White Paper:

Country Analysis: Mexico

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Executive Summary

Mexico is an important emerging market within North America.

- Total GDP for Mexico is US$561 billion; for Canada it is US$644 billion.
- Although total debt for Mexico is US$171 billion, this is less than most emerging markets and only represents 25% of GDP. For comparison purposes, debt to GDP for Canada is 105%, and for the United States it is 57%. Canada has for years consistently run a budget deficit, only recently being able to report surpluses.
- Bank interest rates have lowered dramatically from a high of over 35% in 1998 to under 10% for most of 2001.
- Foreign trade is important to Mexico. Despite a trade balance of US$-10 billion, Mexico exported US$166 billion to markets around the world. Its two largest trading partners are the United States and Canada. Mexico is heavily dependent upon the trade with the United States; 24.7% of its GDP is traded with the US. A prolonged economic slowdown in the United States will have a negative affect on the Mexican economy.
- In July 2000, Vincente Fox won an historic presidential election in Mexico. President Fox, who has extremely close ties to US President George Bush, has identified the following economic and political goals:
    - Achieve sustainable growth of 7% by 2006;
    - Lower inflation to 3% by 2003;
    - Balance the budget by 2004;
    - Political reform involving the transfer of more money and power to the states;
    - Reduce federal police corruption.
    - Achieve greater immigration flow across North America.
- There are two economic problems that can spread to Mexico as a result of the emerging markets meltdown (lead by Argentina and Turkey):
    - The slowdown could result in less export trade with Argentina, Turkey, and Brazil, which could adversely affect the Mexican economy. Brazil is the only market of possible concern to Mexico, since it accounts for 1.1% of all export trade.
    - Contagion of the financial system as investors pull their money out of emerging markets altogether.
- Therefore, despite Mexico's carefully executed monetary and fiscal policies, it may find itself drawn into the crisis through association to its less progressive neighbors.
- The overall assessment of Mexico is a positive one, if it can weather the short term global economic slowdown.

Background

It is important for a manager to be able to evaluate investment opportunities around the world, and to not only recognize the intricacies of different economic systems employed globally, but also to understand how the relationships of the global economic community could ultimately affect demand for corporate goods or services.

This Country Analysis is based on the model developed by the Harvard Business School. It is a four-step process that incorporates information from a wide variety of measures including economic, social, political and geographic sources, enabling a strategic analysis.

The specific measures included in this analysis are:

1. Analyze past performance
    - external measures (Balance of payments, exchange rates)
    - internal measures
        - General: GNP, inflation, employment
        - Supply side: Interest rates, investment, capacity
        - Demand side: consumption, income distribution
        - Social side: Human migration, population growth, education

2. Analyze a country's context
    - Physical: size, population, geography
    - Political: Government type, stability, corruption, leaders
    - Institutions: Government agencies, business, labour, religion, agriculture
    - Ideological: role of the government, family, culture, individualism.

3. Identify the country's strategy
    - Goals: Autonomy, Productivity, Equity
    - Policies: Fiscal, monetary, trade, social

4. Make a prediction on steps 1-3 above.

Throughout the course of this analysis, all currencies are in US dollars, unless otherwise specified.

Country Specified: Mexico

The country to be analyzed for this case is Mexico. Mexico was selected for several reasons. First, it is an important trading partner for both Canada and the United States.

Second, this importance as a strategic trading partner within the North American marketplace is demonstrated by Mexico's inclusion in the 1994 North American Free Trade Agreement (NAFTA). Third, the country has recently elected in a new president (who has already developed a close relationship with United States President, George W. Bush). This has the potential for increasing the strategic importance of Mexico, both within North America, but also as a foothold into Latin America.

It is important to recognize that this analysis was conducted in late summer 2001, as the global economies teetered on the brink of a major economic slowdown. Unlike other economic contractions, which are often characterized by slowdowns in one region coupled with simultaneous prosperity in others, this is the first major economic slowdown since World War II that has had a truly global affect. This heightens the importance of economic understanding.

1. Analyze past performance

External Measures

The trade balance for Mexico (as of May 2000) has declined $9.7 billion over the last 12 months, and the current account has declined $17.8 billion[1]. These figures are significantly larger than for other major Latin American countries.

