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## Mexico In Transition

An economic success story is playing out south of the U.S. border. Mexico's economy is expected to grow by as much as 3.5 percent this year, and exports have climbed to all-time highs. More companies are moving their manufacturing operations to the country as it begins to churn out everything from iPhones to refrigerators. Newly elected Mexican President Enrique Pena Nieto has promised new growth through economic and political reforms, such as opening up the energy industry and fixing the education, telecom and tax systems.

Yet Mexico faces challenges ahead that could threaten to divert it from the path to greater prosperity. The country has deep social and economic divisions and problems of lingering violence from a prolific and extended drug trade.

For an update on Mexico, *OUTLOOK* turned to Alberto Diaz-Cayeros, director of the Center for U.S.-Mexican Studies at the University of California, San Diego. An expert in both Mexican politics and economics, Diaz-Cayeros splits his time between Mexico and the United States. He also has taught at Stanford University, UCLA and Instituto Tecnológico Autónomo de México in Mexico City.

***OUTLOOK:*** Give us an overview of what is happening in Mexico today.

**Alberto Diaz-Cayeros:** Economic indicators are up. The 1994 North American Free Trade Agreement has been very successful for Mexico, especially in the manufacturing and agribusiness sectors. After a deep recession in 2008, automotive and auto part production has quickly rebounded. As part of the pipeline envisioned in NAFTA, sophisticated car engines are now made in Mexico and then shipped to Canada or the United States, where the rest of the car is made. Carmakers are opening up factories all over Mexico, including European companies like VW, Renault and Seat.

Manufacturing also is up in other sectors outside automotive, including aerospace, medical equipment and consumer electronics. Mexico does not simply export low-value-added commodities such as oil, minerals or cement. The country has also seen export growth in food processing, such as bread and corn products, tomato and avocado growing, household appliances and cell phones.

# The Mexican economy has to find its own engine of growth by looking at opportunities internally. There's untapped potential in the country's growing middle class.

## About this article



Alberto Diaz-Cayeros is the director of the Center for U.S.-Mexican Studies at the University of California, San Diego. He also is an associate professor at the UCSD's Graduate School of International Relations and Pacific Studies, and an adjunct associate professor in the Political Science Department. An expert in both Mexican politics and economics, Diaz-Cayeros splits his time between Mexico and the United States. He also has taught at Stanford University, UCLA and Instituto Tecnológico Autónomo de México in Mexico City.

Mr. Diaz-Cayeros has a doctorate and master's in political science from Duke University.

### **OUTLOOK: What are the key drivers of the Mexican economy?**

**ADC:** The engine of growth is highly diversified in Mexico from light manufacturing or processing plants, called "maquiladoras," to technologically sophisticated electronics. Services have expanded not just in traditional sectors such as tourism but there is an increased presence of retailers in Central America and telecoms throughout South America. Agribusiness has also thrived in many areas of the country with exports of winter vegetables and poultry and meat.

The world commodity boom is also having an effect on mining for copper and silver. In fact, the third- and fourth-richest Mexicans have made their fortunes in mining. Mexico has the world's largest silver company as well the third-largest copper producer.

Maseca, the Mexican corn maker, has become a very successful multinational company with facilities in the Ukraine, England and the United States. An even more striking story is that of Bimbo, which purchased Sara Lee to become the largest baked goods product company in the United States. It's now expanding in China.

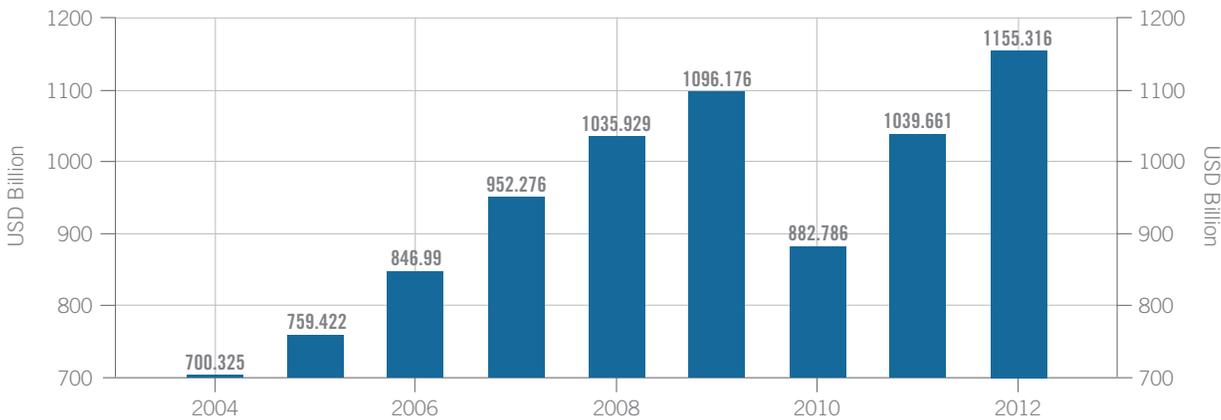
For the past eight years, the basic premise has been that the Mexican economy will grow only if the U.S. economy grows. If the U.S. has a crisis, then the Mexican economy slows down. Going forward, the Mexican economy has to find its own engine of growth by looking at opportunities internally. There's untapped potential in the country's growing middle class. Banks have been stable and lending at reasonable rates, allowing Mexican households to buy more consumables as well as housing. So we've seen Mexican movie theaters, restaurants and services thrive, as well as the construction industry.

