

# Mexican peso's nosedive seen as heralding total financial blowout

by Peter Rush

Mexico plunged once again into monetary and financial chaos, with the nosedive of the value of the free market peso in Mexico on Wednesday, Nov. 18. While the drop was intended to inhibit capital flight and protect the nation's reserves, it is more likely to heighten overall perception that a total blow-out is in the works, which will fuel both capital flight and inflation.

Doing nothing would have permitted an accelerating run on dollar reserves, but the action taken may be no better than the alternative. Many people fear that a "new 1982" may have begun, referring to the monetary collapse of that year touched off by a similar devaluation. None is commenting on the fact that the underlying health of the economy is immeasurably worse now than then.

Moreover, it comes just as both Argentina and Brazil are also facing runaway inflation, economic crisis, and constant danger of debt defaults. Despite appearances, Mexico could find the much-touted "success story" of its deal with the banks unraveling in short order, as the effects of the peso devaluation and the collapse of the stock market bubble work their way through the economy.

It was in response to very heavy capital flight during the last weeks that the Central Bank of Mexico announced the evening of Nov. 17 that as of the next morning, it would cease to support the peso on the free market. By noon Nov. 18, the peso had fallen to between 2,200 and 2,700 to the dollar, from 1,700 the night before. By Nov. 19, it was selling at up to 5,000 along the U.S. border. At the same time, interest rates, which had moved up 6-7 points in the previous two weeks to about 105%, jumped another 8-10 points to around 115% for 91-day Treasury Certificates (Cetes) by Thursday.

Neither the central bank nor Finance Minister Gustavo Petricioli has revealed the extent of either capital flight or the drop in reserves in recent weeks. It is generally agreed that capital flight has been on the order of \$80 million daily, or \$400 million weekly, though nobody has said exactly for how many weeks this may have been going on. In his address to the Mexican Congress Nov. 19, Petricioli denied that capital flight had exceeded \$1.5 billion, and claimed that central bank reserves were still around \$15 billion, "the highest level in Mexican history."

However, most reports say that the reserves are believed to have fallen at least \$1 billion over the last few weeks to cover a run out of pesos into dollars, which have then left the country, and the *Wall Street Journal* Nov. 20 reported that the reserves are believed to have fallen by closer to \$2 billion, from \$16 to \$14 billion. Petricioli conceded that there must have already been heavy losses when he said that "the speculative movements had begun to threaten our level of reserves," and that there had been "drastic increases" in the demand for dollars from people fleeing the stock market.

The Mexican government's response to the fall, expressed through Petricioli, has been to assure all and sundry that everything is under control and the "fundamentals" of the economy are sound. In his televised remarks Nov. 18, Petricioli said the main problem had been speculators fleeing the stock market trying to take dollars out of the country. He made clear that the official rate of exchange, which all importers and exporters are compelled to use, had not been devalued, and remained in the range of 1,720. He said that "as the speculative factors diminish, the free-market peso will rise and there will be a convergence of the two rates." Saying that "we have made a great effort to increase internal savings," largely by the sharp rises in the interest rates, he said the measures are aimed "to begin a period of recovery with greater stability in the future."

The next day, the widely read *Excelsior* wrote in a page-one editorial, "The country launches itself one more time into a monetary whirlwind, like a modern-day Sisyphus" condemned to eternally repeat the past. Other analysts pointed out that the similar measures of 1982 led to increased capital flight after a devaluation, as confidence evaporated. The *Wall Street Journal* speculated that "the psychological effect of the sudden drop in the peso's value could trigger more capital flight and a further drain on reserves."

The underlying problem, however, is not the financial parameters, but the basic health of the economy. Until Oct. 9, there had been but two pillars propping up the façade that the Mexican economy was somehow working—the stock market and the non-petroleum export boom. Beginning 10 days before the crash in New York on Oct. 19, the first bubble burst, as the market which had risen eightfold in nine months based on nothing but speculative mania collapsed 74% to a

level, in inflation-adjusted pesos, 14% below the level of Jan. 1. Largely as a result of that crash, speculators sought to turn their remaining pesos into dollars and park them outside the country.

