

LATIN AMERICA ECONOMICS UPDATE

6th May 2009



Mexico facing deep recession – regardless of swine flu

- Our initial assessment was that the damage to the Mexican economy and financial markets from swine flu would probably be small and short-lived. Developments in the last week have supported that view. But **Mexico is still facing a deep recession as a result of the slump in global commodity prices and the collapse in the US economy.** The longer-term impact of swine flu on tourism also remains a big unknown.
- As of this morning Mexico has reported 1,122 laboratory-confirmed human cases of infection including 42 deaths. This is well below earlier estimates that more than 150 people had died of *suspected* swine flu. Any loss of life is a tragedy and there is still uncertainty over what might happen next. Nonetheless, based on the medical evidence so far, **the swine flu virus is proving much less dangerous than originally feared.**
- **People were advised to stay at home and non-essential public services were closed from Friday to Tuesday. However, these five days were essentially a long holiday weekend from Labor Day to the Cinco de Mayo celebrations.** Many businesses, such as factories and banks, would therefore have been closed anyway. As for the rest, the advice to stay at home was only partially followed in Mexico City and largely ignored in much of the rest of the country. Finally, some economic activity – notably consumer spending – will simply have been delayed rather than lost altogether. The net impact on the economy from the partial shutdown is likely to be no more than a rounding error in the annual GDP data.
- However, **we remain concerned about the longer-term damage to tourism.** The industry was already suffering from bad publicity over drug-related crime and the impact of the global recession (particularly in the US). In recent years, tourism has accounted for as much as 9% of Mexico's GDP. Admittedly this figure includes spending by domestic tourists travelling within the country as well as that by foreign visitors, but both will be hit to some degree. At the very least, spending by foreign visitors will fall sharply. This was estimated at \$13.3bn in 2008, equivalent to around 1.2% of last year's GDP. **A plausible six-month boycott by foreign visitors could therefore reduce GDP by 0.6%** (and probably by at least 1.0% once the multiplier effects of this lost spending on the rest of the economy are taken into account).
- **The crucial question is therefore how soon tourists return, and in what numbers.** The recent precedents from elsewhere are reassuring. In the last few years many countries and cities have been victims of natural disasters (such as the Asian tsunami), health scares (SARS and avian flu) and terrorism (including Bali, New York, Madrid and London). Visitor numbers have typically recovered quickly when the story has dropped off the front pages. **One factor to watch will be when the advice against "non-essential" travel to Mexico is withdrawn.** This seems likely to happen sooner rather than later, given the growing medical evidence and the views of organisations like the WHO, which have continued to argue against travel or trade bans.
- In the meantime, **the Mexican government has at least moved quickly to support the most vulnerable parts of the economy.** Officials have estimated the cost of the crisis at between 0.3% and 0.5% of GDP (significant but manageable). They hope that a package of support for small businesses and the tourist sector worth 17.4bn pesos (0.15% of GDP) will keep the total impact towards the bottom of this range. That may well prove to be too optimistic if tourists continue to stay away, but public finances are relatively healthy and more could be done if required.
- Nonetheless, it is important not to lose sight of the fact that **Mexico is facing a deep recession as a result of the slump in global commodity prices and the collapse in the US economy.** In this respect, the markets look complacent. Mexican equities have resumed their rally since global risk appetite began to recover in early March and are now trading at new highs for the year. The peso is only a touch below its mid-April peak against the US dollar. However, the Finance Ministry has already estimated that GDP fell by around 7.0% y/y in the first quarter. (Official data will be released on 20th May.) Even our forecast of a 5.0% decline in 2009 as a whole may now not be pessimistic enough.

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