

## **I. THE ECONOMIC ENVIRONMENT AND TRADE**

### **(1) OVERVIEW**

1. The Mexican economy performed very well between 1997 and 2000, driven in good part by growing domestic demand, trade, and investment. Over the period, Mexico's trade attained the fastest growth rate among the WTO's twenty largest single Members, and foreign direct investment has flowed copiously. Growth has benefited large segments of the society, GDP per capita having reached US\$6,000 in 2000. Sound macroeconomic policies, denoted by a stable exchange rate, falling inflation, and moderate fiscal deficits, have buttressed the good performance. However, a better outcome might have been desirable as concerns fiscal deficits, in view of the economy's strong performance. The fiscal position also remains exposed to fluctuations in petroleum revenues, and to significant contingent liabilities.

2. Since late 2000, in the wake of falling U.S. demand and declining international oil prices, trade and GDP growth have slowed, accompanied by a contraction in employment. The policy options open to the authorities to address these trends appear limited with respect to both monetary and fiscal policies. The resumption of growth thus depends largely on a turnaround in the world economy, and in particular in the United States, by far Mexico's largest trading partner.

### **(2) RECENT ECONOMIC DEVELOPMENTS**

3. Between 1997 and 2000, Mexican GDP grew at an annual average rate of 5.2% in real terms; growth was particularly strong in 1997 and 2000, with rates close to 7%. This pattern resulted mainly from the strength of domestic demand, particularly of private consumption, which grew at an annual average rate of 6.4%, and of the external sector, with imports and exports growing at a real annual average rate of 17.2% and 13.4% respectively. The latter reflected in part the lead of strong growth in the U.S. economy. The share of total trade to GDP increased from 61% in 1997 to 65% in 2000.

4. The expansion of trade in recent years has gone hand in hand with structural adjustments carried out in Mexico, and most notably, those related to growing external openness. This has motivated an intense process of investment in export-related activities: between 1997 and 2000 private investment grew at a real annual average rate of 10.6%. Manufacturing GDP expanded at a real annual average rate of 6.2%, outpacing growth in the economy as a whole; GDP growth in services was in line with total growth, while rates were lower in agricultural and mining GDP, respectively 1.8% and 2.3% (Table I.1).

5. Economic growth benefited large segments of the society. Real GDP per capita increased at an annual average rate of 3.8% between 1997 and 2000, reaching US\$6,000 in 2000; and unemployment fell from 3.7% to 2.3%. Though progress has been made, poverty and unequal income distribution remain major concerns for the Mexican authorities.<sup>1</sup>

6. From late 2000, the Mexican economy has faced a less favourable external environment, characterized by a falling demand in the United States and declining international oil prices. The economic downturn in the United States and the contraction of domestic demand have particularly affected the Mexican industrial sector in terms of both production and employment levels; over 200,000 jobs were lost during the first nine months of 2001. All components of aggregate demand were expected to experience a slowdown during 2001, with private investment spending registering the strongest contraction. Preliminary figures for the first half of 2001, indicate that trade was also slowing down; exports grew by less than 2% with respect to the same period of 2000, while imports grew at 3.8%.

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<sup>1</sup> Banco de México (2000).

