Mexico: from crash to concussion

by Carlos Cota Meza

What happened to Mexico's government and financial and business circles last Oct. 27, that "Black Monday" when stock markets crashed around the world, was not really a stock market crisis, but a cerebral concussion.

As defined in high-risk contact sports, a concussion occurs after a hard blow to the head causes the brain to strike the inside of the cranium, and the brain stem twists, which produces unconsciousness, convulsions, amnesia, and loss of vital functions. The symptoms which then follow are loss of memory, irritability or euphoria, and, in extreme cases, profound depression.

These are the symptoms which were observed in Mexico in the last week of October.

Treasury Secretary Guillermo Ortiz declared on Oct. 28 that, "once the dust settles," Mexico will find itself "in a relatively improved position; it will even be among the first to achieve a recovery of the markets."

Macario Schettino, economic adviser to the mayor-elect of Mexico City, Cuauhtémoc Cárdenas, the leader of the left-wing Democratic Revolutionary Party (PRD), said, "with a little luck, the exchange rate could stabilize at 8.30 to the dollar, and we will have received a blessing from the crash."

President Ernesto Zedillo, in the course of reviewing reconstruction efforts after Hurricane Pauline hit Mexico (efforts, incidentally, which were handled well by the Mexican Army), declared that the Mexican economy is in such good shape, that it can withstand these natural phenomena and "financial hurricanes coming from abroad."

Miguel Mancera, head of the Banco de México (the central bank), as euphoric as he is capable of, declared that the policy of maintaining a free-floating exchange rate "saved Mexico" from another crisis, and that the exchange-rate instability of that week of October only cost the country $2 billion.

By the first week of November, as strong shocks continued in stock markets around the world, some of those who had been euphoric became depressive; others, such as Foreign Minister José Angel Gurría, regained consciousness not knowing where they were, and, out of place, tried to give advice to the Group of 15, the developing countries' counterpart to the Group of Seven developed nations, on how to deal with the crisis.

The Mexican foreign minister began his speech at the G-15 meeting with that well-worn expression: "Mexico does not intend to give advice, but . . . ," and then proceeded to unfurl the International Monetary Fund's prescriptions as the only option for poor countries. The G-15 conference took place in Malaysia, whose Prime Minister Mahathir bin Mohamad waged an open battle against the IMF and its "adjustment" policies.

To understand the delirium of the Mexican officials, we have to take into account that they are exhibiting symptoms of the "second-shock syndrome," medically more dangerous than the first, since the Carlos Salinas economic model (remember that?) blew apart in December 1994 with worldwide repercussions, and 34 months later, in October 1997, similar convulsions have returned.

What happened, and what comes next

What happened over the last few weeks in Mexico, swept along by the worldwide crash, is straightforward: with a generalized mass sell-off of stocks under way (panic), the speculators turned to buying dollars, which, as it spread (capital flight), devalued the peso. As an automatic reflex, the government raised interest rates to attract capital, attempting to make national speculative circuits "sufficiently attractive" for investors.

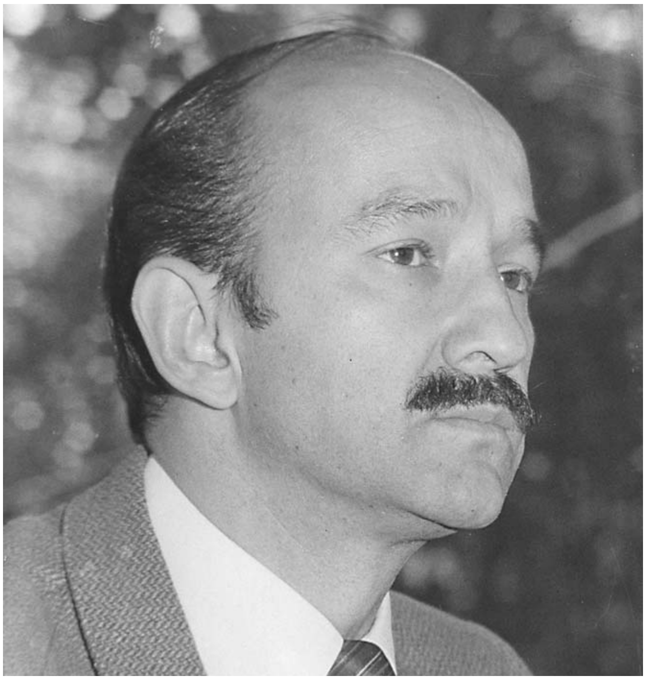
Up to this point, it would appear that everything was going to proceed as it had in 1995-96, and part of 1997. However, the recurrent crises, in ever-shorter time-frames and progressively encompassing more and more of world finance, has led to maximum chaos, which the Mexican government hysterically refuses to see. Mexico today has the very same vulnerabilities as in 1994, only worse: a collapsing physical economy (which the official GNP statistics only cover up), and a bubble of debt, both foreign and domestic, which is growing like a cancer. Mexico only appears relatively "healthy," when it is lined up alongside Brazil and Argentina.

