10-100

mexico

EW
STB
JP
IO
F

Rcv: @1IM/5.07514 Line: 5

RECEIVED
IMF CABLE ROOM

DEC 30 1986 1529
440040 FUND UI

1986 DEC 30 PM 4:26

1773050 BMCKME   748705
30/12/86 14:28:28
NOTE:ACTUALLY BANCO DE MEXICO HAVE TELEFACSIMIL SERVICES
(5129990 NUMBER)IF YOU HAVE THE SAME SERVICES PLEASE NOTIFY
US YOUR TELEPHONE NUMBER AND GROUP CODE

ORIG: TRE
CC: MR. ORTIZ
WHD

T 92 MEXICO D F 30 DIC 86 CMF   RVL

TREASURER
INTERFUND
WASHINGTON DC

REF FRK/86/T-80

NO. 39

TEST [redacted]

MEXICO WISHES TO ACQUIRE SDR 50,300.000 AGAINST A FREELY USABLE
CURRENCY PREFERABLY U.S. DOLLARS TO PAY SEMI-ANNUAL CHARGES IN THE
GENERAL RESOURCES ACCOUNT FOR THE PERIOD ENDING DECEMBER 31ST., 1986
IN A TRANSACTION TO BE ARRANGED BY THE FUND VALUE JANUARY 15TH.,
1987.

BANXICO

30/12/86 14:30:08

440040 FUND UI

1773050 BMCKME

REPLY VIA ITT

FOR YOUR 1987 HOROSCOPE CALL USA 472222+ CODE 1400

?
Time: 15:43 12/30/86 ???
Connect Time :   137 seconds

1986 DEC 31 AM 8:34

INCOMING CABLE/TELEX

TEST NUMBER: [redacted]
☑ CHECKS
☐ DOES NOT CHECK, IT HAS BEEN SERVICED.
KG
CABLE ROOM

EW
S7B
JP
10

Office Memorandum

INTERNATIONAL MONETARY FUND
WESTERN HEMISPHERE DEPT

1986 DEC 30 PM 4: 31

TO: Mr. Beza

December 30, 1986

FROM: C. M. Watson CMW

SUBJECT: Mexico--Burden Sharing

As part of the work on "options," we have been studying the effect on burden sharing between banks in major creditor countries of applying a cut-off point to different levels of bank exposure. The results for Mexico appear to be at odds with the common perception that national shares would change as the cut-off level is raised:

Relative Shares of Banks by Nationality
in Exposure to Mexico as of August 1982

(In percent)

	Top 100	Top 200	Top 300	Top 400	Top 500	All 524
United States	37.6	37.9	38.0	37.8	37.7	37.7
Japan	21.1	18.6	17.8	17.5	17.4	17.4
United Kingdom	9.5	9.9	10.1	10.2	10.2	10.2
Canada	9.2	8.1	7.8	7.7	7.7	7.7
France	7.6	7.4	7.5	7.5	7.5	7.5
Germany	4.1	4.2	4.0	4.0	4.0	4.0
Switzerland	3.0	2.6	2.6	2.7	2.7	2.7
Other countries	7.9	11.3	12.2	12.6	12.8	12.8
Total	100.0	100.0	100.0	100.0	100.0	100.0

Thus, significant changes in relative exposure do not occur on eliminating the 124 banks with the smallest exposures (i.e., the Top 400 banks). Even the elimination of 224 banks (i.e., the Top 300 banks) does not affect substantially the pattern of national burden sharing.

This analysis suggests that the approach of setting an absolute or tapered cut-off point for the top 300 banks would mainly pose burden sharing problems within national groups of banks rather than between them. This pattern of national burden sharing would remove one complication from the problems associated with the option of a cut-off point for banks with small exposures.

cc: Mr. Finch
Mr. Guitian

Mexico

F✓

INTERNATIONAL MONETARY FUND
WASHINGTON, D.C. 20431

FACSIMILE NUMBERS
Group 2/3 (202) 623-4661
Group 2/3 (202) 623-4662
Group 2/3 (202) 623-7491

cc's sent to Leg. Mr. Seland
ETR Mr. Watson

Facsimile Service Cover Sheet

Number of pages (including cover sheet)	Message number	Date
1		December 22, 1986

To

Name of addressee (type)

Mr. Alfred Mudge
Shearman and Sterling

Facsimile telephone number
212/ 750-8671
212/ 838-2346
212/ 752-0371

From

Name of sender (type)

Eduardo Wiesner
International Monetary Fund
(202) 623-8628

Text or special instructions

Alfred:

As per our conversation last Thursday

Eduardo

Department and division (type)	Extension (type)
Western Hemisphere, ImmediateOffice	8628
Authorized by (type)	**Signature**
Eduardo Wiesner	

SEC-56, Rev. 1
11-13-85

Office Memorandum

To: Mr. Alfred Mudge

Date: December 19, 1986

From: E. Wiesner E.W.

Subject: Mexico - Multi-Facility Agreement

We have the following comments on the discussion draft of December 2, 1986:

1. Page 1-25, definition of IMF Stand-by Arrangement, line 3: substitute November 19, 1986 for November 17, 1986.

2. Page 2-6, first paragraph, lines 14-18: delete until end of sentence. Possible rejection of Fund certificate is not consistent with appropriate role for Fund, as envisaged in term sheet.

3. Page 7-3, paragraph (j), line 5: substitute "Article XXVI" for "Article XXIII."

4. Page 12-3, paragraph (j), line 5: same comment as in 3.

5. Certificates generally. Delete individual reference to "J. de Larosiere" as sender or signatory.

6. Exhibit 1, paragraph 2, line 1: substitute "provisions" for "the observance of the performance clauses", and
line 3: substitute "until" for "ending on" after "period".

7. Exhibit 11: delete numbered paragraphs (1) and (4), and make consequential changes in Exhibit 12, p. 2, last paragraph, last sentence. The material refers to borrowing requests which are not within the special knowledge of the Fund.

mexico

Rcv: @1IM/5.07211 Line: 5 INTERNATIONAL MONETARY FUND WESTERN HEMISPHERE DEPT.

RECEIVED
IMF CABLE ROOM
1986 DEC 19 PM 10: 35

DEC 19 1986 2015
440040 FUND UI

747643
1986 DEC 22 PM 1:07

1772669 BMCJME
19/12/86 19:10:00
NOTE:ACTUALLY BANCO DE MEXICO HAVE TELEFACSIMIL SERVICES
(5129990 NUMBER)IF YOU HAVE THE SAME SERVICES PLEASE NOTIFY
US YOUR TELEPHONE NUMBER AND GROUP CODE

ORIG: TRE

CC: DMD
MR.ORTIZ
ETR
FAD
LEG
RES
SEC
WHD

EW
STB
JO
JP
F

T 112 MEXICO DF DEC 19 1986 GGA RVL
INTERNATIONAL MONETARY FUND
WASHINGTON D.C.

NO. 37

REFERENCE YOUR TELEX NO. OCRA4672 DATED DECEMBER 17, 1986.

1. AS FISCAL AGENCY FOR THE GOVERNMENT OF MEXICO WE DESIRE TO PURCHASE FROM THE INTERNATIONAL MONETARY FUND SDR 112,500,000 AND THE EQUIVALENT OF SDR 112,500,000 IN U.S. DOLLARS TOTALING THE EQUIVALENT OF SDR 225,000,000 IN ACCORDANCE WITH TERMS OF ARTICLE V, SECTIONS 3 AND 4 AND WITH STAND-BY ARRANGEMENT EFFECTIVE NOVEMBER 19, 1986.
2. WE DO HEREBY REPRESENT THAT THIS PURCHASE IS NEEDED IN ACCORDANCE WITH THE PROVISIONS OF FUND AGREEMENT.
3. PLEASE CREDIT MEXICO'S SDR ACCOUNT WITH SDR 112,500,000 ON VALUE DATE OF PURCHASE.
4. PLEASE ARRANGE PAYMENT OF U.S. DOLLARS TO OUR ACCOUNT WITH FEDERAL RESERVE BANK OF NEW YORK, NEW YORK ON VALUE DATE OF PURCHASE.
5. THE EQUIVALENT OF DESIRED PURCHASE, NAMELY MEXICAN PESOS 133,459,873,064.83 WILL BE CREDITED TO FUND'S NO. 1 ACCOUNT WITH OURSELVES ON THE VALUE DATE OF PURCHASE.
6. REGARDING SERVICE CHARGE, PLEASE DEBIT MEXICO'S SDR ACCOUNT WITH SDR 1,125,000 ON VALUE DATE OF PURCHASE.
7. PLEASE ARRANGE TO CREDIT OUR ACCOUNT WITH THE FEDERAL RESERVE BANK OF NEW YORK IN NEW YORK WITH U.S. DOLLARS EQUIVALENT TO SDR 111,375,000 ON VALUE DATE OF PURCHASE.
8. WE STATE THAT ANY USE OF SDR AT THIS TIME UNDER ARTICLE XIX, SECTION 2 (A) IS IN ACCORDANCE WITH SECTION 3 (A) OF THIS ARTICLE.
9. HOWEVER, WE AUTHORIZE YOU TO ARRANGE ON OUR BEHALF FOR ALL OR PART OF THIS AMOUNT TO BE SOLD TO PARTICIPANTS OR PRESCRIBED HOLDERS THAT AGREE TO ACQUIRE THEM UNDER ARTICLE XIX, SECTION 2 (B).

TEST [redacted]

REGARDS,

BANXICO
19/12/86 19:15:00

440040 FUND UI

1772669 BMCJME
REPLY VIA ITT

TEST NUMBER:
☑ CHECKS
☐ DOES NOT CHECK, IT HAS BEEN SERVICED.
KG
CABLE ROOM

INCOMING CABLE/TELEX

mexico

Rcv: @1IM/5.07210 Line: 5

RECEIVED
IMF CABLE ROOM

1986 DEC 19 PM 10: 36

1986 DEC 22 PM 1: 07

747644

EW
S1B
IO
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DEC 19 1986 1917
440040 FUND UI

1773050 BMCKME
19/12/86 18:13:37
NOTE:ACTUALLY BANCO DE MEXICO HAVE TELEFACSIMIL SERVICES (5129990 NUMBER)IF YOU HAVE THE SAME SERVICES PLEASE NOTIFY US YOUR TELEPHONE NUMBER AND GROUP CODE

INCOMING CABLE/TELEX

ORIG: TRE

CC: MR. ORTIZ

WHD

T 108 MEXICO DF DEC 19 1986 GGA CMF
TREASURER
INTERFUND
WASHINGTON, D.C.

VERY URGENT

REF.: JACG/86T-77

NO. 36

MEXICO WISHES TO ACQUIRE SDR 28,700,000 AGAINST A FREELY USABLE CURRENCY, PREFERABLY U.S. DOLLARS, IN A TRANSACTION TO BE ARRANGED BY THE FUND VALUE DECEMBER 26, 1986, FOR THE REPURCHASES DUE DECEMBER 28, 1986 AND JANUARY 6TH, 1987.

MEXICO HEREBY AUTHORIZE THE INTERNATIONAL MONETARY FUND TO DEBIT - MEXICO'S SDR ACCOUNT WITH SDR 25,078,125 VALUE DECEMBER 28, 1986 AND SDR 6,269,375 VALUE JANUARY 6TH, 1987 IN DISCHARGES OF REPURCHASES OBLIGATIONS.

TEST [redacted]

BANXICO

19/12/86 18:15:57

440040 FUND UI

1773050 BMCKME
REPLY VIA ITT

TEST NUMBER:
☑ CHECKS
☐ DOES NOT CHECK, IT HAS BEEN SERVICED.
CABLE ROOM

?
Time: 19:29 12/19/86 ???
Connect Time : 168 seconds

~~The Deputy Managing Director~~

EW
STB
JP
F

Office Memorandum

→ Mr. Wiesner
ok
DDE
Dec 23, 1986

TO: The Deputy Managing Director DATE: December 19, 1986

FROM: E. Wiesner E.W.

SUBJECT: Mexico's Financial Legal Agreement

This morning I held a meeting with Mr. Silard (LEG), Mr. Bonvicini and Mr. Kalter (WHD), to review our response to the draft document sent to you by Mr. A. Mudge from Shearman and Sterling.

It seems that we have no major problems with the draft and, with your approval, I would send to Mr. Mudge the enclosed memorandum. Mr. Watson (ETR) agrees with this text.

One point worthwhile mentioning to you has to do with the activation of the trigger mechanism for the growth facility. Mr. Mudge's draft gave the banks the capacity to question the Fund's certification that the trigger conditions had been met. This situation would be corrected by the new language that we are now proposing for pages 2-6. ok

Yesterday, I talked to Mr. Mudge and I informed him that I would send him our comments early next week. He had no difficulty with this.

Attachment

cc: Mr. Silard
Mr. Watson
Mr. Brown

Office Memorandum

To Mr Alfred Mudge   Date December 19, 1986

From E. Wiesner

Subject Mexico - Multi-Facility Agreement

We have the following comments on the discussion draft of December 2, 1986

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2. Page 2-6, first paragraph, lines 14-18 delete until end of sentence Possible rejection of Fund certificate is not consistent with appropriate role for Fund, as envisaged in term sheet

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5 Certificates generally Delete individual reference to J de Larosiere as sender or signatory

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line 3 substitute until for ending on after period

7 Exhibit 11 delete numbered paragraphs (1) and (4), and make consequential changes in Exhibit 12, p 2, last paragraph, last sentence The material refers to borrowing requests which are not within the special knowledge of the Fund

F

Office Memorandum

TO: Mr. Gupta

DATE: December 17, 1986

FROM: J. Pujol

SUBJECT: Mexico--Performance Under Stand-by

I would like to inform you that we have now received all the information pertaining to Mexico's performance with regards to the quantitative criteria for September 1986 established under the current stand-by arrangement. According to this information, Mexico has met the various performance criteria and thus becomes eligible to make the corresponding drawing from the Fund.

cc: Mr. Wiesner

EW
IO
F

Mexico

INTERNATIONAL MONETARY FUND
WESTERN HEMISPHERE DEPT.

1986 DEC -3 AM 11:25

TRANSMITTAL LETTER

ORIG: DMD
CC: FINCH
MR. WIESNER
MR. BEZA
MR. PUJOL

PLEASE DELIVER THE FOLLOWING PAGES TO:

NAME J. DE LAROSIERE PHONE# (202) 623-7491

FROM

OF PAGES INCLUDING COVER 3

IF YOU DO NOT RECEIVE ALL OF THE PAGES PLEASE CONTACT:

NAME Angie Rosario PHONE# 212-559-4655

RAPICOM 1500 (212) 421-1658

DEX 3600 (212) 688-9844

745276

RECEIVED
IMF CABLE ROOM
1986 DEC -2 PM 9:09

DECEMBER 2, 1986

TO MR. JACQUES DE LAROSIERE
MANAGING DIRECTOR
INTERNATIONAL MONETARY FUND

TO MR. ERNEST STERN
EXECUTIVE VICE PRESIDENT
WORLD BANK

RE MEXICO 1986-87 COMMERCIAL BANK PACKAGE

BELOW PLEASE FIND A STATUS REPORT OF CERTAIN BANKS IN BELGIUM, FRANCE, PORTUGAL AND SPAIN. KINDLY NOTE THAT THE ESTIMATED COMMITMENT EXPECTED FROM EACH BANK IS INDICATED IN PARENTHESES.

BELGIUM

A BANKS DECLINING

- BANQUE EUROPEENE DE CREDIT (USDLR 48 MM) - IN LIQUIDATION

- EUROPEAN ARAB BANK (USDLR 5.9 MM) - CONSORTIUM OF 27 ARAB BANKS - INDICATES NO INTEREST IN INCREASING MEXICAN EXPOSURE, HAS AFFILIATE IN LONDON (USDLR 2 MM).

B. BANKS NOT RESPONDING

- BANQUE INDOSUEZ BELGIQUE (USDLR 1.8 MM) - AFFILIATE OF BANQUE INDOSUEZ, PARIS - PARENT HAS INDICATED IT WILL PRESENT THROUGH COMMITTEE PROCESS.

C LARGE SHORTFALLS

- GENERALE BANK, SA/NV - (USDLR 43.9 MM) - COMMITTED USDLR 33.4 MM, INDICATES SHORTFALL DUE TO ASSET SALES, NEEDS FOLLOW-UP.

FRANCE

A. BANKS DECLINING

- BANQUE PRIVEE DE GESTION FINANCIERE (USDLR 64,500) - FRENCH TREASURY HAS CALLED.

- BANQUE WORMS (USDLR 1.07 MM) - BANK HAS BEEN RE-ORGANIZED, FRENCH TREASURY HAS CALLED, CHAIRMAN HAS INDICATED APPROVAL BUT CREDIT COMMITTEE DECLINED, FOLLOW-UP WOULD BE HELPFUL.

B. BANKS NOT RESPONDING

- BANQUE ARABE ET INTERNATIONALE D'INVESTISSEMENT (USDLR 5.7 MM) - FRENCH TREASURY HAS CALLED, POSITIVE INCLINATION FOR TOKEN AMOUNT ONLY FOLLOW-UP WOULD BE HELPFUL.

- FRAB BANK INTERNATIONAL (USDLR 3.5 MM) - VERBAL DECLINE, BANK REPORTED TO BE IN POOR FINANCIAL CONDITION

PORTUGAL

BANCO ESPIRITO SANTO E COMERCIAL DE LISBOA - (USDLR 2.686 MM) - FORMALLY DECLINED.

BANCO TOTTA E ACORES - (USDLR 2.2 MM) - NO FORMAL RESPONSE.

SPAIN

A. SEVERAL LARGE SPANISH BANKS WHICH HAVE COMMITTED ARE INDICATING THEIR COMMITMENTS INCLUDE ALL RESPECTIVE AFFILIATES RESULTING IN RATHER LARGE SHORTFALLS. THESE BANKS ARE:

- BANCO DE VIZCAYA (USDLR 23.14 MM) - COMMITTED USDLR 7.74 MM, COMMITMENT SHOULD INCLUDE ADDITIONAL AMOUNTS FOR BANCA CATALANA (6.057 MM), BANCA MARCH (.571 MM), BANCO DE PROGRESSO (.563 MM), BANCO INDUSTRIAL DE CATALUNA (.645 MM).

  BANCO POPULAR ESPANOL - (USDLR 8.281) COMMITTED USDLR 7.095 MM. COMMITMENT SHOULD INCLUDE BANCO DE ANDALUCIA (.516 MM), BANCO DE CASTILLA (.285 MM), BANCO DE CREDITO BALEAR (.129 MM) AND BANCO DE GALICIA (.258 MM).

  BANCO HISPANO AMERICANO - (USDLR 26.706 MM) COMMITTED USDLR 22.316 MM. COMMITMENT SHOULD INCLUDE BANCO HISPANO INDUSTRIAL (258 MM), AND BANCO URQUIJO UNION (USDLR 10.9 MM).

B OTHERS

BANCO CENTRAL CORP. - (USDLR 2.8 MM) INDICATES ASSETS TRANSFERRED TO SUBSIDIARY, UNWILLING TO FOLLOW-UP, ALSO OWNS BANCO INTERNACIONAL DE COMERCIO (.819 MM).

CC: Mr. Erb
Mr. Finch
Mr. Wiesner
Mr. Beza
Mr. Gianviti
Mr. Pujol
Mr. Silard.

Mexico

EW
STB
JP
IO
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INTERNATIONAL MONETARY FUND
WASHINGTON, D. C. 20431

MANAGING DIRECTOR

CABLE ADDRESS
INTERFUND

December 3, 1986

Dear Mr. Volcker:

Reference is made to the stand-by arrangement approved by the International Monetary Fund for Mexico for the period from November 19, 1986 until April 1, 1988 for an amount equivalent to SDR 1.4 billion.

1. The arrangement became effective on November 19, 1986.

2. Mexico became entitled to make a purchase equivalent to SDR 225 million under the arrangement, and made the purchase on November 26, 1986.

3. Mexico is entitled to make a second purchase of SDR 225 million, subject to compliance with the relevant performance criteria.

Sincerely,

Larosière

J. de Larosiere

Mr. Paul A. Volcker
Chairman
Board of Governors
Federal Reserve System
Twentieth Street and
Constitution Avenue, N.W.
Washington, D.C. 20551

1986 DEC -4 PM 12: 20

→ Mr. Erb
Mr. Wiesner
Mr. Beza

STB
JP
TP
F

.BER 2, 1986

: MR. JACQUES DE LAROSIERE
MANAGING DIRECTOR
INTERNATIONAL MONETARY FUND

TO: MR. ERNEST STERN
EXECUTIVE VICE PRESIDENT
WORLD BANK

RE: MEXICO 1986-87 COMMERCIAL BANK PACKAGE

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I talked to R. G. Scary [illegible] Dec 6-86

B. BANKS NOT RESPONDING:

- BANQUE INDOSUEZ BELGIQUE (USDLR 1.8 MM) - AFFILIATE OF BANQUE INDOSUEZ, PARIS - PARENT HAS INDICATED IT WILL PRESENT THROUGH COMMITTEE PROCESS.

C. LARGE SHORTFALLS

- GENERALE BANK, SA/NV - (USDLR 43.9 MM) - COMMITTED USDLR 33.4 MM, INDICATES SHORTFALL DUE TO ASSET SALES, NEEDS FOLLOW-UP.

There is also a rumour that this bank will reduce the amount it has committed — the Mexicans are worried about the precedent this could create.

FRANCE

A. BANKS DECLINING:

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- BANQUE WORMS (USDLR 1.07 MM) - BANK HAS BEEN RE-ORGANIZED, FRENCH TREASURY HAS CALLED, CHAIRMAN HAS INDICATED APPROVAL BUT CREDIT COMMITTEE DECLINED, FOLLOW-UP WOULD BE HELPFUL.

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PORTUGAL

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B. OTHERS

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Liste des banques

Banque Internationale Arabe	1,153 million
Banque Privée de gestion financière	64 000
Banque Worms	1,070 million
FRAB	3,541 millions
Société Lyonnaise de banques	140 000
BAII PLC	9 000
BAII	5,700 millions
Neuflize, Schlumberger Mallet	1 million
Banque Internationale de placement	687 000

Mr. Beza

Mexico

INTERNATIONAL MONETARY FUND
WASHINGTON, D.C. 20431

CABLE ADDRESS
INTERFUND

December 1, 1986

Ms. Wanda Olson
Cleary, Gottlieb, Steen & Hamilton
One State Street Plaza
New York, N.Y. 10004

Dear Ms. Olson:

I enclose an envelope, addressed to Citibank, containing the Managing Director's confirmation of the telex dated November 25, 1986 in respect of the stand-by arrangement for Mexico, per your request.

Sincerely yours,

Stephen A. Silard

Stephen A. Silard
Assistant General Counsel

Enclosure

bc: Mr. Beza

INTERNATIONAL MONETARY FUND
WASHINGTON D C 20431

MANAGING DIRECTOR

CABLE ADDRESS
INTERFUND

December 1, 1986

Citibank, N A , as Agent Under
the Commercial Bank Facility
for Contingency Support for
Mexico's International Reserves

Attention Ms D M Nemer

Madam

This will confirm the telex sent to you on November 25, 1986, as follows

I AM PLEASED TO CONFIRM THAT ON THE BASIS OF COMMITMENTS BY A CRITICAL MASS OF COMMERCIAL BANKS TO A 1986-87 COMMERCIAL BANK FINANCING PACKAGE FOR MEXICO I HAVE PROPOSED TO THE EXECUTIVE BOARD OF THE FUND THAT IT APPROVE THE MEXICAN STAND-BY ARRANGEMENT FOR SDR 1,400 MILLION FOR THE PERIOD UNTIL APRIL 1, 1988, IT BEING UNDERSTOOD THAT I HAVE CONSIDERED COMMITMENTS OF APPROXIMATELY 90 PERCENT TO CONSTITUTE A CRITICAL MASS I AM FURTHER PLEASED TO CONFIRM THAT ON NOVEMBER 19, 1986 THE MEXICAN STAND-BY ARRANGEMENT BECAME EFFECTIVE
REGARDS,
J DE LAROSIERE
MANAGING DIRECTOR
INTERFUND

Very truly yours,

Larosière

J de Larosiere
Managing Director

EW
STB
IO
JP
F

Mexico

NOV 25 1986

Gentlemen:

I am enclosing herewith the text of the Stand-by Arrangement for Mexico approved by the Executive Board on November 19, 1986.

Sincerely yours,

Alfred Mathuran
Senior Operations Officer
Operations Division
for General Resources

Enclosure

CC TRE
MR ORTIZ
WHD

Banco de Mexico
Apartado Postal 98 Bis
5 de Mayo, No. 2
06059 Mexico 1, D.F.
Mexico

/jg
11/25/86

CENTRAL FILES

Mexico

CLEARY, GOTTLIEB, STEEN & HAMILTON
One State Street Plaza, New York, New York 10004 (212) 344-0600

FACSIMILE MESSAGE TO:

Fax Number(s): (202) 623-4661/623-4662

Name: Mr. Sterie Beza

Company: ~~International Monetary Fund~~

City: Washington, D.C

State/
Country: U S.A.

Telephone
Number: (202) 623-8631

From: Mark A. Walker

Date: November 20, 1986

Number of Pages
(including cover). 2

Our File Number: 24636-050

****

IF COPY IS ILLEGIBLE OR INCOMPLETE, PLEASE CALL
212-344-0600, x 700 or x 738 IMMEDIATELY FOR RETRANSMISSION.

****

212-344-0925	(GR. I & II)	212-422-5276	Rapifax
212-480-0152	(GR. I, II & III)	212-483-1361	Rapifax
212-269-5724	(GR. I, II & III)		

RECEIVED
IMF CABLE ROOM
86 NOV 20 PM 1: 0

(This space to be used for short or supplemental messages)

Dear Ted:

Now that a "critical mass" of banks has committed to the 1986-87 Commercial Bank Financing Package for Mexico, we are preparing for Mexico's drawings under the official and commercial bank facilities for contingency support. Before drawings may be made under the commercial bank bridge loan, we must receive a communication from the Managing Director in the form that follows, confirming his determination that critical mass has been obtained. You may recall that we cleared this text with the Fund some time ago. I would much appreciate your obtaining this message from Mr. de Larosiere and sending five signed copies to me as soon as possible.

Best regards,

Mark A. Walker/WJO

Mark A. Walker

Attachment

TO. CITIBANK, N.A., AS AGENT UNDER THE COMMERCIAL BANK FACILITY FOR CONTINGENCY SUPPORT FOR MEXICO'S INTERNATIONAL RESERVES

FROM: J. DE LAROSIERE, MANAGING DIRECTOR, INTERNATIONAL MONETARY FUND

DATE: __________, 198_

I AM PLEASED TO CONFIRM THAT ON THE BASIS OF COMMITMENTS BY A CRITICAL MASS OF COMMERCIAL BANKS TO A 1986-87 COMMERCIAL BANK FINANCING PACKAGE FOR MEXICO I HAVE PROPOSED TO THE EXECUTIVE BOARD OF THE FUND THAT THE MEXICAN STAND-BY ARRANGEMENT FOR SDR 1,400 MILLION FOR A PERIOD OF 18 MONTHS, REQUESTED BY MEXICO AND APPROVED IN PRINCIPLE BY THE EXECUTIVE BOARD, BECOME EFFECTIVE, IT BEING UNDERSTOOD THAT I HAVE CONSIDERED COMMITMENTS OF APPROXIMATELY 90% TO CONSTITUTE A CRITICAL MASS

REGARDS,

J DE LAROSIERE
MANAGING DIRECTOR
INTERNATIONAL MONETARY FUND

CLEARY, GOTTLIEB, STEEN & HAMILTON
One State Street Plaza, New York, New York 10004 (212) 344-0600

FACSIMILE MESSAGE TO:

Fax Number(s): (202) 623-4661/623-4662

Name: Mr. Sterie Beza

Company: ~~International Monetary Fund~~

City: Washington, D.C.

State/
Country: U.S.A.

Telephone
Number: (202) 623-8631

From: Mark A. Walker

Date: November 20, 1986

Number of Pages
(including cover). 2

7123776

Our File Number: 24636-050

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(This space to be used for short or supplemental messages)

Dear Ted:

Now that a "critical mass" of banks has committed to the 1986-87 Commercial Bank Financing Package for Mexico, we are preparing for Mexico's drawings under the official and commercial bank facilities for contingency support. Before drawings may be made under the commercial bank bridge loan, we must receive a communication from the Managing Director in the form that follows, confirming his determination that critical mass has been obtained. You may recall that we cleared this text with the Fund some time ago. I would much appreciate your obtaining this message from Mr. de Larosiere and sending five signed copies to me as soon as possible.

Best regards,

Mark A. Walker/WJO

Mark A. Walker

Attachment

TO. CITIBANK, N.A., AS AGENT UNDER THE COMMERCIAL BANK FACILITY FOR CONTINGENCY SUPPORT FOR MEXICO'S INTERNATIONAL RESERVES

FROM: J. DE LAROSIERE, MANAGING DIRECTOR, INTERNATIONAL MONETARY FUND

DATE: __________, 198_

I AM PLEASED TO CONFIRM THAT ON THE BASIS OF COMMITMENTS BY A CRITICAL MASS OF COMMERCIAL BANKS TO A 1986-87 COMMERCIAL BANK FINANCING PACKAGE FOR MEXICO I HAVE PROPOSED TO THE EXECUTIVE BOARD OF THE FUND THAT THE MEXICAN STAND-BY ARRANGEMENT FOR SDR 1,400 MILLION FOR A PERIOD OF 18 MONTHS, REQUESTED BY MEXICO AND APPROVED IN PRINCIPLE BY THE EXECUTIVE BOARD, BECOME EFFECTIVE, IT BEING UNDERSTOOD THAT I HAVE CONSIDERED COMMITMENTS OF APPROXIMATELY 90% TO CONSTITUTE A CRITICAL MASS.

REGARDS,

J. DE LAROSIERE
MANAGING DIRECTOR
INTERNATIONAL MONETARY FUND

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MONETARY FUND

1986 NOV 26 PM 4:01

OFFICE OF
THE MANAGING DIRECTOR

Office Memorandum

CONFIDENTIAL

TO: The Acting Managing Director

DATE: ~~November 26,~~ 1986 Nov. 5 Nov 30. 86

FROM: J. Pujol

SUBJECT: Mission to Mexico (November 3-20, 1986)

The mission that recently visited Mexico City reviewed with the authorities developments under the program adopted by the Mexican administration since July 1986 and started the discussions on the quantitative performance criteria to be applied for calendar year 1987. I returned to Washington before the rest of the mission to participate in the Board Meeting that approved the stand-by arrangement with Mexico.

During its visit, the mission met with a number of officials from the Central Bank, the Ministry of Finance, the Ministry of Planning, the Ministry of Trade, the Minimum Wage Council and the government-owned petroleum company (PEMEX). Despite extensive discussions, the mission had some difficulty in obtaining a clear picture of the objectives that are being sought and the strategy that the authorities intend to follow to attain these objectives in 1987. Part of this difficulty may be attributed to uncertainties related to the availability and timing of the external financing. However, the mission also gained the impression that there has been a shift in responsibilities from the Finance Ministry to the Planning Ministry; certain officials from the Finance Ministry who in the past had taken the initiative in discussing economic policies now were taking a passive attitude while waiting to hear the proposals of the Planning Ministry officials. It also appeared that some important policy issues, such as the manner in which the foreign funding might be used during 1987, had not been fully discussed and settled among the various agencies involved.

The mission had one joint meeting with the Secretary of Finance, Mr. Petricioli, and the Secretary of Planning, Mr. Salinas, concerning the broad guidelines being established for the 1987 budget. At this meeting, which was attended also by Mr. Suarez (Undersecretary of Finance), Mr. Aspe (Undersecretary of Planning), Mr. Serra (Undersecretary of Revenues in the Ministry of Finance), Mr. Cordoba (Director of the Budget in the Planning Ministry), and Mr. Reyes Heroles (Director of Economic Policy in the Ministry of Finance), the authorities made a general presentation of their overall strategy and their budget plans for 1987. They emphasized throughout this meeting that their budget plans had been drawn up to be in compliance with the agreement reached last July as formalized in the letter of intent.

Prior to my return to Washington, I also had two private meetings, one with the Secretary of Finance, Mr. Petricioli, and another with the Under Secretary of Finance, Mr. Suárez, where the issues of the

Sent to Central File 12/8/86

possible uses of the external resources that might become available under the program and the timing of the work program of the mission were taken up In these meetings the Mexican authorities pointed out that given that they would be tied up with their presentation of the budget to Congress in the last two weeks of November and that Mr Petricioli would be temporarily absent from Mexico--he will be accompanying President De la Madrid on a trip to Japan and China later this month--discussions on the quantitative financial program for 1987 should be resumed at the beginning of December

Although the authorities were not ready to enter into a detailed discussion of the financial programming exercise for 1987 during the last mission, as indicated above, they outlined elements of the general strategy they expected to follow in various policy areas Their views on policy issues, as well as the staff position on them, are summarized below A discussion of recent economic developments and the performance under the program since its inception was part of the statement prepared by the staff for the Board Meeting of November 19, 1986 and thus this note will concentrate on the policy issues that arise in connection with the 1987 program Certain issues pertaining to the September and December 1986 ceilings and the architecture of the 1987 program also are addressed in this note

1 Summary of policy discussions

As regards the overall aims of the economic program for 1987, it seems fairly clear that the authorities want to make sure that the balance of payments continues to strengthen in the year to come They repeatedly expressed their intention to maintain the gain in competitiveness achieved during the past year and to achieve a build up of international reserves, they did not address the question of how much the reserve target might be adjusted in the light of the overperformance in the balance of payments that has been taking place since mid-1986 In the private meeting I had with Mr Petricioli, however, he observed that in view of the difficulties encountered in putting in place the current financing package it was unlikely that this administration would be able to raise much financing abroad during 1988--its last year in office--and thus there was a need to put aside some funds to meet their needs for external resources during that year The authorities were vague with regard to their target for inflation in 1987, placing it into a range of 70-80 percent (compared with their projection of about 105 percent for the 12-month period ended December 1986) With respect to growth, the authorities seemed resigned to a relatively low rate of growth in 1987--around 2 to 3 percent on a year over year basis--although they still hoped that the growth rate would reach a rate of some 3 1/2 percent by the last quarter of 1987

The authorities emphasized that their general policy strategy continued to be one in which they would be attempting to eliminate existing distortions in relative prices and reduce inflation in order to set the stage for a sustained recuperation of growth

With regards to relative prices, the authorities pointed out that they already had started the process of realignment of public sector prices and that few prices in the private sector still remained under price control A number of important adjustments in public sector prices had been introduced since last June, although they acknowledged that in some cases--e g electricity tariffs-- corrective adjustments had been delayed The authorities expect that the process of realigning public sector prices will be completed in early 1987, rather than in late 1986 as originally envisaged, subsequently, public sector prices and tariffs would continue to be adjusted frequently and in a flexible manner so as to avoid new lags but without the introduction of a formal mechanism of indexation The staff pointed out that the delays that had taken place in adjusting some public sector prices had contributed to the weakness observed in public sector receipts, and that some of the ground lost this year probably would not be made up It was important, the staff argued, to move to realistic prices with as little delay as possible

With respect to the reduction of inflation, the authorities expect that the measures being adopted to strengthen the public finances will help deal with the demand sources of inflation, but in their view, the major problem they faced in this area stemmed from the implicit indexation mechanisms already built in into the economy They see the availability of foreign financing as providing them relief both in terms of the future path of the exchange rate and of interest rates While they did not want to lose the international competitiveness already achieved, once external financing became available they would not need to devalue the peso further in real effective terms and that this in itself would help in their efforts to slow inflation With respect to interest rates, they did not foresee an immediate decline from the high real positive rates now prevailing, but they thought that the availability of external financing--together with the decrease in the public sector deficit--would release loanable funds to the private sector The staff cautioned the authorities against drifting into a strategy of trying to slow inflation through an appreciation of the exchange rate or administered reductions in interest rates Such policies had failed in the past and could endanger the recovery of the balance of payments situation and the generation of domestic savings The staff took the position that the best way to achieve a lasting reduction in inflation was through the reduction of the public sector deficit and the pursuit of a cautious credit policy

The authorities indicated that in their view a shorter periodicity of wage adjustments would permit the size of the adjustments to be smaller at any given time and thus reduce one element that is contributing to the variance of the price-wage spiral and feeding inflationary expectations Accordingly, they have introduced legislation to permit more frequent revisions of the minimum wage They stressed, however, that these new procedures should not be viewed as a movement in the direction of further indexation of the economy, and that wage adjustments in the future will still take into account the objectives for inflation rather than merely seek to recuperate the purchasing power that had been lost

The staff drew attention to the problems that could arise from more frequent wage adjustments Experience in other countries had shown that such practices tended to lead to indexation or near-indexation, which made the breaking of the price-wage spiral more difficult to achieve In a situation where the terms of trade had turned so sharply against the country it was virtually impossible to prevent a fall in real wages and the maintenance in the external competitiveness called for a careful approach to wage policy

With regard to fiscal policy, the authorities indicated that the budget proposal for 1987 sent to Congress last week incorporates measures designed to raise the primary balance from the equivalent of an estimated 3 3 percent of GDP in 1986 to 6 6 percent of GDP in 1987 Among these measures are changes in tax laws which they estimate will yield 1 3 percentage point of GDP in additional revenues, changes in public sector prices designed to yield some 0 6 percentage point of GDP in additional receipts, and cuts in current expenditures which are expected to reduce expenditures by the equivalent of 1 percentage point of GDP, the budget also provides for a rise of 0 5 percentage point of GDP in investment outlays The authorities estimate that the implementation of their proposed budget will lead to a public sector borrowing requirement (PSBR) equivalent to 13 8 percent of GDP (some 2 5 percent less than their latest estimate for 1986) and an operational result which may be between balanced and a deficit of 1 percent of GDP (compared with an estimated deficit of 1 7 percent of GDP in 1986) The staff is currently in the process of reviewing the various documents prepared in connection with the budget to analyze whether the impact of the various measures proposed can be expected to yield these results and whether the proposed fiscal plan is consistent with the reduction of inflation that is being sought

In its initial reaction, the staff took the position that the authorities might have been bolder with their inflation target (say an inflation rate of 60 percent during 1987) and aim at a PSBR in the neighborhood of 11 percent of GDP, as had been sought in the briefing paper The staff has pointed out that even though the primary fiscal surplus is projected to double in relation to GDP from 1986 to 1987, and large amounts of foreign financing are likely to be available, the impact on inflation seems to be quite limited In effect, the authorities appear to be very cautious with their projections, leaving themselves a large margin for error The staff has emphasized that even if such a margin is maintained for the announced inflation objective, it is important that the underlying policies do not validate a high rate of inflation. In particular, the staff has taken the position that the credit policy will need to be kept under a tight rein and that any overperformance of the balance of payments in 1986 should be taken into account in framing the program for 1987

2 Issues concerning the September and December 1986 ceilings

As you are aware some problems have arisen concerning the determination of performance under the operational deficit for September 1986 Although we are still awaiting for the final figures for the banking system for September, preliminary information available indicates that on the basis of the methodology established for calculating such a concept last July the limit on the operational deficit was exceeded, at the same time, it appears that there was compliance with the limit on the PSBR and all other performance criteria The Mexican authorities have noted that the above mentioned calculations of the operational balance do not take into account the profits that accrued to the Bank of Mexico during the period January-September 1986, and which will eventually be turned over to the Government in the form of a refund of interest payments In the past, such refunds have normally taken place at the end of the calendar year, after the net results of the total operations of the Bank of Mexico are known The authorities argue that at least a portion of such profits should be transferred monthly to the Treasury, and have indicated their intention to do so in the future They point out that if the accumulated profits for the period January-September 1986 were imputed to the Treasury, then the adjusted figure would meet the limit established under the program for September

The staff has been reluctant to accept the authorities' position, particularly without having a complete accounting of the nature of these profits and the methodology used for their imputation. We also have noted to the authorities that some of the gains achieved during the period under consideration appear to be 'paper profits stemming from the sale of foreign exchange at historical rather than replacement value The staff has requested detailed information from the authorities on the nature and calculations of these profits and is currently awaiting for this information Once this information becomes available, a decision will have to be reached whether the appropriate course of action would be to grant a waiver under the program (a course of action that the authorities have been extremely reluctant to take), to accept a modification to the methodology for calculating the performance under the ceiling, to ask the authorities to postpone any further drawings until the completion of the review of the performance under the program with the Executive Board, or to withhold the drawing until additional measures are taken to correct the deviation

With regards to the December ceilings, the delays in concluding the commercial bank financing package make it very likely that no disbursement will occur from this source before the end of 1986 Such an outcome would affect the performance of various ceilings and targets of the program for the end of the year The mission will discuss with the authorities the likely impact on the various targets and ceilings of delays in the drawings from commercial banks and the corresponding adjustments that may be needed in the performance criteria for 1987

3 Issues concerning the architecture of the 1987 program

An issue to be resolved in framing the financial program for 1987 concerns the target for accumulation of international reserves and its quarterly distribution Because of the likely spillover into 1987 of sizable external drawings originally scheduled for 1986, the staff estimates that external capital flows to the public sector in 1987 may reach the range of US$8 5 to 9 billion (excluding any drawings under the oil contingency) compared with US$5 1 billion assumed when the original program was framed Of course, any downward adjustment in the reserve target for end 1986 owing to the delays in the entry of external financing (particularly from the banks) would need to be accompanied by the upward adjustment of the target for 1987, in addition, however, there is the question of the possible adjustment for overperformance in 1986

A second issue that may arise concerning the architecture of the 1987 program concerns the maintenance of the ceiling on financial intermediation Last July the authorities had complained about the number of ceilings being applied to the fiscal performance and argued that, with a ceiling on the PSBR and one on the operational deficit, the ceiling on financial intermediation was excessive At that time the staff pointed out that the ceiling on the operational deficit was a new concept with which we had no previous experience and that it was important for the credibility of the program to maintain the same measurements of performance that had been used for the EFF, which were ones with which everyone was familiar Moreover, the staff argued that there was merit in putting a limit on the operations of financial intermediation of development banks and official trust funds, given the potential fiscal costs of these types of preferential credits for the future For these reasons, the staff will continue to resist the elimination of this performance criterion

A third issue that will need to be addressed concerns the trigger mechanism for the growth contingency The mission in its recent visit tried to get the authorities to focus on this issue, particularly since a note will soon need to be prepared for the commercial banks on the technical aspects of this mechanism Little work, however, seemed to have been done on the Mexican side so far, although at the same time the authorities seemed to be taking for granted that the growth contingency would be activated given the sluggishness of the economy The mission will seek to set up a special working group with Mexican officials to address the issues involving the growth contingency mechanism

cc The Managing Director (o/r)
Mr Guitián
Mr Habermeier
Mr Gianviti
Mr Tanzi
Mr Wiesner (o/r)
Mr Brown

Mr. Beza

EW
STB
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JP
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Office Memorandum

To: The Managing Director (o/r)

November 26, 1986

From: Stephen A. Silard SAS

Subject: Mexico - Confirmation of Telex

I attach for your signature a letter confirming the telex sent on November 25, 1986 to Citibank as agent under the commercial bank bridge loan facility. Upon your signature, please return it to me for dispatch to the lawyers for Mexico, who will personally deliver it to Citibank.