However, no one believes that the government can maintain such an enormous differential between the official rate and the free-market rate for very long. The incentive of cash-strapped companies to under- and over-invoice, in order to get dollars with which they can buy pesos at the free-market rate—and make a 50-100% profit off the top—will rapidly lead to distortion in the foreign trade arena. A major devaluation of the official rate is widely expected.

But such a devaluation would make imports more expensive, stoking the already superheated fires of inflation. It would also make foreign debt payments, which also use the official rate, much more expensive. The immediate effect on the federal government deficit alone would be to raise the peso cost of the debt by the percentage of the devaluation. But the budget already makes the U.S. budget deficit problems look minor, as fully 33% of the entire federal budget of Mexico is scheduled to come from borrowings, mostly internally. Most of this deficit is ultimately covered by simply printing money, which is one main cause of the inflation, and a devaluation of the official peso would exacerbate the government's necessity to print money.

What nobody is recognizing, at least publicly, is that the second pillar of President Miguel de la Madrid's economic "success," the export boom, has been built on the deepening poverty of Mexicans. It is generally conceded that real incomes have fallen at least 50% since de la Madrid came to power five years ago. The internal consumer market has evaporated, and those companies that have survived now produce mainly for the export market, enabled to sell their goods, largely to the United States, at absurdly low prices thanks to a sharply undervalued peso. Imports are correspondingly very expensive, limiting both consumer goods and capital goods import. The collapse of the internal market is the true fundamental reason for the escalating inflation, which grows as consumption falls. According to the president of the Mexican Confederation of Sales Executives, Eduardo Rodríguez Flores, sales of such products as food, clothing, shoes, home items, pharmaceuticals, paper, books, etc., are off 25% in 1987 alone, and the purchasing power of the minimum wage has fallen 42% in the same period.

Hence, and all observers concur, inflation, already at 140% (having been 95% in 1986), will shoot up further on expectations of further devaluations, in response to increasingly insistent wage demands from labor, increasing cost of imports, and all the other factors now operating. A hyperinflationary spiral is in the making. But this will ensure that the pressure of flight capital will not only not be curbed by the devaluation, but will grow ever more intense in the weeks and months ahead. And that pressure will keep the free-market peso value falling. So far, it is not at all clear that

either Petricioli nor his critics understand the magnitude of the problem they face. But many bankers, both in Mexico and the United States, are privately very pessimistic.

### The Argentine case

The fundamentals of the Argentine economy are quite similar to Mexico's, the difference being that, in contrast to Mexico, Argentina has virtually no reserves. On Nov. 19, the economics ministry announced that following secret negotiations with the International Monetary Fund, a new pact had been worked out, by which Argentina would only have to keep its budget deficit to within 5.6% of the gross domestic product, instead of the 4% previously agreed upon last July. However, the government of President Raúl Alfonsín committed itself to passing a tax increase package through the Argentine Congress as part of the agreement, upon which meeting even the 5.6% target depends. The package will increase taxes an astounding 6% of the GDP, equivalent to \$4.5 billion.

There is intense opposition to the tax package throughout the country and in Congress. The first two efforts to introduce the tax package bill have been thwarted by the Peronist legislators and a few others who have boycotted the sessions, robbing them of a quorum. The Argentine Industrial Union, representing the business sector, has told Finance Minister Sourrouille to drop the entire package.

As in Mexico, there have been steep declines in real purchasing power, as real wages have fallen due to accelerating inflation. The difference is that falling domestic sales have not been compensated with exports. Inflation has already entered the hyperinflationary stage, with overall consumer prices rising 19% in October, and wholesale prices an astounding 30%. With these rates, the entire fiscal and financial structure is on the eve of the kind of total blowout that is still only on the horizon for Mexico.

# SILVER

## SHORT SQUEEZE

**● WHO? ● WHAT? ● WHY? ●**

Not what you think! Daily limits soon. Exchange cannot stop this one because it is different. **Send \$5 to SIBBET for information. He is the one advisor who predicted the other two squeezes.**

**SIBBET PUBLICATIONS**  
1091 E. WOODBURY RD., PASADENA, CA 91104

Name \_\_\_\_\_

Address \_\_\_\_\_

Zip \_\_\_\_\_