### **OUTLOOK: What are the challenges the Mexican economy faces?**

**ADC:** Violence from drug trafficking will remain a big issue. The new administration has been very successful in creating a new image because reports of killings and violence are not being played up as much in the media. But there is no sign that things are really getting better. The drug market is extremely profitable. The new administration has yet to articulate a strategy for fighting the drug cartels.

## MEXICO'S GDP

The Gross Domestic Product in Mexico was worth \$1.2 trillion dollars in 2011 – an all-time high. The GDP value of Mexico represents 1.86 percent of the world economy.



Source: [www.tradingeconomics.com](http://www.tradingeconomics.com), The World Bank Group

The violence has impacted the economy. For example, a Stanford study looked at the impact that the drug trafficking had on electricity consumption. In Monterrey, the industrial powerhouse in the North, businesses were charged “derecho de piso” – a fee to operate by the drug traffickers. A lot of businesses didn’t want to pay so they just shut down. That caused a downturn in electricity consumption. Another Harvard study recently looked at the lack of female participation in the labor force. The violence caused 7 percent of women to stay home with their kids rather than risk their lives to go to work. There is economic growth that could have happened, if not for the violence.

Also, even though the new Pena Nieto administration has been trying to play up trade and deepen the relationship with the United States, there is still room for improvement. For instance, plenty of manufacturers who rely on speed want to reduce the time it takes for container ships filled with goods made in Mexican factories to get through the U.S. border. The process, which right now isn’t very efficient, can last up to 18 hours. One of the benefits for a U.S. company to manufacture in Mexico, rather than China, should be speed to market.

### **OUTLOOK: What about new opportunities?**

**ADC:** Opportunities are opening up in new sectors of the economy, such as oil and natural gas exploration and extraction. The energy sector in Mexico has been reserved exclusively to government monopolies (PEMEX in oil and CFE in utilities), but the incoming administration may be able to open those sectors to competition and foreign investment.

**OUTLOOK: What would the impact be for Mexico?**

**ADC:** Mexico identified about 10 years ago that deep sea oil drilling was going to be very important for oil companies. The country's state-owned oil monopoly, Pemex, said it would invest in new technologies to extract more oil. They did not do it.

The other big thing is the discovery of giant oil and gas fields in the Chicontepec basin near the border with the United States, which could be the fourth-largest reserves in the world. But tapping into it will require sophisticated technical expertise the national oil company does not have. The Chicontepec basin, due to its geological complexities, requires as many as 15,000 wells to be drilled. But it took Pemex 60 years to drill a few thousand oil wells. In other words, Pemex alone cannot extract that reserve; Mexico does not have the technology. If foreign companies are allowed to tap these resources, it could offer big economic growth. But it's still a contentious issue in Mexico because people question whether the government can really create the conditions for competition. If they substitute a public monopoly for a private one, will citizens really be better off? Furthermore, if oil tax revenues aren't collected in a transparent and effective manner, citizens will think that private and foreign companies are basically profiting at the expense of the Mexican people.

**MEXICO EXPORTS**

Mexico has an export-oriented economy and the total value of exports from the country increased to \$328 billion in April 2013. The exports of automobiles and related products have gained importance in recent years.



Source: [www.tradingeconomics.com](http://www.tradingeconomics.com), Instituto Nacional de Estadística Y Geografía

## WAGES UP IN MEXICO

The value of wages in Mexico decreased slightly in April 2013 to 269 pesos a day but has been steadily on the rise for more than a decade. In Mexico, wages are benchmarked using average daily earnings.