Gross Domestic Product (GDP)

The gross domestic product (GDP) measures the value of all goods and services produced within countries borders. This measure differs from gross national product (GNP) which measures the value of goods and services produced by the country, including the values contributed by any international or overseas operations. For Mexico, (as of the first quarter of 2001), the GDP increased 1.9% compared to the first quarter of 2000[2].

In 2000, the Gross Domestic Product for Mexico was Ps 5.3 trillion. Alternatively, this translates to US$561 billion, or US$981 billion using purchasing power parity (PPP)[3]. Purchasing power parity states that exchange rates between two countries move primarily as a result in price level behavior between two countries in such as a way as to maintain the terms of trade constant; it is a method of examining foreign exchange by including inflation[4]. By comparison, the GDP for Canada is US$644 billion (2000)[5], and for the

[1] The Economist, July 14th, 2001.
[2] The Economist, July 14th, 2001.
[3] The Economist Intelligence Unit, Survey Mexico
[4] Dornbusch, Rudiger, Stanley Fischer, and Gordon Sparks, "Macroeconomics", 3rd Canadian Edition, McGraw-Hill, Toronto, 1989.

United States US$9.3 trillion (1999)[6]. Looking at GDP per person, the figure for Mexico is US$5,764, or US$10,075 accounting for purchasing power parity[7]. Corresponding figures for Canada are US$21,146 per person (2000), and for the United States, US$36,155 (1999)[8].

Debt levels

In 2000, the public debt, as a percentage of GDP for Mexico, is 25.40. This is significantly lower than most emerging markets, and is lower than Canada (105% of GDP) and the United States (57%) over the same time periods. The total public debt (as of April 2001), is Ps 1171.40 billion or US$171.5 billion[9].

Forecasted Growth

The Economist Intelligence Unit forecasts 1.6% growth in GDP in 2001, and 3.4% growth in 2002[10].

Internal Measures

Industrial production has declined by 3.2% (April 2000), and consumer prices have risen 6.6% (June 2000).

Interest Rates:

Bank rates in Mexico have fallen dramatically since November 1998. From a high of 35%, bank rates closed at 8.10% on August 23, 2001[11]. Graphically, this is depicted below:

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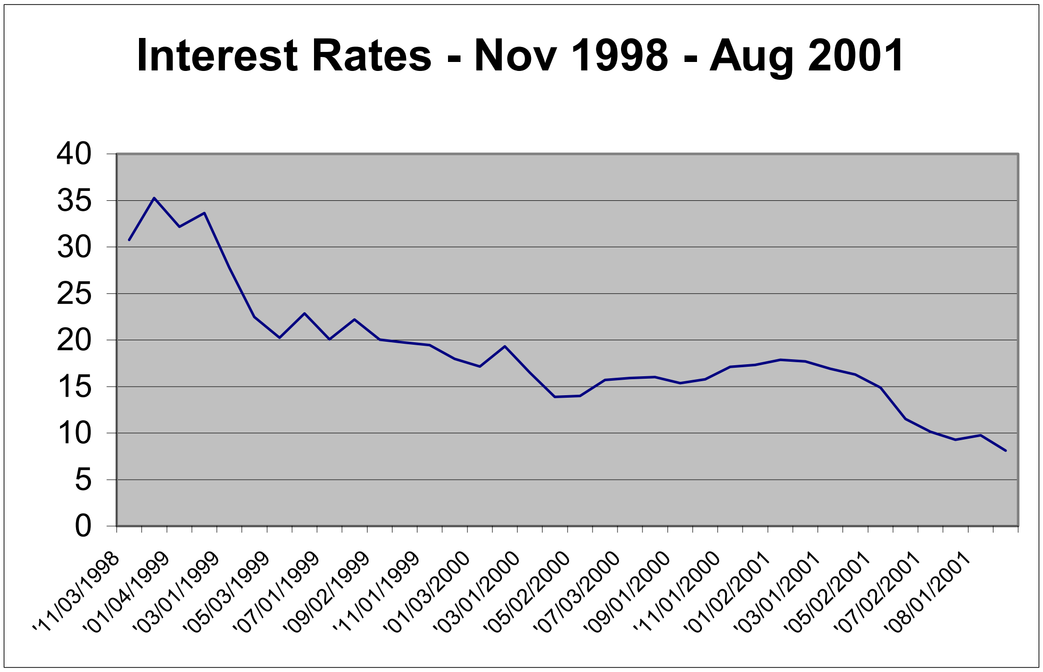
5 The Economist Intelligence Unit, Survey Canada
6 The Economist Intelligence Unit, Survey United States
7 The Economist Intelligence Unit, Survey Mexico
8 The Economist Intelligence Unit, Survey Canada and the United States
9 Banco de Mexico, www.banxico.org.mx/siteBanxicoINGLES/eInfoFinanciera/FSinfoFinanciera.html
10 The Economist Intelligence Unit, Survey Mexico: Economic Forecast, August 10, 2001.
11 Banco de Mexioc, www.banxico.org.mx/siteBanxicoINGLES/eInfoFinanciera/FSinfoFinanciera.html