Table I.1  
Basic macroeconomic indicators, 1997-01

	1997	1998	1999	2000	2001 <sup>a</sup>
<b>I. Gross domestic product (GDP)</b>					
GDP current (Mex\$ billion)	3,179.1	3,848.2	4,588.5	5,432.4	5,688.5
Real GDP (1993 Mex\$ billion)	1,381.5	1,449.3	1,505.0	1,609.1	1,612.9
Nominal GDP (US\$ billion)	401.5	421.2	479.9	574.5	602.1
Nominal GDP per capita (US\$)	4,288	4,439	4,990	5,893	6,094
Sectoral breakdown (% of current GDP)					
Agriculture	5.7	5.3	4.8	4.4	4.2
Industry	28.6	28.6	28.7	28.4	27.3
Services	65.7	66.1	66.4	67.3	68.5
Breakdown by expenditure (% of current GDP)					
Total consumption	74.1	77.8	78.0	78.5	81.0
Private	64.2	67.4	67.1	67.5	71.1
Public	9.9	10.4	10.9	11.0	9.9
Total investment <sup>b</sup>	19.5	20.9	21.2	20.9	19.3
Private	16.4	18.1	18.3	18.0	17.1
Public	3.1	2.8	2.9	2.9	2.1
Exports of goods and services	30.3	30.7	30.8	31.4	28.9
Imports of goods and services	30.4	32.8	32.4	33.2	30.8
Real rates of growth (%)					
Total GDP	6.8	4.9	3.8	6.9	0.9
Agriculture	0.2	0.8	3.5	3.4	-0.6
Industry	9.3	6.3	4.2	6.6	-2.5
Services	6.4	4.6	3.7	7.4	2.5
Total consumption	6.0	5.0	4.2	8.7	..
Private	6.5	5.4	4.3	9.5	..
Public	2.9	2.3	3.9	3.5	..
Total investment <sup>b</sup>	21.0	10.3	7.7	10.0	..
Private	23.5	13.8	7.9	10.2	..
Public	10.1	-7.5	6.2	8.6	..
Exports of goods and services	10.7	12.1	12.4	16.0	..
Imports of goods and services	22.7	16.6	13.8	21.4	..
<b>II. Employment and prices</b>					
Rate of unemployment (%)	3.7	3.2	2.5	2.2	2.4
Consumer price index (% change)	20.6	15.9	16.6	9.5	4.4
<b>III. Money and interest rates (end of period; annual change)</b>					
M1	32.7	19.2	26.1	15.4	9.1
M2	30.1	27.9	21.1	16.2	14.0
M4	25.9	25.9	19.1	15.1	13.7
28-day commercial paper rates					
Real	7.8	7.0	11.3	8.1	..
Nominal	24.8	26.9	25.0	17.8	..

.. Not available.

a Annual estimate based on the first two quarters for section I; Q2 estimates for real GDP growth rates and money indicators.

b Excludes change in stocks.

Source: Banco de México and Instituto Nacional de Estadística, Geografía e Informática (INEGI).

### (3) PUBLIC FINANCES

7. Increasingly sound public finances have contributed significantly to Mexico's growth over recent years. Between 1997 and 2000, public revenues as a percentage of GDP ranged from 20.3% to 23.0%; fluctuations were mainly explained by variable oil revenues, which generally accounted for one third of total revenues. In response to these variations, the authorities adjusted expenditure to meet the fiscal objectives established yearly in the Budget Decree. Import duties accounted for a

marginal share of tax revenues (less than 3% of total revenues in 2000). Over the period, the public sector overall deficit was maintained at some 1% of GDP (Table I.2). The measure of overall public sector balance should be considered cautiously, however, since the methodology used by Mexico deviates from international practices.<sup>2</sup> To increase transparency and comparability, from May 2001, the authorities have started to publish a measure broadly in line with international standards, the Public Sector Borrowing Requirement (PSBR).<sup>3</sup> According to this indicator, the public fiscal deficit at the end of 2000 stood at 3.7% of GDP, significantly lower than in the previous three years.<sup>4</sup> The Government's medium-term objective is to reduce the PSBR to 1% of GDP.

8. From 2000, the Budget Decree has included automatic adjusters that are triggered when government revenues are lower than anticipated.<sup>5</sup> In particular, when oil revenues are lower than expected, adjustments are made as specified in the rules of the Oil Stabilization Fund (see Box I.1). If revenues decrease by 5% or less, for reasons other than a change in oil prices, the Government is required to cut programmable expenditures and inform Congress of the sectors where these expenditure reductions will be carried out; if the reduction in revenues is larger than 5%, programmable expenditures are reduced and Congressional approval is required for the specific sectors where reductions will take place.

9. The evolution of public sector finances during 2001 was determined by the deceleration of economic activity, the strength of the Mexican peso, the fall in oil prices, the increase in transfers to states and municipalities, and the reduction of domestic and external interest rates. Budgetary revenues for the first nine months were lower than expected and, therefore, various adjustments to public expenditures were made in order to comply with the objective set in the economic policy guidelines for 2001, which are at strengthening Mexico's fiscal stance.

