

MEXICO: THE OPPORTUNITY

HIGHLIGHTS

Mexico has a number of advantages that make it an excellent source of long-term opportunities for Canadian exporters:

- A strategic geographical location including a 3,234 kilometre border with the United States, coastlines facing Europe and Asia, and a gateway into Latin America.
- Preferred access to the United States, the world's largest market, under the North American Free Trade Agreement (NAFTA).
- A relatively young workforce of more than 30 million people that has proved capable of delivering quality at substantially lower labour costs than in the advanced industrialized economies.
- Plentiful natural resources.
- A rapidly growing domestic market of 92 million people, about half of them under 20 years of age.
- An economic and regulatory climate that is supportive of the private sector.

In spite of the economic crisis spawned by the sharp devaluation of the peso in December 1994, Mexico presents major opportunities to Canadian exporters. These arise from Mexico's sweeping economic reforms, which began in the late 1980s. The North American Free Trade Agreement (NAFTA), which came into effect on January 1, 1994 has further reduced the barriers facing Canadian companies that want to move into Mexico.

Mexico's reforms were driven by a set of complementary policies that included trade liberalization, deregulation and privatization. The government also embarked on a massive program to modernize a dilapidated infrastructure that was the legacy of decades of protectionism. The result was several years of sustained economic growth, and a dramatic drop in the rate of inflation.

Unfortunately, the forces of expansion and modernization also had negative effects. Mexico lacked the sophisticated technology needed to bring about an economic revolution on its own. Imports surged as Mexican manufacturers scrambled to modernize their operations so as to compete in international markets. The surge in imports put pressure on the peso. Prior to the end of 1994, the government, led by President Carlos Salinas, put off the problem by drawing down its foreign currency reserves to dangerously-low levels. The succeeding government, led by Ernesto Zedillo, could not sustain this policy. Over the Christmas holidays of 1994, the three-week-old Zedillo administration stopped supporting the peso. Within days, the currency had lost one-third of its value relative to the American dollar. Subsequent market adjustments have left it at less than half of its 1994 value.

These dramatic events triggered a serious economic crisis as higher import prices cascaded through the economy. Mexico's gross domestic product (GDP) fell by about 6 percent during 1995. Inflation surged from 7 percent in 1994 to more than 50 percent in 1995, and the market for imports was profoundly affected by the rise in peso prices.

Most observers think these problems were caused by mismanagement of an inevitable devaluation in the peso, not by any fundamental structural weakness in the economy itself. Within a year, the devaluation shock had worked its way through most of the economy, which then began to recover. Forecasts suggest that by 1996 inflation will fall to the 20 percent range and economic growth will rise to between 1 and 3 percent. Although this level of growth will not restore industrial output to 1994 levels, it is a sign that the worst of the crisis is over.