Attachment

cc: The Deputy Managing Director
Mr. Beza
Mr. Brown

INTERNATIONAL MONETARY FUND
WASHINGTON D C 20431

MANAGING DIRECTOR

CABLE ADDRESS
INTERFUND

Citibank, N A , as Agent Under
the Commercial Bank Facility
for Contingency Support for
Mexico's International Reserves

Attention Ms D M Nemer

Madam

This will confirm the telex sent to you on November 25, 1986, as follows

I AM PLEASED TO CONFIRM THAT ON THE BASIS OF COMMITMENTS BY A CRITICAL MASS OF COMMERCIAL BANKS TO A 1986-87 COMMERCIAL BANK FINANCING PACKAGE FOR MEXICO I HAVE PROPOSED TO THE EXECUTIVE BOARD OF THE FUND THAT IT APPROVE THE MEXICAN STAND-BY ARRANGEMENT FOR SDR 1,400 MILLION FOR THE PERIOD UNTIL APRIL 1, 1988, IT BEING UNDERSTOOD THAT I HAVE CONSIDERED COMMITMENTS OF APPROXIMATELY 90 PERCENT TO CONSTITUTE A CRITICAL MASS I AM FURTHER PLEASED TO CONFIRM THAT ON NOVEMBER 19, 1986 THE MEXICAN STAND-BY ARRANGEMENT BECAME EFFECTIVE.
REGARDS,
J DE LAROSIERE
MANAGING DIRECTOR
INTERFUND

Very truly yours,

J de Larosiere
Managing Director

Office Memorandum

√ ① Mexico
② Travel — approval memo
ok
RDE Nov 24, 1986

EW
STB
ADM
JP
F/

TO: The Deputy Managing Director (Cleared with Administration)

DATE: November 25, 1986

FROM: S. T. Beza

SUBJECT: Travel to Mexico

The mission that visited Mexico City in the period November 3-20, 1986 did not complete the discussions with the authorities on the quantitative program for 1987. Mr. Pujol returned to Washington on November 17 to participate in the Board meeting that approved Mexico's stand-by arrangement, and prior to his departure from Mexico the authorities requested that the mission return on December 1, 1986 to continue the work on the 1987 program.

Subject to your agreement, I would propose that the mission return to Mexico City on December 1, as requested by the authorities, for a period of two weeks. The mission will consist of the same members as before, i.e., Messrs. Pujol (Head), Bonvicini, Gil Díaz, Kalter (all WHD), Durán-Downing, Valdivieso (both ETR), and Miss De Lucio (Secretary-WHD). Mr. Beveridge is in agreement with this proposal.

cc: ADM
ETR
Mr. Caiola
Mrs. Braña

Mission No. 87197700

Prog. No. 420

1986 NOV 25 PM 1:03
OFFICE OF THE DEPUTY MANAGING DIRECTOR

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DY. DIR. ADM.

INTERNATIONAL MONETARY FUND
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IMF OFFICIAL MESSAGE

WASHINGTON, D. C. 20431

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mexico

CITIBANK, N.A., AS AGENT UNDER THE COMMERCIAL BANK
FACILITY FOR CONTINGENCY SUPPORT FOR MEXICO'S INTERNATIONAL
RESERVES
ATTENTION: MS. D.M. NEMER

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I AM PLEASED TO CONFIRM THAT ON THE BASIS OF COMMITMENTS BY A CRITICAL MASS OF COMMERCIAL BANKS TO A 1986-87 COMMERCIAL BANK FINANCING PACKAGE FOR MEXICO I HAVE PROPOSED TO THE EXECUTIVE BOARD OF THE FUND THAT IT APPROVE THE MEXICAN STAND-BY ARRANGEMENT FOR SDR 1,400 MILLION FOR THE PERIOD UNTIL APRIL 1, 1988, IT BEING UNDERSTOOD THAT I HAVE CONSIDERED COMMITMENTS OF APPROXIMATELY 90 PERCENT TO CONSTITUTE A CRITICAL MASS.

I AM FURTHER PLEASED TO CONFIRM THAT ON NOVEMBER 19, 1986 THE MEXICAN STAND-BY ARRANGEMENT BECAME EFFECTIVE.

REGARDS,

J. DE LAROSIERE

MANAGING DIRECTOR

INTERFUND

MD
DMD
MR. ORTIZ
ETR
LEG
WHD
MR. BROWN

IF REQUIRED INITIAL BELOW

SPECIAL INSTRUCTIONS

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TELEX NO.: ~~XXXXXXXX~~ RCA INTEL 236066(ANSWER BACK: CMG WH NYK)

DRAFTED BY NAME (TYPE): SASilard:ch

EXT.: 7715 DEPT.: Legal DATE: 11-25-86

AUTHORIZED BY NAME (TYPE): Sterie T. Beza

AUTHORIZED BY NAME (TYPE): Richard D. Erb

(**)

TYPE ** ON LAST OR ONLY PAGE OF MESSAGE

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INTERNATIONAL MONETARY FUND

1986 NOV 26 PM 1 04

COMMUNICATIONS

TO	JACQUES DE LAROSIERE MANAGING DIRECTOR INTERNATIONAL MONETARY FUND	CC	MR ERB MR WIESNER MR BEZA MR FINCH
FROM	THE BANK ADVISORY GROUP FOR MEXICO		
DATE	NOVEMBER 24, 1986		
RE	MEXICO		

EW

enclosure JP

F

WE REFER TO THE COMMUNICATION DATED OCTOBER 16, 1986 FROM THE MEXICAN MINISTER OF FINANCE AND PUBLIC CREDIT TO THE INTERNATIONAL BANKING COMMUNITY REQUESTING PARTICIPATION IN THE 1986-87 COMMERCIAL BANK FINANCING PACKAGE FOR MEXICO

AS OF 5 00 P M (NEW YORK CITY TIME) ON NOVEMBER 19, 1986, THE BANK ADVISORY GROUP FOR MEXICO (THE 'ADVISORY GROUP") HAD RECEIVED POSITIVE RESPONSES FROM 210 BANKS FOR TOTAL COMMITMENTS OF U S DOLLARS 6,966,077,672 TO THE FOUR FACILITIES AGGREGATING APPROXIMATELY U S DOLLARS 7 7 BILLION AND CONSTITUTING THE NEW MONEY FINANCING FOR GROWTH-ORIENTED ADJUSTMENT AND STRUCTURAL REFORM IN MEXICO

AS YOU ARE AWARE, MEXICO REQUESTED THAT BANKS RESPOND INDIVIDUALLY BY TELEX IN THE FORM OF SCHEDULE 1 MANY BANKS SO RESPONDED BY INDIVIDUAL TELEX

SOME BANKS RESPONDED CONSISTENT WITH THE REQUESTED FORM BUT STIPULATED ADDITIONAL CONDITIONS TO THEIR COMMITMENTS SET FORTH ON SCHEDULE 2 IS A QUOTATION OF THE ADDITIONAL CONDITIONS CONTAINED IN THESE TELEXES, AS BEST AS THE ADVISORY GROUP HAS BEEN ABLE TO COMPILE SUCH LIST IN THE GIVEN TIME CONSTRAINTS YOU WILL OBSERVE THAT MANY OF THE CONDITIONS ARE REPETITIVE AND NOT INCONSISTENT WITH THE PROPOSED FINANCING

REGARDS

BANK OF AMERICA N T AND S A
BANK OF MONTREAL
THE BANK OF TOKYO, LTD
BANKERS TRUST COMPANY
THE CHASE MANHATTAN BANK, N A
CHEMICAL BANK
CITIBANK, N A
DEUTSCHE BANK AG
LLOYDS BANK PLC
MANUFACTURERS HANOVER TRUST COMPANY OF NEW YORK
MORGAN GUARANTY TRUST COMPANY OF NEW YORK
SOCIETE GENERALE
SWISS BANK CORPORATION

Schedule 1

TO	CITIBANK, N A , AS AGENT ATTENTION D M NEMER A MATAS	
TELEX	RCA INTL 236066	CMG WH NYK
	WUD 127782	CMG WH NYK
	WUD 6801437	CITI CIB
	WUI 661934	CITI CIB
	WUI 662528	CITI CIB
	WUI 662409	CITI CIB

CC (APPROPRIATE ADVISORY GROUP CONTACT), FOR INFORMATION

FROM (BANK NAME)

DATE

RE MEXICO

WE REFER TO THE COMMUNICATION DATED OCTOBER 16, 1986 FROM THE MEXICAN MINISTER OF FINANCE AND PUBLIC CREDIT TO THE INTERNATIONAL BANKING COMMUNITY REQUESTING PARTICIPATION IN THE NEW MONEY FINANCING FOR GROWTH-ORIENTED ADJUSTMENT AND STRUCTURAL REFORM IN MEXICO IN THE AGGREGATE AMOUNT OF U S DOLLARS 7 7 BILLION ON THE TERMS DESCRIBED IN THE MINISTER S COMMUNICATION, CONSISTING OF NEW MONEY FACILITIES IN THE AMOUNT OF U S DOLLARS 6 BILLION AND CONTINGENCY FACILITIES IN THE AMOUNT OF U S DOLLARS 1 7 BILLION

WE ACKNOWLEDGE RECEIPT OF THE MATERIALS ENCLOSED WITH THE MINISTER S COMMUNICATION, INCLUDING THE COMMUNICATIONS TO THE INTERNATIONAL BANKING COMMUNITY FROM THE MANAGING DIRECTOR OF THE IMF, THE PRESIDENT OF THE WORLD BANK, AND THE EXECUTIVE VICE PRESIDENT OF THE INTER-AMERICAN DEVELOPMENT BANK

IN THIS CONTEXT, WE ARE PLEASED TO COMMIT THE AMOUNT INDICATED BELOW IN THE FRAMEWORK OF AN INTERNATIONAL SYNDICATE COMMITTING U S DOLLARS 7 7 BILLION TO FOUR FACILITIES CONSTITUTING THE NEW MONEY FINANCING FOR GROWTH-ORIENTED ADJUSTMENT AND STRUCTURAL REFORM IN MEXICO AND SUBJECT TO THE EXECUTION OF SATISFACTORY LOAN DOCUMENTATION

COMMITTED AMOUNT (U S DOLLARS)	CURRENCY OF LOAN DISBURSEMENTS

OUR COMMITMENT IS TO BE ALLOCATED TO ALL FOUR FACILITIES CONSTITUTING THE NEW MONEY FINANCING FOR GROWTH-ORIENTED ADJUSTMENT AND STRUCTURAL REFORM IN MEXICO, RATABLY IN ACCORDANCE WITH THE PRINCIPAL AMOUNT OF EACH FACILITY OUR CURRENCY OF DISBURSEMENT UNDER ALL FOUR FACILITIES WILL BE THE CURRENCY INDICATED ABOVE

WE ACKNOWLEDGE RECEIPT OF THE BASIC TERMS OF THE REQUESTED AMENDMENTS TO THE 1983 U S DOLLARS 5 BILLION CREDIT AGREEMENT AND THE 1984 U S DOLLARS 3 8 BILLION CREDIT AGREEMENT WITH THE UNITED MEXICAN STATES AND TO THE 52 RESTRUCTURE AGREEMENTS AND 35 NEW RESTRUCTURE AGREEMENTS WITH MEXICAN PUBLIC SECTOR OBLIGORS, AS SET FORTH IN PARTS I AND II OF THE 1986-87 COMMERCIAL BANK FINANCING PACKAGE FOR MEXICO WE AGREE IN PRINCIPLE TO THE REQUESTED AMENDMENTS OF SUCH AGREEMENTS TO WHICH WE ARE PARTY, SUBJECT TO THE PREPARATION OF SATISFACTORY DOCUMENTATION

FURTHER COMMUNICATIONS ON THE 1986-87 COMMERCIAL BANK FINANCING PACKAGE FOR MEXICO SHOULD BE SENT TO US AS FOLLOWS

BANK NAME

ATTENTION

ADDRESS

TELEX

TELEPHONE

REGARDS,

(BANK OFFICER ON BEHALF OF BANK NAME)

INTERNATIONAL MONETARY FUND
WASHINGTON, D.C. 20431

FACSIMILE NUMBERS
Group 2/3 (202) 623-4661
Group 2/3 (202) 623-4662
Group 2/3 (202) 623-7491

mexico

Facsimile Service Cover Sheet

Number of pages (including cover sheet)	Message number	Date
		11/24/86

To	Name of addressee (type) Miss A. Demel Cleary, Gottlieb, Steen & Hamilton One State Street Plaza New York, New York 10004 212-269-5724 (GR. I, II & III) 212-480-0152 (GR. I, II & III) Facsimile telephone number 212-344-0925 (GR. I & II)
From	Name of sender (type) Mr. Sterie T. Beza International Monetary Fund 700 - 19th St., N.W. Wash., D.C. 20431

Text or special instructions

Department and division (type)	Extension (type)
WHD - Immediate Office	8631
Authorized by (type)	**Signature**
S. T. Beza	[signature]

SEC-56, Rev. 1
11-13-85

INTERNATIONAL MONETARY FUND

BEZA, STERIE T.

ROOM 10-100 08

PRESS RELEASE NO. 86/43

FOR IMMEDIATE RELEASE
November 19, 1986

The International Monetary Fund has approved a stand-by arrangement for the Government of Mexico, authorizing purchases up to the equivalent of SDR 1,400 million over the period through April 1, 1988. Purchases under the stand-by arrangement will be financed partly from the Fund's ordinary resources (SDR 382.8 million) and partly from resources borrowed by the Fund (SDR 1,017.2 million). The amount of Mexico's purchases under the arrangement may be augmented by up to SDR 600 million as described below. Mexico's quota in the Fund is SDR 1,165.5 million, and its outstanding financial obligations to the Fund resulting from past operations and transactions currently total the equivalent of SDR 2,913.2 million.

The economic program adopted by the Mexican authorities late in 1982 brought about a marked turnaround in economic conditions in 1983 and 1984. Under this program, which was supported by an extended arrangement from the Fund, the overall public sector borrowing requirement (PSBR) was reduced by the equivalent of close to 10 percentage points of gross domestic product (GDP) from 1982 to 1984, inflationary pressures abated, and the balance of payments improved markedly. The external current account shifted from a large deficit in 1981-82 to a surplus in 1983 and 1984, and Mexico was able to reconstitute its international reserves. Although output continued to fall in early 1983, the level of employment was preserved through the pursuit of restrained incomes policies. By the second half of 1983, an upward trend in real GDP was in evidence, and during 1984 the economy expanded by 3.7 percent, compared with a contraction of 5.3 percent in 1983 and 0.5 percent in 1982.

Economic performance began to falter in the latter part of 1984 and worsened in 1985, partly reflecting the weakening of the international petroleum market and the devastating earthquakes which struck in September 1985 and partly reflecting slippages in domestic policy implementation. Economic growth slowed to 2.7 percent in 1985, price pressures increased, and the balance of payments swung into deficit, despite the efforts of the authorities to implement a more flexible exchange rate policy, a tighter credit policy, cutbacks in public sector outlays, and a liberalization of import restrictions. Since the beginning of 1986, the steep fall of petroleum prices has had sizable negative effects on the public finances and the balance of payments. The loss of earnings from oil exports for 1986 is estimated at about US$9 billion, causing a direct loss in public sector revenue equivalent, on an annual basis, to some 6 1/2 percent of GDP and of more than 20 percent of total public sector receipts.

External Relations Department • Washington, D.C. 20431 • Telephone 202-623-7100

The economic program for 1986-87, which the stand-by arrangement supports, relies on demand management measures and on structural adjustment and reform to restore growth in the economy in the context of financial stability. The program has been framed in a medium-term context to encompass both measures to deal with pressing domestic and external imbalances, and supply policies to increase efficiency and thus reinforce the country's growth potential. The policies being adopted are expected to restore balance of payments viability over the medium-term, to help break the inflationary trend, to strengthen savings in the economy, and to improve efficiency in the use of resources as the basis for reestablishing sustained growth. The Mexican authorities believe that, with the economy already in recession, any attempt to compensate immediately and in full for the loss of export earnings through adjustment alone could not be sustained. Accordingly, the authorities are relying on the financial support from all creditors that have financed Mexico's development in the past to help them implement a growth-oriented program.

The program contains three special mechanisms that are aimed at insulating the implementation of the program from certain external shocks and uncertainties. In view of the unsettled conditions in the international petroleum market and the vulnerability of Mexico's economy and its investment program to changes in petroleum export receipts, some of the targets of the program and the structure and size of the financing package are related to the evolution of export receipts.

First, the amount of purchases under the stand-by arrangement may be augmented by up to SDR 600 million to finance a contingency mechanism if the export price of Mexican oil should fall below US$9 a barrel; if the export price of Mexican oil should rise above US$14 a barrel, there would be a reduction of foreign financing.

Under the second mechanism, designed to help protect the continued implementation of the country's economic program and its investment plan from unforeseen large changes in external conditions, commercial banks would provide additional financing to Mexico on a contingent basis for up to US$1.2 billion in case of a sudden decline in the external receipts of the public sector.

A third mechanism provides for a contingency increase in capital expenditure during 1987 if sufficient recovery from recession fails to materialize by the end of March 1987, despite appropriate policy implementation. The mechanism involves an increase in public investment in selected projects identified as having a high domestic content and substantial secondary repercussions on the private sector. The projects in question will have been jointly identified by the Mexican authorities and by the World Bank before disbursements under the mechanism take place, and the potential release of funds will be limited under this mechanism to US$500 million for the period of the program. This mechanism would be financed by commercial banks with World Bank participation taking the form of guarantees for up to 50 percent of disbursements.

A key element of the Mexican program is the strengthening of the public finances beyond the efforts that had been planned at the very beginning of 1986 The authorities plan to implement fiscal measures equivalent to 3 percentage points of GDP over the period through the end of 1987 These will include increases in revenues and cutbacks in spending in relation to GDP In this context, the authorities plan to reduce current spending in terms of GDP in order to make room for a 15 percent real increase in capital outlays In addition, the Government intends to intensify its efforts to restructure the parastatal sector

During the program period, the authorities plan to conduct monetary and credit policies consistent with the objective of reducing the rate of inflation and attaining their balance of payments target As a result of the tightening of fiscal policies and the resumption of use of external credits by the public sector, the authorities expect to limit the overall expansion of credit, while making room for private credit to support the recovery of economic activity Interest rate policy will be flexible and responsive to market forces

The Government's policies are designed to facilitate the shift of economic resources to the export sector and to encourage efficient import substitution activities To these ends, the Government intends to continue to pursue a flexible exchange rate policy guided by internal price and wage developments, the evolution of the terms of trade, and the balance of payments outcome Furthermore, the authorities are committed to continue the trade liberalization efforts begun in mid-1985 and which are being supported by a Trade Policy Loan of US$500 million from the World Bank In this context, the Government has completed steps to become a full member of the General Agreement on Tariffs and Trade

The authorities assign great importance to removing obstacles to the creation of productive employment In addition to the reduction in the number of parastatal enterprises, industrial reconversion plans are being carried out or planned in the sugar, fertilizer, and steel sectors, the railways and shipyards are being modernized, and a major airline has been offered for sale to the private sector Furthermore, the authorities have stated their intention to encourage foreign investment, especially in ventures to expand export capacity and activities that involve transfer of technology

The external financing package necessary to support attainment of the program's objectives seeks a reasonable balance between financing and adjustment External financing for the official sector (excluding any use of resources under the contingency mechanisms) for the 1986-87 period is to be provided as follows US$6 0 billion by the commercial banks, US$2 3 billion by the World Bank (including the net present value of its guarantees), US$0 4 billion by the Inter-American Development Bank, US$2 5 billion by official bilateral creditors, and about US$1 3 billion (net of repurchases) by the International Monetary Fund

IMF OFFICIAL MESSAGE
WASHINGTON, D. C. 20431

DO NOT SOFT ROLL EXCEPT WHEN ALIGNING INTO LINE 23

START ADDRESS IN THE BOX

SHEARMAN AND STERLING

153 EAST 53RD STREET

NEW YORK, NEW YORK 10022

ATTENTION: MR. MICHAEL CHAMBERLAIN

INTERNATIONAL MONETARY FUND
WESTERN HEMISPHERE DEPT.
1986 NOV 25 PM 2:55

mexico

MARK XX FOR CODE
(_______) CODE

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START TEXT HERE

I AM PLEASED TO CONFIRM THAT ON THE BASIS OF COMMITMENTS BY A CRITICAL MASS OF COMMERCIAL BANKS TO A 1986-87 COMMERCIAL BANK FINANCING PACKAGE FOR MEXICO I HAVE PROPOSED TO THE EXECUTIVE BOARD OF THE FUND THAT IT APPROVE THE MEXICAN STAND-BY ARRANGEMENT FOR SDR 1,400 MILLION FOR THE PERIOD UNTIL APRIL 1, 1988, IT BEING UNDERSTOOD THAT I HAVE CONSIDERED COMMITMENTS OF APPROXIMATELY 90 PERCENT TO CONSTITUTE A CRITICAL MASS. I AM FURTHER PLEASED TO CONFIRM THAT ON NOVEMBER 19, 1986 THE MEXICAN STAND-BY ARRANGEMENT BECAME EFFECTIVE.

REGARDS,

J. DE LAROSIERE

MANAGING DIRECTOR

INTERFUND

MD
DMD
MR. ORTIZ
ETR
LEG
WHD
MR. BROWN

DO NOT TYPE HERE

IF REQUIRED INITIAL BELOW

SPECIAL INSTRUCTIONS — TEXT MUST END HERE

TELEX NO.: 126698WU

DRAFTED BY NAME (TYPE): SAS/msb EXT.: 7715 DEPT.: Legal DATE: 11-21-86

AUTHORIZED BY NAME (TYPE): Sterie T. Beza

AUTHORIZED BY NAME (TYPE): Richard D. Erb (**)

TYPE ** ON LAST OR ONLY PAGE OF MESSAGE

Log A-3704

SIGNATURE (PLEASE KEEP SIGNATURE IN SPACE ALLOWED) SIGNATURE

EC. 48 REV 1
11-18-82

mexico

Rcv: @1IM/5.06150 Line: 5

INTERNATIONAL MONETARY FUND
WESTERN HEMISPHERE DEPT.
1986 NOV 24 AM 10 00

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1986 NOV 21 PM 7:14

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ORIG: TRE
CC:
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MR. ORTIZ
ETR
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INCOMING CABLE/TELEX

INTERNATIONAL MONETARY FUND
WASHINGTON, D.C.

NO. 29
TEST [redacted]

WE REFER TO YOUR TELEX NUMBER OCRA2040, DATED NOVEMBER 19 AND RECEIVED TODAY, RELATED TO OUR INTENDED PURCHASE EQUIVALENT TO SDR 225,000,000.00 UNDER STAND BY ARRANGEMENT.

1. AS FISCAL AGENCY FOR THE GOVERNMENT OF MEXICO WE DESIRE TO PURCHASE FROM THE INTERNATIONAL MONETARY FUND SDR 103,500,000 AND THE EQUIVALENTS OF SDR 3,000,000 IN FRENCH FRANCS AND SDR 118,500,000 IN SAUDI ARABIAN RIYALS TOTALING THE EQUIVALENT OF SDR 225,000,000 IN ACCORDANCE WITH TERMS OF ARTICLE V, SECTIONS 3 AND 4 AND WITH STAND-BY ARRANGEMENT EFFECTIVE NOVEMBER 19, 1986. THE VALUE DATE OF THE PURCHASE IS NOVEMBER 26, 1986.
2. WE DO HEREBY REPRESENT THAT THIS PURCHASE IS NEEDED IN ACCORDANCE WITH THE PROVISIONS OF FUND AGREEMENT.
3. PLEASE CREDIT MEXICO'S SDR ACCOUNT WITH SDR 103,500,000 ON VALUE DATE OF PURCHASE.
4. PLEASE PLACE FRENCH FRANCS AND SAUDI ARABIAN RIYALS EQUIVALENT TO SDR 6,000,000 AT OUR DISPOSAL AT BANQUE DE FRANCE, PARIS AND SAUDI ARABIAN MONETARY AGENCY, RIYADH AND REQUEST THESE INSTITUTIONS TO ARRANGE EXCHANGE OF CURRENCIES INTO U.S. DOLLARS AND PAYMENT OF PROCEEDS TO OUR ACCOUNT WITH FEDERAL RESERVE BANK OF NEW YORK, NEW YORK ON VALUE DATE OF PURCHASE.
5. WE UNDERSTAND THAT THE BALANCE OF SAUDI ARABIAN RIYALS EQUIVALENT TO SDR 112,500,000 WILL BE CONVERTED INTO JAPANESE YEN EQUIVALENT TO APPROXIMATELY SDR 95,400,000 AND INTO DEUTSCHE MARK EQUIVALENT TO APPROXIMATELY SDR 17,100,000 AND WILL BE PAID IN THOSE CURRENCIES. PLEASE ARRANGE EXCHANGE OF THESE CURRENCIES INTO U.S. DOLLARS AND PAYMENT OF PROCEEDS TO OUR ACCOUNT WITH FEDERAL RESERVE BANK OF NEW YORK, NEW YORK ON VALUE DATE OF PURCHASE.
6. THE EQUIVALENT OF DESIRED PURCHASE, NAMELY MEXICAN PESOS 133,459,873,064.83 WILL BE CREDITED TO FUND'S NO. 1 ACCOUNT WITH OURSELVES ON THE VALUE DATE OF PURCHASE.
7. REGARDING SERVICE CHARGE, PLEASE DEBIT MEXICO'S SDR ACCOUNT WITH SDR 1,125,000 ON VALUE DATE OF PURCHASE.
8. YOU ARE AUTHORIZED TO DEBIT MEXICO'S SDR ACCOUNT WITH SDR 3,500,000 VALUE NOVEMBER 19, 1986 IN PAYMENT OF CHARGE ON STAND-BY ARRANGEMENT.
9. PLEASE ARRANGE TO CREDIT OUR ACCOUNT WITH FEDERAL RESERVE BANK OF NEW YORK, NEW YORK WITH US DOLLARS EQUIVALENT TO SDR 98,875,000, ON VALUE DATE OF PURCHASE
10. WE STATE THAT ANY USE OF SDRS AT THIS TIME UNDER ARTICLE XIX, SECTION 2(A) IS IN ACCORDANCE WITH SECTION 3(A) OF THIS ARTICLE.
11. HOWEVER, WE AUTHORIZE YOU TO ARRANGE ON OUR BEHALF FOR ALL

PART OF THIS AMOUNT TO BE SOLD TO PARTICIPANTS OR PRESCRIBED HOLDERS THAT AGREE TO ACQUIRE THEM UNDER ARTICLE XIX, SECTION 2(B).

PLEASE CONFIRM EXECUTION BY TELEX TO US.

BANCO DE MEXICO

WELL RECD PLS?????

440040 FUND UI

1775805 BMCOME
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REPLY VIA ITT

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Time: 19:12 11/21/86 EST
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1986 NOV 21 PM 7:53

743989

November 21, 1986

10-100

To: Mr. Ted Beza
International Monetary Fund

FROM: Mr. E. Castro Tapia
Ministry of Finance of Mexico, NY

INTERNATIONAL MONETARY FUND
WESTERN HEMISPHERE DEPT.
1986 NOV 24 AM 9:36

MEXICO STATUS BY COUNTRY/REGION AS OF 1:00 P.M. NEW YORK TIME THURSDAY, NOVEMBER 20, 1986

COUNTRY/REGION	AMOUNT COMMITTED	% OF EXPECTED COMMITMENTS
ASIA	14,034,467	63.36
AUSTRALIA & NEW ZEALAND	3,938,996	7.66
AUSTRIA	14,253,464	46.01
BELGIUM & LUXEMBOURG	82,640,674	43.60
CANADA	606,401,857	89.64
FRANCE	548,801,537	81.60
GERMANY	333,586,299	77.49
INDIA	3,570,000	59.19
ITALY	90,862,247	46.86
JAPAN	1,547,005,562	97.51
LATIN AMERICA	5,451,790	3.68
MIDDLE EAST	47,096,625	29.24
NETHERLANDS	52,572,878	71.48
SCANDINAVIA	5,928,657	16.69
PORTUGAL	0	0
SPAIN	101,183,498	60.26
SWITZERLAND	181,359,505	73.29
UNITED KINGDOM & IRELAND	856,222,141	85.62
UNITED STATES	2,489,063,040	74.10
OTHER	0	0
TOTAL AMOUNT	6,983,973,237	
TOTAL AMOUNT COMMITTED AS PERCENT OF $7.7 Billion	90.70	

mexico

EW
STB
IO
JP
FI
Mr. Gurtián
Mr. Seland

CLEARY, GOTTLIEB, STEEN & HAMILTON
One State Street Plaza, New York, New York 10004 (212) 344-0600

FACSIMILE MESSAGE TO:

Fax Number(s): (202) 623-4661/623-4662

Name: Mr. Sterie Beza

Company: ~~International Monetary Fund~~

City: Washington, D.C.

State/
Country: U.S.A.

Telephone
Number: (202) 623-8631

From: Mark A. Walker

Date: November 20, 1986

Number of Pages
(including cover): 2

7133776

Our File Number: 24636-050

****

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212-344-0600, x 700 or x 738 IMMEDIATELY FOR RETRANSMISSION.

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212-422-5276 Rapifax
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1986 NOV 20 PM 1:02

(This space to be used for short or supplemental messages)

6

Dear Ted:

Now that a "critical mass" of banks has committed to the 1986-87 Commercial Bank Financing Package for Mexico, we are preparing for Mexico's drawings under the official and commercial bank facilities for contingency support. Before drawings may be made under the commercial bank bridge loan, we must receive a communication from the Managing Director in the form that follows, confirming his determination that critical mass has been obtained. You may recall that we cleared this text with the Fund some time ago. I would much appreciate your obtaining this message from Mr. de Larosiere and sending five signed copies to me as soon as possible.

Best regards,

Mark A. Walker/WJO

Mark A. Walker

Attachment

TO. CITIBANK, N.A., AS AGENT UNDER THE COMMERCIAL BANK FACILITY FOR CONTINGENCY SUPPORT FOR MEXICO'S INTERNATIONAL RESERVES

FROM: J. DE LAROSIERE, MANAGING DIRECTOR, INTERNATIONAL MONETARY FUND

DATE: __________, 198_

I AM PLEASED TO CONFIRM THAT ON THE BASIS OF COMMITMENTS BY A CRITICAL MASS OF COMMERCIAL BANKS TO A 1986-87 COMMERCIAL BANK FINANCING PACKAGE FOR MEXICO I HAVE PROPOSED TO THE EXECUTIVE BOARD OF THE FUND THAT THE MEXICAN STAND-BY ARRANGEMENT FOR SDR 1,400 MILLION FOR A PERIOD OF 18 MONTHS, REQUESTED BY MEXICO AND APPROVED IN PRINCIPLE BY THE EXECUTIVE BOARD, BECOME EFFECTIVE, IT BEING UNDERSTOOD THAT I HAVE CONSIDERED COMMITMENTS OF APPROXIMATELY 90% TO CONSTITUTE A CRITICAL MASS

REGARDS,

J. DE LAROSIERE
MANAGING DIRECTOR
INTERNATIONAL MONETARY FUND

Office Memorandum

Mr. Beza
c/c
RDE

TO	The Acting Managing Director	DATE	November 20, 1986
FROM	S. T. Beza		
SUBJECT	Mexico - Draft Buff		

Attached is a copy of the draft of the buff prepared by Mr. Pujol in connection with the Board meeting on Mexico. It has been reviewed by Mr. Guitián and myself. You might wish to look at it before we circulate it to Executive Directors.

Attachment

cc The Managing Director (o/r)
Mr. Brown

1986 NOV 20 AM 11 49
OFFICE OF THE
DEPUTY MANAGING DIRECTOR

EW
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Office Memorandum

INTERNATIONAL MONETARY FUND
WESTERN HEMISPHERE DEPT.

1986 NOV 21 PM 12: 26

November 19, 1986

To: Treasurer
Internal Auditor
Director, Exchange and Trade Relations Department
Director, Legal Department
Director, Western Hemisphere Department

For B. J. Owen

From: The Secretary

Subject: Mexico - Stand-By Arrangement

At EBM/86/185 (11/19/86), the Executive Board agreed to the request of Mexico for a stand-by arrangement for the period November 19, 1986 until April 1, 1988, and approved the stand-by arrangement as set forth in EBS/86/161, Supplement 6.