10. The authorities noted that the high dependence of public revenues on oil was one of the major deficiencies of the Mexican fiscal structure. To address fiscal vulnerabilities, a broad tax reform was presented to Congress in March 2001; its main objectives were to increase tax revenues, while reducing compliance costs and barriers of entry to the formal economy, and to reduce oil revenue dependence, in particular through a reform of the value-added tax. After long-drawn negotiations in Congress, a compromise fiscal package was adopted for 2002: this was expected to increase tax revenues by less than originally sought, and to accomplish this mainly through modifications to income and excise taxes and a new excise tax on luxury goods and services rather than an overhaul of the value-added tax.<sup>6</sup>

11. The level of public debt declined significantly from 32.5% of GDP in 1997 to 25.9% at the end of 2000. This reduction resulted from a sharp decline of public external debt, which compensated for the observed increase of domestic debt. Consequently, the public debt service was reduced by some 10 percentage points, reaching 26% of the value of exports for 2000. The amount of external debt held by the private sector at the end of 2000 stood at 11.3% of GDP (Table I.3).

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<sup>2</sup> Main differences include: revenues from privatization and unrealized capital gains on international reserves and debt buy-back operations are recorded as income; the inflation component of indexed bonds is not charged as interest; spending on some public investment projects is recorded when the financial obligations are serviced and not when the investment is made; and the cost of quasi-fiscal operations is not included.

<sup>3</sup> A methodological note on the difference between the traditional measure of the fiscal balance and the PSBR is available from the Department of the Treasury and Public Credit [online], at: <http://www.shcp.gob.mx/>.

<sup>4</sup> The PSBR is the traditional surplus/deficit minus the cost of bank restructuring, the cost of debtor support operations, the cost of certain public investment projects, and the income from privatizations if any.

<sup>5</sup> Article 32 of the Budget Decree for 2001 published in the *Official Journal* on 31 December 2000.

<sup>6</sup> Department of the Treasury and Public Credit (2002).

**Table I.2**  
**Consolidated public sector finance, 1997-00**  
(Per cent of GDP)

	1997	1998	1999	2000
<b>A. Revenues</b>	23.0	20.3	20.8	21.9
Oil revenues	8.4	6.6	6.8	7.9
PEMEX	2.0	2.1	2.2	2.0
Federal government	5.7	4.4	4.6	5.9
Non-oil revenues	14.7	13.8	14.1	13.9
Federal government	10.1	9.7	10.1	10.1
Tax revenues	8.2	8.4	8.9	8.8
Of which				
Income tax (ISR)	4.3	4.4	4.7	4.7
Value added tax (IVA)	2.5	2.6	2.8	2.9
Import duties	0.6	0.6	0.6	0.6
Non-tax revenues	1.9	1.3	1.2	1.3
State enterprises and entities <sup>a</sup>	4.5	4.1	3.9	3.9
<b>B. Expenditures</b>	23.6	21.6	22.0	23.0
Programmable expenditure	16.2	15.5	15.4	15.8
Current expenditure	12.8	12.4	12.5	13.2
Wages and salaries <sup>b</sup>	6.8	6.9	7.3	7.2
Other current expenditure	4.3	3.8	3.5	4.2
Aids, subsidies and transfers <sup>c</sup>	1.6	1.6	1.7	1.8
Capital expenditure	3.5	3.1	2.8	2.7
Fixed capital assets	3.2	2.9	2.6	2.6
Direct	2.4	1.8	1.5	1.4
Indirect	0.8	1.2	1.0	1.1
Financial investment and others	0.3	0.2	0.3	0.1
Non-programmable expenditure	7.4	6.1	6.6	7.1
Financial expenditure	4.1	2.9	3.6	3.7
Interest payments	2.8	2.6	3.1	2.6
Federal government	2.3	2.2	2.6	2.1
State owned entities	0.5	0.4	0.4	0.5
Subsidy and economic assistance	1.3	0.3	0.5	1.1
Revenue sharing	3.0	3.0	3.1	3.3
Arrears and others	0.3	0.3	-0.0	0.1
<b>C. Budgetary balance (A - B)</b>	-0.6	-1.2	-1.2	-1.1
<b>D. Non-budgetary balance</b>	-0.1	0.0	0.0	0.0
<b>E. Overall surplus/deficit</b>	-0.7	-1.2	-1.1	-1.1
External financing	-0.8	0.5	0.2	-1.1
Domestic financing	1.6	0.7	1.0	2.2
<b>Memorandum item:</b>				
Public sector borrowing requirement <sup>d</sup> (% of GDP)	-5.6	-6.3	-6.3	-3.7

a Revenues and expenditures net of payment of non-tax royalties and fees.

b Excludes contributions to the Instituto de Seguridad y Servicios Sociales para los Trabajadores del Estado (ISSTE).

c From 2000, aid expenditure is reclassified under other current expenditure and direct fixed capital assets.

d Excluding non-recurrent revenues.

