

Development Challenges in Mexico

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Medium-Term Economic and Social Trends

In the last five years the Mexican economy has faced a complex external environment involving a fall in international oil prices, low economic growth in the United States and the renegotiation of NAFTA. The economy has nonetheless shown resilience, with average GDP growth at the moderate annual rate of 2.5% between 2013 and 2017.

The flexible exchange rate, which has proven fundamental in adjusting to external shocks, has depreciated by 40% since 2013. This depreciation, along with the liberalization in energy prices in January 2017, contributed to a significant acceleration in annual inflation, which reached a 16-year high of 6.8% in December 2017. Since November 2015 the central bank has responded with monetary rate increases totaling 450 basis points, reaching an annual rate of 7.5%. Inflation is expected to return to the upper part of the target range (2%-4%) in the last quarter of 2018.

In addition, economic authorities strengthened fundamentals by committing to a process of fiscal consolidation that generated a reduction in public debt to GDP from 50% in 2016 to 48% in 2017. This policy is expected to continue in 2018 with a primary surplus of 0.9% of GDP and, as a consequence, a further reduction in the debt to GDP ratio.

There are presently no relevant imbalances in external accounts. The external and commercial deficits are moderate, and the flexible exchange rate contributes to mitigating potential imbalances. In 2017, for example, the trade balance and current account deficits were 0.9% and 1.6% of GDP, respectively.

Employment has been recovering (3.4% of unemployment rate in January 2018) and the informality rate has fallen slightly, from 59.7% of total jobs in 2012 to 57.1% in 2017, but real wages have remained practically unchanged in the last years five years (0.9% real growth between 2013 and 2018). As a result, poverty levels remained high (43.6% of total population in 2016), although with a slight improvement compared to 2014 (46.2% of total population), which represents 1.9 million fewer people in poverty.

Medium-Term Economic and Social Outlook

In the years ahead, it is expected that GDP will continue growing at a moderate pace and inflation will return to levels within the range around the target. Nonetheless, the country could experience higher GDP growth if the economic reforms approved in the last six years are progressively implemented in years to come.

Risk Factors

In spite of the resilience of the Mexican economy in previous years, there remain risks to growth. The following are particularly notable: i) a renegotiation of NAFTA with unfavorable results for Mexico's productive sector; ii) volatility in financial markets associated with the electoral process; iii) a faster-than-expected pace of normalization of monetary policy in the United States that could restrict financial conditions in emerging economies.

Development Challenges

Mexico faces several challenges to its long-term development. The economy's main challenge appears to be low productivity, which has generated insufficient economic growth to meet social needs and reduce poverty. Low productivity stems from a deficient legal environment, high informality, inadequate financing and limited competition and infrastructure. The government is aware of this problem and has worked on the approval and implementation of structural reforms in the sectors noted. Specifically, reforms were approved in the financial sector, energy, telecommunications, education and labor, as well as reforms involving transparency and anti-corruption to improve the rule of law. This ambitious program of structural reforms is beginning to bear fruit, although its full impact will take time to materialize as its implementation continues. Another challenge for Mexico is a more homogenous spread of the benefits of economic growth, as inequality remains high and real salaries have not grown to mitigate this outcome.

Conclusion

Mexico has laid important foundations to tackle its challenges. First, in the last two decades, it consolidated a stable macroeconomic policy. Second, in the last five years the country approved a series of economic reforms to increase productivity. Those reforms have so far focused on creating an appropriate legal framework for accommodating changes in each sector. Mexico is now prepared to take those reforms to the next step. In particular, energy, competition, legal, education, labor, and transparency and anticorruption reforms could be implemented in the years ahead and generate important results.