Office Memorandum

TO The Acting Managing Director DATE November 20, 1986

FROM S T Beza

SUBJECT Mexico - Draft Buff

Attached is a copy of the draft of the buff prepared by Mr Pujol in connection with the Board meeting on Mexico It has been reviewed by Mr Guitián and myself You might wish to look at it before we circulate it to Executive Directors

Attachment

cc The Managing Director (o/r)
Mr Brown

Statement by the Staff Representative on Mexico
Executive Board Meeting 86/185
November 19, 1986

In late July 1986, the Mexican authorities described their program of adjustment and structural reform aimed at coping with the impact of the sharp drop in the terms of trade since the beginning of the year and restoring growth in a context of financial stability This note reviews briefly recent developments, the progress made in the implementation of the program, and the results achieved so far

Indications are that economic activity has weakened as the year has advanced and the impact of the deterioration in the terms of trade has been reflected in domestic consumption and investment activity Industrial output declined by more than 4 percent in the period January-August 1986 when compared with the same period of 1985, with the 12-month decline reaching around 7 percent in July and August, agricultural output is expected to register a drop for the year as a whole, reflecting in large part adverse climatic conditions. The fall in industrial output reflects weakness in all of the major subsectors with the exception of electricity generation and those subsectors specifically linked to nonpetroleum exports and in-bond industries, these last mentioned activities have experienced a strong expansion

The weakening in economic activity is already being reflected in employment The indicators available show a decline of employment in manufacturing of the order of 7 percent from mid-1985 to mid-1986, and a considerable deceleration in the rate of growth of the number of persons covered by the social security system With respect to wages, a minimum wage award of 20-23 percent was granted in mid-October, following increases of 33 percent and 25 percent in January and June 1986, respectively, the cumulative rise in minimum wages for the year is around 100 percent

The movements in the national consumer price index up to October suggest that the rate of inflation in 1986 has continued to move up, although it has been somewhat less pronounced that had been assumed under the program. By October 1986 the 12-month rate of increase in the national consumer price index had reached almost 100 percent, compared with about 110 percent assumed in the program for the same period (the 12-month increase in consumer prices in December 1985 was about 60 percent) The lower-than-projected acceleration in the consumer price index may reflect an insufficient allowance for the effects of the weakening of domestic demand and the trade liberalization process upon inflation, to some extent, however, the difference between actual and projected price developments may also reflect some changes in the timing of corrective adjustments to public sector prices

Implementation of the fiscal measures contemplated under the program was expected to result in a significant portion of the adjustment in public sector prices being in place before the end of 1986, both to achieve an improvement in public sector receipts and to realign relative prices at the beginning of the program The price adjustments contemplated for the second half of 1986 were expected to yield public sector receipts of the order of 0 5 percent of GDP over and above the yield of the revenue measures already planned under the 1986 budget which had been approved in late 1985 With these adjustments, the primary fiscal balance in 1986--i e , the balance of the fiscal accounts before interest payments--was expected to remain relatively unchanged from the level observed in 1985 in relation to GDP, despite a loss of the equivalent of some 6 1/2 percentage points of GDP in petroleum export receipts But the rise in interest payments--both in nominal and real terms--was expected to result in a public sector borrowing requirement of 16.9 percent of GDP in 1986 compared with the one of 10 percent of GDP in 1985, and an operational 1/ deficit of 2 1 percent of GDP in 1986 compared with one of 0 9 percent of GDP in 1985

Since the adoption of the program a number of public sector price adjustments have been implemented in late July 1986, railway charges were raised by 50-60 percent and airline fares by 50 percent, in August, the price of regular gasoline was increased by 47 percent and that of the premium gasoline (which accounts for less than 10 percent of total gasoline sales) by 29 percent, and adjustments also were made in the prices of other petroleum derivatives, telephone tariffs and the fare for the subway in Mexico City, and, in October 1986, the price of regular gasoline was raised by 16 1/2 percent and that of premium gasoline by 13 percent

Final results for the public sector accounts through the end of the third quarter of 1986 are not yet available Information available throughout the end of August indicates that even though the fiscal

1/ The operational balance is obtained by adding algebraically to the primary balance an estimate of the real component of interest payments on the domestic debt denominated in Mexican currency and the interest payments on the nonfinancial public sector debt denominated in foreign currency performance in the first half of the year turned out somewhat weaker than estimated when the program was framed, a relatively comfortable margin remains under the limit for the cumulative total public sector borrowing requirement established under the program for end-September Most expenditure categories have show reductions in real terms from June to August, and despite a somewhat weaker than expected performance for public sector receipts the primary balance of the public sector was stronger than projected during that period While the primary balance in the first half of 1986 turned out to be almost Mex$600 billion weaker than estimated when the program was framed, the deviation between actual and programmed figures had been reduced to only Mex$200 billion for the period January-August

The operational balance in the period January-June 1986 was about Mex$250 billion weaker than estimated when the program was framed, and this shortfall was reduced to Mex$180 billion for the period January-August Thus, the strengthening of the primary balance during July and August did not translate fully into a concommitant reduction of the initial January-June shortfall at the level of the operational balance, reflecting higher than projected inflation-adjusted interest payments on the debt denominated in domestic currency The higher than programmed inflation-adjusted interest payments on domestic debt for the period July-August 1986 was the result of nominal interest rates behaving approximately as assumed under the program despite a lower than programmed rate of inflation, this continued to be the pattern in September

The above behavior of the operational deficit has raised a number of issues with respect to the methodology for its calculation This concept, which was introduced as a performance criterion at the request of the Mexican authorities, attempts to measure the fiscal performance net of the "amortization" component included within interest payments on the domestic debt Because this is a new concept for which there is no previous experience in Mexico as regards its measurement and monitoring for purposes of a program, the authorities and the staff are still in the process of trying to understand its behavioral characteristics under various patterns of inflation as well as its relationship to the more traditional ways of measuring the public sector deficit The staff mission currently in Mexico City is reviewing the performance of this variable under the program and the methodology for its calculation

Credit policy has been more restrictive than had been programmed Preliminary data indicate that the performance criterion on the cumulative change in net domestic assets of the monetary authorities was met with an ample margin as of September 30, 1986, as was the floor on the cumulative change in net international reserves of the monetary authorities Net credit to the public sector from the monetary authorities also was within the limit established under the program for end-September 1986

The broadest of Mexico's monetary aggregates, M5, had shown a sharp contraction in real terms in the first half of 1986 and the program did not project a turnaround in this trend until the fourth quarter of 1986 Data through September 1986 indicate that the 12-month rate of exchange of M5 in real terms continued to be negative, but the contraction during the third quarter was smaller than programmed. This performance seems to have been related to the pursuit of an active interest rate policy

Following the reintroduction of the system of auctions for treasury bills in July 1986 (the auction system had been suspended since September 1985), the real effective compounded yield on 30-day treasury bills--measured in relation to changes in the consumer price index over the previous 12 months--rose from 22 percent in June to over 31 percent at the end of September 1986 It has since declined somewhat Moreover, as of July 1986 the rate paid on 3-month deposits in the domestic banking system exceeded equivalent rates being paid abroad, after adjusting for the 12-month rate of depreciation in the peso-dollar exchange rate in the free market, for the first time since June 1985, this pattern has continued since July Nominal interest rates on peso-denominated deposits accompanied the rise in treasury bill rates with some lag and, as a consequence, the relative share of treasury bills in M5 has tended to grow

Net credit to the private sector from the financial system as a whole as of the end of August was somewhat below the amount envisaged under the program In particular, net credit to the private sector from development banks and official trust funds has been lower than originally programmed, and the financial intermediation operations of these institutions as of end-August 1986 showed a large margin under the third quarter ceiling

The authorities have continued to pursue a flexible exchange rate policy The Mexican peso in the controlled foreign exchange market is estimated to have depreciated in real terms by some 54 percent from June 1985 to September 1986, with an estimated real depreciation of more than 9 percent in the third quarter of 1986 In October and thus far in November 1986 the peso in the controlled market has depreciated at about 7-7 1/2 percent a month, which has been above the rate of domestic inflation With the increased flexibility in exchange rate management, the differential between the free and controlled markets has narrowed from a peak of almost 50 percent in November 1985 to less than 3 percent in the four-month period ended October 1986 Recently this differential has dropped to less than 1 1/2 percent

The sharp real depreciation of the peso and the restrictive stance of credit policy have done much to counter the pressures on the balance of payments arising from the drop in international oil prices, a related factor has been the downturn in economic activity In the period January-September 1986, the loss in oil earnings is estimated at close to US$7 billion when compared with the same period a year earlier Notwithstanding this large drop in oil receipts, net international reserves have declined by only US$2 6 billion in that same period (compared with a decline of about US$3 8 billion allowed for in the program), reflecting the turnaround in private current and capital transactions Following large reserve losses in May-August 1986, net international reserves began to recover in September, and a significant gain in international reserves was registered in October

The current account balance shifted from equilibrium in the period January-September 1985 to a deficit of about US$2 0 billion in the same period of 1986 This result is about US$0 7 billion better than had been projected because of the relatively strong performance in both oil and non-oil exports and because imports were lower than had been projected Exports of oil and oil derivatives, which amounted to US$4 5 billion in the period January-September 1986, were higher than projected because of larger volumes and unit prices than those assumed in the program for the third quarter of 1986 Non-oil exports (including in-bond industries) were US$7 7 billion in the period January-September 1986, some 28 percent higher than in the same period of 1985 and above program projections The performance of non-oil exports has reflected the improved competitiveness of Mexican products abroad, price increases of some agricultural goods in world markets, and the effects of the weakening in domestic economic activity

Imports have decreased by 12 percent--to US$8 8 billion--from the first three quarters of 1985 to the same period of this year Public sector imports have declined particularly sharply, by some 27 percent, because public sector investment has been curbed and because imports of foodstuffs have been cut sharply The latter development has come about as a result of high end-1985 inventories and of the transfer of some grain and food imports from the state marketing agency (CONASUPO) to the private sector Private sector imports have fallen by 5 percent in value terms from the first three quarters of 1985 to the same period of 1986 Within this total, imports of capital goods increased by 2 percent Interest payments abroad in the first nine months of 1986 were US$6 3 billion, approximately in line with program projections.

With regard to the capital account of the balance of payments, there have been substantial differences from the projections of the program Preliminary data show that net external capital flows to the public sector were negative by about US$1 billion in the period January-September 1986, compared with a small positive flow (including the proceeds of interest rebates) envisaged in the program. Shortfalls were recorded in disbursements from multilateral and bilateral sources. A large part of these shortfalls is explained by the change in the timing of the disbursement of the first tranche--about US$300 million--of the IBRD's Trade Policy loan and of other loans from the World Bank, as it turned out, disbursement of the first tranche of the trade policy loan was authorized only this week With respect to bilateral sources, the smaller than projected flows may be related to the performance of imports, it may also be the case that some export credit agencies have postponed the decision to reopen cover to Mexico in light of the delays in concluding the financial package with the commercial banks and the arrangement with the Fund With regard to the credits from the Commodity Credit Corporation of the United States (CCC), the negative flows reported in the period may be the result of not capturing some credits utilized by the private sector with government guarantee. In light of the restructuring of CONASUPO's role in the marketing and importing of foodstuffs, an intensification of the use of these lines by the private sector had been expected Adjusting for the estimated use of these lines by the private sector would result in rates of utilization not very different from those assumed in the program

In contrast with developments in the capital account of the public sector, the private sector capital account has been strong, reflecting, inter alia, the tight stance of domestic credit policy Net private capital transactions (including errors and omissions) shifted from an outflow of US$3 3 billion in January-September 1985 to an inflow of US$0 5 billion in the same period of this year However, caution has to be excercised in interpreting this change since the private capital account and the errors and omissions include the impact of certain transactions that might be attributable to shifts in public sector operations In particular, part of the improvement from 1985 to 1986 can be traced to changes in the government-owned petroleum company's (PEMEX) working balances abroad and lags between exports shipped in late 1985 before petroleum prices dropped and actual cash receipts, cash receipts from petroleum exports in early 1986 exceeded actual shipments by some US$0 7 billion In addition, the shift in the use of CCC credits from the public sector to the private sector may explain some of the improvement in the private capital account

The process of trade liberalization that was initiated in July 1985 has continued to be implemented Indications are that the liberalization of trade has contributed to the growth in non-oil exports and may have been a factor in moderating pressures on consumer prices

As regards, quantitative restrictions on imports, on October 31, 1986 the authorities exempted 210 tariff items from import permit requirements These items, which correspond to about 5 7 percent of domestic production, consist mainly of raw materials and capital goods With this measure, the number of tariff lines remaining subject to permits are 638, representing 28 3 percent of imports during the period January-August 1986, however, these items still correspond to about one half of domestic production

The authorities have continued to review official reference prices with a view to reducing their incidence   In the period since July 1986, the number of tariff items subject to official reference prices have been reduced from 1,004 to 981 (at the beginning of 1986 official reference prices numbered 1,191)   The objective is to eliminate reference prices by the end of 1987, when it is expected that the rules and regulations on dumping practices will be fully implemented   The authorities are in the final stages of preparation of these rules and regulations, and expect to publish them shortly

The process of rationalizing the tariff structure has continued Currently, there are 11 tariff levels, but the objective is to reduce them to only 5, with the final structure covering a range of 0-30 percent by October 31, 1988   In the course of this year the dispersion of the tariff has declined from 22 7 percent to 14 1 percent and the weighted average tariff has dropped from 13 3 to 12 5 percent

Mexico has concluded the negotiations on the accession to the GATT and it is currently processing its adherence to the various special codes

The Government recently presented to Congress the budget proposal for 1987   According to the message accompanying this document the budget has been framed on the basis of inflation of 70-80 percent during 1987, a gradual recovery of economic activity, and a buildup of international reserves. It envisages an overall public sector borrowing requirement of 13 8 percent of GDP and an operational deficit of between zero and one percent of GDP. According to the original program, additional fiscal measures yielding the equivalent of 2 1/2 percentage points of GDP are to be implemented in 1987, including the effect of the realignment of public sector prices and tariffs undertaken before the end of 1986, the introduction of a tax reform, and cuts in current outlays The tax and expenditure measures are being incorporated in the budget proposal for 1987 that is expected to be approved by the Congress before the end of 1986 The staff is currently reviewing with the authorities the 1987 budget as well as the overall policy strategy of the authorities for 1987.

Table 1 Mexico Stand-By Arrangement - Quantitative Performance Criteria

	1985	1986 March Actual	1986 June Prel	1986 June Actual	1986 Sept Prog	1986 Sept Actual	1986 Dec Prog	Jan -Dec 1987
Cumulative overall public sector borrowing requirements 1/ 2/								
Unadjusted	4,580	1 077	4,000	4 079	8,350		13,640	3/
Adjusted	--				4/		4/	5/
Cumulative changes in financial intermediation (effective flows)	389	-12	300	146	600		898	3/
Cumulative nonfinancial public sector operational balance 6/								
Unadjusted	-888	719	186	-67	-340		-1,670	3/
Adjusted	--				4/		4/	5/
Cumulative changes in net domestic assets of the monetary authorities (effective flow) 7/	1,409	138	1,108	1 097	2,779	1,602	711	3/
Net credit to the public sector by the monetary authorities 8/								
Unadjusted	5,735 9/	6,489	7,978	7,973	9,624	9,447	8,206	3/
Adjusted 10/	--				13 133		13,700	3/
Cumulative net foreign borrowing by the public sector 1/								
Unadjusted	400	-352	-500	-765	-100	-1,169	5,000	5,100
Adjusted	--				4/		4/	5/
Cumulative change in net international reserves of the monetary authorities	-3,400	-342	-1,863	-1,863	-3,763	-2,624	500	900

Sources Mexican authorities and Fund staff estimates

1/ Limit tested at the end of each period
2/ Effective flows of financing measured on a cash basis
3/ To be agreed upon with the Fund during the first review under the program
4/ Adjustment for additional external financing authorized in line with provisions under oil price contingency mechanism
5/ Adjustment for additional external financing authorized in line with provisions under oil price and supplementary capital expenditure mechanisms
6/ Defined as the difference between the overal public sector borrowing requirements excluding cumulative changes in financial intermediation and the inflation component of the stock of domestic public sector debt denominated in local currency
7/ Net domestic assets of the Bank of Mexico for purposes of the ceiling are defined as the difference between note issue and net international reserves of the monetary authorities
8/ Effective stocks calculated by adding effective flows to nominal stocks outstanding as of December 1985
9/ Stock outstanding at the end of December 1985 unadjusted for changes in the exchange rate (used as base)
10/ Ceiling can be adjusted upwards by an amount equivalent to the commercial banks' lending to the nonfinancial public sector that would result from implementing mandatory portfolio requirements The counterpart of this adjustment would be an equivalent peso reduction of the commercial banks' lending to the nonfinancial public sector based on mandatory portfolio requirements

Table 2 Mexico Public Sector Operations

(In billions of Mexican pesos)

	January-June			July-August			January-August		
	Prel	Actual	Difference	Proj	Actual	Difference	Proj	Actual	Difference
Public sector borrowing requirement (PSBR)	-4 000	-4 079	-79	-3,039	-2,496	543	-7,039	-6 575	464
Financial intermediation	-300	-146	154	-200	76	276	-500	-70	430
Overall economic balance (deficit -)	-3 700	-3 933	-233	-2 839	-2 572	267	-6 539	-6 505	34
Primary balance (deficit -)	1,838	1 262	-576	-132	253	385	1,706	1 515	-191
Interest payments	-5 538	-5 195	343	-2 707	-2,825	-118	-8 245	-8 020	225
Payments on debt denominated in foreign currency	-1,606	-1 422	184	-668	-623	45	-2 274	-2 045	229
Payments on debt denominated in domestic currency	-3,932	-3 773	159	-2,039	-2,202	-163	-5,971	-5 975	-4
Real component	-46	93	139	50	-306	-356	4	-213	-217
Inflation component	-3 886	-3 866	20	-2 089	-1 896	193	-5 975	-5 762	213
Operational balance (deficit -)	186	-67	-253	-750	-676	74	-564	-743	-179
a Primary balance (deficit -)	1 838	1,262	-576	-132	253	385	1 706	1,515	-191
b Interest payments on debt denominated in foreign currency	-1 606	-1 422	184	-668	-623	45	-2 274	-2 045	229
c Real component of interest payments on debt denominated in domestic currency	-46	93	139	50	-306	-356	4	-213	-217

Sources Secretariat of Finance and Public Credit Bank of Mexico· and Fund staff estimates tbmex165(11-19-86)

Table 3 Mexico Balance of Payments

(In billions of U S dollars)

	1985	1985 Jan -Sept	1986 Jan -Sept Est	1986 Jan -Sept Prog
Current account	0 5	--	-2 0	-2 7
Exports	23 1	17 1	12 3	11 7
Oil	14 8	11 0	4 5	4 2
Other	8 4	6 0	7 7	7 5
Imports	-13 5	-10 0	-8 8	-9 4
Interest payments	-9 9	-7 6	-6 3	-6 2
Other	0 7	0 5	0 8	1 2
Official capital	0 4	--	-1 0	0 2
Commercial banks	0 2	0 2	-0 3	-0 2
Drawings	1 3	1 3	0 4	
Amortization	-1 1	-1 1	-0 7	
Multilaterals	0 7	0 4	-0 1	0 4
Drawings	1 2	0 8	0 3	
Amortization	-0 5	-0 4	-0 9	
Bilaterals and suppliers	0 3	0 2	-0 1	0 2
Drawings	1 1	0 6	0 8	
Amortization	-0 8	-0 4	-0 9	
CCC	-0 3	-0 3	-0 4	-0 1
Drawings	0 3	0 2	0 1	
Amortization	-0 6	-0 5	-0 5	
Other and short-term	-0 5	-0 4	-0 5	-0 4
Drawings	1 2	0 9	0 5	
Amortization	-1 7	-1 3	-1 0	
Interest rebate	--	--	0 4	0 3
Private capital (net)	-4 3	-3 3	0 5	-1 3
Interest earnings abroad	-1 3	-0 9	-0 9	
Debt amortization	-1 1	-1 3	-0 4	
External credits				
Direct investment	0 5	0 5	0 4	
Other payments and errors and omissions	-2 4	-1 6	1 4	
Net international reserves (increase -)	3 4	3 3	2 6	3 8

Sources Mexican authorities and Fund staff estimates

FORM NO 75
(6-83)

THE WORLD BANK/IFC

ROUTING SLIP	DATE November 18, 1986

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REMARKS

Re MEXICO

Attached is the final version of the press release

FROM	ROOM NO	EXTENSION
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FOR IMMEDIATE RELEASE

Mexico

World Bank

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1818 H Street, N.W., Washington, D.C. 20433, U.S.A.

DRAFT

World Bank Releases First Tranche of Mexican Trade Policy Loan

Washington, November 18 ---- The World Bank today released $ 300 million to Mexico as the first tranche of its $ 500 million trade policy loan.

The loan, approved by the Bank last July, 29 is the first in a series supporting Mexico's program of growth oriented structural reforms. Many of the trade liberalization measures had already been implemented by Mexico.

" Mexico's resource needs are urgent to finance the costs of its trade liberalization and its investments in expanded output and exports, " noted World Bank President Barber Conable. He added that " the progress made by commercial banks now leads me to believe that they will soon fully commit their share of new resources to Mexico. "

The $ 300 million from The World Bank is available immediately for withdrawal by the Mexican Government. The loan assists Mexico to secure greater domestic economic efficiency and increased international trade competitiveness in order to generate domestic growth, higher employment and additional non-oil export revenue.

As part of the trade liberalization program, Mexico has recently joined the GATT, eliminated import restrictions on more than half of the total value of imports and reduced maximum tariffs from 100% to 45%. At the same time, the Government announced that it would remove all import reference prices by the end of 1987 and gradually reduce the tariff range to 0-30% by November 1988.

The World Bank is prepared to support Mexico's program of economic adjustment in the next several years through follow-up trade policy loans, an agricultural sector loan, and specific industrial restructuring projects. Its lending program for infrastructure and other sectors of the Mexican economy will also be expanded. The World Bank's support for Mexico's economic recovery program is also indicated by its willingness to guarantee a portion of some of the new loans included in the financial package negotiated between Mexico and private commercial banks.

Note: Money figures are expressed in U.S. dollar equivalents.

Mr. Beza

EW
STB
JP
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F

Office Memorandum

To: The Managing Director
The Deputy Managing Director

November 18, 1986

From: L.A. Whittome LAW

Subject: Mexico

I made the contacts which you asked me to do, the position is as follows:

1. Spain. Governor Mancera is presently in Madrid and Governor Rubio tells me that he, together with Mancera, have been meeting the main Spanish banks involved. As of now, with two exceptions, the main Spanish banks say that they are prepared to join the package and a formal answer is expected within a matter of a few hours. Minister Solchaga has also been active in this matter. If the position of the two banks, who have not yet made a decision, leads to difficulties for the others I could approach one of them directly for I personally know its chairman.

2. Ireland. I have spoken to the Governor of the Central Bank of Ireland who assures me that he has spoken to the Irish banks concerned but in careful terms as the Central Bank is also the supervising authority. I happen to know the General Manager of the largest Irish bank (the Bank of Ireland) and after talking to the Governor I spoke directly to him. He said that he was not personally aware of the position but would take immediate steps to find out where matters stood and to expedite a reply.

3. Portugal. We have spoken to the Central Bank and will be speaking with the Chairman of the Banco Totta e Açores who is well known to us. I would hope that at the least the Banco Totta e Açores and the Banco Espirito Santo e Commercial de Lisboa will withdraw their negative response.

cc: Mr. Beza
Mr. Brown

1986 NOV 18 PM 12: 14
INTERNATIONAL MONETARY FUND
WESTERN HEMISPHERE DEPT.

MEXICO

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INTERNATIONAL MONETARY FUND
WESTERN HEMISPHERE DEPT.

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SR. STERIE BEZA
FONDO MONETARIO INTERNACIONAL

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SR. JORGE BONVICINI-FMI

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sp6jp001--11/17/86 (Draft No. 4)

Draft, Buff

In late July 1986, the Mexican authorities adopted a program of adjustment and structural reform aimed at coping with the impact of the sharp drop in the terms of trade since the beginning of the year and restoring growth in a context of financial stability. The economic policies supporting this program involve a combination of fiscal, monetary and exchange rate measures, together with structural policies--particularly with respect to the role played by the state in economic activities and commercial policy designed to strengthen the savings performance of the economy, improve efficiency, and thus restore balance of payment viability and break the inflationary trend. This note reviews briefly the current developments, the progress made in the implementation of the program, and the results achieved so far.

Indications are that economic activity has progressively weakened as the year has advanced and the decline in consumption and investment demand brought about by the deterioration in the terms of trade has permeated throughout the economy. Industrial output declined by more than 4 percent in the period January-August 1986 when compared to the same period of 1985, with the 12-month decline reaching around 7 percent in July and August, and agricultural output is expected to show a decline in real terms for the year as a whole, mostly reflecting adverse climatic conditions. The drop in industrial output reflects weakness in all of the major subsectors with the exception of electricity generation and those subsectors specifically linked to nonpetroleum exports and in-bond industries, which have experienced a very sharp expansion.

The drop in economic activity is already being reflected in the employment situation. The indications available show a decline in employment in manufacturing of the order of 7 percent by mid 1986 over the level attained in mid 1985, and a considerable deceleration in the rate of growth of individuals covered by the social security system. With respect to wages, minimum wage increases of 20-23 percent were granted in mid October, following average increases of 33 percent and 25 percent in January and June, respectively, so that the cumulative increase in minimum wages for the year is around 100 percent.

Changes in the national consumer price index up to October suggest that the upward trend of domestic inflation in 1986 has continued, but is within the level envisaged under the program. Through end-October 1986 the 12-month rate of increase in the national consumer price index reached almost 100 percent, compared with 110 percent assumed in the program for the same period. The lower-than-projected rise in the consumer price index likely reflects some underestimation of the effects of the weakening of domestic demand and the trade liberalization process upon inflation; to some extent, however, this difference also mirrors some deviations from the original schedule of corrective adjustments to public sector prices.

The implementation of the fiscal measures contemplated under the program was timed so that a significant portion of the adjustment in public sector prices would occur before the end of 1986, both to achieve an improvement in public sector receipts and to realign relative prices in order to eliminate existing distortions. The price adjustments contemplated for the second half of 1986 were expected to yield additional public sector receipts in the order of 0.5 percent of GDP over and above the yield of the revenue and expenditure measures already contemplated under the budget for 1986 that had been approved in late 1985. As a result of these efforts the primary fiscal balance--i.e., the balance of the fiscal accounts before interest payments--in 1986 was expected to remain relatively unchanged from the level observed in 1985, despite a loss of the equivalent of some 6 1/2 percentage points of GDP in petroleum export receipts. But the rise in interest payments--both in nominal and real terms--was expected to result in a much higher level of public sector borrowing requirements (16.9 percent of GDP in 1986 compared to 10 percent of GDP in 1985) and in a somewhat higher operational 1/ deficit (2.1 percent of GDP in 1986 compared to 0.9 percent of GDP in 1985).

Since the adoption of the program, a number of public sector price adjustments have been announced: in late July 1986, railway charges were raised by 50-60 percent and airline fares by 50 percent; in August, the price of regular gasoline was increased by 47 percent and that of the premium gasoline (which accounts for less than 10 percent of total gasoline sales) by 28 1/2 percent, and adjustments were also introduced in the prices of other petroleum derivatives, telephone tariffs and the fare for the subway in Mexico City; and, in October 1986 the price of regular gasoline was raised by another 16 1/2 percent and that of premium gasoline by 13 percent.

Final results for the public sector accounts through the end of the third quarter of 1986 are not yet available. Information available throughout the end of August, indicates that, even though the fiscal performance in the first half of the year turned out somewhat weaker than originally estimated for purposes of the program, a comfortable margin remains under the limit for the cumulative total public sector borrowing requirements established under the program for end-September. Most expenditure categories have contracted in real terms between end-June and end-August and, despite a somewhat weaker than expected performance for public sector receipts, the primary balance of the public sector was stronger than projected during that period. While the primary balance in the first half of 1986 turned out to be almost Mex$600 billion weaker than was estimated for purposes of the program, the deviation between actual and programmed figures had been reduced to only Mex$200 billion for the period January-August.

The operational balance in the period January-June 1986 was about Mex$250 billion weaker than initially estimated, and this shortfall was reduced to Mex$180 billion for the period January-August. Thus, the strengthening of the primary balance during July and August did not translate fully into a concommitant reduction of the initial January-June shortfall at the level of the operational balance, because of higher than projected inflation-adjusted interest payments on the debt denominated in domestic currency. The higher than programmed inflation-adjusted interest payments on domestic debt for the period July-August 1986 reflect the prevalence of nominal interest rates similar to those assumed under the program together with a lower than programmed rate of inflation, a deviation which persisted in September. The program envisaged a surplus at the level of the operational balance for the month of September.

The above deviations at the level of the operational deficit have raised a number of issues with respect to the methodology for its calculation. This concept, which was first introduced at the request of the Mexican authorities as a performance criterion, attempts to measure the fiscal performance net of the "amortization" component included within interest payments on the domestic debt. Because this is a new concept for which there is no previous experience as regards its measurement and monitoring for purposes of a program, the authorities and the staff are still in the process of fully grasping its behavioral characteristics under different inflationary scenarios and its relationship to the more traditional ways of measuring the public sector deficit. The staff mission currently in Mexico City is reviewing the performance of this variable under the program and the methodology for its calculation.

Monetary policy has been more restrictive than programmed. Preliminary data indicate that the performance criterion on the cumulative change in net domestic assets of the monetary authorities was met with an ample margin as of September 30, 1986, as was the floor on the cumulative change in net international reserves of the monetary authorities. Net credit to the public sector from the monetary authorities was within the limit established under the program for end-September 1986.

The performance of financial savings---as measured by the broadest monetary aggregate (M5)---had shown a sharp contraction in real terms in the first half of 1986 and the program did not expect a turnaround in this trend until the fourth quarter of

1986. Data through September 1986 show a large contraction of M5 in real terms on an annual basis, although the outturn during the third quarter has been better than programmed. This performance seems to have been related to a more active interest rate policy. Following the reintroduction of the system of auctions for treasury bills in July 1986 (the auction system had been suspended since September 1985) the real effective compounded yield on 30-day treasury bills (measured in relation to changes in the consumer price index over the previous 12 months) rose from an average of 22 percent during the period of administered rates to over 31 percent at the end of September 1986. It has since declined somewhat over the past six weeks. Moreover, the rate paid on 3-month deposits in the domestic banking system exceeded equivalent rates being paid abroad (when adjusted for the 12-month rate of depreciation in the peso-dollar exchange rate in the free market) in July 1986 for the first time since June 1985, and continued to do so subsequently. Nominal interest rates on peso-denominated deposits accompanied the rise in treasury bill rates with some lag and, as a consequence, the relative share of treasury bills in M5 has tended to grow.

Net credit to the private sector from the financial system as of the end of August was within the amount envisaged under the program; however, in real terms the contraction of this credit to the private sector was less than programmed.

Net credit to the private sector from development banks and official trust funds has been lower than originally programmed, as the financial intermediation operations of these institutions --which are subject to ceilings under the program--as of end-August 1986 showed a very large margin under the third quarter ceiling.

The authorities have continued to pursue a flexible exchange rate policy. The Mexican peso in the controlled foreign exchange market is estimated to have depreciated in real terms by almost 54 percent from June 1985 to September 1986, with an estimated real depreciation of more than 9 percent in the third quarter of 1986 alone. In October and early November the peso in the controlled market has continued to depreciate at about 7-7 1/2 percent per month, or above the rate of domestic inflation. With the increased flexibility in exchange rate management, the differential between the free and controlled markets has narrowed from a peak of almost 50 percent in November 1985 to less than 3 percent in the four-month period ended October 1986. By mid-November this differential had been reduced to less than 1 1/2 percent.

The sharp depreciation of the exchange rate and the restrictive stance of credit policy have been of the essence in moderating the pressures on the balance of payments largely arising from the drop in international oil prices. Another contributing factor has been the downturn in economic activity. In the period January-September 1986, the loss in oil earnings is estimated at close to US$7 billion when compared with the same period a year earlier. Notwithstanding this substantial shortfall in oil receipts, net international reserves have declined by only US$2.6 billion, reflecting the turnaround in private current and capital transactions. Following the heavy losses that occurred in May-August 1986, net international reserves began to recover since the first week of September and this trend intensified during October. The decline in net international reserves has been about US$1.2 billion less than was allowed for in the program for the third quarter of 1986.

The current account balance turned from equilibrium in the period January-September 1985 to a deficit of about US$2.0 billion in the same period of 1986. This result is about US$0.7 billion better than the program projection, because of the relatively strong performance in both oil and non-oil exports and of lower than projected imports. Exports of oil and oil derivatives, which amounted to US$4.5 billion in the period January-September 1986, were higher than projected because of larger volumes and unit prices than those assumed in the program during the third quarter of 1986. Non-oil exports (including in-bond industries) amounted to US$7.7 billion in the period January-September 1986, rising by more than 28 percent over the same period of 1985 and exceeding program projections. The performance of non-oil exports has reflected the enhanced competitiveness of Mexican products abroad, price increases of some agricultural goods in world markets, and the downturn in domestic economic activity.

Reflecting overall macroeconomic conditions, imports have decreased by 12 percent--to US$8.8 billion--in the first three quarters of 1986. In particular, public sector imports have declined very sharply, at a rate of 27 percent, because public sector investment has been lower than anticipated and because imports of foodstuffs have been cut sharply. The latter development has come about as a result of high end-1985 inventories and of the transfer of some grain and food imports from the state marketing agency (CONASUPO) to the private sector. Private sector imports have only fallen by 5 percent and, within this total, imports of capital goods increased by 2 percent. This reflects, in part, the rise in operations under the system of temporary imports for exports. Interest payments stood at US$6.3 billion, and are about in line with program projections. Net receipts under other items of the current account did not grow in line with projections, as tourism, border transactions, and other items did not respond, in nominal terms, to the depreciation of the peso with the strength that was anticipated.

With regard to the capital account of the balance of payments, there have been substantial changes with respect to the program. Preliminary data show that net external capital flows to the public sector were negative by about US$1 billion in the period January-September 1986, compared to a small positive flow (including the proceeds of interest rebates) that was anticipated in the program. Shortfalls were recorded in disbursements from multilateral and bilateral sources, including the CCC. A large part of these shortfalls is explained by delays in disbursement of the first tranche---about US$300 million---of the IBRD's Trade Policy loan and of other loans from the World Bank. With respect to bilateral sources, the smaller than projected flows may be related to the marked decline in imports; it may also be the case that some export credit agencies have postponed the decision to reopen cover to Mexico in light of the delays in finalizing the arrangement with the Fund. With regard to the CCC, the negative flows reported in the period may not be capturing some utilization by the private sector with government guarantee. In light of the restructuring of CONASUPO's role in the marketing and importing of foodstuffs, an intensification of the use of these lines by the private sector was expected. Adjusting for the estimated use of these lines by the private sector would result in amounts similar to those incorporated in the program.

In contrast with developments in the public sector capital account, the private sector capital account has been strong, reflecting, inter alia, the tight stance of credit policies and the increased yields on peso-denominated financial instruments relative to yields abroad. Net private capital (including errors and omissions) shifted from an outflow of US$3.3 billion in January-September 1985 to an inflow of US$0.5 billion in the same period of this year. However, caution has to be excercised in interpreting the extent of this result as these capital flows include some changes that might be attributable to public sector operations. In particular, part of the improvement in 1986 can be traced to changes in PEMEX's working balances abroad and lags between exports shipped in late 1985 at higher petroleum prices and actual cash receipts; cash receipts from petroleum exports in early 1986 exceeded actual shipments by some US$0.7 billion. In addition, the use by the private sector of credits guaranteed by CCC may have contributed to the improvement in the private capital account.

The process of <u>trade liberalization</u> that was initiated in July 1985 has continued to be implemented. Indications are that the liberalization of trade has contributed to the growth in non-oil exports and may have been a factor in moderating pressures on consumer prices.

As regards, quantitative restrictions to imports, on October 31, 1986, the authorities exempted 210 tariff items from import permit requirements. These items, which represent about 5.7 percent of domestic production, consist mainly of raw materials and capital goods. With this measure, the number of tariff lines remaining subject to permits are 638, representing 28.3 percent of imports during the period January-August 1986. However, these items still represent about one half of domestic production.

The authorities also have continued to review official reference prices. In the period since July 1986, the number of tariff items subject to official reference prices have been reduced from 1,004 to 981 (at the beginning of 1986 official reference prices numbered 1,191). The objective is to eliminate reference prices by the end of 1987, when it is expected that the rules and regulations on dumping practices will be fully implemented. The authorities are in the final stages of preparation of these rules and regulations, and expect to publish them shortly.

The process of rationalization of the tariff structure has continued. Currently, there are 11 tariff levels, but the objective is to reduce them to only 5, with the final structure covering a range of 0-30 percent by October 31, 1988. During the course of this year the dispersion of the tariff has declined from 22.7 percent to 14.1 percent and the weighted average tariff has dropped from 13.3 to 12.5 percent.

Finally, Mexico has concluded the negotiations on the accession to the GATT and is currently in the process of processing its adherence to the various special codes.