Source: Department of the Treasury and Public Credit and Banco de México.

**Box I.1: Oil Stabilization Fund**

The Oil Stabilization Fund (OSF) was created with the intention of diminishing the impact of abrupt movements in international oil prices or other factors on the permanent sources of revenue, on public finances, and on the Mexican economy in general. Article 35 of the Budget Decree for 2000 established that in the event of higher than expected revenues, these extra resources would be directed first to replenish budget cuts made earlier in the year, and then to amortize public debt (60% of remaining resources) and constitute the OSF (40% of the remaining resources).

In light of the excess revenues registered during the first nine months of 2000, the OSF was created on 15 November 2000. Future contributions to the OSF should be specified every year in the corresponding Budget Decree. In particular, Article 31 of the Budget Decree for 2001 established that 33% of revenues in excess of those budgeted must be directed to the OSF (the remaining resources will be directed to improve the public sector's balance and increase infrastructure investment).

The main rules for disbursements are as follows.

Public expenditures can be financed with no more than 50% of the OSF's total resources accumulated in the previous fiscal year, according to the following criteria: if the actual price of the Mexican oil mix is higher than projected or lower by 1.5 dollars per barrel (dpb) or less, then no resources from the OSF will be drawn (in this case the required fiscal adjustment should be carried out through a reduction in expenditures); if the observed price of the Mexican mix is lower than projected by more than 1.5 dpb, then resources from the OSF will be used (in the event that the maximum amount of resources from the OSF is used then additional fiscal adjustments will take place through lower expenditure).

The resources from the OSF will be directed to cover expenditures related to programmes included in the Budget for the corresponding fiscal year. If the funds from the OSF are insufficient to cover the total amount of the agreed expenditures, then the Department of Finance will determine the allocation of resources according to the priority of the referred programmes. At the end of any fiscal year, resources above US\$4 billion will be transferred to a special account within the OSF, which cannot be used to cover public expenditures and thus, will be directed to amortize debt.

*Source:* Department of the Treasury and Public Credit.

**Table I.3**  
**Debt indicators, 1997-00**  
(% of GDP, unless otherwise specified)

	1997	1998	1999	2000
Public sector	32.5	32.8	30.1	25.9
Domestic	8.2	8.9	9.9	11.2
External	24.3	23.9	20.2	14.7
Medium long term	21.0	20.9	18.3	14.0
Short term	3.3	3.0	1.9	0.7
Private sector				
External	13.9	14.4	14.5	11.3
Medium and long term	11.6	12.3	12.5	9.4
Short term	2.3	2.1	2.0	1.9
Total external debt	38.2	38.4	34.7	26.0
Public sector debt service (% of exports)	36.2	21.6	22.5	26.0

*Source:* WTO Secretariat, based on data released by the Department of the Treasury and Public Credit and the International Monetary Fund.

#### (4) MONETARY AND EXCHANGE POLICY

12. The main objective of Mexico's monetary policy is the sustainable reduction of inflation. Monetary policy is carried out by the Central Bank (Banco de México) in an environment in which

both the exchange rate and interest rates are determined by financial markets. With the adoption of a floating exchange rate regime, following the balance-of-payments crisis in 1994-95, monetary targets became the nominal anchor for inflation stabilization. Since then, the monetary policy scheme has gradually converged towards the inflation targeting regime currently in place. To enhance the transparency and accountability of monetary policy, the Central Bank started publishing quarterly inflation reports in 2000; multi-year inflation target announcements were also introduced. The medium-term inflation objective was set at 3% for the end of 2003, with intermediate targets of 6.5% for 2001, and 4.5% for 2002. The inflation rate, measured as consumer price variations, fell from 52% in 1995 to 9.5% in 2000 (below the targeted level of 10%); preliminary estimates for 2001 indicate that effective inflation stood at some 4.4% below the targeted level of 6.5%.

13. The Central Bank's operational target is settlement balances rather than short-term interest rates (as in most other countries maintaining an inflation targeting policy). The authorities noted that the main advantage of this operational target (compared with short-term interest rates) is that external shocks affecting country risk are absorbed by the exchange rate and short-term interest rates, without the need for Central Bank intervention, and thus exchange rate volatility tends to be lower.