Should bank rates remain low, and if consumers are confident rates will remain low, investment will certainly increase. Although investors may have confidence in the Mexican banking system, the population at large generally distrusts banks and banking institutions. Therefore, consumers may remain confident that rates will remain low, but they may not invest due to a cultural bias.

Social side:

Wage rates in Mexico are very low. The average labor cost per hour for manufacturing was US$1.82 in 2000, up from US$1.58 in 1999[12]. Alternatively, the figure for Canada is US$16.09 and the United States is US$20.03.

The education level is very low. The average level of schooling is 7.7 years, although the new government of Vincente Fox expects to spend an extra 3% on education (which currently receives 4.5% of government expenditures) and to raise the level of schooling to ten years[13]. However, education is compulsory to age sixteen, and public education is free (including text books for primary schools). The official literacy rate in 1990 was 88%[14].

In 1999, crime was down 26 per cent compared to 1995[15].

[12] The Economist Intelligence Unit, Report on Mexico, May 4th, 2001.
[13] The Economist, "The Americas: The Fox Experiment Begins", December 2, 2000.
[14] US Library of Congress: Survey of Mexico
[15] The Economist, "Survey Mexico: The man from whom miracles hang", October 28, 2000.

Thousands of Mexican citizens still attempt to cross the border into the United States each month. It is unclear if they are seeking to pursue the American dream, reacquaint themselves with relatives, or if the poverty forces them to leave. It is estimated that by 1997 more than 2.5 million Mexicans a year were entering the United States illegally[16].

Health and welfare

Health care facilities are generally concentrated in urban centers. The life expectancy in 1996 is estimated at seventy-three years. Infant mortality is twenty-six per 1000 live births. Leading causes of death in Mexico include infections, parasitic diseases, and respiratory and circulatory system failures[17].

One of the challenges facing Mexico is how to support an aging population, without any existing social support program. There are 5 million people over the age of 65 living in Mexico; this figure is expected to double by 2020[18].

Foreign Trade:

In addition to belonging to the North American Free Trade Agreement (NAFTA) with Canada and the United States, Mexico entered into a free trade agreement with the EU in 2000. Additionally, Mexico has entered into bilateral trade agreements with much of Latin American. Despite exporting 90% of its goods and services to Canada and the United States, Mexican politicians have been vocal proponent of the Free Trade of the Americans (FTAA), which would allow the rest of Latin America greater access to the United States and Canada.

The export sector will continue to feel the effect of the deteriorating external environment (particularly the United States slowdown). This indicates how vulnerable Mexico's economy is to volatility in the US, since 83% of exports are destined for, and 75% of imports originate in, this market. Further signs of dependence on the United States are reflected in the exports to the United States as a percentage of GDP. The figure for Mexico is 24.7% (2000), while comparatively for Canada, it is above 30%[19].

[16] Lonely Planet (www.lonelyplanet.com/destinations/north_America/mexico)
[17] US Library of Congress: Survey of Mexcio.
[18] Puente, Teresa, Chicago Tribute, July 27, 2001.
[19] The Economist "Special Report Emerging Markets: How the bug can spread", July 21, 2001.

