounts of money from foreign banks, the Salinas Administration used Mexico's stock market to borrow nearly $18 billion from foreign investors to finance the nation's large current account deficit [U.S Embassy, 1995].

Increasing Mexico's foreign debt, fueling the overvaluation of the peso, and creating the expectation that a major devaluation was coming, resulted in massive capital flight. In all three crises, the overvaluation of the peso ended when payments on the foreign debt were due. The Mexican Government was forced to undertake a sharp devaluation of the peso in order to secure loans from the International Monetary Fund, World Bank, and U.S. Department of the Treasury.

Another Crisis in 2000?

Mexico's economy appears much stronger than in past election years. The Zedillo Administration, 1994-2000 has taken concrete steps to avoid a fifth successive crisis by announcing an inflation target of less than 11%, a budget deficit of less than 1% of the GDP, and the continuation of the flexible exchange rate policy adopted since the 1994 economic crisis. Zedillo states that he won't hesitate to slash government spending if the economy takes a negative turn [Banamex-Accival, 1999; Secretaría de Hacienda y Crédito Público, 1999].

The first quarter of 2000, has shown strong economic growth as a result of rising oil prices. The peso has been strengthened by more than 4% causing a rise in wages, lower prices, increased employment, and the outflowing of consumer demand. More importantly, the reserves in Banco de México reached $30.5 billion dwarfing a trade deficit of $9.7 billion. Indicating that capital flight was surpassed by capital inflows [Banco de México, 1999].

Mexico has moved from a one-party political system, dominated for 70 years by the PRI, to a multi-party system where power is shared between three major parties. This political competition has allowed the Mexican Congress to exert its authority on fiscal matters, which may restrain excessive government spending during the 2000 election.

The Achilles' Heel of the Mexican Economy

The Mexican economy could be vulnerable to another crisis if there is a sharp drop in the price of oil, Mexico's largest export; a slowdown of the U.S. economy, Mexico's largest trading partner; or the fact that Mexico's weak banking system that has not recovered from the 1994 financial crisis and subsequent government bailout which cost more than $100 billion.

Mexico must continue its shift away from volatile foreign stock investment to a more stable foreign direct investment in infrastructure, plants, and equipment.

Weathering the Economic Storm

President Zedillo has voiced his intention to be the first Mexican president to leave office since 1976 with a growing, stable economy. The adoption of a flexible exchange rate, greater political competition, stability in government finances, and better debt management make economic crisis less likely than in the past. The conditions that provoked a sharp devaluation of the peso are no longer present. Companies doing business in Mexico should monitor the market closely and enjoy the ride.

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