14. Although exchange rates are freely determined, the Central Bank participates in the foreign exchange market under two mechanisms: dollar purchases, through put options; and contingent dollar sales. The first mechanism is mainly aimed at accumulating international reserves, and does not seek to alter the nature of the floating regime. The authorities noted that even in the context a flexible exchange rate regime, maintaining a suitable level of international reserves contributes to the country's financial strength, in particular by reducing the risk of a roll-over crisis.<sup>7</sup> As at end 2000, the level of international reserves was equivalent to the value of some three months of imports. The Central Bank also intervenes in the foreign exchange market through the contingent dollar sale mechanism to help moderate the exchange rate volatility. These interventions are not intended to defend a specific exchange rate level.

15. Since its previous Review, Mexico's real effective exchange rate (REER) has appreciated substantially (Table I.4). The Mexican authorities indicated that the real appreciation of the peso was consistent with a sounder economy. However, some observers have suggested that the appreciation might be excessive, in part as a consequence of the tight monetary policy, and have raised concerns about the possible effect of these trends on the competitiveness of Mexico's traded goods sector.<sup>8</sup>

## **(5) BALANCE-OF-PAYMENTS AND TRADE AND INVESTMENT FLOWS**

### **(i) Overview**

16. Since 1997, current account transactions have shown increasing deficits. The deficit increased from 1.8% of GDP in 1997 to 3.1% in 2000. This was mainly the result of a strong deterioration of the merchandise trade balance; the deficits of the factor and non-factor services balances also increased but at significantly lower rates. The deterioration of merchandise trade balance was mainly explained by the sharp expansion of merchandise imports responding to strong domestic demand, in particular for intermediate goods mainly for export production; in 2000 imports of intermediate goods accounted for some 76% of total imports. Merchandise exports also expanded substantially, albeit at a slower pace (see below).

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<sup>7</sup> Banco de México (2001).

<sup>8</sup> IMF (2001a).

**Table I.4**  
**Balance of payments, summary 1997-01**  
(US\$ million)

	1997	1998	1999	2000	2001 QI
<b>Current account balance</b>	-7,448.4	-16,089.8	-14,375.1	-18,079.2	-4,388.1
Merchandise trade balance	623.6	-7,913.5	-5,583.7	-8,003.0	-2,220.5
Exports	110,431.4	117,459.6	136,391.1	166,454.8	39,642.1
Of which					
Petroleum and derivatives	11,323.2	7,134.3	9,928.2	16,382.8	3,520.9
Manufactures <sup>a</sup>	94,802.2	106,062.3	122,084.5	145,334.2	34,601.6
Imports <sup>a</sup>	109,807.8	125,373.1	141,974.8	174,457.8	41,862.6
Consumption goods	9,326.0	11,108.5	12,175.0	16,690.6	4,531.2
Intermediate goods	85,365.7	96,935.2	109,269.6	133,637.3	31,608.7
Capital goods	15,116.1	17,329.4	20,530.1	24,129.9	5,722.7
Factor services, net	-12,789.5	-13,283.7	-13,305.9	-14,746.5	-4,016.0
Revenues	4,560.4	5,047.1	4,516.8	6,090.7	1,523.1
Interest	3,749.6	4,034.3	3,735.7	5,024.5	1,255.0
Other factor income	810.8	1,012.8	781.1	1,066.2	268.1
Expenditures	17,349.9	18,330.8	17,822.7	20,837.2	5,539.1
Of which					
Interest	12,436.2	12,499.7	13,018.2	13,981.3	3,710.0
Non-factor services, net	-529.9	-904.9	-1,798.7	-2,323.4	-275.2
Revenues	11,270.1	11,522.6	11,692.0	13,712.3	3,590.4
Transportation	1,416.9	1,433.1	1,342.6	1,369.3	344.6
Tourism	5,747.6	5,633.3	5,505.7	6,435.4	2,009.3
Tourists (border and cruises)	1,845.0	1,859.8	1,717.2	1,858.8	484.4
Other non-factor services	2,260.6	2,596.4	3,126.5	4,048.8	752.1
Expenditures	11,800.0	12,427.5	13,490.6	16,035.7	3,865.6
Freight and insurance	3,312.4	3,699.1	4,109.2	5,006.4	1,218.8
Miscellaneous transport	1,694.6	1,602.8	1,664.9	1,983.1	428.5
Tourism	1,821.2	2,001.9	1,950.4	2,444.9	561.8
Tourists	2,070.7	2,207.2	2,590.9	3,054.2	759.7
Other non-factor services	2,901.1	2,916.4	3,175.3	3,547.0	896.7
Transfers	5,247.4	6,012.4	6,313.1	6,993.7	2,123.5
Revenues	5,272.9	6,039.5	6,340.0	7,023.1	2,124.6
Expenditures	25.5	27.1	26.9	29.4	1.1
<b>Capital account balance</b>	15,762.7	17,652.1	14,385.6	18,044.2	8,063.8
Foreign direct investment	12,829.6	11,602.4	11,964.6	13,286.1	3,596.9
Portfolio investment	5,037.1	-579.2	10,965.0	-2,224.6	1,719.2
Loans and deposits	-8,819.7	6,197.4	-4,539.3	-560.5	2,964.7
Other financial assets, net <sup>b</sup>	6,715.8	431.5	-4,004.7	7,543.2	-217.0
Errors and omissions	2,179.4	574.6	583.2	2,856.5	804.9
Valuation adjustments	17.8	1.5	-1.4	2.7	3.6
<b>Change in net reserves (increase -)</b>	-10,511.5	-2,138.4	-592.2	-2,824.2	-4,484.2
<b>Memorandum items:</b>					
Crude oil price (average world; US\$/bbl)	19.27	13.07	17.98	28.21	26.78
Exchange rate (Mex\$/US\$)	7.92	9.14	9.56	9.46	9.70
Real effective exchange rate (1990=100) <sup>c</sup>	86.0	84.8	77.9	69.1	67.2
International reserves (months of imports)	3.1	2.9	2.6	2.3	2.7