The Government has recently presented to Congress the budget for 1987. According to the message accompanying this document the budget has been framed on the basis of a target end-of-period inflation of 75-80 percent, a gradual recovery of economic activity, and a buildup of international reserves. It envisages an overall public sector borrowing requirement of 13.8 percent of GDP and an operational deficit of between zero and one percent of GDP. According to the original program, additional fiscal measures yielding the equivalent of 2 1/2 percentage points of GDP are to be implemented in 1987, including the effect of the realignment of public sector prices and tariffs undertaken before the end of 1986, the introduction of a tax reform, and cuts in current outlays. The tax and expenditure measures are being incorporated in the budget proposal for 1987 that should be approved by Congress before the end of 1986. The staff is currently in the process of reviewing the 1987 budget as well as the overall policy strategy of the authorities for 1987.

1/ The operational balance is obtained by adding algebraically to the primary balance an estimate of the real component of interest payments on the domestic debt denominated in Mexican currency and the interest payments on the nonfinancial public sector debt denominated in foreign currency.

Mexico : Stand-By Arrangement- Quantitative Performance Criteria

	1985	1986 March Actual	1986 June Prel.	1986 June Actual	1986 Sept. Prog.	1986 Sept. Actual	1986 Prog. Dec.	1987 Prog. Dec.
Cumulative overall public sector borrowing requirements 1/ 2/								
Unadjusted	4580	1077	4,000	4,079	8,350	...	13,640	... 3/
Adjusted	--				4/		4/	5/
Cumulative changes in financial intermediation (effective flows)	389	-12	300	146	600	...	898	... 3/
Cumulative nonfinancial public sector operational balance 6/								
Unadjusted	-898	719	186	-67	-340	...	-1,670	... 3/
Adjusted	--				4/		4/	5/
Cumulative changes in net domestic assets of the monetary authorities (effective flow) 7/	1,409	138	1,109	1,097	2,779	1,602	711	... 3/
Net credit to the public sector by the monetary authorities 8/								
Unadjusted	5,735 9/	6,489	7,578	7,973	9,624	9,447	8,206	... 3/
Adjusted 10/	--				13,133		13,700	... 3/
Cumulative net foreign borrowing by the public sector 1/								
Unadjusted	400	-352	-500	-765	-100	-1,169	5,000	5,100
Adjusted	--				4/		4/	5/
Cumulative change in net international reserves of the monetary authorities	-3,400	-342	-1,063	-1,863	-3763	-2,624	500	900

Sources: Mexican authorities; and Fund staff estimates.

1/ Limit tested at the end of each period.
2/ Effective flows of financing measured on a cash basis.
3/ Limit to be agreed upon with the Fund before December 31, 1986.
4/ Adjustment for additional external financing authorized in line with provisions under oil price contingency mechanism.
5/ Adjustment for additional external financing authorized in line with provisions under oil price and supplementary capital expenditure mechanisms.
6/ Defined as the difference between the overal public sector borrowing requirements

Sources: Mexican authorities; and Fund staff estimates.

1/ Limit tested at the end of each period.

2/ Effective flows of financing measured on a cash basis.

3/ Limit to be agreed upon with the Fund before December 31, 1986.

4/ Adjustment for additional external financing authorized in line with provisions under oil price contingency mechanism.

5/ Adjustment for additional external financing authorized in line with provisions under oil price and supplementary capital expenditure mechanisms.

6/ Defined as the difference between the overal public sector borrowing requirements excluding cumulative changes in financial intermediation and the inflation component of the stock of domestic public sector debt denominated in local currency.

7/ Net domestic assets of the Bank of Mexico for purposes of the ceiling are defined as the difference between note issue and net international reserves of the monetary authorities.

8/ Effective stocks calculated by adding effective flows to nominal stocks outstanding as of December 1985.

9/ Stock outstanding at the end of December 1985 unadjusted for changes in the exchange rate (used as base).

10/ Ceiling can be adjusted upwards by an amount equivalent to the commercial banks' lending to the nonfinancial public sector that would result from implementing mandatory portfolio requirements. The counterpart of this adjustment would be an equivalent peso reduction of the commercial banks' lending to the nonfinancial public sector based on mandatory portfolio requirements.

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Table 5. Mexico: Public Sector Operations

(In billions of Mexican pesos)

	January-June			July - August			January-~~July~~ August		
	Program	Actual	Difference	Program	Actual	Difference	Program	Actual	Difference
Public sector borrowing requirement (PSBR)	-4,000	-4079 ~~-3,932~~	-79	-3039 ~~-1,505~~	-2496 ~~1,470~~	543 ~~85~~	-7039	-6575 ~~-5,428~~	464 ~~88~~
Financial intermediation	-300	-146 ~~-126~~	154	-200 ~~-100~~	76	276	-500 ~~-400~~	-70 ~~-214~~	530
Overall economic balance (deficit -)	-3,700	-3933 ~~-3,826~~	-233	-2839 ~~-1,405~~	-2572 ~~-1,302~~	266	-6639	-6505	34 ~~-105~~
Primary balance (deficit -)	1,838	1262 ~~1,429~~	-576 ~~-409~~	-132	253	385 ~~146~~	1706 ~~1,666~~	1518	-191
Interest payments	-5,538	-5195 ~~-5,255~~	343 ~~208~~	-2707 ~~-1,295~~	-2825 ~~-1,338~~	-118 ~~-103~~	-8245 ~~-6,773~~	-8020 ~~-6,593~~	225
Payments on debt denominated in foreign currency	-1,606	-1,422	184	-668	-623	45	-2274 ~~-1,990~~	-2045 ~~-1,722~~	229
Payments on debt denominated in domestic currency	-3,932	-3773 ~~-3,833~~	159 ~~99~~	-2039 ~~-911~~	-2202 ~~-1,038~~	-163	-5971 ~~-4,849~~	-5975 ~~-4,871~~	-4
Real component	-46	93	139	50	-306	-356	4	-213	-21
Inflationary component	-3,886	-3,866	20	-2089 ~~-889~~	-1896 ~~-878~~	193 ~~211~~	-5975 ~~-4,775~~	-5762 ~~-4,544~~	213 ~~231~~
Operational balance (deficit -)	186	-67	-253	-750	-677 ~~-904~~	73 ~~-408~~	-564 ~~-330~~	-744 ~~-464~~	-18 ~~-234~~
a. Primary balance (deficit -)	1,838	1262 ~~1,429~~	-576	-132 ~~-270~~	253	385 ~~126~~	1706 ~~1,666~~	1515	-19 ~~-288~~
b. Interest payments on debt denominated in foreign currency	-1,606	-1,422	184	-668 ~~-324~~	-623 ~~-300~~	45	-2274	-2045	229
c. Real component of interest payments on debt denominated in domestic currency	-46	93	139	50 ~~-422~~	-306 ~~-460~~	-356 ~~-338~~	4	-213 ~~-327~~	-217 ~~-239~~

Sources: Secretariat of Finance and Public Credit; Bank of Mexico; and Fund staff estimates.

[illegible]-11-13-86

Table . Mexico: Balance of Payments, 1985-87

(In billions of U.S. dollars)

	1985	Jan.-Sept. 1985	Jan.-Sept. 1986 Est.	Jan.-Sept. 1986 Prog.
Current account	0.5	--	-2.0 ~~-2.1~~	-2.7
Exports	23.1	17.1	12.3	11.7
Oil	14.8	11.1	4.5	4.2
Other	8.4	6.0	7.7	7.5
Imports	-13.5	-10.0	-8.8	-9.4
Interest payments	-9.9	-7.6	-6.3	-6.2
Other	0.7	0.5	0.8 ~~0.7~~	1.2
Official capital	0.1	--	-1.0	0.2
Commercial banks	0.2	0.2	-0.3	-0.2
Drawings	1.3	1.3	0.4	...
Amortization	-1.1	-1.1	-0.7	...
Multilaterals	0.7	0.4	-0.1	0.4
Drawings	1.2	0.8	0.3	...
Amortization	-0.5	-0.4	-0.4	...
Bilaterals and suppliers	0.3	0.2	-0.1	0.2
Drawings	1.1	0.6	0.8	...
Amortization	-0.8	-0.4	-0.9	...
CCC	-0.3	-0.3	-0.4	-0.1
Drawings	0.3	0.2	0.1	...
Amortization	-0.6	-0.5	-0.5	...
Other and short-term	-0.5	-0.4	-0.5	-0.4
Drawings	1.2	0.9	0.5	...
Amortization	-1.7	-1.3	-1.0	...
Interest rebate	--	--	0.4	0.3
Private capital (net)	-4.3	-3.3	0.5	-1.3
Interest earnings abroad	-1.3	-0.9	-0.9	...
Debt amortization	-1.1	-1.3	-0.4	...

Table . Mexico: Balance of Payments, 1985-87 (Concluded)

(In billions of U.S. dollars)

	1985	1985 Jan.-Sept.	1986 Jan.-Sept. Est.	1986 Jan.-Sept. Prog.	[illegible]
External credits	...	...	...	...	[illegible]
Direct investment	0.5	0.5	0.4	...	[illegible]
Other payments and errors and omissions	-2.4	-1.6	1.4	...	[illegible]
Net international reserves (increase -)	3.4	3.3	2.6	3.8	[illegible]

Sources: Mexican authorities; and Fund staff estimates.

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NOVEMBER 13, 1986

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WHD

TREASURER
INTERFUND
WASHINGTON, D.C.

REF: JACG/86/T-69

MEXICO WISHES TO ACQUIRE SDR 500,000 AGAINST U.S. DOLLARS IN A TRANSACTION TO BE ARRANGED BY THE FUND VALUE NOVEMBER 17, 1986.

BANXICO...

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Mr. Wiesner

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1986 NOV 12 PM 5: 18

OFFICE OF
THE MANAGING DIRECTOR

Office Memorandum

TO: The Managing Director

DATE: November 12, 1986

FROM: Hellmut Hartmann H.H.

SUBJECT: Mexico

After a speech to the National Association of Manufacturers, Mr. Conable today stated, apparently in response to questions from reporters, that the critical mass for the fresh money facility for Mexico has been assembled (as reported in the attached wire service report). Although no official confirmation from the World Bank could be obtained, the World Bank's press office believes that Mr. Conable in effect did make this statement.

In response to questions from the press, the World Bank's press office is now saying that the statement was incorrect. If you agree, we could refer journalists calling the Fund to the denial from the World Bank's press office and say that if the critical mass were assembled, the Fund's Executive Board would meet to consider it, and to take action on the proposed Fund program, which would then be announced by us.

Attachment

cc: Mr. Wiesner
Mr. Beza
Mr. Gardner
Mr. Brown

INTERNATIONAL MONETARY FUND
WESTERN HEMISPHERE DEPT.
1986 NOV 12 PM 5: 11

Mr. Wiesner

Office Memorandum

TO: The Managing Director DATE: November 12, 1986

FROM: Hellmut Hartmann H.H.

SUBJECT: Mexico

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Attachment

cc: Mr. Wiesner ✓
Mr. Beza
Mr. Gardner
Mr. Brown

-WORLD BANK HEAD BLASTS BRADLEY PLAN TO EASE LATIN DEBT'
SAYS "CRITICAL MASS" FOR MEXICAN PACKAGE HAS BEEN REACHED

WASHINGTON -(DJ)--WORLD BANK PRESIDENT BARBER CONABLE VOICED STRONG OPPOSITION WEDNESDAY TO A PLAN BY SENATOR BILL BRADLEY, DEMOCRAT, NEW JERSEY, TO HELP EASE THE DEBT CRISIS OF LATIN AMERICAN NATIONS BY FORGIVING A PORTION OF THEIR LOANS.

CONABLE SAID SUCH A PLAN, EXPECTED TO BE CONSIDERED BY CONGRESS EARLY NEXT YEAR, WOULD BACKFIRE, DRYING UP SOURCES OF NEW LOANS COMPLETELY.

SPEAKING TO THE NATIONAL ASSOCIATION OF MANUFACTURERS, CONABLE SAID THE BRADLEY PLAN WOULD BE FAR LESS EFFECTIVE IN DEALING WITH THE THIRD WORLD DEBT CRISIS THAN A PLAN PUT FORWARD BY TREASURY SECRETARY JAMES BAKER.

THE BRADLEY PROPOSAL WOULD CUT THE INTEREST RATES ON INTERNATIONAL LOANS BY 3 PERCENTAGE POINTS AND CANCEL 9 PC OF THE PRINCIPAL THAT DEBTOR NATIONS OWE OVER THREE YEARS.

BUT CONABLE SAID THE BRADLEY PROPOSAL WOULD DO NOTHING TO REVITALIZE THE ECONOMIES OF DEVELOPING NATIONS AND COMMERCIAL BANKS WOULD BALK AT MAKING NEW LOANS WHERE CORRESPONDING STEPS WEREN"T BEING TAKEN TO SPUR GROWTH.

"HOW DO YOU GET THE ADDITIONAL CAPITAL? (BANKS) SIMPLY WON"T COME FORWARD TO MAKE THE NEW LOANS," THE FORMER NEW YORK REPUBLICAN CONGRESSMAN SAID.

THE BAKER PLAN WOULD MAKE 29 BILLION DLRS AVAILABLE OVER THE NEXT THREE YEARS TO 15 DEBTOR NATIONS, MOST OF THEM IN LATIN AMERICA, THAT HAVE DEBTS TOTALLING NEARLY 450 BILLION DLRS. BUT THE LOANS, OF WHICH 20 BILLION DLRS WOULD COME FROM COMMERCIAL BANKS, WOULD BE TIED TO ECONOMIC REFORMS IN THE RECIPIENT NATIONS.

CONABLE SAID THAT THIS APPROACH MADE MORE SENSE, AT LEAST FROM HIS VANTAGE POINT AS HEAD OF THE 151-NATION LENDING ORGANIZATION.

"COMMERCIAL BANKS MUST BE CONVINCED THAT OLD DEBT AND NEW DEBT WILL BE BETTER MANAGED BY A GROWING ECONOMY," HE

SAID.

THE FIRST LOAN PACKAGE TO BE PUT TOGETHER UNDER THE OUTLINES OF THE BAKER PLAN IS AN ARRANGEMENT FOR MEXICO THAT HAS TAKEN MONTHS TO PUT TOGETHER. SOME COMMERCIAL BANKS HAD DELAYED COMMITTING FUNDS TO THE PACKAGE, AND A DEADLINE SET BY THE INTERNATIONAL MONETARY FUND WAS MISSED. BUT CONABLE SAID THE "CRITICAL MASS" OF PRIVATE BANK LOANS THAT WILL MAKE UP THE BULK OF THE MEXICAN PACKAGE HAS NOW BEEN ASSEMBLED.

HE SAID THAT COMPLETION OF THE REST OF THE PACKAGE SHOULD BE ANNOUNCED IN THE NEAR FUTURE.

ON ANOTHER SUBJECT, CONABLE PRAISED RECENT STEPS TAKEN BY JAPAN TO STIMULATE DEMAND FOR THE PRODUCTS OF OTHER NATIONS AND TO PUMP FUNDS INTO THE ECONOMIES OF SOME DEVELOPING NATIONS.

HE SAID RECENT LOANS BY JAPAN TO COLOMBIA AND MEXICO "WEREN'T TIED TO THE PURCHASE OF JAPANESE GOODS, AND THAT'S GOOD NEWS."

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-(DJ-11-12-86 1934GMT)

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√ (1) Mexico (2) Colombian (3) Colo. (4) V

Office Memorandum

CONFIDENTIAL

TO The Managing Director
The Deputy Managing Director

DATE November 11, 1986

FROM E Wiesner EW

SUBJECT Visits to Europe, Colombia, and Venezuela

In this memorandum I would like to inform you, as succintly as possible, about (a) the presentations I made of the Mexican economic program to the international banking community in London, Frankfurt, and Paris, October 21-24, 1986, (b) discussions with the Colombian authorities in Bogota, October 27-28, 1986, (c) Annual Meeting of the Colombian Bankers' Association in Cartagena, October 29-31, 1986, and (d) discussions with the Venezuelan authorities in Caracas, November 3-7, 1986

Presentation of the Mexican economic program

For reasons of brevity I will just report on two specific points which seem to warrant particular attention First, what I said about the intrinsic strength of the Mexican adjustment effort and, secondly, what the representatives of the Bank of England and of the Bundesbank expressed in terms of their support to the Mexican proposal

After explaining--and defending--the main economic features of the Mexican proposal, I echoed the remark you made in New York on July 23, 1986, when you informed a group of major creditor banks that this plan was not without risks I indicated that surely we wanted the support of the international banking community but that we could not guarantee a future without any difficulties

A similar message was delivered by Mr A Crawford from the Bank of England and by Mr G Laske from the Bundesbank bank In his very carefully worded statement, Mr Crawford emphasized that the proposal under consideration was the preferred and realistic alternative, given the constraints of the situation Mr Laske, on his part, clearly hinted that this proposal was the best way to increase bank exposure under a concerted scheme The implicit idea was that exposure was going to increase anyway and that it was preferable to do it under a managed, controlled, and mutually agreed procedure

My general impression of the meetings was that the banks appear to have resigned themselves to go along with the proposal But they are not happy at all with the idea At the end of the day what seems to persuade them is the specter of the risk of an unraveling of the concerted case-by-case approach

Discussion with the Colombian authorities

In Bogota I met with the Minister of Finance, Mr C Gaviria, and with the Governor of the Central Bank, Mr F Ortega The main topic that we discussed was the modality of the relationship that Colombia would like to have with the Fund in 1987 once the current arrangement expires at the end of 1986 The authorities are examining basically three possibilities (a) to propose an extension to the current special arrangement without major changes, (b) to move into an enhanced surveillance type of arrangement, similar to the one the Fund now has with Venezuela, and (c) to simply return to the traditional Article IV consultation exercise

The authorities seem to feel that the first possibility is not really necessary as the country is no longer facing major imbalances and has made considerable progress in its adjustment path But since the third possibility may not be sufficient to convince the commercial banks that Colombia is creditworthy of truly voluntary lending, the authorities may, in the end, propose to the Fund an enhanced Article IV type of arrangement

The authorities will continue to study this matter over the next few weeks and will probably wait until the Board discussion in early December before they adopt a position to be proposed to management

Annual Meetings with the Colombian Bankers' Association

The highlight of this meeting was the speech made by the Minister of Finance of Colombia, in which he emphasized the importance of strengthening the financial sector of the country He also made some comments on the tax reform which he has just proposed to Congress

Discussions with the Venezuelan authorities

Together with Mr Hardy (WHD) and other members of the mission in Caracas, I met twice with the Minister of Finance, Mr Azpurua, and with the Governor of the Central Bank, Mr Anzola, to discuss with them the policy actions required to deal with the large--and growing imbalances--of the Venezuelan economy As you know, the situation is very serious Currently, there is a 200 percent spread between the official exchange rate (Bs 7 50) and the free market rate (Bs 24 00), and the Central Bank is rapidly losing reserves at a rate of more than US$300 million per month. The overall public sector balance seems to be moving from a surplus of about 5 percent of GDP in 1985 to a deficit of about 5-6 percent of GDP in 1986 Monetary policy is expansionary and interest rates are negative in real terms

In view of this situation, we strongly urged the authorities not to postpone the adoption of a strong adjustment program and to implement a managed and controlled transition from the present situation to a sustainable one In particular, we urged them to deal with the external imbalance along the lines of the mission's briefing We also stressed the need for fiscal correction and for a nonexpansionary credit policy

While the authorities acknowledged that the present situation was indeed grave, they seemed hesitant to move forcefully and with a comprehensive and consistent program They were very concerned that if they officially devalued the bolívar they could then be forced to adjust salaries and that inflation would accelerate They also felt that the fiscal situation was not as serious as we saw it because some institutions in the public sector had reserves and savings which could be utilized What seemed to concern them the most was the upward pressure that the unresolved issue of the private sector debt was apparently putting on the free exchange rate Thus, the Central Bank was putting forward a scheme whereby it would get from the private debtors an amount still to be determined in bolívares in exchange for an implicit guarantee on the exchange rate at which they would be able to pay principal and interest to their foreign creditors over an eight-year period The premium charged by the Central Bank to provide the guarantee would form a fund to finance investment projects in the export sector

We had a long a detailed discussion on this scheme with the Governor of the Central Bank and his advisors Our position was that this type of proposal had the high risk of (a) generating large losses to the Central Bank, (b) introducing rigidities in the management of exchange rate policy, and (c) making future monetary and credit policy extremely difficult In brief, we unambiguously stated strong reservations about this scheme Furthermore, we urged the Governor of Central Bank and the Minister of Finance not to embark on this type of exchange rate guarantee before a comprehensive and consistent policy package had been structured Surely it would not be advisable to act in a piecemeal fashion when what was needed was a global and coherent strategy

During my last day at Caracas we met with Mr Carmelo Lauria, a very influential Minister who is President Lusinchi's Cabinet Secretary and who impressed us very well with his clear views on the problems Venezuela is facing today During our discussions he agreed with us that it was better for the Government to move with a comprehensive package in which the measures on the private sector external debt were just one component of the whole strategy

We will know more about the final position of the authorities when Mr Hardy and the rest of the mission return to Washington at the end of this week They were going to have a final discussion with the economic team on Thursday, November 13, 1986

cc Mr Whittome
Mr Finch
Mr Brown

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WASHINGTON, D. C. 20431

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Mexico

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DISTRIBUTION
CC Mr. Mohammed
Mr. Brown, R.

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UPON MY RETURN TO WASHINGTON TODAY, I WOULD LIKE TO WRITE TO YOU TO EXPRESS MY APPRECIATION FOR THE EXCELLENT HOSPITALITY YOU AND YOUR ADVISORS (MESSRS. MURTFELD, VAN DER BOY AND NEUHAUS) PROVIDED TO US DURING OUR RECENT VISIT TO FRANKFURT WHEN WE WENT TO PRESENT THE MEXICAN ECONOMIC PROGRAM TO THE INTERNATIONAL BANKING COMMUNITY. IN PARTICULAR I WISH TO THANK YOU FOR THE SPECIAL ARRANGEMENT YOU PUT TOGETHER SO SWIFTLY ON OCTOBER 23 SO THAT WE COULD GET INTO PARIS THAT SAME EVENING. THAT WAS CERTAINLY MOST KIND ON YOUR PART.I LOOK FORWARD TO SEEING YOU AGAIN IN THE FUTURE.

CORDIALLY YOURS,

EDUARDO WIESNER

INTERFUND

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Office Memorandum

TO: The Managing Director (o/r)
The Deputy Managing Director (o/r)

November 6, 1986

FROM: A.F. Mohammed

SUBJECT: Airlie House Discussion of Mexico

I attended a meeting at Airlie House on October 16-18 sponsored by the Stanley Foundation. The focus of the discussion group in which I participated was the economic and political situation in Mexico. The participants included U.S. government officials as well as non-governmental experts on Mexico. I was the only non-U.S. participant (see attachment 2).

The attached draft summary prepared by the group rapporteur covers quite well the key points discussed and the common ground established in the discussion, but a few of the main disagreements deserve mention. Several of the nongovernmental participants argued that the new financing package for Mexico was not only inadequate, but represented the wrong approach to the problem. They favored negotiated debt relief, possibly along the lines of the Bradley Plan. I noted that two of the advocates of this position are employed as consultants by New York investment banks. I took part in the discussion to point out some of the longer-run advantages of maintaining debt servicing, and the risks inherent in adopting an approach involving compulsory write-offs of loans. The academics in the group tended to be rather dismissive of the innovative elements in the latest Mexican package, regarding it as a crutch for Mexican policy-makers in dealing with public opinion in their own country.

A second theme prompting extensive discussion within the group was the political stability (or fragility) of Mexico's ruling party. Quite a few of the political experts present expected Mexico's economic difficulties to lead to major changes within Mexico's ruling party, the PRI, perhaps including its fragmentation. They felt that these political changes would be likely to disrupt implementation of the policy reforms agreed to by the current government.

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1986 NOV -7 PM 3:45

Attachment

cc: Mr. Habermeier
Mr. Finch
Mr. Wiesner/Mr. Beza
Mr. Whittome
Mr. Brown

INTRODUCTION

The Mexican economic turmoil triggered in August 1982 with the announcement that Mexico was unable to meet its foreign debt obligations has put severe strains on the Mexican political system and US-Mexican bilateral relations The current situation is fundamentally different than anything Mexico has faced since the Institutional Revolutionary Party (PRI) was founded in 1929 Marginal economic tinkerings and political posturing cannot solve it Real economic reforms within the system are necessary, and Mexico must recognize that it cannot simply look to the United States to solve Mexico's problems

In analyzing Mexico's economic situation, the group repeatedly addressed a fundamental question. Will the stagnation of the Mexican economy lead inevitably to the breakdown of the Mexican political system? The prevailing view was that although current economic pressures are more severe than anything that Mexico has faced in the past, the Mexican political system has already weathered a series of crises and will probably also withstand this one. In the process, however, the political system is likely to undergo a significant evolution.

A SENSE OF CRISIS

Mexico's current economic difficulties are different from those it has faced in the past both in severity and circumstance. The severity of the crisis stems from two unprecedented sets of pressures 1)the need to generate $9-10 billion per year to service Mexico's approximately $100 billion foreign debt and 2)the need to create 800,000 new jobs each year for new entrants into the Mexican labor force.

The circumstances surrounding the current economic crisis are different in that it is strongly influenced by developments over which Mexico has limited or no control Mexico's ability to service its foreign debt is determined to a great extent by oil prices, interest rates and foreign exchange rates, all of which are influenced by international markets And the need to create massive numbers of new jobs each year is a result of past population increases.

These pressures are compounded by the fact that whereas in the past Mexico has enjoyed general price stability, today the country is beginning to slide toward hyper-inflation. In 1986 its inflation rate is expected to surpass 100% Real wages in Mexico have declined by some 40% over the past four years, and the move to index wages to inflation is only likely to exacerbate the wage-price spiral. Together, these events have created a new kind of economic crisis -- one that is not only deep seated but also continuous.

The group agreed that there are only two ways out of this economic conundrum 1)genuine reform of the Mexican economy and 2)continued increased foreign lending to Mexico Over the past four years, there has been an attempt to link these two alternatives by making new bank loans conditional on internal economic reforms. The group emphasized that conditionality should continue to be integral to efforts to solve Mexico's economic problems.

Despite the promises accompanying the new international loans that have been pumped into the Mexican economy, however, domestic economic reforms have not taken root. Some members of the group believed that the government had not done as much as it could to institute genuine reform, while others believed that the initiatives taken so far simply needed to be given more time to achieve results

Privatization measures have been widely discussed, but pledges to sell off parastatal enterprises have not been kept and lay-offs of public employees have been undercut by quiet rehirings. In theory, import barriers have been lowered, but in practice controls have, if anything, been tightened in several key sectors. Supposed foreign investment incentives have not resulted in a reduction of the legal restrictions governing foreign investment, and disinvestment by Mexicans remains a serious problem. The public sector deficit has been significantly reduced, but savings were achieved largely by reducing subsidies and cutting back on infrastructure investment rather than by trimming Mexico's bloated bureaucracy or clamping down on corruption. The only initiative to date that holds any real promise for economic reform is Mexico's decision to accede to the General Agreement on Tariffs and Trade (GATT), which should gradually lower Mexican trade barriers But even here real progress is unlikely in the near future

These shortcomings raise the question whether Mexico will continue to operate in a statist economic mode, albeit a more modernized one, or whether the economic crisis will generate genuine efforts to liberalize the economy While affirming that statism is entrenched in Mexico, the group also stressed that it will be difficult to resist some measure of economic liberalization Nonetheless, it was widely agreed that the reform measures implemented under de la Madrid have been inadequate Just why this is the case is unclear. Is de la Madrid not intellectually convinced of the need for a new economic paradigm and therefore content to make shallow symbolic concessions aimed at international public opinion? Or is he convinced of the need for reform, but unable to implement any significant changes because of political restraints?

The group discussed two reasons for the lack of progress. First, government and business in Mexico have traditionally had a cosy relationship, and it is doubtful whether either is genuinely interested in changing it. While the PRI and the Mexican state enjoy an economic spoils system based on widespread corruption, the private sector enjoys protection from foreign competition. As a result, there is entrenched bureaucratic resistance to any reform Closely related to this is the fact that de la Madrid does not have a strong popular or institutional base De la Madrid has been criticized for not exercizing strong leadership, but it is uncertain whether he could push through any fundamental reforms even if he were convinced of their importance Second, there is simply no clear idea of what should be done Unable to define the national interest in terms of concrete programs, de la Madrid has cloaked his office in appeals to nationalist sentiments, just as other Mexican Presidents have before him. Consequently, exhortations about Mexico's dignity, sovreignty and self-determination replace the specific programs and long term commitments necessary to rebuild the economy.

Although Mexico's motives and goals may be murky, the group agreed that the US interest in Mexican economic reform is clearcut The United States cannot continue to excuse Mexico for its unwillingness to press forward with genuine economic reforms that will lay the foundation for sustained economic growth. Inefficient parastatal enterprises should be sold, import liscenses should be cut back, concrete changes in foreign investment laws should be enacted, and investor confidence should be restored so that capital flight can be reduced. Without these reforms, the Mexican economy will remain underdeveloped.

So far, Mexico has attempted to meet the twin challenges of foreign debt and the need to create new jobs by extensive reliance on the United States Although the United States has an important role to play, Mexico must also take the initiative Foreign banks cannot continue to bail out Mexico indefinately, and the United States cannot be expected to welcome ever increasing numbers of Mexican immigrants just because Mexico finds illegal migration a convenient substitute for domestic job creation.

If bank loans are replaced by government capital from the United States, Japan and West Germany, specific quid pro quos will be demanded that will force internal economic reforms in Mexico. And the tougher new US immigration law, even if it is only marginally effective, will restrain Mexico's exodus of illigal migrant workers Mexico would be better off facing difficult economic choices squarely and implementing economic reforms now rather than waiting for its economic crisis to be compounded by international impatience.

POLITICAL PRESSURES

Although the group emphasized the pronounced impact that the economic crisis is having on the political system, the prevailing opinion was that Mexico is probably not headed for a political breakdown in the near or medium term It was stressed that a "breakdown" is the final result of a long process that has many steps and can be influenced along the way The more likely scenario involves changes in the way the political system is organized and works The Mexican political system has proven remarkably resilient in dealing with economic strains and tensions in the past, and although the current crisis is without precedent, it is premature to predict that a political collapse is imminent

Economic dislocation has already led to some significant political developments The polarization of the the elites that was begun by the excesses of the Echeverria and Lopez Portillo administrations today runs much deeper The traditional compact between Mexican businessmen and politicians held that the private sector was free to make substantial profits as long as it stayed out of politics This consensus, however, has been broken by the enduring economic crisis that has stripped firms of profits, eroded workers' real wages and tipped the balance to the state at the expense of the private sector. The political system has also been affected. In the past, elections served to confer the PRI with legitimacy and to convey stability. Because economic hardship and de la Madrid's push for political reform sparked heightened dissent and therefore heightened repression, however, elections now serve notice of political illegitimacy and instability.

The 1983 municipal elections in the northern state of Chihuahua, which were widely believed to be honest, marked a turning point Economic discontent and dislike of the PRI were so prevalent during these elections that the Party of National Action (PAN), which draws support mainly from the private sector and urban middle classes in the north, not only gained control of the seven main city councils but also won the elections for mayor in the state capital and in Ciudad Juarez, which borders the United States and is the fourth largest city in Mexico The PRI responded to these defeats by putting its ballot rigging machine back into full swing in 1984, and when protests of electoral fraud erupted in Coahuila de la Madrid called in the army.

While some members of the group saw these developments as evidence of the fact that the PRI is becoming more authoritarian and willing to go to any extreme to maintain its power, others were not so sure The PRI has not resorted to widespread repression in the past, and since the Mexican military is relatively small the PRI's ability to implement such a campaign is limited.

These political developments are indicative of the increasing disparity between the north and the south. The most dynamic sectors of the Mexican economy are to be found in the north and are increasingly integrated with the United States. These sectors are beginning to resent the political control exercized by the south. As a result, Mexico faces the threat that it will be split into a modern, affluent, relatively democratic north that is closely aligned with the United States, and a backward, destitute, undeocratic south that remains resolutely independent

It is unclear whether Mexico can open its economy without significantly opening its political system. Demands for democratization predate the 1982 crisis and have been given new impetus by Mexico's economic difficulties and other Latin American nations move toward more democratic forms of government. Those calling for political reform argue that Mexico has simply outgrown the PRI's one party system. They claim that what was appropriate for a rural Mexico of 20 million is unsuited for a largely urban Mexico of 80 million where political events are closely monitored by the media.

DEBT AND IMMIGRATION

Before turning to policy recommendations, the group briefly discussed foreign debt and immigration. It was strongly emphasized that despite the up to $7 7 billion in new loans that foreign commercial banks agreed to lend Mexico in October 1986, new commercial bank lending to

Mexico cannot continue There is little hope that the new loan package, which will push Mexico's foreign debt to over $110 billion, will do more than tide Mexico over for a few years while it attempts to get its economic house in order. Mexico cannot expect to meet its debt service obligations indefinately by continued international borrowing Debt restructuring must be linked to conditionality, and Mexico must begin to institute the economic reforms that will provide the basis for long term economic growth

Turning to immigration, it was pointed out that Mexico must create 800,000 new jobs annually just to provide employment for the new Mexicans entering the labor force In this context, the 300,000 Mexicans who migrate to the United States each year to work represent an important safety valve for the Mexican economy. When it is considered that US wage levels are 3-4 times higher than Mexico's and that many migrant workers send their wages back to Mexico to support family members, the net benefit to the Mexican economy is actually much greater. Although the tighter US immigration laws recently passed are very controversial, the group agreed that Mexico has no incentive to act on the immigration issue unless the United States tightens its restrictions.

RECOMMENDATIONS

1. Past discussions of US-Mexican relations have tended to emphasize the mutuality of interests between the two countries. Realism leads us instead to recognize that there are a great many conflicting interests that must be faced squarely, discussed openly and managed in a businesslike manner. The preponderant size and strength of the Untied States creates an obvious asymmetry between the two countries, but the fact that the two economies are extensively and irrevocably integrated must be accepted Mexico cannot continue to hide behind jingoistic nationalism and wait for its domestic problems to be solved by the United States. Instead, a sense of joint responsibility is necessary. There are indications that Mexico's attitude toward the United States is beginning to change as a new generation of Mexicans assumes leadership roles and a new realism that focuses more on the future than the past takes root. We are encouraged by this trend

2. Mexico's willingness to accept its share of responsibility for bilateral problems with the United States seems to follow unilateral US decisions that force Mexico to act In this regard, independent US actions are more effective than American exhortations. Mexico's economic problems predate its debt crisis, and the United States must create accumulating pressure on Mexico to reform its

economy. Soft options only delay necessary reforms. To the extent that economic reform and liberalization lead to a decentralization of decision making, they may also lead to more open channels of political representation, and the United States should encourage this trend The group was divided on the wisdom and potential benefits of pressing specifically for democratic reform in Mexico

3 Little steps can add up to big improvements in US-Mexican bilateral relations, and there is a need for more government and nongovernment exhanges between the two countries. Informal military contacts should be broadened, student exchanges and academic centers should be expanded, and sectoral communications should be increased We are pleased with recently announced US programs to expand research on Mexico, but these efforts will not be effective unless they are focused. In particular, more research needs to be devoted to such issues as the PAN, the changing nature and evolving role of the Mexican elites, econoimc complimentarities, and long term assessment of US labor needs as they relate to immigration.

4. Capital flight and a lack of investment remain serious problems for Mexico and must be addressed. The United States cannot command expatriated capital to return or force greater investment in the Mexican economy Mexico alone can solve these problems by creating a stable domestic

environment that promotes confidence in the future of the Mexican economy Welcoming greater foreign investment is an important part of this process, and less ambivalence on the part of the Mexican government is required

5 Foreign debt remains a critical problem for Mexico and other developing nations The United States should take the lead, in concert with multilateral development banks, creditors and other debtor nations, to introduce a reorganization of domestic economic policies in debtor countries that go hand in hand with a reduction of the debt burden. This process is key to restoring Mexican economic growth. The modalities of debt reduction determined for Mexico could also find selective application elsewhere.

6. The United States should schedule an early visit to Mexico by a high ranking official to discuss with the Mexican foreign minister the new US immigration and drug laws. This mission would represent an attempt to share directly with Mexicans US approaches to issues intimately involving the two countries Mexico can then begin to address these issues domestically with full knowledge of the US postion. Other areas where the two countries can cooperate more closely should also be explored since these kinds of confidence building measures can help improve the overall state of the US-Mexican bilateral relationship.

