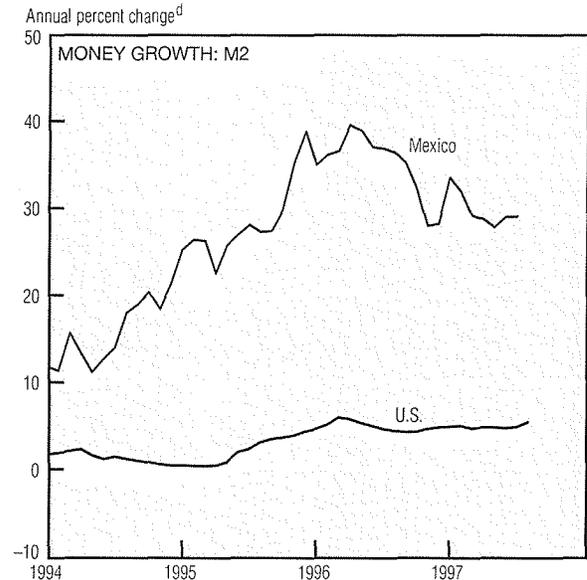
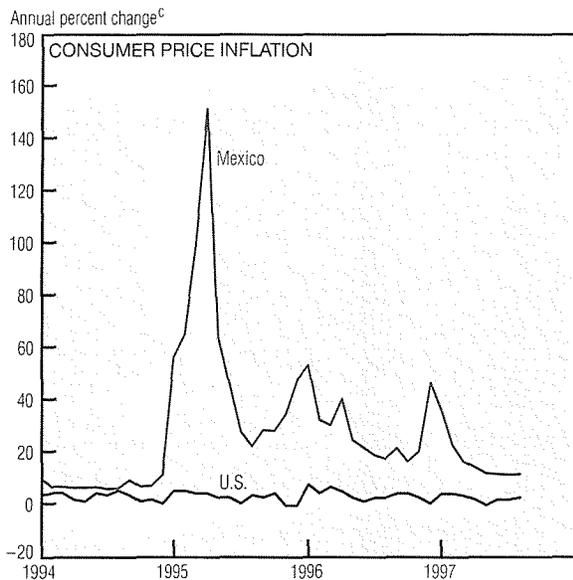
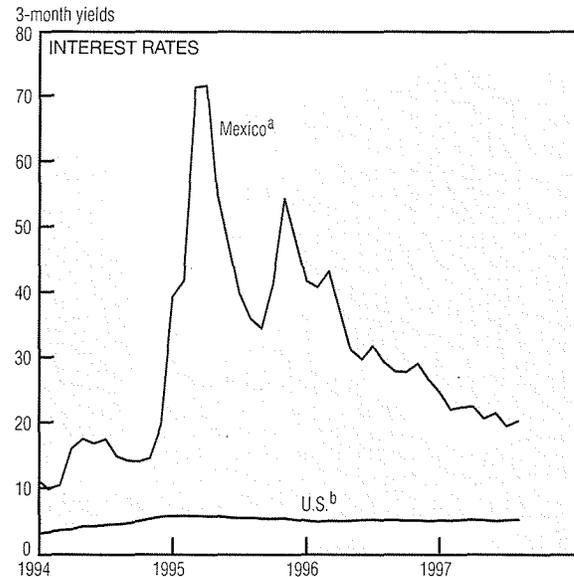
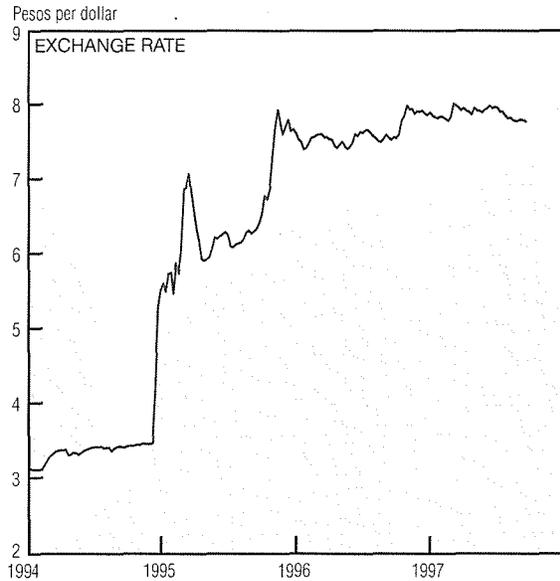


The Mexican Economy



- a. Treasury certificates, 3-month.
b. Government bond yield, 3-month.
c. Calculated on a month-over-month basis, annual rate, not seasonally adjusted.
d. Calculated on a year-over-year basis, not seasonally adjusted.

SOURCES: U.S. Department of Labor, Bureau of Labor Statistics; Board of Governors of the Federal Reserve System; Federal Reserve Bank of New York; and Bank of Mexico.

On September 22, the Bank of Mexico announced that it was taking policy actions designed to lower Mexican interest rates so as to reduce capital inflows and decrease international demand for the peso. This action should help lower the peso's price relative to other currencies. At the time of the announcement, the value of the peso in terms of U.S. dollars was strengthening and had reached a high not seen since late 1996.

A stronger peso makes Mexican exports more expensive for foreign-

ers, ultimately damaging the nation's current account balance (the difference between the value of Mexico's exports of goods and services and the value of its imports). Most analysts were predicting that Mexico's current account balance would deteriorate next year.

The new policy might prevent a repetition of the crisis of late 1994 and 1995, when capital flew out of Mexico in response to a variety of factors, including the perception that Mexico's current account balance was inconsistent with its exchange rate peg. As a practical matter, sus-

taining a current account deficit requires capital inflows, which are sensitive to news about the relative attractiveness of investing abroad.

Before the recent crisis, the attractiveness of the peso to overseas investors had been damaged by the perception that the Mexican economy was accumulating bad debts, mirroring the recent situation in Southeast Asia. In both instances, the bad debts were attributed to massive capital inflows that led to excessive consumer spending and unwise bank lending.