Source: [www.tradingeconomics.com](http://www.tradingeconomics.com), Secretariat of Labor & Social Welfare, Mexico

**OUTLOOK: The International Monetary Fund predicts Mexico's economy will grow at 3.5 percent this year. How strong is that on a relative basis?**

**ADC:** We should keep the 3.5 percent growth rate in perspective. It's feasible Mexico could grow around 3.5 percent this year; it has been growing around 2 to 2.5 percent over the previous years, even during the big global downturn. But that growth rate has been among the worst of any Latin American country except Venezuela. So the Mexican growth looks reasonable compared with the U.S. or Europe. But Mexico should be growing at the rate of its peers. Now, if gas and oil reforms get started, we will see growth rates of 4 percent to 5 percent.

**OUTLOOK: The economic situation in Mexico looked bleak just a few years ago. What turned it around?**

**ADC:** I don't think a lot of the fundamentals have really changed in Mexico. What really changed is the perceptions of international actors with stakes in Mexico. International investors really turned to Mexico as the perils of Brazil became more obvious. The peso appreciated, more capital flowed into financial instruments and the stock exchange. But I think the Mexican economy is pretty much the same one from a few years ago.

Washington is focused on the immigration debate and the Arizona law instead of on trade and economics.

***OUTLOOK: Is the government stable?***

**ADC:** I don't think we'll see any major turmoil or challenges in the next few years. The Mexican political system has no elections at the state level during the first two years after a federal election, so it's very easy to create coalitions to pass reforms. There is, however, a question as to whether the lack of security from drug violence will give birth to paramilitary groups or community police forces in indigenous communities. Those groups promise to protect locals from drug lords but they are heavily armed. In at least one community, Cheran, such a group canceled an election at a municipal level. They said, 'We don't want there to be an election. We will just say who our new mayor will be.'

***OUTLOOK: What should the U.S. do to enhance its relationship with Mexico?***

**ADC:** I don't think the Obama administration has put very much attention on Mexico. Washington, D.C. is very much out of touch with what the governors of the border states are thinking about. States like Texas and Arizona are paying attention to investments in energy and manufacturing and they're worried about violence in Mexico creeping in. Washington is focused on the immigration debate and the Arizona law instead of on trade and economics.

***OUTLOOK: What about U.S. industries that rely on Mexican labor? What impact does solid economic growth in Mexico have on them?***

**ADC:** If Mexico starts to grow at 4 percent to 5 percent, there will be fewer Mexicans wanting to migrate to the U.S. That will have an impact on agricultural labor and spawn a push for legislation for more guest worker visas. Already, it's far more difficult than ever to get into the United States. In fact, the Obama administration has deported more Mexicans than the Bush administration. For the first time, we've seen fewer Mexicans come in to the United States than Mexicans who have left America.

That impacts the seasonal need of agricultural labor in the California central valleys. If Mexicans are finding well-paid jobs in agribusiness at home, they will not take the risk of coming here unless the U.S. devises some new form of legal temporary work with visas and fewer risks. You can expect agricultural producers in the U.S. will push for such legislation.

## MEXICO AT A GLANCE



GDP: \$1.177 trillion (2012 estimate)

GDP growth: 3.5 percent in 2013 (projected)

- Economy is the 13th largest in the world in nominal terms and 11th by purchasing power parity, according to the World Bank.
- Sixth-largest electronics industry in the world.
- Second-largest exporter of electronics to the United States (\$71.4 billion worth of electronics in 2011).
- Third-largest manufacturer of computers in the world.
- Sixth-largest oil producer in the world, with 3,700,000 barrels per day.

**OUTLOOK:** *You say that Mexico is shedding its image of cheap labor. Yet experts are predicting that the nation's average wages of \$3.50 an hour are going to be cheaper than China's in the next five years or so. What do you think of that?*

**ADC:** That average wage hides a huge variation that covers everything from unskilled labor to engineers. And although the cost of Chinese labor is going up, there will always be cheaper places than Mexico to source low-skill manufacturing – places like Honduras, Haiti and Bangladesh.

Going forward, Mexico has to compete on productivity.

**OUTLOOK:** *Mexico is characterized by sharp class and social divisions and is a country in which a small wealthy class controls much of the property and wealth. Does recent new economic growth promise to change this?*

**ADC:** Poverty has decreased in the country as a whole. One scenario that is worrisome, however, is if Mexico grows, it could create a North that is developed and a South that's left behind. The opportunities in mining, agriculture, light manufacturing or even in non-tradable services like tourism will not be reaped in the South, which has an agricultural economy with a few profitable exports such as coffee or raw materials like oil that are subject to the typical fluctuations of commodity prices.