"US Policy Toward Mexico"
27th Strategy for Peace, US Foreign Policy Conference
Sponsored by The Stanley Foundation
October 16-18, 1986, Airlie House, Warrenton, Virginia

Chair: Susan Kaufman Purcell, Director of the Latin American Program, Council on Foreign Relations, The Harold Pratt House, 58 East 68th Street, New York, NY 10021, (212) 734-0400

Rapporteur: Daniel F. Burton, Executive Director, Economic Policy Council, UNA/USA, 300 East 42nd Street, 8th Floor, New York, NY 10017, (212) 697-3232

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"US Policy Toward Mexico" (continued)

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November 6, 1986

mexico

TO: Mr. Ted Beza
~~International Monetary~~ Fund

FROM: E. Castro Tapia
Representative SHCP New York

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INTERNATIONAL MONETARY FUND
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1986 NOV -6 PM 5:36

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NEW MONEY COMMITTMENTS BY COUNTRY

COUNTRY	# OF BANKS	ESTIMATED COMMITTMENT US MILLIONS	ACTUAL COMMITTMENT US MILLIONS	# OF RESPONSES
ARGENTINA	3	29.8	--	--
ASIA MISC.	1	1.1	--	--
AUSTRALIA	5	47.5	--	--
AUSTRIA	11	31.0	1.4	1
BAHAMAS	1	5.4	3.8	1
BELGIUM	10	155.7	7.2	2
BRAZIL	10	75.4	--	--
CANADA	11	676.5	192.6	2
COLOMBIA	2	7.4	--	--
CONSORTIUM	8	28.3	.9	1
DENMARK	3	5.7	--	--
EASTERN EUROPE	1	.9	--	--
EGYPT	2	4.9	--	--
FINLAND	1	.3	--	--
FRANCE	40	671.6	468.2	16
GERMANY	30	450.4	212.1	5
HONG KONG	7	17.9	1.8	1
INDIA	4	6.0	--	--
IRELAND	3	12.9	--	--
ISRAEL	4	7.8	--	--
ITALY	11	193.6	--	--
JAPAN	36	1,586.5	1,387.3	27
KOREA	1	4.3	--	--
KUWAIT	7	16.5	.3	1
LEBANON	1	.4	--	--
LIBYA	1	7.0	--	--
LUXEMBURG	15	39.1	4.7	1
MIDDLE EAST	10	113.9	--	--
NETHERLANDS	7	68.3	45.2	4
NEW ZEALAND	2	3.9	3.9	2
NORWAY	4	3.9	7.4	1
PANAMA	4	2.6	--	--
PERU	2	25.6	--	--
PORTUGAL	3	10.1	--	--
SAUDI ARABIA	2	10.8	--	--
SPAIN	27	166.1	.015	1
SWEDEN	3	25.6	.8	1
SWITZERLAND	19	247.5	127.8	5
UNITED KINGDOM	49	957.0	282.4	6
UNITED STATES	176	3,369.5	1,973.2	26
VENEZUELA	3	1.9	--	--

Mr Beza
F

Office Memorandum

To Mr Pujol

From Dhruba Gupta and Basil Zavoico

Subject Draft Briefing for Mission to Mexico

November 4, 1986

We have the following comments on this draft

1 We found that the discussion regarding fiscal policy needs strengthening, with an emphasis placed on the need for immediate and effective measures in order to keep the PSBR from getting out of hand

In particular, you note that the 1986 budget presented for approval at end-1985 provided for a reduction in the PSBR to 5 percent of GDP (page 4), representing a halving of the 1985 outcome It is then noted that the loss of revenues assocated with the decline in oil prices are estimated at 6 5 percent of GDP, and that the rise in debt and interest rates have increased the interest component of public sector expenditure by a further 6 5 percent of GDP (page 5) These two factors, we assume, would together imply a revised estimate for 1986 in the order of about 18 percent of GDP (which is consistent with the July 1986 estimate of 17 percent, taking into account delays in price adjustments noted on page 10) For 1987, it is noted that the fiscal effort is estimated at 2 5 percent of GDP (page 11), suggesting a PSBR in the order of 15 - 16 percent of GDP, or not significantly different from that projected for 1986 earlier this year

Although the briefing paper alludes to the need to explore measures to reduce the fiscal deficit so as to get a better grip on inflation, we would argue that at the levels projected for 1987, the fiscal deficit itself is a matter of great concern, not least because of the consequences for the growth of debt and debt service, these are particularly alarming in the light of the recent increases in interest rates, which you note have risen by over 50 percent from the levels experienced in mid-1986 Meanwhile, the fiscal effort for 1987 implicit in the policy commitments negotiated earlier appears very feeble, at about 2 1/2 percent of GDP, this is exactly half that had initially been programmed into the 1986 budget (relative to 1985), at a time when the level of the PSBR was at a much less alarming level We would therefore be more comfortable if a much stronger case were made for an immediate and dramatic effort on this front, say a reduction in the PSBR for 1987 in the order of about 10 percent of GDP, or we fear that a return to a sustainable internal and external situation will become increasingly elusive

2 Regarding the external sector, it would be useful if a brief analysis could be made of the impact of the contemplated import liberalization measures (pages 7 and 17) on the current account in the period ahead, as well as a review of whether capital flight has been

contained, and if not, what additional measures are being considered by the authorities to make the liabilities of Mexican financial institutions more attractive

3 You will have seen our corrections to the Fund relations page which we had sent yesterday under seperate cover

cc Mr Habermeier
Mr Beza
Mr Guitian
Mr Silard
Mr Tanzi

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PARA: Mr. Ted Beza
International Monetary Fund

Mexico

DE: E. CASTRO TAPIA
REPRESENTANTE SHCP, NUEVA YORK

REF: ESTADO DE LA SINDICACION DEL CREDITO DE LOS E.U.M. POR DLS. 6,000 MILLONES.

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PAIS	NO ESPERADO DE BANCOS	MONTO ESPERADO DLS. MILLONES	MONTO RECIBIDO DLS. MILLONES	RESPUESTAS NO DE BANCOS
ARGENTINA	3	29.7	--	--
ASIA MISC	1	1.1	--	--
AUSTRALIA	5	47.5	--	--
AUSTRIA	11	31.0	1.4	1
BAHAMAS	1	5.4	--	--
BELGICA	10	155.7	1.4	1
BRAZIL	10	75.4	--	--
CANADA	11	676.5	145.6	1
COLOMBIA	2	7.4	--	--
CONSORCIOS	8	28.3	0.9	1
DINAMARCA	3	5.7	--	--
EUROPA ESTE	1	0.9	--	--
EGIPTO	2	4.9	--	--
FINLANDIA	1	0.3	--	--
FRANCIA	39	670.6	170.7	9
ALEMANIA	31	451.4	129.0	3
HONG KONG	7	17.9	1.8	1
INDIA	4	6.0	--	--
IRLANDA	3	12.9	--	--
ISRAEL	4	7.8	--	--
ITALIA	11	193.6	--	--
JAPON	36	1,586.5	1,387.3	27
KOREA	1	4.3	--	--
KWAIT	7	16.5	0.3	1
LIBANO	1	0.4	--	--
LIBIA	1	7.0	--	--
LUXEMBURGO	15	39.1	--	--
MEDIO ORIENTE	10	113.9	--	--
HOLANDA	7	68.3	16.8	4
NUEVA ZELANDIA	2	3.9	3.9	2
NORUEGA	4	3.9	--	--
PANAMA	4	2.6	--	--
PERU	2	25.6	--	--
PORTUGAL	3	10.1	--	--
ARABIA SAUDIA	2	10.8	--	--
ESPANA	27	166.1	--	--
SUECIA	3	25.6	--	--
SUIZA	19	247.5	1.9	3
REINO UNIDO	49	957.0	108.1	3
ESTADOS UNIDOS	176	3,369.5	1,129.5	10
VENEZUELA	3	1.9	--	--
TOTAL BANCOS	540		3,098.6	

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INTERNATIONAL MONETARY FUND
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PARIS
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TELEX: 610712

Facsimile:

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DATE: November 4, 1986

NUMBER OF PAGES
(including cover page): 3

SUBJECT: Mexico Road Show, October 24-30, 1986

FROM: J. van Houten
Office in Europe

TO: Managing Director
Deputy Managing Director

INTERNATIONAL MONETARY FUND
WESTERN HEMISPHERE DEPT.
1986 NOV -4 PM 12:50

CC: Mr. Finch
Mr. Wiesner
Mr. Brown

Office Memorandum

TO. Managing Director
Deputy Managing Director

DATE November 4, 1986

FROM J. van Houten JvH

SUBJECT Mexico Road Show, October 24-30, 1986

I accompanied Angel Gurría, Director General of the Budget Office of Mexico, from Paris to Bahrain, Zurich, Amsterdam, Rome, and Madrid to make a presentation in support of Mexico's request for financial support from the commercial banking community. The World Bank made presentations in Zurich and Madrid. The meetings were well attended by commercial bankers in the region and by representatives from both the Central Bank and the Finance Ministry (except in Bahrain where only the Monetary Board was represented).

No unexpected difficulties were encountered. Bankers invariably complained about the very short deadline given for approval of a very complex package. Nevertheless, banks with sizable exposure (French, Swiss, Italian and Spanish) were resigned to go along with the new money package, while banks with small exposures tended to be less forthcoming (particularly in Bahrain).

There was general interest in the economic policies adopted by Mexico, particularly with regard to the medium-term outlook, the reduction and eventual reversal of capital flight, and the rationale for the various contingency mechanisms. The discussion on economic fundamentals was most animated in Zurich, leading to an exchange of views on the feasibility in Mexico of a wage-price freeze. Mr. Gurría concluded the discussion by declaring that even though at the present time a more orthodox stabilization approach had been chosen, a wage-price freeze had not been discarded as a possibility under appropriate circumstances.

With respect to the technicalities of the financing package, certain themes tended to be repeated in a number of cities. One issue, in particular, was raised consistently not only at the general meetings but also at the informal lunch or dinner hosted by the local bank coordinator. Bankers (especially those in Zurich, Paris, and Rome and, I understand, also in Frankfurt) considered that after four years of experience with concerted lending, there had been little, if any, progress in tailoring the new money packages more closely to the circumstances of non-U.S. banks. In particular, they would have liked to have been given the option of capitalizing interest payments in lieu of increasing exposure through new money. The bankers suggested that the lack of progress in this areas was related to the unduly powerful influence of the U.S. regulatory authorities on the bank steering committee and, hence, on the overall negotiating process At the same time, they acknowledged that a lack of cohesiveness among the non-U.S. banks represented on the committee also was an important factor It remains to be seen whether the European bankers can convert these views, which apparently are strongly held, into a more coordinated stance in future concerted lending operations.

Many questions were directed at the size of the requested percentage increase in base date exposure (12.9 percent). Bankers were concerned that the choice of such a high percentage had not been dictated solely by the need to reach critical mass in a short period of time (as claimed by Mr Gurria) but reflected also a sense of pessimism about the degree of participation by banks. Indeed, in most cities questions were raised about the obligations in respect of the new money package of those banks that had sold their base date exposure, or had made debt to equity conversions The answer was that all banks were asked to participate in accordance with the base date exposure, unless these responsibilities had been contractually passed on along with the sale of exposure, in which case the new holder was responsible.

Other issues raised by bankers were the relending and onlending provisions (Paris, Amsterdam), the choice of currency (the possibility of choosing the ECU was raised in Paris and Rome), the distribution of Mexican international reserves among creditor banks, and debt-equity conversion provisions. Specific questions were raised about the possibility of using the debt-to-equity mechanism to purchase or participate in one of the nationalized Mexican financial institutions. Mr. Gurria's reply left no doubt that this was not being considered by the Government.

cc: Mr. Finch
Mr. Wiesner
Mr. Brown

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CC: MR. ORTIZ

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T E L E X

MEXICO, D.F., NOVEMBER 3, 1986.

TREASURER
INTERFUND
WASHINGTON,D C.

REF: JACG/86/T-68

REFERENCE YOUR CABLE GRA 31 DATED OCTOBER 31, 1986. MEXICO WISHES TO ACQUIRE SDR 2,500,000 AGAINST U.S. DOLLARS IN A TRANSACTION TO BE ARRANGED BY THE FUND VALUE NOVEMBER 5, 1986.

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Connect Time : 84 seconds

INTERNATIONAL MONETARY FUND
WESTERN HEMISPHERE DEPT.
1986 NOV -4 AM 11: 53

INCOMING CABLE/TELEX

Office Memorandum

TO Mr Pujol

November 3, 1986

FROM Manuel Guitián *MG*

SUBJECT Mexico - Briefing Paper

I have a general comment on the draft briefing which preempts my usual approach of providing you with concrete drafting suggestions It concerns the structure and contents of the terms of reference of a mission like this one which I think should focus on two main tasks

The first major task to be addressed is an assessment of developments under the program, in particular, since July 1986 In this section, the areas of public sector pricing, wage policy, operational deficit outlook need to be discussed Performance vis-à-vis the intent of the program through September 1986 will also have to be ascertained In this connection, the briefing should flag the problems that would arise if the program is off-track by the time drawings can be made It will also be necessary to mention that further delays in the arrangement going into effect raise questions with regard to the level and the phasing of access given the definite date of expiration of the arrangement The guidelines in these matters indicate that a reduction in access and a rephasing of drawings may become necessary and management should be alerted to them

The second major task, of course, is the policy preparation for 1987, which is not independent of the assessment of the outlook for 1986 On this point, the briefing outlines three possible approaches a Southern Cone modality of predetermined overvaluation, an austral-cruzado"-like shock, and a strategy of gradual reduction in inflation Experience with the first approach is not encouraging, to say the least, and we should dissuade the authorities by simply noting that the required domestic adjustment would have to go well beyond anything envisaged so far The second approach is more appealing, but it will also require ex ante' a larger domestic adjustment effort than contemplated in the program

With regard to the third approach, our degree of freedom is to some extent bound by the general framework of the agreed arrangement Given this constraint, the more we can get the authorities to be specific on their actions and the corresponding timing, the better

Let us discuss these matters

10-100

Mexico

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CC: MR.P.PEREZ
WHD

T E L E X

MEXICO, D.F., 31 DE OCTUBRE DE 1986.

TREASURER
INTERFUND
WASHINGTON, D.C.

REF: JACG/86/T-67

REFERENCE YOUR CABLE OCRB 6280 DATED OCTOBER 30, 1986.
MEXICO WISHES TO ACQUIRE SDR 3,500,000 AGAINST U.S. DOLLARS IN
A TRANSACTION TO BE ARRANGED BY THE FUND VALUE NOVEMBER 4, 1986.

B A N X I C O . . .

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Office Memorandum

TO: Mr. Pujol | October 30, 1986

FROM: Luis Duran-Downing

SUBJECT: Mexico--Recent Developments in the External Sector

The attached tables were prepared on the basis of certain information provided by the Banco de Mexico yesterday. With the exception of the trade balance, data for the month of September are projections. For convenience these figures are compared to program targets whenever possible.

Two-thirds of the overperformance of net international reserves with respect to program targets is explained by a stronger current account which mirrors developments in the trade balance (Table 1). The better than expected trade balance reflects both larger exports and lower imports, in about the same proportions. Nonpetroleum exports have been growing at very high rates. (Table 2).

Net official capital inflows are substantially below program projections reflecting mainly large shortfalls in disbursements from multilateral and bilateral sources. You may recall that the first tranche of the IBRD Trade development loan was assumed to be disbursed in the third quarter of 1986. Similarly, gross disbursements from bilateral sources--especially from CCC--were assumed to be stepped up. In contrast, private capital flows have been substantially larger than anticipated. Within this item, direct foreign investment and net external credits appear to be about in line with program projections. However, the composite of transactions including interest earnings abroad, other private sector payments, and errors and omissions, is substantially better than projected.

Attachments

cc: Mr. Beza
Mr. Guitian
Mr. Bonvicini
Mr. Gil-Diaz
Mr. Kalter
Mr. Valdivieso

INTERNATIONAL MONETARY FUND
WESTERN HEMISPHERE DEPT.
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Table 1 Mexico Balance of Payments

	1985	January-September 1986 (Est)	January-September 1986 (Prog)
	(In billions of U S dollars)		
Current account	0 5	-1 9	-2 7
Exports 1/	23 1	12 3	11 7
Oil	(14 8)	(4 5)	(4 2)
Other 1/	(8 4)	(7 8)	(7 5)
Imports	-13 5	-8 8	-9 4
Interest payments	-9 9	-6 4	-6 2
Other	0 7	1 0	1 2
Official capital	0 4	-0 9	0 2
Commercial banks	0 2	-0 2	-0 2
Multilaterals	0 7	-0 1	0 4
Bilaterals and suppliers	0 3	--	0 2
CCC	-0 3	-0 5	-0 1
Other and short-term	-0 5	-0 5	-0 4
Interest rebate	--	0 4	0 3
Private capital and errors and omissions	-4 3	0 2	-1 3
Direct investment	0 5	0 3	
External credits (net)	-1 1	-0 4	
Other	-3 7	0 3	
Change in net reserves	3 4	2 6	3 8

Source Banco de Mexico
1/ Including in bond industries

Table 2 Mexico Trade Balance

	1984	1985	January-September 1985	January-September 1986	Percentage change Jan -Sept 1985/86
Trade balance	12 9	8 4	6 1	2 5	-59 1
Total exports 1/	24 2	21 9	16 1	11 3	-30 0
Petroleum	16 6	14 8	11 0	4 5	-58 9
Crude	(15 0)	(13 3)	(9 9)	(4 0)	(-59 2)
Other	(1 6)	(1 5)	(1 1)	(0 5)	(-55 7)
Nonpetroleum	7 6	7 1	5 1	6 8	32 6
Agriculture and mining	(2 0)	(1 8)	(1 4)	(2 1)	(50 0)
Manufacturing	(5 6)	(5 3)	(3 7)	(4 7)	(26 7)
Total imports	11 2	13 5	10 0	8 8	-12 2
Consumption goods	0 8	1 1	0 8	0 6	-23 4
Intermediate goods	7 8	9 2	7 0	6 0	-14 6
Capital goods	2 6	3 2	2 2	2 2	-0 8
Memorandum items					
Imports					
Public sector	4 8	4 4	3 3	2 5	-26 9
Private sector	6 5	9 1	6 7	6 3	-4 8
Exports					
Public sector	17 8	15 8	11 8	5 5	-53 5
Private sector	6 4	6 1	4 3	5 8	34 7

Sources Banco de Mexico, and Fund staff estimates

Note Partials may not add due to rounding

1/ Exclude in bond industries

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OFFICE OF
THE MANAGING DIRECTOR

Office Memorandum

To: The Managing Director

DATE: October 27, 1986

Nov 31, 86

FROM: S. T. Beza STB

SUBJECT: Mexico--Answer to your Queries on the Draft of Staff Report Containing Supplementary Information and a Proposed Decision on Mexico's Request for a Stand-By Arrangement

In reviewing the paper on Mexico you asked whether the banks would disburse if the Mexicans were to reduce deliberately the volume of their oil exports (page 9). The answer is yes. The only qualification would be that in order for a disbursement from the banks to occur there must be a shortfall under our Oil Contingency Mechanism, but there is no provision that it must be for a cause beyond the control of the authorities. I might note that the Mexican authorities were quite surprised that the banks wanted to include volume changes among the factors to modify the shortfall.

Concerning the charges on the SDR 600 million to cover possible purchases under the Oil Contingency Mechanism (page 14), the funding for such purchases comes from an augmentation of the arrangement and not from an activation of the CFF; thus the appropriate rules to apply are those relating to the purchases under the arrangement.

The stand-by charges are levied under rule I-8 because the augmentation would increase resources under the stand-by arrangement which would become available to Mexico--once the contingency occurrs--in the same way and subject to the same conditions as the other resources committed under the arrangement. It should be noted that all purchases under the arrangement are contingent, but in the case of purchases related to the Oil Contingency Mechanism they are contingent on the oil price dropping below US$9 a barrel as well as on compliance with the performance criteria under the program.

Mexico would have an assured right to purchase the resources in question for the period of the arrangement once the augmentation takes place (though, of course, the augmented amounts would reduce pro tanto Mexico's entitlement to make CF purchases during the period of the arrangement). The situation is different under the CFF, where no assured right of purchase exists.

The augmented amounts would be subject to the same financial terms as other amounts under the arrangements. In particular, the financing of purchases of augmented amounts would be in accordance with

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the rules of mixing in the arrangement, and stand-by charges would be payable on the increase in the commitment under the stand-by arising from any augmentation The stand-by commitment charges would, of course, be refunded in full once purchases of the augmented amount are made The total possible purchases under the arrangement, if fully augmented, would be SDR 2 billion (the sum of SDR 1 4 billion of the basic arrangement plus the SDR 600 million of the potential augmentation).

This memorandum incorporates the comments of Messrs Guitián, Gupta, and Silard

cc The Deputy Managing Director (o/r)
Mr Guitián
Mr Gupta
Mr Silard
Mr. Brown

F

Office Memorandum

TO The Deputy Managing Director DATE October 24, 1986

FROM S T. Beza

SUBJECT Mexico - Commercial Bank Exposure

As I had indicated to you in our conversation yesterday, an increase in commercial bank exposure of 12 9 percent over the base August 1982 exposure of US$63 9 billion (including private debt) would yield a bank package of US$8 24 billion. This would allow a margin of some US$540 million over the requested increase of US$7 7 billion in bank exposure (including the amounts under the contingent facilities)

I might note that the US$63 9 billion of total Mexican debt to commercial banks may exclude loans guaranteed by official non-Mexican agencies, which according to BIS/OECD sources totaled about US$2 4 billion at the end of 1982. If financing from official non-Mexican agencies has not been deducted from the total just mentioned, then unguaranteed bank exposure could be around US$61 5 billion and the margin in the bank package would be as little as US$230 million

cc The Managing Director
Mr Finch
Mr. Brown

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Office Memorandum

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OFFICE OF
THE MANAGING DIRECTOR

TO: The Managing Director
The Deputy Managing Director

DATE: October 23, 1986

FROM: S. T. Beza

SUBJECT: Mexico--Draft of Request for Stand-By Arrangement Supplementary Information and Proposed Decision

A few questions.

Attached for your consideration and approval is the draft of the report prepared by the staff on the impact of the financing arrangement agreed between the Mexican authorities and the commercial banks' advisory committee. The report includes a proposed decision for approval of the stand-by arrangement and has as attachment the revised text of the arrangement and of the Technical Memorandum of Understanding. We are still awaiting confirmation from the Mexican authorities as to their agreement to the revised text of the Technical Memorandum.

The report does not include a discussion of recent developments with respect to the program, but the staff will be preparing a buff or supplement to be circulated to the Executive Board just prior to the meeting. I would like to flag for you the text of footnote 1, in page 14, which has been included at the suggestion of the Treasurer's Department.

This report has been reviewed by the following departments:

Exchange and Trade Relations:	Mr. Guitián
Legal:	Mr. Silard
Treasurer's:	Messrs. Leddy and Gupta
Western Hemisphere:	Messrs. Caiola, van Beek and myself

Attachments

cc: Mr. Brown

F

Office Memorandum

TO: The Managing Director
The Deputy Managing Director

DATE: October 23, 1986

FROM: S. T. Beza STB

SUBJECT: Mexico--Draft of Request for Stand-By Arrangement Supplementary Information and Proposed Decision

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Exchange and Trade Relations:	Mr. Guitián
Legal:	Mr. Silard
Treasurer's:	Messrs. Leddy and Gupta
Western Hemisphere:	Messrs. Caiola, van Beek and myself

Attachments

cc: Mr. Brown

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INTERNATIONAL MONETARY FUND
WASHINGTON, D. C. 20431

DEPUTY MANAGING DIRECTOR

CABLE ADDRESS
INTERFUND

October 22, 1986

MEMORANDUM

To: Mr. Beza

From: Richard D. Erb

Subject: Mexico

During yesterday's session in Toronto on the Mexican financial package, some banks asked why an increase in bank exposure of 12.9 percent over the base 1982 exposure was warranted. They had deduced that, if all banks participated, this percentage increase would result in total commitments that would exceed $6 billion; one estimate of this excess was $900 million. These banks were concerned with the implication that the leakage in this bank package might be larger than in previous cases.

In their responses, Rhodes and Gurria both explained that indeed some cushion had been built into the financing package to cover potential loss of participation. They felt that this approach was fairer than having a smaller subset of banks top up the package at the end of the day. They also said that any amounts in excess of the required total commercial bank financing would be returned to the banks on a pro rata basis.

In light of the concerns expressed by a number of banks in the room on the prospects of large-scale leakage, and the desire to ensure that every effort is made to bring all banks into the package, I reaffirmed that from the perspective of the IMF we felt that it was important to have full participation by all banks.

I would appreciate your checking into the magnitude of the leakage built into the financial package in light of the 12.9 per cent target for each bank.

cc: The Managing Director
Mr. Finch

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ORIG: MR.JAN VAN HOUTEN
CC: WHD

-- COMPUTER MESSAGE NO DIALOG --

FROM: SWISS BANK CORPORATION
LATIN AMERICA II DEPT
NEW YORK

1986 OCT 22 PM 3:47

INTERNATIONAL MONETARY FUND
WESTERN HEMISPHERE DEPT

REF: VS2/5899 ON 21-OCT-86 AT 19:15
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TO: MR. ENRIQUE CASTRO T.
REPRESENTATIVE
MEXICAN MINISTRY OF FINANCE
NEW YORK

TELEX NO. 147189

CC: BANK OF MONTREAL
TORONTO/CANADA
ATTN: MR. KEN SMITH, VP

CC: DEUTSCHE BANK
FRANKFURT TLX. NO. (041)41730200
ATTN: MR. PETER TILS / PETER LUDESCHER
ZIA/DI

CC: SOCIETE GENERALE
NEW YORK TLX ITT 428802 SOCGEN
ATTN: MR. EMILIO MARTINEZ, VP

CC: SWISS BANK CORPORATION
GENERAL MANAGERS
ZURICH TLX NO. 813091
ATTN: MR. R. S. MERTEN, SVP, LAC DEPT.

CC: CREDITO ITALIANO
MILANO TLX NO. 312401
ATTN: SIG. VOLPATO
DIREZIONE CENTRALE RELAZIONE ESTERE

CC: BANCO EXTERIOR DE ESPANA
MADRID TLX NO. 48739
ATTN: NORMAN MOYA

CC: INTERNATIONAL MONETARY FUND
PARIS OFFICE TLX NO. 610712
ATTN: MR. JAN VAN HOUTEN, DEPUTY DIRECTOR

CC: WORLD BANK
WASHINGTON, D.C. (TLX NO. 248423 RCA)
ATTN: MR. RAINER B. STECKHAN, DIRECTOR

RE: EUROPEAN AND MIDDLE EASTERN ROAD SHOW REGARDING MEXICO'S EXTERNAL FINANCING PROGRAM FOR 1986 AND 1987

FOLLOWING THE SEVERAL TELEPHONE CONVERSATIONS OF TODAY WE HAVE, SO FAR, RECEIVED CONFIRMATION THAT THE PRESENTATIONS TO BE HELD AFTER OCTOBER 24, 1986 WILL BE ATTENDED BY:

- JOSE ANGEL GURRIA TREVINO
  DIRECTOR OF PUBLIC CREDIT
  MINISTRY OF FINANCE OF THE UNITED MEXICAN STATES

- JAN VAN HOUTEN,
  DEPUTY DIRECTOR
  INTERNATIONAL MONETARY FUND

- (NAME OF EXECUTIVE OF THE WORLD BANK STILL TO BE CONFIRMED)

PROGRAM

- OCTOBER 24, 1986
  DEPARTURE - PARIS 9:40 P.M. GULF AIR NO. 26

- OCTOBER 25, 1986
  ARRIVAL - BAHRAIN 5:45 A.M.

- PRESENTATION ON 10/25 TO BE ARRANGED BY THE LLOYDS BANK PLC

- OCTOBER 26, 1986
  DEPARTURE - BAHRAIN 4:15 A.M. SINGAPORE AIRLINES 36
  ARRIVAL - ZURICH 8:05 A.M.

- OCTOBER 27, 1986

  9:30 A.M. PRESENTATION TO THE SWISS AND AUSTRIAN BANKS.
  HOST: SWISS BANK CORPORATION
  MEETING AT: BAERENGASSE 16/4TH FLOOR
  LUNCHEON: OFFERED BY SBC IN HONOR OF PRESENTORS PLUS A SELECTED GROUP OF BANKS AND GOVERNMENT OFFICIALS

  2:40 P.M. DEPARTURE - ZURICH KLM NO. 314
  4:05 P.M. ARRIVAL - AMSTERDAM

- OCTOBER 28, 1986

9:30 A.M. PRESENTATION ORGANIZED JOINTLY BY THE REGIONAL COORDINATOR ABN AND DEUTSCHE BANK.

1:45 P.M. DEPARTURE - AMSTERDAM ALITALIA NO. 371
4:00 P.M. ARRIVAL ROME

- OCTOBER 29, 1986

9:30 A.M. PRESENTATION ORGANIZED BY CREDITO ITALIANO

(12:30 P.M. DEPARTURE - ROME
3:05 P.M. ARRIVAL - MADRID IBERIA NO. 771
BOOKED OUT FOR THE TIME BEING)

6:40 P.M. DEPARTURE - ROME IBERIA NO. 775
10 00 P.M. ARRIVAL - MADRID (STOP-OVER IN BARCELONA)

- OCTOBER 30 1986

9:30 A.M. PRESENTATION ORGANIZED BY BANCO EXTERIOR DE ESPANA

ON BEHALF OF THE MEXICAN GOVERNMENT WE KINDLY ASK EACH HOST/ORGANIZER TO INVITE ALL FINANCIAL INSTITUTIONS IN ITS AREA OF RESPONSIBILITY TO THE SCHEDULED MEETING AND TO CONFIRM AS SOON AS POSSIBLE TO THE REPRESENTATIVE OF THE MEXICAN GOVERNMENT IN NEW YORK, THE IMF OFFICE IN PARIS AND THE WORLD BANK IN WASHINGTON THE ADDRESSES OF THE MEETING PLACES, WHETHER ADDITIONAL DINNER (OCT. 27 AND 28, 1986 AMSTERDAM AND ROME RESPECTIVELY) OR LUNCHEON (OCTOBER 29, 1986 - MADRID) HAVE BEEN ORGANIZED, AS WELL AS TO RESERVE 3 (THREE) HOTEL ROOMS FOR THE PRESENTORS (INDICATE NAME OF HOTEL IN YOUR REPLY).

SHOULD YOU NEED ANY ADDITIONAL INFORMATION, PLEASE DO NOT HESITATE TO CONTACT ENRIQUE CASTRO AT TEL. (212) 753-8030.

FLIGHT RESERVATIONS ARE THE RESPONSIBILITY OF EACH PRESENTOR.

BEST REGARDS,

SWISS BANK CORPORATION
NEW YORK BRANCH
B. LILLHIL, AVP

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Office Memorandum

mexico

TO: Mr. Williams

October 21, 1986

FROM: G. Bélanger GB

SUBJECT: Information Notice System--Real Effective Exchange Rate Calculations for Mexico

I refer to your memorandum of September 8, 1986, to Mr. Borensztein ("Quarterly Report on Indicators of Real Effective Exchange Rates") highlighting the possible differences in the INS and EFF-related monitoring of indices of real effective exchange rates for the Mexican peso.

The possibility of differences in estimates was brought to our attention in early 1985 in connection with the preparation of an information notice for Mexico (EBS/85/99, 4/23/85). You will note that this information notice has included both estimates: the INS estimate based on the standard methodology which triggered the information notice and, in a footnote, the change over the corresponding period shown by the index used for monitoring under the EFF.

Discussions with Mr. Pujol at that time (based in part on a memorandum from Mr. Valdivieso dated 4/11/85 comparing the different estimates) led to the following conclusions:

1. The weights were responsible for only a small portion of the difference in estimates since the weights were very similar, as can be seen from the following comparison.

Trading Partner	EFF-Related Monitoring Weight	INS Weight
United States	75.0	69.3
Japan	6.5	6.1
Germany	6.1	5.0
Brazil	3.1	3.1
France	2.9	3.6
United Kingdom	2.2	1.8
Spain	2.1	2.2
Canada	2.1	1.6
Other	--	7.3
Total	100.0	100.0

As a separate point, both sets of weights are based on non-oil trade It is not clear to me how taking into account Mexico's non-oil trade with another 28 trading partners makes the INS index any more challangeable than the index used for monitoring under the EFF

2 The main factor responsible for the large differences identified at that time was the use in the INS of monthly average exchange rates and, for the EFF-related monitoring, of end-month exchange rates

Other possible sources of difference could be the use of different averaging procedures or different price indices the INS estimate uses geometric averaging while the EFF-related monitoring index uses arithmetic averaging, the INS estimate is based mostly on CPI data while the EFF-related is based mostly on WPI data As regards the weighting procedure, for short enough periods and small enough changes in exchange rates, geometric and arithmetic averaging will typically yield very similar results However, arithmetic averaging implicitly changes the weights over time, giving an increasingly large weight over time to currencies with a rising index and distorting the measurement of changes in effective exchange rates For example, the currency of a country with two trading partners (each with a 50 percent weight) should show no change in effective terms if the currency of the first trading partner appreciated by 10 percent while that of the second depreciated by 10 percent It can be easily verified, however, that arithmetic averaging will not yield, even approximately, this result if the currencies of trading partners had already moved significantly and in opposite directions prior to the further 10 percent appreciation/ depreciation 1/

cc Mr Borensztein

1/ For example (with exchange rates measured in foreign currency per unit of local currency), arithmetic averaging would suggest a further 5 percent appreciation as a result of the concurrent 10 percent appreciation/depreciation if the currency of one trade partner had already appreciated by 50 percent while that of the second trade partner had depreciated by 50 percent

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INTERFUND PARIS, OCTOBER 21, 1986

INTERFUND
WASHINGTON DC

FOR DEPUTY MANAGING DIRECTOR, VIA ADMINISTRATION DEPARTMENT

WE HAVE RECEIVED A REQUEST FROM THE WESTERN HEMISPHERE DEPARTMENT TO MAKE MR JAN VAN HOUTEN AVAILABLE TO REPRESENT THE FUND IN THE PRESENTATION OF THE MEXICAN FINANCIAL PROGRAM TO BANKERS IN:

PARIS 24-25
BAHREIN 26
ZURICH 27
AMSTERDAM
ROME
MADRID

THE ABOVE TRAVEL WAS NOT INCLUDED IN THE SIX-MONTH TRAVEL SCHEDULE AND WE ARE THEREFORE REQUESTING YOUR AUTHORIZATION.

REGARDS,
BEITH
INTERFUND
PARIS

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REPLY VIA ITT

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Office Memorandum

INTERNATIONAL MONETARY FUND
WESTERN HEMISPHERE DEPT.
1986 OCT 21 AM 9:33

To: Mr. Pujol

October 20, 1986

From: Dhruba Gupta and Klaus Boese

Subject: Mexico - Request for Stand-by Arrangement

We understand that if during the program period the price of Mexico's crude oil exports over a calendar quarter rises beyond US$14 a barrel, excess revenue calculated in accordance with the Oil Contingency Mechanism would be used to reduce foreign financing or accumulate net foreign reserves above the targeted levels. Our understanding also is that three quarters of the excess revenue would be used to repay commercial banks in a certain order. There is, however, no provision for repayments to the Fund in these circumstances, which we find puts the Fund very much as the least preferred creditor in circumstances where Mexico has the ability to repay and is in fact repaying commercial banks. We urge strongly that parallel provisions be included for repayments to the Fund from the excess revenues.

Our other comments concern minor typographical changes and have been passed on verbally. Comments on the financial terms were sent to you on October 17, 1986 in a memorandum from Mr. Leddy. Please let us know if you have any difficulties in including the specific suggestions in the draft paper.

cc Mr. Habermeier
Mr. Wiesner
Mr. Guitian
Mr. Silard

CC: SEC
MD
DMD
MR. DALLARA
WHD
LEG
MRS. HUGHS
MR. R. BROWN

Mexico

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OCT 17 1986

Sir:

I enclose a copy of a letter dated October 2, 1986 from the Secretary of Finance and Public Credit and Governor of the Fund for Mexico, requesting that you extend to Mr. Guillermo Ortiz, an Executive Director in the International Monetary Fund, the privileges and immunities accorded to officials of Specialized Agencies referred to in paragraph 4 of Section 15 of Article V of the Headquarters Agreement between the United Nations and the United States.

In the event that you decide to accede to this request, I wish to inform you that, as Acting Managing Director of the Fund, I shall have no objection.

Yours very truly,

/s/

Richard D. Erb
Acting Managing Director

Enclosure

The Honorable
The Secretary of State
Washington, D.C. 20520

BRHughes:nnm
10/16/86

INFORMATION COPY

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CC: MD
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SEC
MR. PEREZ
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MRS. HUGHES
MR. R. BROWN

OCT 17 1986

Sir:

I wish to acknowledge your letter of October 2, 1986, informing the Managing Director that Mr. Guillermo Ortiz has been designated by the government of Mexico as its Principal Resident Representative at the Headquarters of the International Monetary Fund in the United States within the meaning of Section 15(4) of the Headquarters Agreement between the United Nations and the United States.

For your information there is enclosed a copy of the Fund's communication to the U.S. Department of State transmitting this designation.

Very truly yours,

Leo Van Houtven
Secretary

Enclosure

Mr. Gustavo Petricioli
Secretary of Finance and
Public Credit
Secretariat of Finance and
Public Credit
Palacio Nacional
1 Patio Mariano
06066 Mexico, D.F.
Mexico

INTERNATIONAL MONETARY FUND
WESTERN HEMISPHERE DEPT.
1986 OCT 22 PM 3:49

BRHughes:nnm
10/16/86

INFORMATION COPY

Office Memorandum

① Travel approval memo
② mexico
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Oct 17, 1986

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ADM

To: The Deputy Managing Director
(cleared with Administration)

October 17, 1986

E.W.

From: E. Wiesner

Subject: Presentation of Mexican Program in Europe

Pursuant to our conversation last night, I am making arrangements to travel to London, Frankfurt, and Paris to accompany the Mexican authorities in their presentation of their economic program to the international financial community.

Subject to your approval, I plan to leave Washington on Monday night, October 20, 1986. So that I may be able to maintain my previous travel schedule to Colombia and Venezuela, I will fly from London to Miami on October 25.

cc: ADM
Mr. Mohammed
Mr. Brown

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Germany	87025503)	412
France	87025504)	

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IMF OFFICIAL MESSAGE
WASHINGTON, D. C. 20431

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Mexico

THE INTERNATIONAL BANKING COMMUNITY

INTERNATIONAL MONETARY FUND
WESTERN HEMISPHERE DEPT.
1986 OCT 17 PM 4:41

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1986 OCT 16 PM 8 24

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cc: MD
DMD
MR. ORTIZ
ETR
LEG
WHD
MR. BROWN

I WOULD LIKE TO INFORM YOU ABOUT THE ECONOMIC PROGRAM ADOPTED BY MEXICO. ON JULY 23, 1986, AT THE INVITATION OF THE MEXICAN GOVERNMENT, I ADDRESSED A GROUP OF MAJOR CREDITOR BANKS IN NEW YORK CITY ABOUT THIS PROGRAM, FOR WHICH THE AUTHORITIES HAVE REQUESTED THE SUPPORT OF THE INTERNATIONAL MONETARY FUND IN THE FORM OF A STAND-BY ARRANGEMENT IN AN AMOUNT OF SDR 1.4 BILLION, WITH THE POSSIBILITY OF AUGMENTING THIS SUM BY UP TO SDR 600 MILLION THROUGH THE OIL CONTINGENCY MECHANISM DESCRIBED BELOW. THE STRUCTURAL REFORMS TO BE CARRIED OUT BY MEXICO UNDER THIS PROGRAM HAVE BEEN REVIEWED BY THE WORLD BANK AND I UNDERSTAND THAT THE PRESIDENT OF THE BANK WILL INFORM YOU DIRECTLY ABOUT THE BANK'S ASSESSMENT OF THESE REFORMS.