This slowdown is mostly confined to the export sector, and domestic demand remains strong (although it is possible this will decline as well)[20 21]. Canada represents 5.2% of the total export market for Mexico. Significant trading partners include[22]:

Leading Markets (1999)	Leading Suppliers (1999)
United States (83.3%) Canada (5.2%) Japan (1.3%) Brazil (1.1%)	United States (74.8%) Germany (3.9%) Japan (3.8%) Korea (1.8%)

During the last twelve months (until May, 2001), the trade balance for Mexico has been US$-9.7 billion, and the current account deficit through the first quarter of 2001 amounted to US$-17.8 billion[23]. This represents approximately US$166 billion worth of exports and US$174 billion worth of imported goods[24]. The larger the current account deficit, the more new funds a country needs to raise each year.

The major exports and imports for Mexico are[25]:

Major Exports (2000)	Major Imports (2000)
Manufactures (88%)	Intermediate Goods (76.5%)
Maquiladora (47%)	Maquiladora (35.4%)
Oil (9.8%)	Capital Goods (13.9%)
Agricultural products (2.2%)	Consumer goods (9.6%)

All figures represent the percentage of total

Economic structure:

The primary driver of economic activity in Mexico is the service sector, which consistently accounts for two thirds of GDP, while industry accounts for one third. The primary drivers of Mexican GDP include[26]:

- Community and social services (21.5% of GDP)
- Manufacturing (20.8%)
- Financial services (13% of GDP)
- Transport and telecommunication (11.4%)
- Construction (4.8%)

[20] Garber, Gerald, PriceWaterhouseCoopers, Briefing on Mexico, July 2001.
[21] Toronto Dominion Bank (TD Bank) Economics Report: The Domino Effect, June 11, 2001
[22] The Economist Intelligence Unit: Report on Mexico, March 12, 2001.
[23] The Economist, Emerging market indicators, July 21, 2001.
[24] The Economist Intelligence Unit: Report on Mexico, March 12, 2001.
[25] The Economist Intelligence Unit, Report on Mexico, March 12, 2001.
[26] The Economist Intelligence Unit: Survey Mexico, Economic Structure, August 19, 2001.

2- Country's Context

In July 2000, Vincente Fox won an historic election as president of Mexico. His victory marked the end of seven decades of rule by the Institutional Revolutionary Party (PRI). This positions Mexico with the opportunity for unprecedented change.

Physical:

Covering almost two million sq km (800,000 sq mi), Mexico curves from northwest to southeast, narrowing to the Isthmus of Tehuantepec, then continuing to the Yucatán Peninsula. On the west and south the country is bordered by the Pacific Ocean, with the Gulf of California lying between the Baja California peninsula and the mainland. Mexico's east coast is bordered by the Gulf of Mexico, and the east coast of the Yucatán Peninsula faces the Caribbean Sea. Mexico shares borders with the USA to the north (specifically, the States of California, Arizona, New Mexico and Texas), and Guatemala and Belize (to the southeast).

The population of Mexico is 100,368,000, with a population density of 51 (pop/km^2). The population growth rate for 2000-2005 is 1.4% overall, 1.7% in urban centers, and 0.6% in rural locations[27]. Mexico City, the capital, has a population of 22 million – two thirds of the entire population of Canada – making it the world's largest metropolitan area, and second largest city[28].

Spanish is the dominant language in Mexico, although there are as many as 50 indigenous languages throughout the country.

Political Structure:

The Mexican political system is presidential, bicameral (Senate and Chamber of Deputies) and federal (with 32 states). The president is elected for a single six year term; Vincente Fox took over in December 2000. The members of the chamber of deputies are elected every three years: 300 elected from single member districts, and 200 by proportional representation. In the Senate, 75% of the members are elected directly for a six-year term, while the remaining 25% are elected by proportional representation.

Although the political structure in Mexico is stable under the democratically appointed leadership of President Fox, authoritative regimes and political unrest are a part of Mexico's history:

[27] United Nations, Population Division, as of August, 2001.
[28] Lonely Planet (www.lonelyplanet.com/destinations/north_America/mexico)

- In January 1994, days after the creation of NAFTA, fearing that the agreement would increase the poverty of indigenous people, a group of unarmed peasants took over the State Capital of San Critobal de Las Casas. Called the Zapatista uprising, this intensified and spread throughout the country with peasants forcibly taking over hundreds of farms, estates, and ranches.
- In March 1994, presidential candidate Luis Donaldo Colosio was assassinated.