a Includes *maquiladoras*.

b Refers to active capital accounts.

c Based on CPI; 111 partner countries included. A decrease in the value represents an appreciation of the Mexican peso in real terms.

Source: Banco de México and International Monetary Fund.

17. The persistent deficits of the factor services balance were mainly due to interest payments, which, despite the reduction of external debt (see section (3)), increased slightly between 1997 and 2000. The non-factor services deficit increased sharply, from some US\$530 million in 1997 to over US\$2,300 million in 2000. This was explained by a relative stagnation of non-factor services exports compared with the sustained growth of imports, mainly of freight and insurance and tourism services (section (iii) below).

18. The only balance item of the current account that consistently registered positive values over the period was the transfer component. In 2000, net transfers amounted to some US\$7,000 million, equivalent to 87% of the merchandise trade deficit. The bulk of these transfers corresponded to remittances from Mexicans residing abroad.

19. The worsening current account position observed between 1997 and 2000 was generally compensated by the capital account surplus; foreign direct investment was the main financing source. Indeed the favourable capital account position permitted the accumulation of foreign exchange reserves (Table I.4).

## **(ii) Developments in merchandise trade**

20. The expansion of Mexico's merchandise trade since the mid-1990s has contributed significantly to the good performance of the Mexican economy up to 2001. Between 1997 and 2000, merchandise trade grew at an annual average rate of 17.1%, with merchandise imports slightly outpacing merchandise exports (respectively 19.4% and 14.7% growth rates).<sup>9</sup> Imports of both agricultural and manufactured products increased markedly although, as a result of the dynamism of the manufacturing sector, the share of manufactured imports increased by three percentage points and reached 86.5% of total imports in 2000 (Table AI.1). Machinery and transport equipment accounted for half of total merchandise imports; within this category, imports of office and telecommunication equipment and automotive products were particularly dynamic.

21. Merchandise exports showed a similar pattern with the share of manufactured goods increasing by some three percentage points, reaching 83.4% of total exports in 2000 (Table AI.2). Mainly as a result of the geographic proximity between Mexican and U.S. producers and Mexico's maquiladora programme, which have encouraged both intra-industry and intra-firm trade, the largest Mexican export industries tend also to be the most important importers (Chapter IV(4)). Thus, not surprisingly, export growth was particularly sharp for office and telecommunication products (20.5% of total exports in 2000); the contribution of the automotive industry as well as of textiles and clothing to total exports remained relatively constant at some 18% and 7% respectively. Fuels exports, mostly crude petroleum, accounted for a significant share of Mexico's exports, though, they were subject to substantial fluctuations.