AS YOU KNOW, IN LATE 1982 MEXICO EMBARKED ON A THREE-YEAR ADJUSTMENT PROGRAM THAT WAS SUPPORTED BY AN EXTENDED ARRANGEMENT FROM THE FUND. THE IMPLEMENTATION OF THAT PROGRAM BROUGHT ABOUT A MARKED TURNAROUND IN ECONOMIC

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CLEARED WITH MR. GUITIAN (ETR) AND MR. SILARD (LEG).

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DRAFTED BY NAME (TYPE): J.PUJOL/asc

EXT.: 8480 DEPT.: WHD DATE: 10/16/86

AUTHORIZED BY NAME (TYPE): E.WIESNER

AUTHORIZED BY NAME (TYPE): ACTING MANAGING DIRECTOR

TYPE ** ON LAST OR ONLY PAGE OF MESSAGE

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CONDITIONS IN 1983 AND 1984; THE OVERALL PURLIC SECTOR DEFICIT WAS REDUCED BY MORE THAN 10 PEPCENTAGE POINTS OF GDP FROM 1982 TO 1984, INFLATIONARY PPESSURES ABATED, AND THE BALANCE OF PAYMENTS IMPROVED MAPKEDLY. MOREOVEP, PROSPECTS FOR SUSTAINED ECONOMIC GROWTH WERE ENHANCED BY THE IMPROVEMENT IN MEXICO'S COMPETITIVENESS STEMMING FROM THE ADJUSTMENT OF THE EXCHANGE RATE AND THE PURSUIT OF A PRUDENT WAGE POLICY. HOWEVER, ECONOMIC PERFORMANCE BEGAN TO FALTER IN LATE 1984 AND WOPSENED IN 1985, PARTLY REFLECTING SLIPPAGES IN DOMESTIC POLICY IMPLEMENTATION, BUT ALSO AS A RESULT OF THE WEAKENING OF THE INTERNATIONAL PETROLEUM MARKET AND THE EFFECTS OF THE EARTHQUAKES THAT STRUCK MEXICO CITY IN SEPTEMBER 1985.

THE SHARP AND RAPID DECLINE IN OIL PPICES THAT HAS OCCURRED SINCE THE BEGINNING OF 1986 HAS EXACERBATED MEXICO'S DIFFICULTIES. WHILE THE MEXICAN AUTHORITIES HAD INITIALLY FRAMED A BUDGET FOR THIS YEAR THAT SOUGHT TO ACHIEVE A MAJOR STRENGTHENING OF FISCAL PERFORMANCE, THE

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MORE THAN 50 PERCENT DROP OF OIL PRICES DURING THE FIRST HALF OF 1986 WORSENFD THE PUBLIC SECTOP FINANCIAL POSITION AND THE BALANCE OF PAYMENTS SHARPLY.

TO ADDRESS THE SEVERE EXTERNAL AND INTERNAL IMBALANCES AND TO BRING THF ECONOMY BACK ON A PATH OF SUSTAINED GROWTH, THE GOVERNMENT OF MEXICO HAS EMBARKED ON A NEW ECONOMIC PROGRAM. THIS PROGRAM NEEDS SUPPOPT FROM OFFICIAL SOURCES (ON WHICH UNDERSTANDINGS HAVE ALREADY BEEN REACHED) AS WELL AS FROM COMMERCIAL BANKS. IN VIEW OF THE 1986-87 COMMERCIAL BANK FINANCING PACKAGE FOR MEXICO WHICH IS BEING CIRCULATED TO YOU, THE MANAGEMENT OF THE FUND IS PREPARED TO SUBMIT TO THE EXECUTIVE BOARD MEXICO'S REQUEST FOR A STAND-BY ARRANGEMENT AS EXPLAINED BELOW.

THE MEXICAN ΡΡΟGRAΜ COMBINES FINANCIAL AND STPUCTURAL POLICIES UHICH, BY STRENGTHENING THE SAVINGS PERFORMANCE OF THE ECONOMY AND IMPROVING ECONOMIC EFFICIENCY, ARE EXPECTED TO PESTORE BALANCE OF PAYMENTS VIABILITY, BREAK

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THE INFLATIONARY TREND, AND PROMOTE SUSTAINED GPOWTH. A CENTPAL COMPONENT OF THE PROGRAM IS THE IMPPOVEMENT OF THE PUBLIC SECTOR FINANCES. FISCAL MEASUPES CALCULATED TO YIELD THE EQUIVALENT OF 3 PERCENTAGE POINTS OF GDP ARE TO BE IMPLEMENTED OVER THE PERIOD OF THE PROGPAM. THESE ACTIONS--WHICH INCLUDE TAX INCREASES, PRICE AND TARIFF ADJUSTMENT, AND SPENDING CURBS--ARE IN ADDITION TO THE ADJUSTMENT ALREADY BEGUN UNDER THE 1986 BUDGET. THE FISCAL EFFOPT IS TO BE ACCOMPANIED BY MONETARY AND CREDIT POLICIES GEARED TO REDUCING INFLATION AND ATTAINING THE BALANCE OF PAYMENTS TARGET, WHILE MAKING PROVISION FOR A VOLUME OF CREDIT TO THE PRIVATE SECTOR CONSISTENT WITH THE GROWTH OBJECTIVE OF THE PROGRAM. IN ADDITION TO THE CONTINUED PURSUIT OF A FLEXIBLE EXCHANGE RATE POLICY, THE AUTHOPITIES HAVE ASSIGNED AN IMPORTANT ROLE TO IMPROVING RESOURCE ALLOCATION. STEPS ARE BEING TAKEN TO INCPEASE THE SCOPE OF MARKET FORCES IN INTEREST RATE DETERMINATION, TO REALIGN PRICES AND TARIFFS AND RAISE EFFICIENCY IN THE

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OPERATIONS OF PUBLIC ENTFRPRISES, TO LIBFRALIZE THE TRADF SYSTEM, AND TO PROMOTE FOREIGN DIRECT INVESTMENT. AS ALREADY NOTED, THE WORLD BANK IS TO PLAY A CENTRAL ROLE IN ASSISTING THF MEXICAN AUTHORITIES IN THEIR EFFOPTS TO IMPLEMENT THE STPUCTURAL REFORMS.

THE PROGRAM SEEKS TO STRIKE A PEASONABLE BALANCE BETWEEN FINANCING AND ADJUSTMENT. THE CURRENT ACCOUNT OF MEXICO'S BALANCE OF PAYMENTS IS EXPECTED TO SHIFT FROM A SURPLUS OF U.S. DOLLARS 0.5 BILLION IN 1985 TO DEFICITS OF U.S. DOLLARS 3.5 BILLION IN 1986 AND OF U.S. DOLLARS 2.9 BILLION IN 1987, THUS, THE DETERIORATION IN THE CURRENT ACCOUNT IS PROJECTED AT ABOUT ONE HALF OF THE LOSS IN EXPOPTS PECEIPTS RESULTING FROM THE DROP IN OIL EXPORT EARNINGS. IN ORDER TO SUPPLEMENT DOMESTIC RESOURCES IN THE EFFORT TO ATTAIN SOUND ECONOMIC GROWTH AND STRENGTHEN THE BALANCE OF PAYMENTS, INCLUDING THE RESERVE POSITION, THE PROGRAM CALLS FOR NET CAPITAL INFLOWS OF U.S. DOLLAPS 12.5 BILLION DURING 1986-87. OF THIS AMOUNT, OFFICIAL

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SOURCES (INCLUDING THE FUND) APE TO PROVIDE U.S. DOLLARS 6.5 BILLION. BESIDES DRAWINGS FROM THE FUND, NET DISBURSEMENTS OF U.S. DOLLARS 2.7 BILLION ARE ENVISAGED FPOM THE WORLD BANK AND THE INTER-AMEPICAN DEVELOPMENT BANK FOR PROJECTS ALREADY UNDERWAY AND NEW ONES TO BE APPROVED, AND NET DISBURSEMENTS OF U.S. DOLLAPS 2.5 BILLION APE PROJECTED FROM OFFICIAL BILATEPAL SOURCES; THIS REPRESENTS AN INCREASF IN THE EXPOSUPE TO MEXICO BY OFFICIAL CREDITORS DURING 1986-87 OF SOME 45 PERCENT OVER THE STOCK OUTSTANDING AT THE END OF 1985. THE REMAINING U.S. DOLLARS 6 BILLION NEEDED TO FINANCE THIS PROGRAM FOP THE PERIOD 1986-87 WOULD BE PROVIDED BY COMMERCIAL BANKS UNDER THE 1986-87 COMMERCIAL BANK FINANCING PACKAGE FOR MEXICO.

THE PROGRAM CONTAINS THREE SPECIAL MECHANISMS THAT ARE AIMED AT INSULATING THE IMPLEMENTATION OF THE PPOGRAM FROM FURTHER EXTERNAL SHOCKS AND UNCERTAINTIES. IN VIEW OF THE UNSETTLED CONDITIONS IN THE INTERNATIONAL PETROLEUM

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MARKET AND OF THE VULNERABILITY OF MEXICO'S FCONOMY AND ITS INVESTMENT PROGRAM TO CHANGES IN PETROLEUM EXPORT RECEIPTS, SOME OF THE TARGETS OF THE PROGRAM AND THE STRUCTURE AND SIZE OF THE FINANCING PACKAGE APE RELATED TO THE EVOLUTION OF EXPORT RECEIPTS OF MEXICO'S PUBLIC SECTOR. FIRST, THE STAND-BY ARRANGEMENT TO BE PPOPOSED TO THE FUND'S EXECUTIVE BOARD CONTAINS A COMMITMENT BY THE FUND OF UP TO SDR 600 MILLION (BY WHICH THE AMOUNT OF THE ARPANGEMENT IS TO BE AUGMENTED) TOWARD THE FUNDING OF A CONTINGENCY MECHANISM THAT CALLS FOR A COMBINATION OF ADDITIONAL FOREIGN FINANCING AND ADJUSTMENT IF THE EXPORT PRICE OF MEXICAN OIL SHOULD FALL BELOW U.S. DOLLAPS 9 A BARPEL, AND A RFDUCTION OF FINANCING IF THE EXPORT PRICE OF MEXICAN OIL SHOULD RISE ABOVE U.S. DOLLARS 14 A BARREL. SECOND, TO HELP PROTECT THE CONTINUED IMPLEMENTATION OF THE COUNTRY'S ECONOMIC PPOGRAM AND ITS INVESTMENT PLAN FROM UNFORESEEN AND LARGE CHANGES IN EXTERNAL CONDITIONS, COMMERCIAL BANKS WOULD PROVIDE

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ADDITIONAL FINANCING TO MEXICO ON A CONTINGENT BASIS FOR UP TO U.S. DOLLARS 1.2 BILLION IN CASE OF A SUDDEN DECLINE IN EXTERNAL RECEIPTS OF THE PUBLIC SECTOR. A THIRD MECHANISM PROVIDES FOR ADDITIONAL FOREIGN FINANCING FOR INVESTMENT PROJECTS DEVELOPED BY MEXICO AND THE WORLD BANK IF THE ECONOMIC RECOVERY FAILS TO MATERIALIZE DESPITE THE EFFECTIVE IMPLEMENTATION OF POLICIES UNDER THE PROGRAM.

ON SEPTEMBER 8, 1986, THE EXECUTIVE BOARD OF THE FUND EXAMINED THE ECONOMIC PROGRAM UNDERLYING MEXICO'S REQUEST FOR EXTERNAL SUPPORT AND WAS PREPARED TO SUPPORT THAT PROGRAM WITH FUND RESOURCES PROVIDED THAT ADEQUATE EXTERNAL FINANCING WAS FORTHCOMING IN A TIMELY MANNER.AS I HAVE NOTED, I AM PREPARED TO PROPOSE TO THE EXECUTIVE BOARD OF THE FUND FINAL APPROVAL OF MEXICO'S REQUEST FOR A STAND-BY ARRANGEMENT IN SUPPORT OF THIS PROGRAM ONCE I AM INFORMED THAT THE NECESSARY EXTERNAL FINANCING WILL BE AVAILABLE. SUPPORT FROM THE FUND WOULD NOT BE EFFECTIVE UNLESS THE PROGRAM IS FULLY FINANCED, INCLUDING THE

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PARTICIPATION OF THE COMMERCIAL BANKS. ALSO, WHILE THE EXECUTIVE BOARD OF THE WORLD BANK HAS ALREADY APPROVED A MAJOR LOAN PACKAGE FOR MEXICO AND CREDITOR GOVERNMENTS HAVE AGREED TO A RESCHEDULING OF DEBT SERVICE PAYMENTS FALLING DUE OVER THE PERIOD SEPTEMBER 22, 1986-MARCH 31, 1988 FOR DEBT CONTRACTED THROUGH DECEMBER 31, 1985, BOTH OF THESE ARRANGEMENTS DEPEND UPON THE FULL COOPERATION OF MEXICO'S COMMERCIAL BANK CREDITORS.

TO ENSURE THE AVAILABILITY OF FINANCING FROM OFFICIAL SOURCES AND IN ORDER TO BE IN A POSITION TO PROPOSE APPROVAL OF THE STAND-BY ARRANGEMENT BY THE EXECUTIVE BOARD OF THE FUND, I NEED WRITTEN ASSURANCES FROM THE INTERNATIONAL BANKING COMMUNITY DURING THE WEEK ENDING OCTOBER 31, 1986 AT THE LATEST, CONFIRMING ITS PARTICIPATION IN MEETING MEXICO'S FINANCING REQUIREMENTS FOR 1986 AND 1987 AS INDICATED ABOVE.

THE PROCESS OF COLLABORATION INITIATED IN LATE 1982 AMONG THE MEMBERS OF THE INTERNATIONAL FINANCIAL COMMUNITY

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TO HELP COUNTPIES SUCH AS MEXICO IN DEALING WITH THEIR INTERNATIONAL PAYMENTS PROBLEMS HAS PERMITTED THE MAINTENANCE OF AN ORDEPLY SYSTEM OF PAYMENTS. MEXICO HAS CHOSEN TO DEAL WITH ITS EXTERNAL DIFFICULTIES THROUGH NEGOTIATION WHILE ADOPTING POLICIES OF ADJUSTMENT AND STRUCTURAL REFORMS THAT WOULD HELP THE COUNTRY TO GROW OUT OF ITS DEBT PPOBLEM. THE STPATEGY TO PESOLVE THE DEBT PROBLEM HAS STRENGTHENED BY THE INITIATIVE LAUNCHED BY THE U.S. SECRETARY OF THE TREASURY AT THE ANNUAL MEETINGS OF THE FUND AND WORLD BANK IN SEOUL LAST YEAR, WHICH HAS RECEIVED THE SUPPORT OF THE INTERNATIONAL FINANCIAL COMMUNITY AT LARGE. I BELIEVE THAT THE MEXICAN CASE OFFERS AN IMPORTANT OPPORTUNITY FOR CONTINUED COOPERATION WITHIN THE CONTEXT OF A STRENGTHENED DEBT STRATEGY WHICH IS IN THE MUTUAL INTEPEST OF ALL PAPTIES.

J. DE LAPOSIERE

MANAGING DIRECTOP

INTERFUND

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THE FUND'S MANAGEMENT IS PREPARED TO RECOMMEND TO THE EXECUTIVE BOARD COMPLETION OF THE MID-TERM REVIEW OF THE STAND-BY ARRANGEMENT ON THE BASIS OF THE POLICIES OUTLINED IN THE ECONOMIC POLICY MEMORANDUM NEGOTIATED BY THE RECENT STAFF MISSION, SUBJECT TO THE CHANGES SPECIFIED BELOW. THESE CHANGES, MOST OF WHICH ARE OF AN EDITORIAL NATURE, ARE THE RESULT OF A REVIEW OF THE DRAFT DOCUMENTATION BY MANAGEMENT AND STAFF OF THE FUND.

WITH REGARD TO YOUR REQUEST FOR A FIRST-YEAR DISBURSEMENT UNDER THE STRUCTURAL ADJUSTMENT FACILITY IN SUPPORT OF A POLICY PROGRAM COVERING CALENDAR YEAR 1987, PLEASE NOTE THAT THE PROGRAM NEGOTIATED WITH THE RECENT STAFF MISSION REPRESENTS THE FIRST STAGE OF A THREE-YEAR POLICY FRAMEWORK WHICH ALSO REQUIRES THE PREPARATION OF A PAPER ON THE BASIS OF UNDERSTANDINGS REACHED WITH YOU BY THE STAFFS OF THE FUND AND THE WORLD BANK. THE STAFF OF THE FUND HAS BEEN WORKING WITH ITS COUNTERPARTS IN THE WORLD BANK SO AS TO COMPLETE THE DRAFT OF SUCH A PAPER AS

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TRE
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B The Acting Managing Director

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D DRAFTED BY NAME (TYPE): Hans Flickenschild — EXT.: 8621 DEPT WHD — DATE: 10-14-86

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A BASIS FOR JOINT DISCUSSIONS WITH THE BOLIVIAN AUTHORITIES TO BE HELD IN THE SECOND HALF OF THIS MONTH. IF WE CAN ADHERE TO THE TIME SCHEDULE JUST INDICATED, THE REQUEST FOR A DISBURSEMENT UNDER THE STRUCTURAL ADJUSTMENT FACILITY WOULD BE SUBMITTED TO THE FUND'S EXECUTIVE BOARD CONCURRENTLY WITH THE STAND-BY REVIEW.

THE SUGGESTED CHANGES OF THE LETTER OF INTENT, THE ECONOMIC POLICY MEMORANDUM AND THE TECHNICAL MEMORANDUM ARE AS FOLLOWS:

<u>LETTER OF INTENT</u>:

PAGE 1, LINES 10-12: REPLACE "THROUGH THE END OF 1987 AND THE QUANTITATIVE TARGETS IT EXPECTS TO ACHIEVE IN THE PERIOD OCTOBER 1, 1986-DECEMBER 31, 1987" BY "DURING THE REMAINING PERIOD OF THE CURRENT STAND-BY ARRANGEMENT FROM THE INTERNATIONAL MONETARY FUND AND THE CORRESPONDING QUANTITATIVE TARGETS".

PAGE 1, LINE 17. DELETE "SHARPLY".

PAGE 1, LINE 19: REPLACE "WHILE INFLATION" BY "

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INFLATION".

PAGE 1, LINE 20: BEFORE "NET" INSERT "AND".

MEMORANDUM OF UNDERSTANDING ON ECONOMIC POLICY THROUGH THE END OF 1987:

PAGE 1, LINE 15: AFTER "OFFICIAL MARKET" INSERT "HAS".

PAGE 2, LINES 8-9: REPLACE "INTERDICTION OPERATIONS" BY "OPERATIONS UNDERTAKEN".

PAGE 2, LINE 22: AFTER "THAT" INSERT "THE".

PAGE 2, LINE 25: REPLACE "--REFLECTING CONTINUED SUCCESS IN REDUCING INFLATION--" BY "IN REAL TERMS,".

PAGE 3, LINE 1: REPLACE "LARGE" BY "INTERNATIONAL".

PAGE 3, LINE 8. DELETE "CONTINUED".

PAGE 3, LINES 21-22: CHANGE "IN THE FIRST HALF OF 1986 INCREASED TO 13 PERCENT OF GDP ON AN ANNUAL BASIS FROM 9 PERCENT OF GDP IN 1985." TO "INCREASED FROM 9 PERCENT OF GDP IN 1985 TO 13 PERCENT OF GDP ON AN ANNUAL BASIS IN THE FIRST HALF OF 1986."

PAGE 3, LINES 25-27 AND PAGE 4, LINES 1-4: REPLACE THE

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SENTENCE IN THESE LINES BY "AFTER INCREASING FURTHER TO
15 PERCENT OF GDP ON AN ANNUAL BASIS IN THE SECOND HALF OF
1986, REVENUE COLLECTIONS ARE LIKELY TO DECLINE TO
13 1/2 PERCENT OF GDP IN 1987, REFLECTING LOWER TRANSFERS
FROM YPFB AS A RESULT OF THE POOR PROSPECTS FOR
INTERNATIONAL PETROLEUM PRICES. TO STRENGTHEN REVENUE
COLLECTIONS FROM OTHER SOURCES, AN UNDERSECRETARY OF".
PAGE 5, LINE 3: DELETE "BEING".
PAGE 5, LINE 7: DELETE "25".
PAGE 7, LINES 12-13: DELETE "THE REMAINING".
PAGE 8, LINE 1: REPLACE "EXTERNAL LOANS" BY "THOSE
EXTERNAL LOANS THAT CANNOT BE RESTRUCTURED".
PAGE 8, LINE 9: DELETE "GENERALLY".
PAGE 10, LINE 9: REPLACE "ON" BY "FOR".
PAGE 11, LINE 14 REPLACE "GIVE AWAY" BY "DISTRIBUTE".
PAGE 11, LINE 17: REPLACE "REDUCE" BY "LIMIT".
PAGE 11, LINE 26 REPLACE "SPENDING" BY "QUANTITATIVE".
PAGE 11, LINES 26-27: REPLACE "MENTIONED IN THE PRECEDING

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PARAGRAPHS" BY "IN TABLES 1 TO 5".

PAGE 12, LINE 2: REPLACE "TARGETS" BY "OBJECTIVES".

PAGE 12, LINE 7: REPLACE "CONSISTENTLY" BY "TO BE CONSISTENT".

PAGE 12, LINE 13: REPLACE "SET CONTINUOUS" BY "ESTABLISHED".

PAGE 12, LINE 20: CHANGE "," TO "(" AND INSERT "DEPOSIT" BEFORE "ACCOUNTS".

PAGE 12, LINE 21: CHANGE "," TO ")".

PAGE 12, LINE 22: REPLACE "ENVISAGED" BY "EXPECTED".

PAGE 13, LINE 1: REPLACE "THIS ESTIMATION INCLUDES" BY "THESE ESTIMATES INCLUDE".

PAGE 13, LINE 5: REPLACE "INDICATED IN THE PRECEDING SENTENCE" BY "JUST INDICATED".

PAGE 13, LINE 8: DELETE "HAVC".

PAGE 13, LINE 11: REPLACC "PROGRAMMED" BY "EXPCCTED".

PAGE 13, LINES 21-22: REPLACE "COMPARATIVELY CHEAP FOREIGN RESOURCES" BY "FOREIGN RESOURCES AVAILABLE".

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PAGE 15, LINE 15: DELETE "A MAJOR EFFORT".

PAGE 15, LINE 17. REPLACE "FUND IS ALREADY" BY "FUND, A MAJOR EFFORT IS".

PAGE 15, LINES 20-21: REPLACE "DEPOLITICIZED THE DETERMINATION OF" BY "ENHANCED FLEXIBILITY IN DETERMINING".

PAGE 16, LINE 12: REPLACE "RESERVES POLICY" BY "POLICY TOWARD FOREIGN RESERVES".

PAGE 16, LINES 20-21. REPLACE "CREATE AN APPRECIATION BIAS" BY "INDICATE A BIAS TOWARD CURRENCY APPRECIATION".

PAGE 16, LINE 25: REPLACE "HAS REMAINED GENERALLY" BY "GENERALLY HAS BEEN".

PAGE 17, LINES 16-25: REPLACE THE LAST SENTENCE BY "THE EXCHANGE SYSTEM IS FREE OF RESTRICTIONS SUBJECT TO ARTICLE VIII OF THE FUND'S ARTICLES OF AGREEMENT EXCEPT FOR ARREARS ON CERTAIN EXTERNAL DEBT SERVICE PAYMENTS (SEE PARAGRAPH 18(A) BELOW). THE SPREADS RESULTING FROM (I) THE OPERATION OF THE AUCTION MARKET FOR FOREIGN EXCHANGE,

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IN WHICH EACH SUCCESSFUL BIDDER PAYS THE PRICE OFFERED, AND (II) THE OPERATION OF THE PARALLEL EXCHANGE MARKET, IN WHICH THE PROCEEDS FROM NONMERCHANDISE EXPORTS MAY BE SURRENDERED, HAVE REMAINED WELL BELOW 2 PERCENT IN THE RECENT PAST. HOWEVER, A MULTIPLE CURRENCY PRACTICE COULD ARISE IF EITHER SPREAD WERE TO EXCEED 2 PERCENT."

PAGE 18, LINE 8: REPLACE "WITH THE" BY "WITH A".

PAGE 18, LINE 9: REPLACE "AFTER MID-1987." BY "IN THE PERIOD JULY 1987-JUNE 1988."

PAGE 18, LINE 19: AT THE END OF THE PARAGRAPH, ADD "NO NEW ARREARS WILL BE INCURRED THEREAFTER."

PAGE 18, LINES 20-21: REPLACE "WHILE FOREIGN CREDITORS HAVE BEEN SLOW IN DISBURSING NEW LOANS AND GRANTS," BY "WHILE THE DISBURSEMENT OF NEW LOANS AND GRANTS HAS BEEN SLOW,".

PAGE 19, LINE 7. DELETE "MEDIUM- AND LONG-TERM".

PAGE 19, LINE 9: AFTER "MATURITIES OF" INSERT "MORE THAN ONE YEAR AND".

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PAGE 19, LINE 24. AFTER "DEFICIT" INSERT A COMMA.

PAGE 19, LINE 25: AFTER THE END OF THE SENTENCE, INSERT "BOTH IMPORTS AND THE CURRENT ACCOUNT DEFICIT WOULD BE LOWER IF THE FLOW OF EXTERNAL FINANCING WERE TO TURN OUT TO BE SMALLER THAN EXPECTED. NONETHELESS,".

PAGE 20, LINE 9. AFTER "DOMESTIC" INSERT "INDIRECT".

PAGE 20, LINE 16: REPLACE "IMPROVE" BY "AMELIORATE".

TABLE 1. CHANGE "JUNE 30, 1987" TO "JUNE 30, 1987 2/".

TABLE 2: A) CHANGE "MARCH 31, 1986-JUNE 30, 1987 2/" TO "MARCH 31, 1986-JUNE 30, 1987 2/ 3/" FOR BOTH THE CEILING AND THE SUBCEILING.

B) RENUMBER FOOTNOTE 3 TO BE FOOTNOTE 5.

C) ADD A NEW FOOTNOTE 3 TO READ "INDICATIVE LIMIT AFTER JUNE 18, 1987."

D) CHANGE "MARCH 31, 1986-SEPTEMBER 30, 1986 2/ 4/" TO "MARCH 31, 1986-SEPTEMBER 30, 1987 2/ 4/" FOR THE CEILING.

E) CHANGE THE FOOTNOTE APPEARING AT THE END OF

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THE SUBHEADING "2. CUMULATIVE CHANGES IN THE NET POSITION OF THE NONFINANCIAL PUBLIC SECTOR WITH THE CENTRAL BANK OF BOLIVIA" FROM "3/" TO "5/".

TABLE 3: A) IN THE TABLE HEADING, REPLACE "LIMITS ON CHANGES" BY "MINIMUM GAIN OR MAXIMUM LOSS".

B) CHANGE "JUNE 30, 1987" TO "JUNE 30, 1987 2/".

TABLE 5: CHANGE "MARCH 31, 1986-JUNE 30, 1987" TO "MARCH 31, 1986-JUNE 30, 1987 3/".

IN THE TECHNICAL MEMORANDUM OF UNDERSTANDING:

PAGE 1, LINE 4: REPLACE "MENTIONED" BY "REFERRED TO".

PAGE 2, LINE 5: DELETE THE COMMA.

PAGE 3, LINE 25: REPLACE "REMAIN" BY "CONTINUE TO BE".

PAGE 4, LINE 11: REPLACE "AT LEAST" BY "MORE THAN" AND "OF NOT MORE THAN" BY "UP TO".

PAGE 5, LINE 19: REPLACE "ADJUSTMENTS" BY "ADJUSTMENT".

REGARDS,

E. WIESNER, DIRECTOR,

WESTERN HEMISPHERE DEPARTMENT, INTERFUND

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Minister of Planning and Coordination
La Paz, Bolivia

Lic. Juan Cariaga
Minister of Finance BV. MF
La Paz, Bolivia

Lic. Javier Nogales
President
Central Bank of Bolivia BV. G. Loc
La Paz, Bolivia

Mr. David Hoelscher
Resident Representative BV. rep
International Monetary Fund
La Paz, Bolivia

INTERNATIONAL MONETARY FUND

October 16, 1986

Mr. Beza
Mr. Pujol

The attached memorandum for files is for your information.

Attachment

File Mexico

Luis Duran-Downing

Office Memorandum

October 16, 1986

MEMORANDUM FOR FILES

Subject: Mexico--Japanese Special Facility

In a meeting of the OECD export credit group on October 6-7, 1986 in Paris, the representative of the Eximbank of Japan indicated that the bank has recently agreed to extend about US$1 billion in new loans to Mexico. The agreement was reached during a recent visit of Mr. Petricioli, the Mexican Finance Minister, to Japan. The delegate clarified that these new loans are to be related to several projects and are expected to be fully disbursed in a period of 2-3 years.

In a private conversation at the end of the plenary session, I asked Mr. Kimura, senior advisor of the Eximbank of Japan, some details of the loan. In his reply, Mr Kimura indicated that the new credits are to finance part of the cost related to a Pacific petroleum project with a total cost of about US$500 million, a steel complex (SICARTSA) with a total cost of about US$250 million, and an export development project of about US$250 million to be cofinanced with the World Bank. Mr. Kimura said that the details of the agreement are being worked out and that he expected that the agreement could be concluded before the end of the Japanese fiscal year--before March 1987. The loan is not considered to be a tied loan.

He mentioned that the Mexican authorities are asking for a quick disbursement scheme whereby the full amount could be disbursed up front and then used to finance the normal flow of imports stemming from the projects as they occur. Mr. Kimura said that the Japanese authorities find it difficult to accept this proposal and that they would prefer to link the actual disbursements to specific projects. However, he said, that they are prepared to reach a compromise on this aspect. One possibility would be retroactive financing for projects already made. Other possibility would be policy lending. In any case he expects that some disbursements will be made on account of this new facility before March 1987 since part of it was included in the current budget.

Luis Duran-Downing
Senior Economist
External Finance Division
Exchange and Trade Relations Department

INTERNATIONAL MONETARY FUND
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File Mexico

INTERNATIONAL MONETARY FUND

October 17, 1986

Mr. Wiesner:

Attached please find a table providing details of the recent rescheduling of the Mexican debt with official creditors.

Attachment

cc: Mr. Beza
Mr. Pujol

Luis Duran-Downing

Table . Mexico: Rescheduling of the Debt Service due to Official Creditors by the Mexican Public Sector 1/

(In millions of U.S. dollars)

	1986			1987		
	Principal	Interest	Total	Principal	Interest	Total
A. Debt service due	1,646	380	2,026	942	353	1,295
Bilateral	980	335	1,315	731	335	1,066
CCC	666	45	711	211	18	229
B. Debt service paid						
Jan.1-Sept.21 1986	1,304	217	1,521	--	--	--
Bilateral	751	187	938	--	--	--
CCC	553	30	583	--	--	--
C. (=A-B) Eligible debt						
service	342	163	505	942	353	1,295
Bilateral	229	148	377	731	335	1,066
CCC	113	15	128	211	18	229
D. Debt relief 2/	342	98	440	942	212	1,154
Bilateral	229	89	318	731	201	932
CCC	113	9	122	211	11	222
Memorandum items:						
Stock outstanding 12/31/85	5,736					
Bilateral	4,780					
CCC	956					

Source: Data provided by the Mexican authorities; official creditors; and Fund staff estimates.

1/ Includes estimates of debt service due on guarantees from national credit institutions to the Mexican private sector.
2/ Rescheduling of 100 percent of principal and 60 percent of interest due over the period September 22, 1986 - December 31, 1987.

Note: Official creditors also rescheduled 100 percent of principal falling due in the period January 1 - March 31, 1988. This amount is estimated at about US$165 million.

File Mexico

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TERM SHEET FOR
COMMERCIAL BANK CONTINGENT
INVESTMENT SUPPORT FACILITY
(Investment Support Facility)

Borrower: The United Mexican States, with Banco de Mexico Foreign Exchange Undertaking

Purpose: To support ongoing high-priority non-o[illegible] sector investment programs. Up to U.S. $[illegible] million of amounts drawn to be available for onlending to private sector borrowers upon terms to be established.

Lenders: As per general term sheet.

Amount: 5 separate Tranches whose amounts and quarterly availability are specified below:

Tranche	Tranche Amount	Quarterly Availability
1	U.S. $249,000,000	February 15, 1987-April 14, 1987
2	405,000,000	April 15, 1987-July 14, 1987
3	344,000,000	July 15, 1987-October 14, 1987
4	233,000,000	October 15, 1987-January 14, 1988
5	172,000,000	January 15, 1988-April 14, 1988

;provided that the maximum aggregate amount drawable shall be U.S. Dollars 1.2 billion.

Termination Date: April 14, 1988. Tranches undrawn in any quarterly period will be cancelled.

Commitment
Fee: 1/4 of 1% from the date of the agreement.

Interest Rate: Each Bank to make a one-time election of LIBO, domestic or fixed rate pricing.

LIBO and domestic pricing to be at 13/16 of 1% over LIBOR or domestic reference rate based on domestic reference rate for each currency in the Mexican Public Sector Restructure Agreements.

Fixed rate option to be priced comparably to floating rate options.

Final
Maturity: 7 years with 3 years grace from date of the agreement.

Repayment: 17 equal quarterly installments commencing on the 3rd anniversary of the date of the agreement.

Drawdown
Conditions: To include the conditions set forth in the general term sheet and the following specific conditions for each Tranche:

Tranche 1 (Available from February 15, 1987):

Conditions for Drawdowns available from January 1, 1987 per general term sheet.

Tranche 2 (Available from April 15, 1987):

Conditions for Drawdowns available from April 1, 1987 per general term sheet.

Tranche 3 (Available from July 15, 1987):

Conditions for Drawdowns available from July 1, 1987 per general term sheet.

Tranche 4 (Available from October 15, 1987):

Conditions for Drawdowns available from October 1, 1987 per general term sheet.

Tranche 5 (Available from January 15, 1988):

Conditions for Drawdowns available from January 1, 1988 per general term sheet.

All Tranches:

(1) Cumulative drawings under the IMF Oil Contingency Facility equivalent to at least U.S. $200 million and an additional drawing under such Facility has occurred during the quarterly period in which a disbursement is to be made under the Investment Support Facility.

(2) Certificate of IMF (after appropriate consultations with Mexico and The World Bank) that

(a) a shortfall in Mexico's public sector external receipts (both oil and non-oil) has occurred which will reduce Mexico's capacity to maintain its 1986-87 public sector investment program, and

(b) a disbursement under the Investment Support Facility is necessary in order to maintain Mexico's public sector investment program in specified high-priority non-oil areas.

(3) Certificate of The World Bank that the Mexican public sector investment program in specified high-priority non-oil areas is [being properly implemented].

Disbursement Amounts: Subject to quarterly availability, the amount of each quarterly disbursement will be the amount certified by the IMF (using foreign trade data) and determined on the following basis:

(1) Shortfall for the prior calendar quarter in Mexico's public sector external receipts attributable to crude oil price (determined as provided in the IMF Oil Contingency Facility), as adjusted to reflect

(a) Net increase (or decrease) for the prior calendar quarter in actual external receipts from projected external receipts attributable to public sector non-crude oil exports (including, but not limited to, ____________________) (the amount of any such adjustment being limited in the first quarterly period to U.S. $49MM, in the second quarterly period to U.S. $55MM, in the third quarterly period to U.S. $44MM, in the fourth quarterly period to U.S. $33MM and in the fifth quarterly period to U.S. $22MM), and

(b) Increase (or decrease) for the prior calendar quarter in public sector external receipts attributable to an increase (or decrease) in crude oil export volumes from the reference volumes used in calculations under the IMF Oil Contingency Facility,

<u>less</u> (2) The amount of the drawing under the IMF Oil Contingency Facility relating to the shortfall specified in (1) above (which shall be at least 1/4 of such shortfall).

<u>Reduction of Commitments; Mandatory Prepayments</u>: In the case of excess external revenues as defined under the IMF Oil Contingency Facility, 3/4's of such revenues in excess of the first U.S. $200 million would be applied in the following order:

(1) to prepay amounts drawn under the Investment Support Facility;

(2) to reduce remaining commitments under the Parallel New Money Facility;

(3) to prepay amounts drawn under the Parallel New Money Facility; and

(4) to prepay amounts drawn under the Commercial Bank Growth Contingency Cofinancing Facility.

Description of Investment Program: The agreement will contain a schedule prepared by Mexico in consultation with The World Bank describing the 1986-87 public sector investment program in specified high-priority non-oil areas, including ways in which such program promotes private sector activity.

Other Terms: As per general term sheet.

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Other Terms: As per general term sheet.