The southern region has very bad ports, few railroads or good roads to move product to the world markets. Sustained development there requires closing the gap in education, infrastructure, basic public services like drinking water and sanitation so businesses can see opportunities to invest and produce in those regions. That all makes for fertile ground for insurgency or other armed expressions of discontent. It's not a visible or immediate danger but possible over the long run.

**OUTLOOK:** *What's the most important thing the U.S. should be doing today to establish a strong, productive relationship with Mexico for the long term?*

**ADC:** The U.S. must focus on more than one politically salient issue at a time when it comes to Mexico. It won't be easy for the two countries to agree on policies to shared problems. But there are a series of important issues, including economic integration, security, migration, and environmental management that require joint solutions. And it's really in the best interest of the United States to have a stable, successful neighbor to the south who can help expand U.S. exports and ensure energy security long into the future. ■

# Interest Rates and Economic Indicators

The interest rate and economic data on this page were updated as of 5/31/13. They are intended to provide rate or cost indications only and are for notional amounts in excess of \$5 million except for forward fixed rates.

## KEY ECONOMIC INDICATORS

Gross Domestic Product (GDP) measures the change in total output of the U.S. economy. The Consumer Price Index (CPI) is a measure of consumer inflation. The federal funds rate is the rate charged by banks to one another on overnight funds. The target federal funds rate is set by the Federal Reserve as one of the tools of monetary policy. The interest rate on the 10-year U.S. Treasury Note is considered a reflection of the market's view of longer-term macroeconomic performance; the 2-year projection provides a view of more near-term economic performance.

## ECONOMIC AND INTEREST RATE PROJECTIONS

Source: Insight Economics, LLC and Blue Chip Economic Indicators

### US Treasury Securities

	2013	GDP	CPI	Funds	2-year	10-year
Q2		1.70%	1.10%	0.10%	0.25%	1.88%
Q3		2.30%	2.10%	0.13%	0.31%	2.01%
Q4		2.60%	2.00%	0.15%	0.39%	2.20%
2014	GDP	CPI	Funds	2-year	10-year	
Q1		2.70%	2.00%	0.18%	0.47%	2.39%
Q2		2.80%	2.10%	0.22%	0.62%	2.58%

## PROJECTIONS OF FUTURE INTEREST RATES

The table below reflects current market expectations about interest rates at given points in the future. Implied forward rates are the most commonly used measure of the outlook for interest rates. The forward rates listed are derived from the current interest rate curve using a mathematical formula to project future interest rate levels.

## IMPLIED FORWARD SWAP RATES

Years Forward	3-month LIBOR	1-year Swap	3-year Swap	5-year Swap	7-year Swap	10-year Swap
Today	0.28%	0.33%	0.65%	1.20%	1.72%	2.29%
0.25	0.30%	0.38%	0.76%	1.33%	1.85%	2.39%
0.50	0.35%	0.44%	0.89%	1.45%	1.96%	2.49%
0.75	0.41%	0.51%	1.00%	1.59%	2.08%	2.58%
1.00	0.48%	0.58%	1.12%	1.71%	2.20%	2.68%
1.50	0.62%	0.82%	1.41%	1.99%	2.43%	2.86%
2.00	0.88%	1.06%	1.72%	2.27%	2.62%	3.05%
2.50	1.19%	1.37%	2.02%	2.56%	2.85%	3.21%
3.00	1.51%	1.67%	2.33%	2.85%	3.08%	3.36%
4.00	2.20%	2.39%	2.84%	3.22%	3.44%	3.64%
5.00	2.77%	2.95%	3.31%	3.49%	3.71%	3.84%

## HEDGING THE COST OF FUTURE LOANS

A forward fixed rate is a fixed loan rate on a specified balance that can be drawn on or before a predetermined future date. The table below lists the additional cost incurred today to fix a loan at a future date.