What comes next, within the parameters adopted by the government, is another devaluation of the peso like that of December 1994 (over 40%). If all the markets hit by the crash respond the same way as Mexico, then we will tend to see a generalized rise in interest rates, and the dollars now circulating inside Mexico will be sucked out of the country, possibly by rising U.S. Federal Reserve interest rates, as occurred from February 1994 until "Black December" of that year.

A drastic devaluation of the peso would, among other things, blow up the servicing of the public and private foreign debt, the which would become more onerous in proportion to the devaluation, and would quickly become impossible to pay.

Obviously, Miguel Mancera lied when he said that Mexico got out of the October crisis cheaply. From Oct. 27 to Nov. 7, the Banco de México intervened in the exchange market three times, using about $600 million of foreign reserves to support the peso. But that is not all.

Since August 1996, the Banco de México decided to "buy" Mexican commercial banks' "excess" dollars. This system began with the purchase of $130 million a month, to later grow in February 1997 to $300 million a month. In July, purchases increased to $500 million a month, and by October,



Former President Carlos Salinas oversaw the crash of 1994-95. The much-touted "fundamentals" are no more sound now, than they were then.

the purchases had dropped slightly back to $400 million. These "purchases" cumulatively pulled into the central bank some $3.35 billion in foreign reserves.

Not much is known publicly about this shady mechanism between the Banco de México and the commercial banks, which is carried out by buying and selling of so-called "options." An "option" gives its holder the right, but not the obligation, to buy or sell an asset at a set price at a future date, which presumably provides the holder protection against potential losses from future price fluctuations—for example, a devaluation.

This means that the commercial banks have been buying the "option" to sell their "excess dollars" to the Banco de México. Options in general are very short-term (for example, one week), and if not exercised, they expire at the end of that term.

According to the central bank's records, the dollar total of "options" *not* exercised by the commercial banks over the course of 1997, adds up to $829 million. What is most likely, is that the commercial banks took the dollars they did not sell to the Banco de México, and shipped them out of the country over the course of the last few weeks. Thus, this amount should in fact be added to the $600 million officially spent by the Banco de México to support the peso, which means that total capital flight over the ten days in question was actually about $1.4 billion—and counting.

To get an idea of the magnitude of the problem actually facing the government, consider the new $2.5 billion "contingency fund for shocks from abroad," which 31 private financial institutions from ten countries have created, to try to prevent the inevitable from happening in Mexico.

The domestic public debt is another major problem. The Banco de México has been paying for its purchase of "excess dollars" from the banks by issuing government bonds (Cetes, Bondes, Udibonos), at an accelerating rate since September of this year. Over the first three quarters of 1997, the domestic public debt had already grown, according to official figures, from 150 billion pesos in December 1996, to 267 billion pesos in October 1997—an increase of 78% in less than a year! A runaway rise in interest rates (e.g., to "attract" fickle speculative capital from abroad) will not only dramatically increase the internal debt, but it will tear apart the 1998 Federal budget. It will also create major additional problems for the already insolvent commercial banks, by dramaticaly raising the non-performing component of their debt portfolios.