WHD1/MEX (ntmexal) October 8, 1986

Mexico

I Economic Background

1 The program of 1983-85

a The achievements

Four years ago the Government of Mexico was faced with a severe economic situation The economy had plunged into the deepest recession it had experienced in recent times, the country's foreign exchange reserves were virtually wiped out, and inflation soared to very high levels. The administration that came to office in late 1982 adopted an economic program designed to address the country's external and internal imbalances and put the economy back on a path of sustained growth

The program also involved structural features to reverse many of the tendencies of the years leading to 1983 when large petroleum export earnings and Mexico's substantial use of foreign savings provided the Government the means to subsidize consumption on a large scale, run large fiscal deficits, and maintain an overvalued exchange rate In this setting, domestic savings suffered, exports outside the oil sector declined, and the country's dependence on the petroleum sector became more pronounced

The program that was adopted in 1982 involved a major strengthening of the fiscal position, a tightening of credit, and a large initial adjustment of the currency, followed by frequent adjustments based on projected inflation On the basis of these policies, the Mexican economy made important gains Inflationary pressures abated and the balance of payments improved markedly In 1983 the external current acount moved into surplus after registering large deficits in the two preceding years, and the Bank of Mexico was able to reconstitute its international reserves The elimination of subsidies by an estimated 6 percent of GDP liberated resources for more productive uses, and the reduction of the fiscal deficit by 9 percentage points of GDP in 1983 strengthened the savings performance of the economy and made more room for private credit The growth prospects of the economy also were enhanced by the improvement in Mexico's competitiveness that stemmed from the exchange rate adjustment combined with a prudent wage policy

b The slippages

Notwithstanding its auspicious start, the program ran into difficulties in the latter part of 1984, and by the first half of 1985 it became apparent that problems in policy implementation were having adverse effects on economic performance Efforts to curb the rate of inflation stalled as public sector receipts began to lag the rise in the overall price level and public expenditure increased as a proportion of GDP The fiscal slippages were compounded by the weakening of the international petroleum market and the effects of the September 1985 earthquakes The fiscal deficit widened to 10 percent of GDP in 1985, compared with 8 1/2 percent the year before and with 5 percent of GDP that had been planned initially The effect of this development was that the Bank of Mexico's foreign reserve position again came under pressure, particularly since exchange rate policy was not sufficiently active for a time, and the availability of credit to the private sector was reduced, especially toward the end of the year In mid-1985 a step adjustment of the exchange rate that was followed by the adoption of a flexibly managed float prevented a further deterioration in Mexico's external position in the latter part of the year, but the squeeze of private credit intensified

2 Effect of the collapse of oil prices in 1986

For 1986, the authorities framed a budget that aimed at correcting the imbalances that had become so pronounced in 1985, indeed, the fiscal policy approved by the Congress in late 1985 envisaged a reduction in the overall public sector deficit by one half in relation to GDP, to 5 percent of GDP in 1986 However, the more than 50 percent drop of oil prices during the first half of 1986 had massive negative repercussions on the public sector financial position and the balance of payments, and thus dealt a severe blow to an already weakened economy At prevailing oil prices, the loss in petroleum revenue has been estimated at more than 6 percent of GDP and some 20 percent of total public sector receipts, at current production levels the decline in export earnings may be estimated at about US$8 billion

As external earnings fell, and in a situation in which Mexico did not have access to external credit, the public sector's financing needs gave rise to a rapid expansion of credit to the public sector and to a sharp increase in the rate of inflation. Tight restrictions were applied on credit to the private sector and interest rates moved up sharply In the effort to counter the effects of the loss of oil export earnings, the authorities pursued an active exchange rate policy, depreciating the rate in the controlled foreign exchange market at a faster pace than domestic inflation The rise in interest rates associated with the growth of public sector deficit and the upturn of inflation has had pronounced effects on the interest payments of the public sector The interest payments component in total public outlays is now estimated to rise to some 18 5 percent of GDP in 1986, up from 12 percent of GDP in 1985, and to exceed by about two percentage points of GDP the overall fiscal borrowing needs (4 5 percentage points out of the 18 5 percentage points are external interest payments and 14 percent are domestic)

II The Program for 1986-87

1 The objectives

In response to the difficult situation that the economy again has come to confront, the Government has developed an economic and financial program that combines fiscal and monetary policies together with structural policies in an effort to restore balance of payments viability, strengthen the savings performance of the economy, and improve efficiency in order to re-establish sustained growth of the Mexican economy To these ends, the program is designed to avoid an acceleration in the rate of inflation and to start to bring it down, to reduce pressures on interest rates and provide for a better distribution of credit between the public and private sectors, and to eliminate rigidities and relative price distortions that affect adversely the allocation of resources

2 The policy content of the program

We agreed yesterday (July 22) at the management level on the economic program and the letter of intent has been signed by the Minister a Fiscal

Fiscal policy will be called upon to play a key role The fiscal effort envisaged over 1986-87 would be of the order of 3 percent of GDP, on a real basis, to be achieved through a combination of changes in the structure of the tax system, adjustment in the prices and tariffs of the public enterprises, and reductions in public expenditure (a) On tax policy (which is to contribute an additional 1 3 percent of GDP in revenue), the intention is to correct the distortion and revenue loss that evolved from the application of a tax code which was not designed to operate in an environment of high inflation, and thus to make the tax system more responsive to movements in nominal income (b) The policy with regard to prices and tariffs charged by the public enterprises will be to introduce initial catch-up adjustments to compensate for the effect of lags in price revisions that have arisen in the wake of accelerating inflation, and then to ensure that adjustments are made at frequent intervals to prevent situations where transfers from the Government or borrowing are required to cover operational costs (Pricing policies are to raise revenue by 1 2 percent of GDP) (c) The margin for maneuver on the expenditure side is circumscribed by the burden of interest payments on the public debt, and by the already large reductions that have occurred, especially in capital expenditures, in recent years The adjustment in public expenditures is the equivalent of 0.5 percent of GDP, and there are to be important changes in the composition of public spending From 1986 to 1987, capital outlays--which have been cut very severely--would rise by 0 5 percent of GDP, or by some 15 percent in real terms, to make room for this increase, real current spending will decline by some 1 percent of GDP and will thus be kept below the projected growth of real GDP

b <u>Monetary and exchange rate policies</u>

Monetary and credit policy is to be consistent with the objective of reducing the rate of inflation and the attainment of the balance of payments target of the program, also, with the assistance of the tightening of fiscal policies, credit will be managed so as to provide resources to the private sector to support the recovery of economic activity. Preferential lending rates offered by the national development banks will be subject to more selectivity, and interest rate policies will seek to secure yields in real terms on domestic financial holdings In determining interest rates, market forces will be given increased prominence.

Flexibility in exchange rate management will continue to be exercised in order to protect Mexico's external competitiveness, help rebuild international reserves, and facilitate the liberalization of trade policies The real effective exchange rate of Mexico has been depreciated by some 40 percent since last summer, and this change has had a very salutary effect on the non-oil transactions of the current account (in January-May 1986 non-oil exports were up by 25 percent from the same period of the previous year) and on the capital account The authorities are very much aware of the importance of avoiding currency overvaluation, and have affirmed very strongly their intentions in this regard The exchange rate differential between the controlled rate and the free rate has been reduced substantially as compared with earlier periods and, at present, it is well below 10 percent In recognition of the distortions in relative prices that exchange rate spreads can give rise to, the aim of the authorities is to guard against their further widening and to move toward their elimination

c <u>Structural/supply side policies</u>

Together with the adjustment effort that is to be made through the pursuit of fiscal and monetary policies, the program assigns great weight to the role of growth-oriented policies aimed at removing obstacles that stand in the way of more rapid economic gains and the creation of productive employment through a better use of resources

To this end, there will be important changes in the area of public expenditure as the Government takes steps to reduce its involvement in the economy by selling, merging, and/or transferring to the private sector firms that are not considered as having priority interest or strategic importance In addition, industrial reconversion plans are to be carried out in the sugar, fertilizer and steel sectors to reduce costs and to make room for investment Shipyards are being adapted to benefit from new technology, and the operations of the railways and the national airlines are being conducted more flexibly

Advances are being made in the area of trade liberalization (N B In the oral presentation the Managing Director shortened this paragraph and made reference to the role of the World Bank in this field) Prior import requirements will continue to be eliminated, as the customs tariff is being simplified with a view to improving the structure of effective protection The diversification of the export base also is being sought actively The recent performance of nonpetroleum exports is indicative of the key role that active exchange rate policies have played in this regard, and the recent evolution of domestic wages has been another element contributing to the increased competitiveness of Mexican exports Exporters and re-exporters have benefited from measures in support of their activities The elimination of licensing requirements for most exports, the simplification of export administrative procedures and custom requirements, and Mexico's accession to the GATT all have been well received More recently, changes have been introduced in the foreign exchange system to allow the retention by exporters and their domestic suppliers of their foreign exchange earnings for payment of imported inputs.

Results also have been obtained from policies to promote foreign investment, especially on ventures to expand export capacity and activities that involve transfer of technology Steps have been taken recently, and will be strengthened in the future, to streamline the administrative procedures for initiating and approving foreign investment projects, so as to increase the flow of foreign capital In particular, automatic approval of investment projects fundamentally oriented to export markets will be granted after a period of 30 days Special efforts also will be made to facilitate an enlarged access to the Mexican market by small- and medium-sized foreign companies It should be noted that debt-equity swap operations already have taken place and that the Government intends to follow this practice in a selective fashion as part of the promotion of foreign investment

3 The instrumentation

a Performance criteria

For the purpose of monitoring the program, use will continue to be made of all the indicators employed in the past In addition, use will be made of an operational fiscal balance to help assess the effort being achieved in this field independent of the inflationary developments The performance criteria will cover

a) the public sector performance,

b) the usual performance criteria on credit,

c) and a target for international reserves to rebuild a more normal position

It should be emphasized that the fiscal measures that are being planned will bring the operational balance into equilibrium or even a small surplus by 1987

b <u>The oil contingency</u>

In view of the heavy dependence of Mexico on petroleum exports and because of unsettled conditions and uncertainties in the international petroleum market, the program contains a feature that makes some of its targets and the structure of the financial package dependent on the evolution of oil markets Three cases are considered

— <u>The baseline scenario</u>

If the price of the Mexican oil fluctuates within a range of US$9 to US$14 per barrel in a given quarter, there will be a corresponding adjustment to be carried through a combination of reserve changes and exchange rate and credit policies No additional external financing will be sought in this range

— <u>Lower-end scenario</u>

If prices drop blow US$9 per barrel for a sustained period of time, the program will be fully protected for a period of nine months After the initial nine months there would be a sharing of the shortfall between domestic adjustment and external financing, with the portion of adjustment increasing over the subsequent five quarters This additional financing would not exceed US$2 5 billion over a period of eighteen months

-- Upper-end scenario

If prices move above US$14 a barrel external financing would be reduced in accordance with the additional revenue

c. The growth contingency

The program features a second special mechanism designed to become operative if the economic recovery fails to materialize despite the appropriate implementation of the agreed policies This mechanism would trigger an increase in public investment in selected projects identified as having a high domestic content and substantial secondary effects on the private sector The estimated amount of this potential release of funds would be US$500 million for the period of the program and the Mexican Government expects this amount to be secured in advance as an additional segment of the overall financial package that is required to fund the program The World Bank is expected to play a key role in the implementation of this mechanism

III The Financial Requirements

1 The medium-term horizon for the balance of payments

The program of adjustment and structural changes that the Government of Mexico has begun to implement should help in laying the basis for external payments viability and in creating the conditions necessary for sustained growth But the problems that Mexico is faced with are of such severity as to leave little doubt that they cannot be dealt with in a period of just 18 months. In the light of the loss of earnings from the oil sector alone, a substantial restructuring of the economy needs to be achieved over the next several years The structural changes that the Government has begun to put into effect will take some time to bear fruit and therefore the framework within which the program has been formulated is one that relates to the medium term, Mexican officials and the Fund staff are working on medium-term scenarios that will be presented to the economic subcommittee. This not only means that the authorities will need to persevere in the efforts to adapt the economy to a more competitive international environment over an extended period of time, but also that the international financial community will be expected to lend its support to those efforts into 1988 and possibly beyond

2. The balance of payments for 1986-87

The objectives of stabilization and growth in the economic program of the Mexican Government are not only closely interrelated but, from a balance of payments perspective, also point to the need for a careful blending of adjustment and financing. The economic program has to avoid the development of an external payments situation that leads to a rate of growth of external debt that is clearly not sustainable At the same time, however, it has to be recognized that the impact of the fall in oil prices cannot be fully absorbed internally in the short run without serious repercussions on Mexico's ability to grow and thus to service its existing external commitment On another level, the mix of the financial package between official creditors and private sources has to strike a reasonable balance

An objective of the program is to limit the deficit on current transactions to US$3 5 billion in 1986, and to reduce it to US$2 9 billion in 1987 We have incorporated in the program a target for rebuilding net international reserves by US$0 5 billion in 1986 and US$0 9 billion in 1987, or US$1 4 billion over the program period This is less than half of the reserve loss in 1985 and would permit gross reserves to cover the equivalent of three months of the sum of payments of goods and services (including interest payments) by the end of the program period Reserves are now at an extremely low level (two months of imports and interest payments) and this is not adequate for an economy of the size and vulnerability of the Mexican economy To cover these requirements, as well as some inevitable repayments on private capital account, the official capital account would have to show net inflows amounting to US$10 6 billion over the two-year period 1986-87

Achieving this figure for official capital will involve a sharp increase in the flow of capital from official sources Indeed, we have assurances that this will happen On the basis of a particularly marked increase in credit available from the World Bank, official sources of finance are expected to provide some US$5 billion over the two-year period 1986-87. If one includes the Fund in official financing (the Fund is customarily treated below the line as part of the net reserve position), the total from such sources would rise well above US$6 billion According to these estimates, the portion to be covered by commercial banks would be US$6 billion over the same two-year period

For this support of Mexico's balance of payments to materialize, it is clear that creditors need to be reasonably assured that the policies

Mexico pursues will increase its ability to maintain orderly relations with its creditors into the future The growth orientation of the program is an attempt to address these concerns The expanded activities in Mexico by the World Bank is another factor that should help allay creditors' possible apprehension as regards the efficient use of their increased exposure The growth contingency provides an added safeguard that the economic program gets off to a satisfactory start

I should note that the increase in commercial bank exposure is in line with the ranges envisaged in the Baker Plan concept The figure of US$6 billion that I just mentioned for the commercial banks would involve an increase in bank exposure to Mexico over the 1986-87 period, but when account is taken of debt repayment by the private sector the increase in exposure to the economy as a whole would be close to 6 1/2 percent (a little more than 3 percent a year) Moreover, when consideration is given to Mexico's limited access to foreign bank financing since 1984, the increase in bank exposure to Mexico would average out to less than 2 1/2 percent a year for the period 1985-87 It should be noted in this connection that the global increase in bank exposure contemplated for the 15 Baker Plan countries is about 2 1/2 percent a year, and that the Baker Plan had not foreseen the debilitating economic impact of the oil problem on petroleum-producing countries

It should be emphasized that Mexico has chosen the route of orderly adjustment and structural reform It has chosen to deal with its external policies through negotiation. Thus, the Mexican case presents an opportunity to test the debt strategy in the wake of adverse external shifts The country is making an effort to address its problems in very difficult external circumstances, and it is up to the financial community to rise to the challenge

In conclusion, our discussions with the Mexican authorities dwelt at length with the complex issues that I have referred to, and I want you to know that we explored with them all possible means of strengthening the adjustment effort But I do not want to suggest that the economic plan is without risk. In the light of recent external developments I should instead emphasize to you that economic policies will need to be kept under close scrutiny, and we will do our best to work with the authorities to deal with problems as they arise At the same time, it is important that the creditors cooperate actively with the country and the Fund in this very important and difficult case. I do not need to remind you that without such cooperation, there would be serious questions whether orderly payments arrangements could be maintained

File I.0

INTERNATIONAL MONETARY FUND
WASHINGTON, D. C. 20431

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Group 2/3 (202) 623-7491

Mexico

Facsimile Service Cover Sheet

Number of pages (including cover sheet)	Message number	Date
5		10/07/86

To

Name of addressee (type)

Mr. Michael Chamberlain
Shearman and Sterling
New York, N.Y.

Rapicom 6300, Automatic Group 3, (212) 750-8671
Xerox 495, Automatic Groups 1, 2, and 3 (212) 752-0371

Facsimile telephone number

From

Name of sender (type)

Mr. Joaquin Pujol
Assistant Director
Western Hemisphere Department
International Monetary Fund
Washington, D.C.

Text or special instructions

Attached please find the material promised.

Department and division (type)	Extension (type)
WHD - M/LCD	8480
Authorized by (type): J. Pujol JP	Signature

SEC-56, Rev. 1
11-13-85

Alternative Draft

(Investment Support Facility linked to Contingency Mechanism)

The following modifications would be made to your original text

I) Availability

'Up to US$250 million in the first quarter of 1987, up to US$450 million in the second quarter of 1987, up to US$350 million in the third quarter of 1987, up to US$300 million in the fourth quarter of 1987, and up to US$200 million in the first quarter of 1988, but with the cumulative amount of availability not to exceed the total of US$1 2 billion provided for under the facility

Amounts undrawn in any quarter will be canceled at the end of the following quarter

II) Termination

As in our previous communication

III) Usage

As in our previous communication

IV) Drawdown conditions

(1) should read Cumulative use of the IMF Oil Contingency Mechanism has reached US$200 million and use of such Mechanism has

occurred in respect of the quarter in respect of which a disbursement is to be made under the Investment Support Facility'

(2) (b) should read a disbursement under the Investment Support Facility is necessary in order to help protect Mexico's economic program, including its investment plan

(3) As in our previous communication

(4) would become (3) and should read Conditions for drawing under the Parallel New Money Facility are satisfied (including the most recent scheduled purchase under the IMF stand-by arrangement) [This condition is subject to IMF examination of conditions on New Money Facility referred to]

V) Disbursement amounts

Subject to quarterly availability, the amount of each quarterly disbursement will be the amount calculated using foreign trade data and certified by the IMF on the following basis

(1) Shortfall for the preceding quarter in that part of Mexico's public sector external receipts that is calculated for the IMF Oil Contingency Mechanism, adjusted for deviations in noncrude oil exports of the public sector from their projected level, with the permissible adjustment limited to a maximum amount derived by applying the percentages stipulated below to the projected levels

Quarter	Percentage
1987 I	10
1987 II	10
1987 III	8
1987 IV	6
1988 I	4

(2) The amount under (1) shall be reduced

(a) by the amount necessary to bring cumulative drawings under the IMF Oil Contingency Mechanism to US$200 million, and following that,

(b) by 1/5 of the unadjusted shortfall specified in (1) above for as long as cumulative drawings under the Investment Support Facility are less than twice the cumulative drawings under the IMF Oil Contingency Mechanism, and

(c) by 1/3 of the unadjusted shortfall specified in (1) above thereafter

VI) Reduction of Commitments

As in our previous communication

VII) Description of Investment Program

As in our previous communication

Mexico: Public Sector Noncrude Oil Exports 1/

	Millions of U.S. dollars	
	Total	Potential Maximum Adjustment
1986	1,950	
Actual I Quarter	468	
Est. II Quarter	510	
Proj. III Quarter	486	
Proj. IV Quarter	486	± 49
1987	2,200	
Proj. I Quarter	550	± 55
Proj. II Quarter	550	± 44
Proj. III Quarter	550	± 33
Proj. IV Quarter	550	± 22

Sources: Indicadores Economicos, Banco de Mexico, Table IV-2 "Indicadores de Comercio Exterior"; and Fund staff estimates.

1/ This list includes steel and steel products, coffee, fertilizers, petroleum derivatives, sugar, and fishery products.

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Office Memorandum

mex CO

TO	Mr Guitián Mr Wiesner Mr Beza Mr Silard Mr Bonvicini	DATE	October 6, 1986
FROM	J Pujol JP		
SUBJECT	Alternative Proposal		

Attached is the draft of the alternative proposal

Attachment

nt6mex04
MEX

Alternative Draft

(Investment Support Facility linked to Contingency Mechanism)

I) Availability

"Up to US$200 million in the first quarter of 1987, up to US$400 million in the second quarter of 1987, up to US$325 million in the third quarter of 1987, up to US$250 million in the fourth quarter of 1987, and up to US$200 million in the first quarter of 1988, but with the cumulative amount of availability never to exceed the total of US$1 2 billion provided for under the facility "

"Amounts undrawn in any quarter will be canceled at the end of the following quarter "

II) Termination

April 16, 1988 (15 day disbursement period after last possible request for purchase under IMF stand-by arrangement)

III) Usage

We would propose that the first sentence read as follows "To support Mexico's economic program, including its investment plan "

IV) Drawdown conditions

(1) should read "IMF Oil Contingency Mechanism drawn in the aggregate amount of no less than US$200 million and an additional drawing under such Mechanism has occurred during the quarter in which a disbursement is to be made under the Investment Support Facility

(2) (b) should read "a disbursement under the Investment Support Facility is necessary in order to help protect Mexico's economic program, including its investment plan "

(3) would be deleted

(4) would become (3) and should read "Conditions for drawing under the Parallel New Money Facility are satisfied (including the most recent scheduled purchase under the IMF stand-by arrangement) " [This condition is subject to IMF examination of conditions on New Money Facility referred to]

V) Disbursement amounts

Subject to quarterly availability, the amount of each quarterly disbursement will be the amount certified by the IMF on the following basis

(1) Shortfall for the preceding quarter in that part of Mexico's public sector external receipts that is calculated for the IMF Oil Contingency Mechanism, as adjusted to reflect

(a) net increase or decrease for the preceding quarter in actual external receipts from projected external receipts attributable to public sector non-oil exports, and

(b) increase or decrease for the preceding quarter in public sector external receipts attributable to an increase in oil export volumes from the reference volumes used in calculations under the IMF Oil Contingency Mechanism

(2) The amount under (1) shall be reduced by

(a) by the amount necessary to bring cumulative drawings under the IMF Oil Contingency Mechanism to US$200 million, and following that

(b) by 1/5 of the unadjusted shortfall specified in (1) above for as long as cumulative drawings under the Investment Support Facility are less than twice the cumulative drawings under the IMF Oil Contingency Mechanism, and

(c) by 1/3 of the unadjusted shortfall specified in (1) above thereafter

VI) Reduction of Commitments

The first paragraph should read as follows

"In the case of excess external revenue as defined under the IMF Oil Contingency Mechanism, after the first US$200 million, the portion of the excess applied to the reduction of commitments or prepayments to the commercial banks would be determined by applying the ratio of the amounts outstanding under the Commercial Bank Contingent Investment

Support Facility to the total amount outstanding under both that facility and the IMF Oil Contingency Mechanism The portion to be applied to reduction of commitments or prepayments to commercial banks would be applied in the following order "

VII) Description of Investment Program

This section would be deleted

Mexico

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INTERNATIONAL MONETARY FUND
WASHINGTON D C 20431

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Group 2/3 (202) 623-4662
Group 2/3 (202) 623 7491

Facsimile Service Cover Sheet

Number of pages (including cover sheet)	Message number	Date
5	2	10/6/86

To

Name of addressee (type)

Mr Michael Chamberlain
c/o Alfredo Gutierrez
Shearman and Sterling
New York, N Y

Rapicom 6300, Automatic Group 3, (212) 750-8671
Xerox 495, Automatic Groups 1, 2, and 3 (212) 752-0371

Facsimile telephone number

From

Name of sender (type)

Mr Joaquin Pujol
Assistant Director
Western Hemisphere Department
International Monetary Fund
Washington, D C

Text or special instructions

Attached please find the material promised

Department and division (type)	Extension (type)
WHD - M/LCD	8480
Authorized by (type)	**Signature**
J Pujol	

SEC 56 Rev 1
11 13 85

Following are some of our initial reactions to the draft term sheet for the Commercial Bank Contingent Investment Support Facility, which you sent for discussion. Additional changes may be necessary in light of the reactions of the Mexican authorities and the World Bank with respect to various issues raised by your proposal In proposing these changes we have been guided by your desire to separate the Contingent Investment Support Facility from the IMF Oil Contingency Mechanism.

I) Availability

With respect to the amounts, any agreement would be subject to the drawdown conditions (see discussion below) and the degree of linkage between the IMF Oil Contingency Mechanism and the Commercial Bank Contingent Investment Support Facility

With respect to the cancellation of undrawn amounts, we would propose that amounts undrawn in any quarter will be cancelled at the end of the following quarter.

II) Termination

April 16, 1988 (15 day disbursement period after last possible request for purchase under IMF stand-by arrangement)

III) Usage

We would propose that the first sentence read as follows

'To support Mexico's economic program, including its investment plan.

IV) Drawdown conditions

We would propose the following text

(1) Certificate of IMF that

(a) a shortfall in Mexico's public sector external receipts (both oil and non-oil) has occurred which will reduce Mexico's capacity to carry out its 1986-87 economic program, including its public sector investment plan,

(b) a disbursement in an amount not to exceed quarterly availability under the Investment Support Facility is necessary in order to help protect Mexico's public sector investment plan, and

(c) if the shortfall is related to oil price, draw down of the IMF Oil Contingency Mechanism in the aggregate amount of no less than US$ 200MM

(2) Conditions for drawing under the Parallel New Money Facility are satisfied (including the most recent scheduled purchase under the IMF stand-by arrangement) [This condition is subject to IMF examination of conditions on New Money Facility referred to]

V) Disbursement amounts

We would propose the following text

Subject to quarterly availability, the amount of each quarterly disbursement will be the amount calculated using foreign trade data and certified by the IMF on the following basis

(1) Shortfall for the preceding quarter in that part of Mexico's

public sector external receipts that is calculated for the IMF Oil Contingency Mechanism, as adjusted to reflect

(a) Net increase or decrease for the preceding quarter in actual external receipts from projected external receipts attributable to public sector non-oil exports, and

(b) Increase or decrease for the preceding quarter in public sector external receipts attributable to an increase or decrease in oil export volumes from the reference volumes used in calculations under the IMF Oil Contingency Mechanism

(2) If the shortfall under (1) includes a component related to the oil price, the amount attributable to such component shall be reduced by

(a) by the amount necessary to bring cumulative drawings under the IMF Oil Contingency Mechanism to US$200 million, and, following that

(b) by 1/5 of the unadjusted shortfall specified in (1) above for as long as cumulative drawings under the Investment Support Facility are less than twice the cumulative drawings under the IMF Oil Contingency Mechanism, and

(c) by 1/3 of the unadjusted shortfall specified in (1) above thereafter.

VI) <u>Reduction of Commitments</u>

The first paragraph should read as follows

"In the case of excess external revenue as defined under the IMF Oil Contingency Mechanism, after the first US$200 million, the portion of the excess applied to the reduction of commitments or prepayments to the commercial banks would be determined by applying the ratio of the amounts outstanding under the Commercial Bank Contingent Investment Support Facility to the total amount outstanding under both that facility and the IMF Oil Contingency Mechanism. The portion to be applied to reduction of commitments or prepayments to commercial banks would be applied in the following order

VII) <u>Description of Investment Program</u>

This section would be deleted.

Mexico

Mexico was sent to New York 10/3/83 for the visit of Messrs Pujol, Bouvrain + Siland

mexjb-10-3-86

The economic program of Mexico contains contingent financing arrangements aimed at protecting the program, including the public investment plan, from unforeseen and large changes in external conditions Experience has shown that when such large sudden disruptions occur in external receipts, investment at large tends to suffer the most--either because projects tend to be postponed or abandoned or because as the public sector seeks to finance itself from available domestic savings and private investment is crowded out. To minimize such risk, two contingent financing mechanisms have been established to cushion Mexico's economic program from the impact of sizable and sudden exogenous changes in external receipts of the public sector

In the context of the stand-by arrangement from the Fund, a contingency mechanism has been established that would provide additional financing to Mexico's public sector if the average price of crude oil exports falls below US$9 a barrel in a calendar quarter, and would call for an increase in the programmed accumulation of net international reserves or for an early repurchase to the Fund if the average price of crude oil exports rises above US$14 a barrel in a calendar quarter

In the context of negotiations between Mexico and its commercial bank creditors, a contingent investment support facility also has been agreed in order to protect Mexico's economic and investment program from the impact of an unexpected decline in external receipts of the public sector caused by exogenous factors

Financing by the Fund under the oil contingency mechanism would be for up to SDR 600 million, while the total amount available under the banks investment support facility would be up to US$1.2 billion. The facilities would operate separately, and together could provide up to US$1 8 billion. They would be disbursed in such a way so that over the period of their operation their relative contribution in U S dollar terms to the support of the Mexican program would be targeted in a ratio of 1 to 2.

To activate the Fund's oil contingency mechanism the export price of oil over a calendar quarter would have to drop below US$9 a barrel or rise above US$14 a barrel The resulting amount of financing or international reserve accumulation would be an agreed proportion of a shortfall or excess in revenues determined on the basis of a reference volume of oil and the difference between the actual price of oil exports and the above-mentioned benchmarks. Disbursement to Mexico under the oil contingency mechanism would require compliance with the relevant performance criteria of the stand-by arrangement and thus would be in parallel with the corresponding quarterly purchase under the arrangement.

It should be noted that the quarterly performance criteria and the reviews provided for under the arrangement cover a wide range of macroeconomic parameters which serve as indicators as to whether the overall program is on track and signal to the Mexican authorities and the Fund staff areas where policies might need to be reinforced. In assessing performance under the program the staff normally engages in consultation with the Mexican authorities, the World Bank, and other relevant parties on the progress that has been achieved in the implementation of the program and the identification of areas in need of remedial action.

As regards the commercial banks contingent investment support facility, the Fund staff would make an assessment whether there is a shortfall in the export receipts of the Mexican public sector that would adversely affect Mexico's economic program and reduce its capacity to carry out its investment plan In making this assessment the staff would take into consideration, in addition to the possible drop in the export price of oil, the following: (i) differences between the actual volume of crude oil exports over the relevant quarter and the reference volume used in the oil contingency mechanism and (ii) deviations of actual from projected U S. dollar values of other public sector exports Other public sector exports would include, inter alia, petroleum derivatives, petrochemicals, steel and steel products, silver and fish products. The calculated shortfall adjusted for the amount disbursed from the Fund would be covered by the bank's investment support facility. The staff would issue a notification to the banks indicating the amount to be disbursed under the investment support facility

2/3

mexico

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Mr. Ortiz
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440040:06-543=D1169+ FUND UI
ATTN INTERNATIONAL MONETARY FUND
JACQUES DE LAROSIERE S.T. BEZA
BT
TO: THE INTERNATIONAL BANKING COMMUNITY

FROM: THE CO-CHAIRMAN OF THE BANK OF ADVISORY GROUP FOR MEXICO

DATE: SEPTEMBER 30, 1986

RE: MEXICO

INCOMING CABLE/TELEX

1. SET FOURTH BELOW IS THE TEXT OF THE PRESS RELEASE SUMMARIZING THE AGREEMENT IN PRINCIPLE REACHED TODAY ON THE 1986-87 COMMERCIAL BANK FINANCING PACKAGE FOR MEXICO.

QUOTE

WASHINGTON, SEPTEMBER 30---WILLIAM R. RHODES, CO-CHAIRMAN OF THE BANK ADVISORY GROUP FOR MEXICO, TODAY INFORMED JACQUES DE LAROSIERE THAT THE GOVERNMENT OF MEXICO AND THE BANK GROUP TODAY REACHED AGREEMENT IN PRINCIPLE ON THE COMMERCIAL BANK PORTION OF MEXICO'S EXTERNAL FINANCING PROGRAM FOR 1986 AND 1987.

TODAY'S AGREEMENT IS SUBJECT TO THE SUCCESSFUL COMPLETION OF ONGOING NEGOTIATIONS ON THE DETAILS OF VARIOUS PORTIONS OF THE PACKAGE.

THE AGREEMENTIN PRINCIPLE INCLUDES THE FOLLOWING ELEMENTS: USDLRS. 43.7 BILLION OF PREVIOUSLY RESTRUCTURED DEBT WILL BE PAYABLE OVER 20 YEARS WITH SEVEN YEARS OF GRACE. MATURITIES ON USDLRS. 8.6 BILLION, CONSISTING OF NEW-MONEY FACILITIES SIGNED IN 1983 AND 1984, WILL REMAIN THE SAME. A 1986-87 NEW-MONEY FACILITY TOTALING USDLRS. 6 BILLION WILL BE REPAID OVER 12 YEARS WITH FIVE YEARS GRACE. THE USDLRS. 6 BILLION NEW MONEY INCLUDES A USDLRS. 1 BILLION CO-FINANCING WITH THE WORLD BANK IN WHICH THE WORLD BANK WILL GUARANTEE USDLRS. 500 MILLION.

THE PACKAGE WILL ALSO INCLUDE A COMMERCIAL BANK GROWTH CONTINGENCY CO-FINANCING WITH THE WORLD BANK OF USDLRS. 500 MILLION, OF WHICH USDLRS. 250 MILLION WILL BE GUARANTEED BY THE WORLD BANK, AND A COMMERCIAL BANK CONTINGENT INVESTMENT SUPPORT FACILITY OF USDLRS. 1.2 BILLION TO SUPPORT PUBLIC AND PRIVATE SECTOR INVESTMENT.

3/3

THE MARGIN ON ALL ELEMENTS OF THE PACKAGE WILL BE 13/16
PERCENT OVER LIBOR OR DOMESTIC COST OF FUNDS.

END QUOTE

2. THE ADVISORY GROUP CONTINUES TO WORK WITH THE MEXICAN AUTHORITIES ON A TERM SHEET FOR TRANSMITTAL TO YOU FOR YOUR CONSIDERATION.

REGARDS,

BANK OF AMERICA NT AND SA
CITIBANK, N.A.
SWISS BANK CORPORATION

(D1169)
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INCOMING CABLE/TELEX

Mr. Beza

Office Memorandum

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October 1, 1986 ✓ Files

MEMORANDUM FOR FILES

SUBJECT: Mexico: US$1.6 Billion Bridge Financing

I obtained the following information on the bridge financing loan to Mexico from Ms. Tigert, Assistant General Counsel on International Banking at the Federal Reserve Board:

--Mexico repaid US$270 million on September 30, 1986 of the US$850 million borrowed from its US$1.6 billion bridge loan. This occurred despite the stated link between repayment and the "first two Mexican drawings from the "Fund," and from disbursement from the World Bank loans..." (see attachment).

More generally, the bridge financing is from two broad sources, with US$1.1 billion from official creditors and US$500 million from commercial banks. The composition of the US$1.1 billion by creditor is: BIS US$400 million; Argentina US$60 million; Brazil US$10 million; Colombia US$20 million; United States US$545 million; and Uruguay US$15 million.

No additional disbursements from the bridge loan can be made prior to the commercial banks reaching their "critical mass." Concerning the remaining US$250 million from the official creditors, disbursements are to occur simultaneously with disbursements from the commercial banks. Concerning the US$500 million from commercial banks, the commercial banks must reach their "critical mass" on the 1986-87 commercial bank financing package prior to disbursement of this part of the bridge financing.

Eliot Kalter
Senior Economist
Mexico/Latin Caribbean Division

Attachment

cc: Mr. Beza
Mr. Pujol
Mr. Bonvicini
Mr. Duran-Downing
Mr. Gil-Diaz
Mr. Valdivieso

Annex I

Facility to Provide Near-Term Contingency Support for Mexico's International Reserves

The purpose of the Facility is for the official sector and the commercial banks to join in a mutual effort to provide near-term contingency support for Mexico's international reserves The amounts of the respective participations are U S $1 billion from the official sector and U S $500 million from the commercial banks The first disbursements from the official sector will precede the disbursements from the commercial banks, and it is intended that the commercial banks will be paid out in full before the official sector The official sector participation is intended to be a prefinancing of facilities to be made available to Mexico by the IMF and the World Bank, and the commercial bank participation is intended to be a bridge to more permanent financing from commercial banks ?