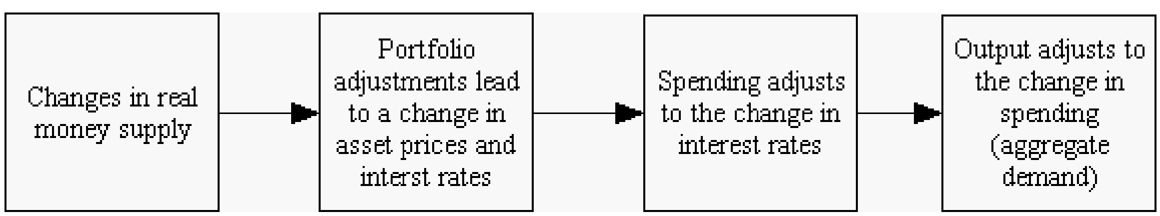
The President appoints his cabinet. The two most significant appointments are:

- Finance and Public Debt: Headed by Francisco Gil Diaz, a pro-market deputy finance minister under the previous political administration. Mr. Diaz holds a PhD in Economics from the University of Chicago; hence he is likely to be an advocate of Milton Friedman’s belief in the importance of monetary policy.

- Foreign Relations: Is headed by Jorge Castaneda Gutman, a left-of-center former University Professor.

Economic Policy

Monetary policy is concerned with the effect of changes in the quantity of money on the levels of interest and income. Monetarists believe that the Government is incapable of controlling the economy through spending, and in fact can do more damage by crowding out private investment. By controlling the money supply, and therefore controlling interest rates, inflation can be brought under control, thereby increasing the real purchasing power of the consumer. The primary tool for controlling the economy, from the monetarists’ perspective – changes in the money supply – and its effect on income, is demonstrated below in the Transmission Mechanism below[29]:



Alternatively, Fiscal Policy, as advocated by John Maynard Keynes, states that direct government intervention, through expenditures, the level of transfers, and the tax structure, can directly improve the economy. The formula for calculating Gross National Product illustrates how these variables can influence overall national income:

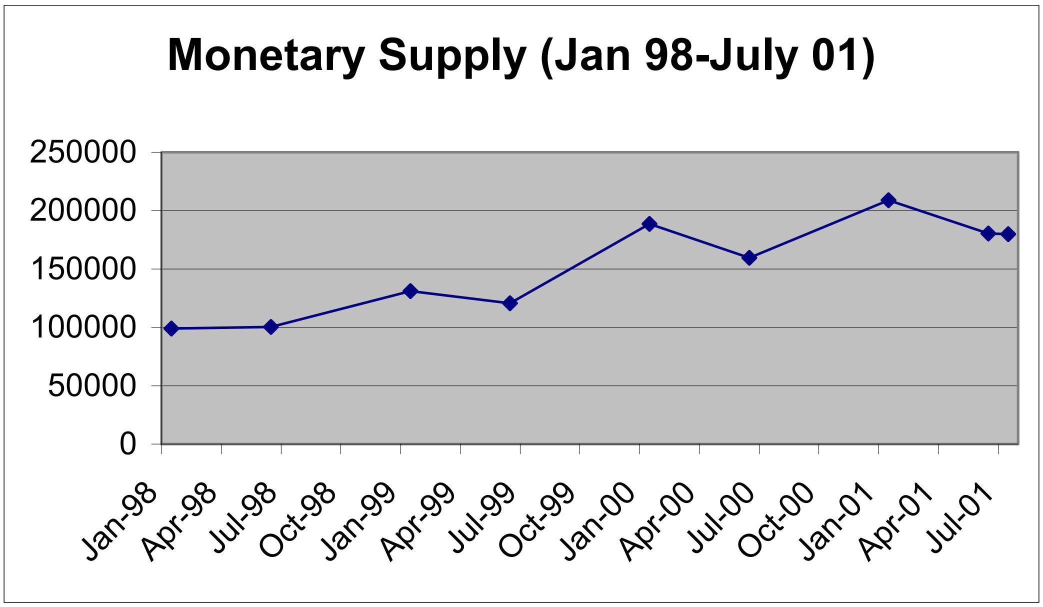
$$GNP = C + I + G + (X - M) \quad (1)$$

$$GNP = \text{Consumer spending} + \text{Investments} + \text{Government Spending} + \text{exports} - \text{imports} \quad (2)$$

29 Dornbusch, Rudiger, Stanley Fischer, and Gordon Sparks, “Macroeconomics”, 3rd Canadian Edition, McGraw-Hill, Toronto, 1989.