22. The United States was by far Mexico's principal imports source, though its share of total imports declined slightly, from 74.3% in 1997 to 73.1% in 2000 (Table AI.3). Over that period, imports from the Americas countries represented some 78% of total imports, with increasing, albeit modest, participation of Canada, Brazil, and Chile. In Europe, Germany and Italy were the main suppliers of goods to Mexico, with 3.2% and 1.3% of imports in 2000. Japan remained the major supplier in the Asean region (some 4%), the Republic of Korea and China increased significantly their participation in the Mexican market.

23. Between 1997 and 2000, the United States consolidated its position as Mexico's major export market, increasing its share in total Mexican merchandise exports by some four percentage points to

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<sup>9</sup> These figures are based on trade data reported by Mexico to the UN Comtrade database; reported merchandise imports for 2000 appear to be substantially higher than the figure reported in the balance-of-payments table, according to which merchandise imports grew at an average annual rate of 16.7%.



some 89% in 2000 (Table AI.4). Exports to non-NAFTA American partners grew at a much slower pace, as a result, their share in total Mexican exports fell from 6.5% to 4.1%. Exports to Asia contracted markedly with their share in total exports falling from 2.7% to 1.4%. The importance of European countries as export markets remained roughly constant over the period, at a relatively modest level of less than 4%. With respect to individual countries, Canada was the second largest destination for Mexican products, accounting for some 2% of exports. Outside NAFTA, no individual country absorbed more than 1% of total Mexican exports.

### **(iii) Trade in non-factor services**

24. Between 1997 and 2000, trade in non-factor services grew at an average annual rate of 8.8% (substantially below merchandise trade growth). This expansion was mainly due to dynamic imports, and resulted, as noted above, in a widening of Mexico's non-factor services trade deficit. In comparison with merchandise trade, non-factor services trade is relatively modest.

25. In 2000, freight, insurance, and transport services accounted for some 43% of total non-factor services imports, while tourism expenditures represented 34% of non-factor imports. The strength of the Mexican peso together with the favourable domestic economic conditions explain in large part the increase in expenditures for tourism activities, from US\$2.9 billion in 1997 to US\$5.5 billion in 2000. With respect to exports, the main source of revenue was tourism activities, which in 2000 generated 60% of non-factor services exports. Despite expanding merchandise trade, transportation services exports decreased slightly over the period, both in absolute value and share of total exports (Table I.4).

### **(iv) Foreign direct investment**

26. Mexico remained one of the main magnets for FDI in the developing world. Between 1997 and 2000, Mexico continued to receive important foreign direct investment (FDI) flows, which covered a large proportion of current account deficits. Over the period, the level of FDI inflows accounted for some 2.7% GDP on average. Between 1994 and 2000, the major magnets for FDI were: manufacturing (62% of total FDI flows); financial services (14%); and commerce (11%). FDI increased in most sectors, although from low base in primary activities, utilities, and construction (Table AI.5). By origin, the bulk of FDI flows came from the United States (some 63%); other significant FDI sources included the Netherlands (8.5%), and Canada and Japan (4.3% each) (Table AI.6). In recent years, Mexico had also become a sizable source of FDI flows.

## **(6) OUTLOOK**

27. Driven by the slowdown in the global economy, economic activity in Mexico during 2001 was weaker than anticipated; real growth was expected to be at best nil. The inflation rate for 2001 was 4.4%, significantly lower than its target level of 6.5%. With the exception of private consumption, expected to grow at a real rate of 2.9%, all components of aggregate demand were expected to contract during 2001, private investment and exports experiencing the strongest contraction (respectively 5.8% and 3.8%). Imports were also anticipated to decline by some 4%.

28. For 2002, in a context of high uncertainty in external markets, the Mexican economy was expected to grow at an annual real rate of 1.7%; with inflation meeting its targeted level of 3%. Investment was expected to be the most dynamic component of aggregate demand, driven by lower interest rates and by the promotion of public investment projects. Public sector deficit was expected to remain at a 0.65% of GDP, although increasing public investment spending, not counted in the traditional public finance balance, should increase the public sector borrowing requirements to 3.65% of GDP. Imports and exports of goods and services were expected to grow at rates of 1% and 2.4%.