Some economic analysts in Mexico even fear that, if IMF prescriptions prevail in the "restructuring" of the economies of Southeast Asia, then the "Mexican model" will become even more devalued. According to this school of thought, the so-called Asian Tigers would become even greater exporters in the globalized economy, with freshly devalued currencies and reduced wage bills, in areas that would compete with, and eventually displace, Mexico products in various international markets. That, of course, assumes that there are still markets left to export to, as the financial firestorm sweeps the world economy.

'El Niño'

Giving President Zedillo the benefit of the doubt, one might argue that his economic policies will withstand the financial hurricanes coming from abroad, for as long as the international financial institutions can maintain this fiction called "Mexico" on their books.

But, Mexico's physical economy, will not respect this line of argument. For example, the effects of the weather phenomenon popularly known as "El Niño," is leaving the Mexican physical economy in a situation which some describe as a "natural disaster," but which in fact reveals the woeful lack of essential economic infrastructure, which was either never built or was destroyed under the IMF's dictatorship over the last 15 years.

Consider, for example, the agricultural sector. In the last 15 years, IMF policies have produced a calamity in this sector, as we have documented on various occasions: a drop in the number of hectares under cultivation, a collapse of per-capita production, an increase of imports of basic grains which previously were produced within the country, etc. On top of this IMF catastrophe, the damage done by Hurricane Pauline has to be added.

According to the Agriculture Ministry, in the state of Guerrero, the hurricane destroyed 180,000 hectares of coffee, banana, corn, lime, papaya, and peanut crops. In Oaxaca, 120,000 hectares (mainly corn and coffee) were destroyed. The mudslides were so great that much land will not be cultivable again for two years. As for livestock, the losses are said to reach some 6,500 head of cattle.

Agriculture Minister Francisco Labastida Ochoa reports that damage caused by climatic changes this year (rains, droughts, and freezes) will affect 1,667,000 hectares, more than double the average 735,000 hectares affected annually. He argues, however, that these losses will not affect national production of food, because these disasters have occurred "in largely unproductive lands" where the effects, more than being economic, "are of a social order."

The devastated areas are in fact lands dedicated mainly to subsistence farming, so that the affected populations are in danger of starvation, when government assistance programs and the distribution of humanitarian aid run out.

The people affected by Hurricane Pauline are largely strata who are already suffering extreme poverty. According to the UN Economic Commission for Latin America and the Caribbean (ECLAC), in 1992 there were 13.6 million Mexicans who did not even consume the minimal market basket of food. The households of another 23.6 million Mexicans, consumed less than two minimum market baskets—still a paltry amount.

And at that time, the "hurricane" of December 1994 had not yet occurred, nor had the Mexican economy been treated to the "successful" IMF reconstructions of 1995 and 1996. And so arrived at 1997. Unfortunately for the agriculture minister, the phenomenon, with all its "natural" features, is in fact eminently economic.

One Mexican agricultural insurance company, Agrosemex, projects major continuing damage from El Niño. Between November 1997 and March 1998, the weather pattern will enter into its second phase, they forecast, with a substantial increase in rains in Mexico. Thus, excess humidity is projected to put corn cultivation at risk in the state of Baja California, and excess rains will endanger the corn harvest and the planting of wheat in Sonora. In Jalisco, the corn production will be limited by rainfall levels expected there. In Sinaloa, beans and chickpeas are expected to be affected. Nayarit may face floods, affecting the production of tobacco in that state. Michoacán, Guerrero, Oaxaca, and Chiapas could be flooded by new torrential rains.

Altogether, Agrosemex calculates 1.2 million hectares in the Pacific coastal zone will be affected, with the investment that is at risk of being lost possibly rising to 8 billion pesos—nearly $1 billion. Whether or not El Niño hits with the specific severity projected, here we are talking about regions which are the heart of Mexico's national food production.

For all the amnesia, unconsciousness, and convulsions, real or feigned, which Mexican government officials and politicians are displaying, the nature of the financial crisis and natural climate phenomena is telling them that their world of virtual reality is over. The symptom of profound depression in those affected by concussions could lead to suicide, medical experts warn.