Most economists, whether belonging to the Monetarist or Keynesian school of thought, will agree on the principles of the above equation; government spending and the other components do indeed impact on national income. They disagree on whether it is appropriate for the Government to alter spending to control national income.

Examining the size of the money supply pre-election and comparing that to the post-election results will identify which school of thought is prevailing. The graph below depicts the size of the money supply (defined as currency in circulation and current account bank deposits) from January 1, 1998 until July 31, 2001, in Millions of Pesos[30].



The end of the graph depicts a clear downward constriction in the money supply. Whether Mexico continues to decrease the money supply, or whether the traditional upward swing as has historically been witnessed, will determine the resolve of the central bank; increasing the money supply will by necessity increase inflation, and therefore erode real purchasing power.

Government Consumption: For 2000, Government consumption as a percentage of GDP is around 10%, and has been stable for several years[31]. This is roughly half the level of Government expenditure in Canada.

[30] http://www.banxico.org.mx/siteBanxicoINGLES/eInfoFinanciera/FSinfoFinanciera.html
[31] The Economist Intelligence Unit: Survey Mexico, Economic Data, May 4, 2001.

3- Mexico's Strategy

Economic policy goals

The economic goals for the new Mexican administration are very aggressive. First, the administration is seeking sustainable growth of 7% per year by 2006, with inflation falling to 3% by 2003, and a balanced budget by 2004[32]. Growth is currently around 2% (first quarter), and consumer prices at around 6.5% (June 2001). Slower growth has helped push inflation lower and allowed interest rates to fall[33].

Monetary policy is geared towards reducing inflation. Fiscal policy, especially the tax system, requires reform to lessen dependence on oil royalties. Additionally, President Fox is interested in modernizing Pemex, the state run oil company, and reducing government oil and gas royalties to make government income less dependent on fluctuating oil prices.

Political policy goals

There are two major political policies that will be implemented by the Fox government. The first is political reform, transferring more power and money to the states, and will permit mayors and legislators (but not the president) to be allowed re-election.

The second primary policy is to reduce federal police corruption.

Foreign policy goals

With respect to foreign policy, Mexico is traditionally introverted, preferring to ignore foreign policy and concentrate on domestic issues. This is beginning to change under President Fox. Mexico wants strengthened ties with the rest of Latin America, and hopes to position itself as a gateway to Latin America from the United States, and supports the Free Trade of the Americas idea. Mexico appears willing to learn from other countries, so it is getting more involved in their affairs.

Further, President Fox would like a deepening of NAFTA to include migration[34].

Context of Mexico as a competing emerging market

One of the key challenges facing Mexico, in addition to a slowing United States Economy, is the possibility of a looming emerging market meltdown. In recent weeks, Argentina, Brazil, and Turkey have been on the brink of financial chaos; in these markets, interest rates are soaring, currencies have been devalued, and overall debt has

[32] The Economist, "The Americas: The Fox Experiment Begins", December 2, 2000.
[33] http://www.citibank.com/privatebank/ip/em-la.htm
[34] The Economist, "Mexico's Foreign Policy: Branching Out", July 21, 2001.

risen to dangerous proportions. Once a country begins to struggle, investors pull out seeking safer returns, thus exacerbating the problem.

Investors are wondering, after previous emerging market meltdowns (namely crisis in the Mexico 1994, east Asia in 1997, Russian in 1998, and Brazil in 1999), if another market contraction is occurring. Although there are some similarities to the market structure today compared to these previous crises (notably a difficulty for a country to sell more debt, high interest rates, high unemployment, and high inflation), the most marked difference; the United States, the world's biggest economy, is in a contraction, and close to a recession. In 1997, the United States helped the troubled East Asia economies export their way out of the crisis. Today, with the United States economy slowing, assistance may not be as forthcoming[35].