## FORWARD FIXED RATES

### Cost of Forward Funds

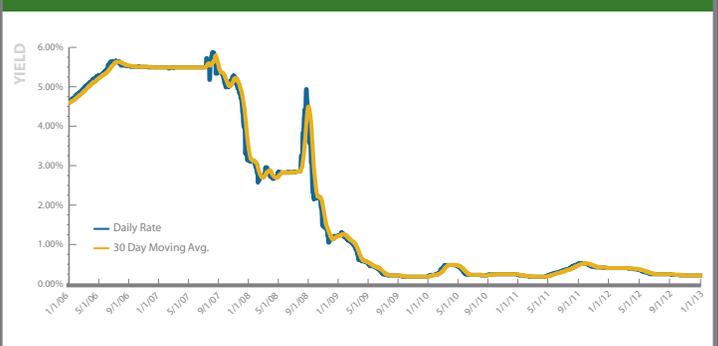
Forward Period (Days)	Average Life of Loan			
	2-yr	3-yr	5-yr	10-yr
30	5	5	6	5
90	9	13	16	12
180	14	22	28	23
365	36	48	58	44

Costs are stated in basis points per year.

## SHORT-TERM INTEREST RATES

This graph depicts the recent history of the cost to fund floating rate loans. Three-month LIBOR is the most commonly used index for short-term financing.

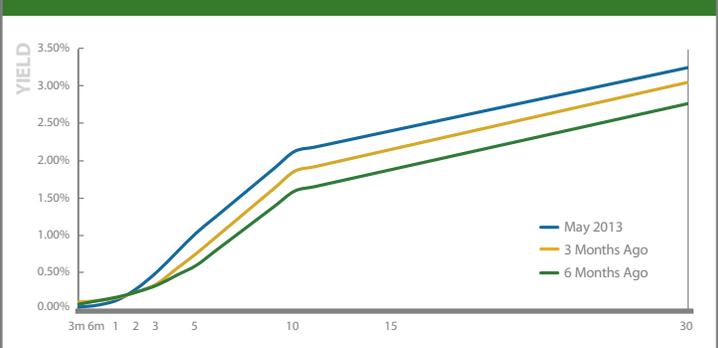
## 3-MONTH LIBOR



## RELATION OF INTEREST RATE TO MATURITY

The yield curve is the relation between the cost of borrowing and the time to maturity of debt for a given borrower in a given currency. Typically, interest rates on long-term securities are higher than rates on short-term securities. Long-term securities generally require a risk premium for inflation uncertainty, for liquidity, and for potential default risk.

## TREASURY YIELD CURVE





### About CoBank

CoBank is a \$95 billion cooperative bank serving vital industries across rural America. The bank provides loans, leases, export financing and other financial services to agribusinesses and rural power, water and communications providers in all 50 states. The bank also provides wholesale loans and other financial services to affiliated Farm Credit associations serving farmers, ranchers and other rural borrowers in 23 states around the country.

CoBank is a member of the Farm Credit System, a nationwide network of banks and retail lending associations chartered to support the borrowing needs of U.S. agriculture and the nation's rural economy.

Headquartered outside Denver, Colorado, CoBank serves customers from regional banking centers across the U.S. and also maintains an international representative office in Singapore.

For more information about CoBank, visit the bank's web site at [www.cobank.com](http://www.cobank.com).

*Commentary in Outlook is for general information only and does not necessarily reflect the opinion of CoBank. The information was obtained from sources that CoBank believes to be reliable but is not intended to provide specific advice.*

## CoBank Announces Renewal Of "Sharing Success" Charitable Contribution Program

CoBank announced this month that it is renewing its "Sharing Success" program in 2013.

The bank's board of directors has approved the commitment of \$3 million to match charitable contributions made by cooperative customers between now and the end of the year. The bank will match donations on a dollar-for-dollar basis, from a minimum of \$1,000 up to a maximum of \$5,000 per customer. CoBank first launched the program in 2012 in conjunction with the International Year of Cooperatives.



*Robert B. Engel*

"The response from customers to our Sharing Success program last year was overwhelming," said Bob Engel, CoBank's president and chief executive officer. "Over 600 cooperatives from all the industries we serve ended up taking part, joining with CoBank to support worthy causes across rural America. We're delighted that our board has agreed to renew Sharing Success this year, and we hope even more customers will take advantage of the program in 2013."

CoBank will begin formally accepting applications for funding from customers on August 1, 2013. The program will run through November 30, 2013 or the point when the fund is exhausted, whichever comes first. Cooperatives interested in participating should contact their CoBank relationship manager for an application and detailed program requirements.

"The principles of concern for community and cooperation among cooperatives are central to the cooperative model," Engel said. "The Sharing Success program has been so successful because it embodies both of these important ideas. We look forward to working with our customers in the months ahead in order to help people in need and strengthen their local communities."

Additional information about the "Sharing Success" program, along with an application form, is available at [www.cobank.com/sharingsuccess](http://www.cobank.com/sharingsuccess). ■