Through an increasingly interconnected global economy, economic down turns in one region can have direct impacts on others; in East Asia in 1997, many of the countries such as Malaysia, that were dependent upon other countries like Thailand for exports, found the demand for their goods suddenly curtailed, resulting in the contagion spreading.

Economists believe that economic problems can spread among emerging markets in two ways:

- The traditional route is through trade links as identified above.
- The second route is contagion through the financial system. Investors may realize that Argentina, facing a potential economic crisis, is an unsafe place for investment and pull out. Argentina's problems may hurt Brazil and other emerging markets because they focus attention on their own high debt and economic difficulties. In fact, this is starting to occur.

Therefore, despite well managed and carefully executed monetary and fiscal policies, countries like Mexico may find themselves drawn into an economic crisis because of their less progressive neighbors.

Many economists look at a number of early warning signs when examining the economic stability of a country. Comparing Mexico against other Latin American countries (and Turkey for comparison purposes)[36]:

[35] The Economist, "Emerging Markets: How the bug can spread", July 21, 2001.
[36] The Economist, Red Alert, July 21, 2001, pp. 22.

	Foreign debt as % of exports	Current account balance as % of GDP	Exports to US as % of GDP	Real exchange rate, % since Jan 1997
Argentina	423	-3.2	1.0	+15
Brazil	332	-4.1	2.0	-20
Chile	167	-2.2	4.4	+4
Columbia	228	-1.7	10.6	-14
Mexico	**93**	**-3.6**	**24.7**	**+40**
Peru	351	-2.9	3.8	+2
Venezuela	117	4.7	14.0	+55
Turkey	197	1.7	1.4	+9

Blue shading indicates a potential concern

Foreign Debt: The most important measures are the level of foreign debt, and how this debt level is changing. Argentina, Brazil, Columbia, Peru, and Turkey all have debt levels significantly higher then the value of their countries' exports. Mexico and Venezuela both have significantly lower debt/export ratios.

Current Account balance: This indicates the relative trade-balance; comparing what a country exports to its imports. Recall from the Keynesian definition of national income: $Y = C + I + G + [X – M]$. Therefore, if a country is importing more than it exports, it has a trade deficient and a drain on the economy. Further, the larger the size of the deficit, the more new funds it needs to raise each year.

Dependence on the United States: Mexico, as stated earlier, is highly dependent upon exports to the United States.

Exchange rates: Why are they important?

In an open economy, changes in exchange rates have several important effects on the economy[37]:

- First, an increase in the real exchange rate boosts the demand for domestic goods as foreign goods become relatively more expensive.
- Second, more expensive foreign goods increase consumer prices directly through imported and intermediate goods.

Essentially, exchange rates are important because they affect the relative price of domestically produced goods and services. Lower exchange rates (as have been the case in Canada, relative to the United States, for the last decade) raises the costs of imports, and lowers the costs of exports. The greatest threat to an economy is not necessarily high

[37] Leitemo Kai, and Ulf Soderstrom, "Simple Monetary Policy Rules and Exchange Rate Uncertainty", presented at the Asset price, Exchange rate, and Monetary Policy conference, Stanford University, March 2-3, 2001.

or low exchange rates, but rather exchange rate volatility, which imposes the usual costs of uncertainty for firms operating in the economy.

The valuation of the Mexican Peso: As of the end of August 2001, 1 peso is worth $C0.1693 or US$0.1097[38]. Is this the proper valuation for the Mexican peso? As discussed in section 1 (Analyze past performance, External Measures, Gross Domestic Product) above, the theory of purchasing power parity (PPP) states that, in the long run, two currencies should move towards the rate that equalizes the prices of identical bundles of goods purchased in either country.

An interesting practical examination of PPP is the Big Mac Index produced by the Economist[39]. In this case, the "bundle" of goods produced is the Big Mac, which is a standard good, produced in over 100 countries around the world. The Big Mac PPP is the exchange rate that would leave hamburgers costing the same in each country.

The results of the Big Mac Index for the Mexico, Canada and the United States are:

	Big Mac Prices				
	In local currency	In US$	Implied PPP of the dollar	Actual $ exchange rate	Under/over valuation v the dollar, %
Canada	C$3.33	2.14	1.31	1.56	-16
Mexico	Peso21.9	2.36	8.62	9.29	-7
United States	2.54	2.54	--	--	--

This indicates that the peso is undervalued relative to the United States dollar, so too is the Canadian dollar.

Although the Big Mac Index is not a perfect measure of PPP, since there are many reasons why a Big Mac will cost less in Calgary or Mexico City than in Lexington, Kentucky (including sales taxes, barriers to trade, or differences in the price of rent), it does provide an interesting examination of exchange rate theory in practical terms.

Conclusion: Mexico compared to other emerging markets

Compared to the other emerging markets in Latin American, Mexico (as well as Venezuela and Chile) should fare better than Peru, Argentina, Brazil and Columbia. In 2000, the public debt, as a percentage of GDP for Mexico, is 25.40, compared to 43.70 in Argentina and 49.0 in Brazil. Clearly, Mexico is in a stronger position by not having the burden of a high debt load.

38 Globe and Mail, exchange rate section, August 24, 2001, pp. B16.
39 Big Mac Currencies, The Economist, April 21, 2001.

4- Assessment

Mexico is an important emerging market, especially for Canada and the United States. Not only does it serve as a gateway to Latin America, it is also part of NAFTA.

Change is occurring under President Fox. Mexico is proposing several key strategic policy initiatives aimed at increasing trade and the mobility of people. Monetary policy stability and fiscal constraint appear to be key economic policies that will strengthen Mexico in the long term. On the foreign policy front, Mexico is progressing. In the six months since assuming the Presidency, Mr. Fox has met with United States President George Bush three times. Additionally, cabinet members are traveling extensively, even sending a delegation to Calgary, Canada to discuss petroleum alliances and sell the Canadian oil sector on possible expansion opportunities within Mexico; unheard of with the previous administration.

Mexico has made substantial progress since the Tequila Crisis of 1994/95 in dealing with a number of problems that were worsened as a consequence of that crisis, and compared to many emerging markets today, is in a very strong position[40]. The most important measure of this is the low debt level. Unlike Brazil, Mexico, and even Canada to some extent, Mexico has its level of debt under control. Stability with international debt is important since it signals to investors that the economy is stable, lowers interest rates, allows governments to spend on programs and services instead of servicing the debt, and allows money to flow freely. This results in a stronger currency.

The major economic challenge facing Mexico is to get its trade balance in order. Any time a country imports more than it exports, the difference draws away from national income. It is like a small business buying more in inventory than what their receipts pay them in income. Stronger, more developed economies, like the United States, are able to offset any trade deficient against stronger internal consumption. Mexico, and most emerging markets, do not have this opportunity.

The second challenge facing Mexico is its reliance on the United States as a strategic trading partner. Canada and Mexico both are fortunate to border on the world's largest economy. It has often been said in Canada that living next to the United States is like living next to an elephant; every time it moves, you are bound to feel it. The same certainly applies to Mexico. With 24.7% of its GDP being exported to the United States, the US economic downturn could have a dangerous ripple effect in Mexico.

A third challenge facing Mexico is to distance itself somewhat from other emerging markets, especially if the situations in Argentina, Brazil and Turkey escalate into full blown financial crises, for fear the contagion might spread. Should any of these markets default on debt payments, investors could become collectively wary of all emerging markets. In April 2001, Michael Mussa, the Chief Economist for the International Monetary Fund, stated:

[40] http://www.imf.org/external/np/tr/2001/tr010426.htm

> The present economic and financial environment for emerging market economies generally is one where the markets are very sensitive and very nervous. They will, we believe, reward strength and penalize weakness. Mexico, I think, is benefiting because it has a strong fiscal position and a strong policy record. It looks forward to an upgrade of its status to investment grade in terms of its sovereign credits. It will be important to achieve that upgrade, especially if the environment for emerging markets generally in global financial markets remains relatively tense[41].

Looking forward, it is important that Mexico weather the slow down in the United States Economy. Once the United States recovers, so too will those countries with significant trading linkages to this important market. The challenge is to remain fiscally prudent during these times of uncertainty.

Mexico has tremendous potential as an investment opportunity. In the short run, investors should hold, and increase their coverage, before the United States economy recovers.

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[41] http://www.imf.org/external/np/tr/2001/tr010426.htm, April 26, 2001.