A Official Credit Facility

Borrower: Banco de Mexico

Lenders: Bank for International Settlements
Central Banks and National Treasuries

Amount: $1 MMM in 2 Tranches,

(1) $750 MM to be available upon signature of commitment letter by Mexico and commercial banks for $500 MM facility of Part B

(2) $250 MM to be available simultaneously with disbursements from commercial banks

Interest: Based on various reference rates plus a margin which is less than 7/8%

Fees: To be completed

Repayment Schedule:

9/15/86	$235MM	12/30/86	$235MM
11/30/86	$235MM	1/30/87	$295MM

Sources of Repayment

The Official Credit Facility is to be repaid from the first two Mexican drawings from the International Monetary Fund (the "Fund"), and from disbursements from World Bank loans that are expected to be made by that Bank to the Mexican authorities during the period from the end of August, 1986 to the end of January, 1987 Assuming that the Fund's Board of Directors approves the Mexican program on September 8, 1986, the first Mexican drawing from the Fund under the approved program is expected on September 15, 1986 and the second on November 30, 1986 Assuming, further, that the Bank of Mexico draws the full $1 billion available under the Official Credit Facility in the installments permitted under the Facility, the first and second Fund drawings, and the consequent repayments, should reduce the outstandings under that Facility to $530 million While the World Bank disbursements could be paid out by the Bank of Mexico to reduce the Official Credit Facility as they come in during the World Bank's disbursement period, they will, instead, be held in a Bank of Mexico account at the Federal Reserve Bank of New York, which would not exceed $575 million (which includes an amount for anticipated interest) under the assumptions made above, and paid out on December 30, 1986 in the amount of $235 million and on January 30, 1987, in the amount of $295 million ? In addition, as a contingency repayment facility, arrangements will be made for payments of foreign exchange to Pemex by purchasers of oil to be paid to the Bank of Mexico, as they are now, at its commercial bank account, and for these sums to be transferred to an account of the Bank of Mexico at the Bank for International Settlements (BIS) to repay any amounts that might be unpaid This contingency repayment facility does not become operative, and no sums are to be placed in the Bank of Mexico's account at the BIS, unless there are amounts that remain unpaid after January 30, 1987, when the last repayment is due under the Official Credit Facility under the assumptions about drawings and repayment dates made above (As described by ____________________)

B Commercial Bank Facility for Contingency Support

Borrower	The United Mexican States
Lenders	13 Advisory Group banks plus approximately __ additional banks
Agent	
Amount	$500 MM
Currency	U S Dollars only
Repayment Schedule	Upon first disbursement from commercial banks under the 1986-87 financing package for Mexico referenced below (which disbursement is intended to be before January 30, 1987), or, upon earlier demand All payments received by banks to be ratably shared
Security	None
Interest Rate	7/8% over LIBO
Fees	To be completed
Conditions for Disbursement	(1) "Critical mass" of commercial banks commit to a 1986-87 commercial bank financing package for Mexico (to be negotiated in the immediate future) on basis on which the Managing Director of the International Monetary Fund submits for approval to the Executive Board of the Fund the Mexican request for a stand-by arrangement for SDR 1,400 million for a period of 18 months, it being understood that the Managing Director will consider commitments of approximately 90% to constitute a "critical mass" (2) Simultaneous disbursements through the Agent from all commercial banks committing to Commercial Bank Facility for Contingency Support (3) Prior disbursement of $750MM from official sector and simultaneous disbursement of a further $250 MM from official sector (4) Mexico current on interest
Documentation	Demand Notes governed by New York law and supporting documentation in form and substance satisfactory to participating banks, it being understood that documentation substantially similar to that used for the February 25, 1983 bridge loan from the Bank Advisory Group for Mexico will be used

Office Memorandum

SEP 30 1986

TO: The Managing Director
The Deputy Managing Director

DATE: September 30, 1986

FROM: J. Pujol JP

SUBJECT: Paris Club Meeting on Mexico

In the Paris Club meeting held on September 16-17, agreement was reached between representatives of 14 creditor countries 1/ and a Mexican delegation headed by Mr. Angel Gurria, Mexico's General Director of Public Credit, and Mr. Alfredo Phillips, head of the Mexican Bank of Foreign Trade, on the restructuring of Mexico's debt service payments due through the end of March 1988, on official and officially-guaranteed medium- and long-term credits contracted prior to December 31, 1985. I presented a statement on the Mexican economic situation indicating that the Fund's Executive Board had agreed in principle to support the Mexican program subject to the determination that the financing of the program had been assured. In addition, Ms. Dillon, Mr. Duran-Downing, and I made a number of interventions to clarify technical points and to explain how variations in the restructuring proposals being discussed might fit with the program. 2/

The agreement reached provides for the rescheduling of 100 percent of principal and 60 percent of interest due between September 22, 1986 and December 31, 1987, and 100 percent of principal due between January 1, 1988 and March 31, 1988 (see Attachment). Repayments would occur in 10 semi-annual installments starting on January 1, 1982 and finishing on July 1, 1986. (The Mexican delegation had asked for 12 years with 6 years grace, but there was not support for such terms.) The final agreement, therefore, is somewhat different in the terms from the rescheduling of 90 percent of principal and interest that had been assumed by the Fund staff at the time that the program was framed, but in terms of the value of the relief it is not too different from the staff's assumptions and therefore will not require any significant revision in projections included the balance of payments at the time of the preparation of the program. 3/

1/ The participating creditor countries were: Austria, Belgium, Canada, France, the Federal Republic of Germany, Italy, Japan, Norway, the United Kingdom, and the United States of America. Present at the discussions, but excluded from the agreement under de minimis threshold of SDR 1 million, were representatives of the governments of Australia, Denmark, and Finland. Also attending as observers were representatives of the IBRD, IDB, UNCTAD, and the OECD. The meeting was chaired by Mr. Trichet, Chairman of the Paris Club.

2/ Ms. Dillon, Mr. Duran-Downing, and I also had a number of meetings on September 15 with staff of the Paris Club secretariat, the U.S. delegation, and the Mexican delegation to clarify some statistical matters.

3/ It should be noted that in addition to the debt relief provided by the Paris Club, official creditors have indicated their willingness to maintain or restore cover for new credit operations.

It should be noted that, in picking the figure of 60 percent for the rescheduling of interest, the official creditors were implicitly sending a message to the commercial banking community about the kind of relationship that they expected to see between new money and interest payments in the financial package being negotiated between Mexico and the commercial banks (i e , the US$6 billion in new money requested by Mexico from the banks represents 63 percent of the estimated US$9 5 billion interest that the Mexican public sector will pay the commercial banks during the 1986-87 period) At the same time, by not rescheduling interest payments due beyond the end of 1987 and not offering Mexico the good will clause, creditors were signaling to Mexico that they were counting on the Mexicans to put their own house in order so that they would not need to request further reschedulings after 1987 (It should be noted, however, that the Mexicans did not request the good will clause either and that they indicated that they were doing so as an indication of their intention of not having to return to the Paris Club at a later date) The point was also made that by not rescheduling interest beyond the end of 1987, the process of reestablishment of cover by official credit agencies was facilitated

An issue that provoked considerable discussion was that of the cutoff date Some delegations still had problems with going along with the cutoff date of December 31, 1985 because of the earlier agreement to reschedule the Mexican private date as of December 20, 1982. Participants were particularly preocupied that allowing for the latter date for the current rescheduling might be interpreted as a change in the cutoff date and it took repeated explanations to the effect that these were two completely different operations for the objections to be withdrawn Mr Gurria helped the achievement of this outcome by stating that this was the first and only request for rescheduling of Mexican public debt that had been made to official creditors and that if ever again the Mexicans had to request additional reschedulings--an event which he emphasized they did not expect to take place--the date would remain unchanged

Concessions were sought by certain creditors concerning the tax treatment by Mexico of interest payments to their exporters and suppliers Under the Mexican income tax legislation interest payments abroad are subject to a withholding tax, of 15 percent in the case of financial intermediaries and 42 percent in the case of ordinary suppliers Creditors explained that the presence of this tax obligation had prevented the signing of some bilateral agreements in connection with the rescheduling of the private sector debt and might affect the possibility of reaching bilateral agreements in the case of the public sector debt. The Mexican delegation agreed to assume responsibility for taxes and other charges arising in connection of the public sector debt and to take appropriate measures to help overcome the obstacles that had arisen in connection with the private sector debt

One other issue that arose in the discussion had to do with the definition of the public sector and the inclusion in this definition of agencies of Mexican banks operating abroad which may be subject to the legislation and regulation of other countries In the end it was accepted that ownership of more than 50 percent of the shares of a company at the time of the signature of the Agreed Minute could be accepted as a criterion for inclusion in the public sector.

Despite these issues, the general mood of the meeting was supportive of the Mexican request, particularly in light of the Fund's Board decision of September 8, 1986 The deadline for the conclusion of the bilaterals was set for April 30, 1987

As is customary a short paper is being prepared to inform the Executive Board on the results of the debt renegotiation agreement

Attachment

cc Mr Finch
Mr Wiesner
Mr Brown

ATTACHMENT

Mexico Provisions of the Agreed Minute of the
Paris Club Meeting of September 17, 1986

Principal and interest due

a From September 22, 1986 to December 31, 1987

--estimated amount of these obligations

Principal	US$1,284 million
Interest	US$ 516 million
Total	US$1,800 million

--100 percent of principal and 60 percent of interest to be rescheduled or refinanced

b From January 1, 1988 to March 31, 1988

--estimated amount of these obligations

Principal about US$150 million

--100 percent of principal to be rescheduled or refinanced

Repayment period

--repayments to be made in 10 equal and successive semi-annual installments, with the first payment to be made on January 1, 1992 and the final payment on July 1, 1996

Office Memorandum

CONFIDENTIAL

TO: The Managing Director
The Deputy Managing Director

DATE: September 30, 1986

FROM: E Wiesner EW

SUBJECT: Mexico--Draft Report on Renegotiation of Mexico's External Debt With Official Creditors in the Framework of the Paris Club

Attached please find for your consideration and approval a draft of a report on Mexico's external debt renegotiation with the Paris Club This report would be circulated for the information of Executive Directors and no action is requested of them

The report has been reviewed by

Mr Guitian	ETR
Mr Silard	LEG
Mr Beza and Mr van Beek	WHD

Attachment

cc Mr Brown

OCT 1 1986

Office Memorandum

CONFIDENTIAL

TO The Managing Director
The Deputy Managing Director

DATE September 30, 1986

FROM E Wiesner EW

SUBJECT Mexico--Draft Report on Renegotiation of Mexico's External Debt With Official Creditors in the Framework of the Paris Club

Attached please find for your consideration and approval a draft of a report on Mexico's external debt renegotiation with the Paris Club This report would be circulated for the information of Executive Directors and no action is requested of them

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Mr Guitian	ETR
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Mr Beza and Mr van Beek	WHD

Attachment

cc Mr Brown

Office Memorandum

September 18, 1986

MEMORANDUM FOR FILES

SUBJECT: Mexico: Mexican Proposal for Financial Terms

Mr. Dolenc, Regional Cofinancing Coordinator of the IBRD, related the following terms proposed on September 16, by the Mexican authorities:

a) US$52 billion rescheduled for 25 years with a 10-year grace period.

b) US$6 billion new financing with a 15-year maturity and 5-year grace period at 1/2 percent over LIBOR.

Also proposed was that the cross-conditionality proposed by the commercial banks not be put into place.

Eliot Kalter
Senior Economist
Mexico/Latin Caribbean Division

cc: Mr. Beza
Mr. Pujol (o/r)
Mr. Bonvicini
Mr. Gil-Díaz
Mr. Duran-Downing
Mr. Valdivieso

Office Memorandum

September 18, 1986

MEMORANDUM FOR FILES

SUBJECT: Mexico: US$1.6 Billion Bridge Financing

The US$1.6 billion bridge financing to Mexico is composed of an official credit facility for US$1.1 billion and a commercial bank facility for US$500 million. The terms of these facilities are described in a telex received by the Fund on August 19, 1986 but the country-source of the official credit facility is not. I spoke with Mr. Bradfield, a lawyer at the Federal Reserve Board who is following closely events in Mexico, concerning this composition of the US$1.1 billion.

(In millions of US dollars)

BIS	400
Argentina	60
Brazil	60
Colombia	20
United States	545
Uruguay	15
Total	1,100

Eliot Kalter
Senior Economist
Mexico/Latin Caribbean Division

cc: Mr. Beza
Mr. Pujol (o/r)
Mr. Bonvicini
Mr. Duran-Downing
Mr. Gil-Díaz
Mr. Valdivieso

Mr Wiesner
EW
JP
IO
F

Office Memorandum

INTERNATIONAL MONETARY FUND
WESTERN HEMISPHERE DEPT.
1986 SEP 23 PM 6:50

Mexico

To: The Managing Director
The Deputy Managing Director

September 23, 1986

From: C. David Finch and Francois Gianviti
CDF F.G.

Subject: Mexico--Linkage of Commercial Bank Disbursements to Official Involvement

The draft financing principles recently proposed by commercial banks for Mexico incorporated provisions for very tight and comprehensive linkage of the banks' disbursements to Fund and Bank actions and to contributions of export credit agencies and the Paris Club. These proposals represent an extreme example of the recent tendency for commercial banks to make new money disbursements so conditional on the performance of other parties in the debt strategy that the timing and extent of their own participation can no longer be securely counted upon. Under these circumstances, the assurance provided by the "critical mass" of bank commitments is seriously weakened, raising questions as to the viability of the members' balance of payments and hence the adequacy of safeguards for the use of the Fund's resources. It is notable that the network of links embodied in the proposed bank financing principles for Mexico would in effect arrogate to commercial banks the role of financial monitoring and coordination of financing flows that customarily has devolved on the Fund as organizer of the financing package.

The types of linkage adopted in recent bank financing agreements have varied widely. In several instances, they have posed risks of serious delays in the disbursement of bank finance through linkage to different sources of financing. Recent cases involving official bilateral financing include conditions relating to export credit disbursements in the Philippines and to Paris Club debt relief in Ecuador. Concerns also have arisen about indirect cross-conditionality between the Fund and the Bank. The issue of indirect cross-conditionality was illustrated in the case of Panama, when two commercial bank disbursements were delayed because of a World Bank related performance condition; this delay in turn contributed to noncompliance with the Fund program, which resulted in still further delay in the commercial bank disbursements. Recent examples of cross-linkage to the Fund and the Bank are summarized in Attachment I.

In addition to these concerns, provisions in commercial bank agreements have, in some cases, appeared to conflict with Fund policies as laid down in decisions or guidelines of the Executive Board. Examples of such conflict have included: the linkage of bank agreements to extended periods of enhanced surveillance or performance under future Fund arrangements; the inclusion of covenants to provide Fund staff papers outside the context of enhanced surveillance; the attempt to inhibit early repurchases in the Fund by making this a trigger for early repayment of banks; and the failure to acknowledge that a purchase may not take place because of the absence of balance of payments need.

We will need to work with the authorities and the banks to facilitate agreements that provide adequate assurance to banks, but in ways that are not rigid to the point of unworkability. The question arises how best to achieve this and to begin to establish, more generally, a degree of control over practices in this area of bank linkage to official involvement. First, it may be appropriate for the Fund to go as far as possible in ensuring that the financing contributions of other participants in the debt strategy are on track. This would not only safeguard the Fund's own resources, but assist in reassuring commercial banks.

A second, parallel step would be to develop some guidelines on commercial bank linkage, identifying key concerns and indicating approaches to be avoided. First, the problems associated with cross-linkage could be mitigated by less frequent intervals (annual or semiannual) for linkage to the Bank; this would also reflect more realistically the different nature of the Bank's relations with member countries. Indeed, it might be preferable for commercial banks to link separate disbursements to the Fund and the Bank, avoiding the policy concerns arising from cross-linkage. As regards the other concerns mentioned above, preconditions relating to the terms and scale of official financing should be resisted, and clauses relating to Fund involvement should respect existing guidelines and decisions of the Executive Board. The second attachment to this memorandum suggests tentative guidelines covering these various areas.

While these are important issues for the Fund, some flexibility will no doubt be required to arrive at practical solutions. Moreover, care will be necessary to ensure that the Fund is not drawn into arbitrating on issues that are primarily for commercial judgment. Nevertheless, there may also be a need to take action to alert member countries and banks in general to these various concerns. In due course, a review of experience in this area might appropriately be presented to the Executive Board in conjunction with the next review of enhanced surveillance.

This memorandum has been discussed with the Western Hemisphere Department.

Attachment

cc: Mr. Wiesner
Mr. Beza
Mr. Brown

Linkage of Commercial Bank Financing to World Bank Conditions

There has been considerable diversity in the types of linkage to World Bank activities that have been incorporated in commercial bank financing packages In some cases the linkage has been broadly defined, with commercial banks requiring evidence of progress in negotiation or implementation of structural reforms In other cases, the linkage to Bank loans has been based on certification by the Bank that debtor countries have borrowed a specified amount by a particular deadline In some cases, all commercial bank disbursements under a new money package have been tied to performance under both Fund- and Bank-supported programs, while in other cases linkage to the Bank applied to only one disbursement from a new money package

In the new money agreement for Chile signed in November 1985, in addition to certification from the Fund, banks required a notification from the World Bank before each disbursement confirming that Chile's Structural Adjustment Loan (or comparable facility) was in effect, and that Chile had drawn by specified dates the full amount expected to be available to it under the SAL.

In the new money agreement with Colombia of December 1985, all commercial bank disbursements were linked to the Fund, but one was also contingent on confirmation from the World Bank that Colombia would have access to the second tranche of a trade policy loan

In 1985, commercial banks conditioned their restructuring and new money agreements with Costa Rica on the implementation of a World Bank SAL, as well as on a Fund program Successive delays with implementation of the SAL and the Fund stand-by arrangement meant that the second disbursement of new bank money--expected originally in mid-1985--was made in November 1985

For Cote d'Ivoire, some disbursements under a 1985 new money agreement were conditional on a statement by the Bank on the eligibility of the borrower for drawdowns under a SAL and indicative statements about future loans The restructuring agreements for 1984 and 1985 maturities also contained refinancing conditions involving both the Fund and the World Bank The World Bank condition was not met, as the 1985 SAL was not signed as expected, and banks waived that condition during 1985 in order to continue the refinancing

In addition to conditions involving the Fund, the new money agreement with Panama for 1985-86 required certification from the World Bank regarding progress in negotiating and implementing a structural adjustment loan The double linkage to the Fund and the Bank created difficulties in this case Although the Fund program was on track, commercial banks did not make the first disbursement when it was scheduled, because adequate progress had not been made with the World Bank Some months later, progress had been made with the World Bank, but Panama was no longer in compliance with the Fund program, and so the initial disbursement by commercial banks was again delayed

Tentative Guidelines on the Linkage of Commercial Bank Financing to Official Actions

1 Problems of cross linkage to the Fund and the Bank

a The nature of the involvement of the Fund and the Bank in member countries' economies differs in important ways, and these differences need to be reflected in the procedures for linkage adopted by commercial banks 1/ It may be more in keeping with the nature of the Bank's operations to link annual or semiannual commercial bank disbursements to major Bank actions such as approval of a new sector loan or an assessment by the Bank covering progress in implementing development policies This would tie commercial bank disbursements to events that evidence advancement of the Bank's developing relationship with a country

b To avoid any impression of cross-conditionality on individual disbursements, separate commercial bank disbursements should preferably be tied to each institution Some disbursements would be linked to quarterly evidence of compliance with a Fund arrangement, and certain other disbursements would be linked to World Bank certifications If any commercial bank disbursements are linked both to Fund arrangements and to

---

1/ Specifically, a country's ability to make purchases from the Fund provides evidence, generally on a quarterly basis, that macroeconomic policies remain on track The Bank's normal pattern of disbursements in a country relates to continuing activities under project, sector and structural adjustment loans in different time frames Moreover, the Bank's monitoring procedures differ from those of the Fund the World Bank, less frequent intervals for linkage to the World Bank would reduce the scope for operational problems

c It would seem particularly inappropriate for cofinancing arrangements with the World Bank to contain performance clauses predicated on Fund arrangements, since in these cases the closeness of association with the World Bank raises the issue of implied cross-conditionality particularly sharply

2 Problems of potential conflict with other Fund policies

a Clauses that seek to precommit future resources or procedures of the Fund, including enhanced surveillance, should be worded in ways that do not appear to prejudice the autonomy of the Fund in deciding on its future relations with members, and also take account of existing Board guidelines (e g , on the duration of enhanced surveillance) The understanding reached in the case of Uruguay would represent an acceptable compromise where future Fund procedures are at issue In essence, the Fund management would indicate general willingness to propose to the Board future procedures (such as a financial arrangement or enhanced surveillance) that are requested by the member and are consistent with Board guidelines

b Commercial banks would preferably include Fund involvement among the conditions precedent for specific financial decisions, such as a disbursement of new money or activation of an annual tranche of restructuring under a MYRA, but not as a direct event of default on the country's debt, as was also agreed in the case of Uruguay Such an approach would help to avoid unrealistic conditions relating to Fund involvement over a long period c Agreements with commercial banks should acknowledge that the release of Fund staff reports outside the context of enhanced surveillance is not permitted at present, and should not put the member in the position of having to seek specific approval by the Executive Board

d Agreements should not inhibit a member's right or obligation to make early repurchases in the Fund, thus early repurchases in the Fund should not trigger early repayment of a member country's bank debt

e While commercial bank disbursements may continue to be conditioned on purchases from the Fund (as is the general practice), provision should be included for an alternative certification by the Fund if a purchase is not made for reasons unrelated to the observance of performance criteria, e g , because of the absence of balance of payments need

3 Precommitment of other official financing

a Member countries should be advised of the difficulties that may arise if they agree to clauses that seek to establish in advance the scale or terms of bilateral official financing, such as debt relief in the Paris Club or export credit commitments and disbursements

b Similar considerations arise with regard to the World Bank's future financial involvement in debtor countries, the World Bank has recently objected to the content of such clauses

4 Other issues concerning flexibility

a Member countries should be advised of the need for adequate periods for corrective action to be set after dates for economic performance conditions to be met by the member under a Fund arrangement, so that such actions can be taken without a waiver by banks being necessary.

b. Member countries should be advised that, where waivers under agreement with commercial banks may be necessary, a qualified majority of the banks should be able to approve the waiver, which would avoid undue leverage by individual banks.

5. Assistance by Fund staff

In order to give effect to the guidelines, staff would stand ready to provide technical assistance to members in connection with the formulation of linkage in bank financing agreements.

① Mexico

EW
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International Finance Corporation

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Cable Address: CORINTFIN

Sir WILLIAM RYRIE
Executive Vice President

→ Mr Erb
Mr. Wiesner
Mr. Beza
Mr. Furch

September 18, 1986

Dear Jacques,

Thank you very much for your letter about the idea for an equity fund for Mexico. I am so pleased to have your support. It will not be a panacea, but I believe it could have a significant psychological influence.

We are just revising a paper describing the idea and, in view of your interest, I shall send that to you when it is ready.

We are not yet sure that the Mexican Government will accept the conditions we believe are necesssary for this project to succeed. One key condition is that the fund should be managed by a non-Mexican -- otherwise the banks will simply not participate. However, Petricioli is showing considerable interest. If in your contacts with him you felt able to encourage him, we should greatly appreciate that.

Yours sincerely,

Bill

INTERNATIONAL MONETARY FUND
WESTERN HEMISPHERE DEPT.
1986 SEP 22 PM 12: 07

Mr. J. de Larosiere
Managing Director
International Monetary Fund
Washington, D.C. 20431

SEP.17 '86 15:16 I.M.F.PARIS 33-1-723-40-89 P.01

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INTERNATIONAL MONETARY FUND
66 AVENUE D'IÉNA, 75116 PARIS
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PRINCIPAL OFFICE, WASHINGTON, D.C.

OFFICE IN EUROPE

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TELEPHONE: 723.54.21
TELEX: 610712

Mr. Erb
Mr. Brown

Facsimile:

47.23.40.89

DATE: September 17, 1986

NUMBER OF PAGES
(including cover page): 9 pages

SUBJECT: Paris Club - Mexico

FROM: Mr. Pujol

TO: Mr. BEZA
Western Hemisphere Department

733769

CC:

RECEIVED
IMF CABLE ROOM
1986 SEP 17 AM 9: 33

PRESS RELEASE

Representatives of the Governments of Austria, Belgium, Canada, France, the Federal Republic of Germany, Italy, Japan, the Netherlands, Norway, Spain, Sweden, Switzerland, the United Kingdom and the United States of America referred to as "Participating Countries" met in Paris on September 17, 1986 with the representatives of the Government of Mexico, in order to examine the request for alleviation of that country's external debt service obligation.

Observers from the Governments of Australia, Denmark, and Finland as well as of the International Monetary Fund, the International Bank for Reconstruction and Development, the Inter-American Development Bank, the Secretariat of the U.N.C.T.A.D., and the Organization for Economic Cooperation and Development, also attended the meeting.

Representatives of the Participating Countries welcomed the recovery efforts undertaken by the Government of Mexico. They also noted with satisfaction the implementation by this Government of an economic and financial program supported by the stand-by arrangement with the International Monetary Fund approved in principle by the Executive Board of the Fund on September 8, 1986. They thought it relevant to make a positive contribution to the improvement of this country's external payments prospects in order to facilitate the recovery of its economy.

It is in this spirit that the representatives of the Participating Countries agreed to recommend to their respective Governments a major reorganization of the external debt of Mexico resulting from loans and guaranteed credits extended by creditor countries to the Government of Mexico or the Mexican public sector, or covered by a guarantee of payment of the Mexican Government or the Mexican public sector, originally falling due between September 22, 1986 and March 31, 1988.

This reorganization applies to payments due on these debts. The first repayment will be made by the Government of Mexico in January 1992 and the last in July 1996.

The delegation of the Government of Mexico was headed by Mr. José Angel GURRIA, General Director of Public Credit - Ministry of Finance and Mr. Alfredo PHILLIPS, Head of the Mexican Bank for Foreign Trade. The Mexican Delegation also included representatives of the Banco de Mexico and Nacional Financiera. The meeting was chaired by Mr. Jean-Claude TRICHET, Chairman of the Paris Club .

The delegation of Mexico expressed its thanks to the Creditor countries of the Paris Club for their efforts in assisting Mexico to achieve a sound economic and financial situation.

AGREED MINUTE
ON THE CONSOLIDATION OF THE DEBT
OF MEXICO

I - PREAMBLE.

1. The representatives of the Governments of Austria, Belgium, Canada, France, the Federal Republic of Germany, Italy, Japan, Norway, the Netherlands, Spain, Sweden, Switzerland, the United Kingdom and the United States of America, hereinafter referred to as "Participating Creditor Countries", met in Paris on September 17, 1986 with representatives of the Government of Mexico in order to examine the request for alleviation of that country's external debt service obligation. Observers of the Governments of Australia, Denmark, and Finland, as well as the International Monetary Fund, the International Bank for Reconstruction and Development, the Interamerican Development Bank, the Secretariat of the U.N.C.T.A.D., and the Organization for Economic Cooperation and Development also attended the meeting.

2. The Delegation of Mexico outlined the serious economic and financial difficulties faced by their country and the strong determination of their Government to reduce the economic and financial imbalances and to reach the targets of the program underlying the stand-by arrangement with the International Monetary Fund.

3. The representatives of the International Monetary Fund described the economic situation of Mexico and the major elements of the adjustment program undertaken by the Government of Mexico and supported by the stand-by arrangement with the International Monetary Fund approved in principle by the Executive Board of the Fund on September 8, 1986. This stand-by arrangement, applying to the period through April 1, 1988, involves specific commitments in both the economic and financial fields.

4. The representatives of the Governments of the Participating Creditor countries took note of the measures of adjustment included in the economic financial program undertaken by the Government of Mexico and stressed the importance they attach to the continuing and full implementation of this program, in particular the revitalization of the productive sector of the economy and the improvement of public finances.

II - RECOMMENDATIONS ON TERMS OF THE REORGANIZATION

Mindful of the serious payment difficulties faced by the Government of Mexico, the representatives of the Participating Creditor countries agreed to recommend to their Governments or appropriate institutions that they provide, through rescheduling or refinancing, debt relief for Mexico on the following terms :

1. Debts concerned

The debt service (the "debts") to which this reorganization will apply is that resulting from :

a) commercial credits guaranteed or insured by the Governments of the Participating Creditor countries or their appropriate institutions, having an original maturity of more than one year, and which were extended to the Government of Mexico, or to one of its public sector agencies, organizations, or institutions, or covered by a guarantee of payment of the Mexican Government or one of its public sector agencies, organizations, or institutions, pursuant to a contract or other financial arrangement concluded not later than December 31, 1985.

b) loans from Governments or appropriate institutions of the Participating Creditor countries, having an original maturity of more than one year, which were extended to the Government of Mexico, or to one of its public sector agencies, organizations, or institutions, or covered by a guarantee of payment of the Mexican Government, or one of its public sector agencies, organizations, or institutions, pursuant to an agreement concluded not later than December 31, 1985.

For the implementation of the present Agreed Minute, the Mexican public sector shall include those enterprises in which, as of the date of the present Agreed Minute, the Government of Mexico is directly or indirectly a majority shareholder (more than 50 %), including representative offices and branches of Mexican banks abroad.

It is understood that debt service due as a result of the June 22, 1983 previous consolidation of certain private sector debt payments is not affected by the present reorganization. The Government of Mexico undertakes to finalize as soon as possible the bilateral implementation of the provisions contained in the Agreed Minute of June 22, 1983, by helping to overcome in particular, the fiscal and administrative obstacles which, until now, have hampered the signing and implementing of bilateral agreements concluded or to be concluded pursuant to the above mentioned Agreed Minute.

2. Terms of the consolidation

The debt relief will apply as follows :

a) 100 % of the amounts of principal and 60 % of interest due from September 22, 1986 up to December 31, 1987 inclusive and not paid, and 100 % of the amounts of principal due from January 1, 1988 up to March 31, 1988 inclusive and not paid on loans and credits mentioned in paragraph 1 above, will be rescheduled or refinanced.

Repayment by the Government of Mexico of the corresponding sums will be made in 10 equal and successive semi-annual payments, the first payment to be made on January 1, 1992 (end of the grace period) and the final payment to be made on July 1, 1996 (end of the repayment period).

b) The non consolidated interest will be paid according to the original schedule.

JLS

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3. Rate of interest

The rate and the conditions of interest to be paid in respect of these financial arrangements will be determined bilaterally between the Government of Mexico and the Government or appropriate institutions of each Participating Creditor country on the basis of the appropriate market rate.

4. Guarantee of payment of the Government of Mexico

The Government of Mexico is responsible for all payments of principal and interest under paragraphs 2 and 3 above, without any deduction for taxes, fees and other public charges or any other costs, accruing in the United Mexican States. As a consequence, and as long as the bilateral agreements to be concluded under this Agreed Minute are in force, the creditors will not enforce the corresponding payment obligations on the original debtors.

III - GENERAL RECOMMENDATIONS

1. In order to secure comparable treatment of public and private external creditors on their debts, the Delegation of Mexico stated that their Government will seek to secure from external creditors, including banks and suppliers, rescheduling or refinancing arrangements on terms comparable to those set forth in this Agreed Minute for credits of comparable maturity, making sure to avoid inequity between different categories of creditors. The Government of Mexico will inform in writing the Chairman of this Creditor Group not later than September 29, 1986, of the progress made for this purpose in negotiations with other creditors.

2. The Government of Mexico will seek to secure from each of the Creditor countries not participating in this Agreed Minute, rescheduling or refinancing arrangements on terms comparable to those set forth in this Agreed Minute ; the Government of Mexico agrees not to accord any such Creditor country repayment terms more favourable than those accorded to the Participating Creditor countries.

3. The Government of Mexico undertakes to negotiate promptly rescheduling or refinancing arrangements with all other creditors on debts of a comparable term.

4. The provisions set forth in this Agreed Minute do not apply to countries with respect to which debts of principal and interest, falling due during the reorganization period are less than SDR one million. The payments owed to these countries should be made on the original due dates. Payments already due and not paid, if any, should be made as soon as possible and, in any case, not later than October 31, 1986.

5. Each Participating Creditor country agrees to make available, upon the request of another Participating Creditor country, a copy of its bilateral agreement with the Government of Mexico which implements this Agreed Minute. The Government of Mexico acknowledges this arrangement.

6. Each Participating Creditor country agrees to indicate to the Chairman of this creditor group the date of the signature of its bilateral agreement, the interest rates and the amounts of debts involved. The Government of Mexico acknowledges this arrangement.

JLS IR

7. The Government of Mexico will keep the Chairman of this creditor group informed of the content of its bilateral agreements with all the creditors mentioned in paragraphs 1, 2 and 3 above.

8. The Government of Mexico undertakes to service all public debt due and not paid, if any, and owed to or guaranteed by the Governments of the participating or observer creditor countries or their appropriate institutions, and not covered by this Agreed Minute, as soon as possible, and in any case not later than October 31, 1986.

9. The Government of Mexico will continue to grant access to and transfer of foreign exchange to private sector debtors for the servicing of their debts.

IV - IMPLEMENTATION

The detailed arrangements for the rescheduling or refinancing of the debts will be determined by bilateral agreements to be concluded by the Government or the appropriate institutions of each Participating Creditor country with the Government of Mexico on the basis of the following principles :

1. The Government or the appropriate institutions of each Participating Creditor country will :

- refinance debts by placing new funds at the disposal of the Government of Mexico according to existing payment schedules during the reorganization period and for the above mentioned percentages of payments. These funds will be repaid by the Government of Mexico according to schedules mentioned above in paragraph II.2.

or

- reschedule the corresponding payments.

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2. All other matters involving the rescheduling or the refinancing of the debts will be set forth in the bilateral agreements which the Government of Mexico and the Governments or the appropriate institutions of the Participating Creditor countries will seek to conclude with the least delay and in any case before April 30, 1987.

3. The provisions of the present Agreed Minute will apply as soon as the stand-by arrangement approved in principle by the Executive Board of the International Monetary Fund on September 8, 1986 enters into force. They will continue to apply during the consolidation period provided that the Government of Mexico continues to have an arrangement with the International Monetary Fund in upper credit tranches. For this purpose, the Government of Mexico agrees that the International Monetary Fund inform the Chairman of the Paris Club regarding the status of Mexico's relations with the International Monetary Fund.

4. The representatives of the Government of each Participating Creditor country and of the Government of Mexico agreed to recommend to their respective Governments or appropriate institutions that they initiate bilateral negotiations at the earliest opportunity and conduct them on the basis of the principles set forth herein.

Done in Paris, this 17th day of September 1986 in two versions, English and French both texts equally authentic.

The Chairman of the Paris Club

The Head of the Delegation of Mexico

Delegation of Austria

Delegation of France

Delegation of Belgium

Delegation of the Federal Republic of Germany

Delegation of Canada

Delegation of Italy

Delegation of Japan

Delegation of Sweden

Delegation of the Netherlands

Delegation of Switzerland

Delegation of Norway

Delegation of the United Kingdom

Peter Mountfield

Delegation of Spain

Delegation of the United States of America

WORLD BANK / INTERNATIONAL FINANCE CORPORATION

September 18, 1986

Messrs. Sterie T. Beza, Associate Director
Joaquin P. Pujol, Division Chief
(Western Hemisphere Department, IMF)

The attached (revised) draft telex for Mr. Conable's signature to commercial banks re Mexico has now been cleared by Mr. Stern. Please let us know if you have any comments. It is my understanding that a similar telex would be sent by Mr. de Larosiere at the appropriate time.

P.B

Pieter Bottelier
Division Chief
LC1MX/WB

Attachment

cc: Mr. Steckhan, LC1DR

File Mexico

PBottelier/slc

P-1852

(Modified -- 1/85)

WORLD BANK OUTGOING MESSAGE FORM Cable, Telex

TEXTNAME: Tel-ExtFncg

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WDIAL

LC1MX

OINFO

-SUBJECT: MEXICO - COORDINATION EXTERNAL FINANCING PACKAGE

-DRAFTED BY: PBOTTELIER:JVARALLYAY/SLC EXT: 72543

-AUTHORIZED BY: BARBER B. CONABLE, PRESIDENT

-TO BE CLEARED BY & CC: STERN, SVPOP; KNOX, LCNVP; STECKHAN,

\- LC1DR

-COMMERCIAL BANKS' ADVISORY GROUP

\- AND OTHER MEMBERS OF COMMERCIAL BANK SYNDICATION FOR MEXICO

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BT

WASHINGTON DC - 18-SEP-86

MEXICO ANNOUNCED A FAR-REACHING PROGRAM OF ECONOMIC AND FINANCIAL ADJUSTMENTS IN MEXICO CITY AND IN WASHINGTON, D.C. ON JULY 21. AT A MEETING WITH THE BANKING COMMUNITY IN NEW YORK

END OF TEXT

SIGNATURES:

DRAFTED BY: __________

AUTHORIZED BY: __________

READY FOR TRANSMISSION: __________ (Inputter's Initials)

TRANSMITTED BY: __________

DATE: __________

DELIVERY NOTICES RECEIVED? __________

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WORLD BANK OUTGOING MESSAGE FORM Cable, Telex

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CITY, THE MEXICAN SECRETARY OF FINANCE AND HIS COLLEAGUES PROVIDED THE DETAILS OF THE PROGRAM AS WE INDICATED AT THE NEW YORK MEETING, THE WORLD BANK HAS WORKED WITH THE GOVERNMENT ON THE PROGRAM OF ADJUSTMENT, AND IS OF THE VIEW THAT, IF IMPLEMENTED EFFECTIVELY WITHIN THE NEXT 18 MONTHS, IT CONSTITUTES A BASIS FOR MEXICO TO RESUME GROWTH ON A SUSTAINABLE BASIS, WHILE GRADUALLY REDUCING ITS DEPENDENCE ON EXTFRNAL CAPITAL AND RESTORING ITS CREDITWORTHINESS ON JULY 29, THE EXECUTIVE DIRECTORS OF THE WORLD BANK APPROVED THE FIRST OF OUR LOANS IN SUPPORT OF ONE OF THE MAJOR REFORMS, TRADE LIBFRALIZATION ON SEPTEMBER 8, THE IMF APPROVED A STAND-BY, IN PRINCIPLE, IN SUPPORT OF MEXICO'S PROGRAM THE FUND'S RESOURCES AND OUR LOANS IN SUPPORT OF THE ADJUSTMENT PROGRAM ARE CONTINGENT UPON THE AVAILABILITY OF ADEQUATE SUPPLEMENTARY FINANCIAL RESOURCES FROM PRIVATE BANKS THE PURPOSE OF THIS TELEX IS TO EXPLAIN, IN BROAD TERMS, THE NATURE OF MEXICO'S ADJUSTMENT PROGRAM AND TO RECOMMEND IT FOR YOUR SUPPORT MEXICO'S PROGRAM IS DESIGNED TO IMPROVE THE EFFICIENCY AND COMPETITIVENESS OF THE ECONOMY, WHICH WILL ENABLE MEXICO TO RESUME BADLY NEEDED GROWTH OF PRODUCTION AND EMPLOYMENT AND TO SUSTAIN RAPID ECONOMIC GROWTH IN THE FUTURE THE ADJUSTMENT

END OF TEXT

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PROGRAM IS FAR-REACHING AND WILL REQUIRE IMPROVED DOMESTIC SAVINGS AND ADEQUATE EXTERNAL FINANCING

THE GOVERNMENT HAS ALREADY EMBARKED UPON A SIGNIFICANT TRADE LIBERALIZATION PROGRAM, INCLUDING ACCESSION TO THE GATT, AND HAS UNDERTAKEN MAJOR CUTS IN THE PUBLIC INVESTMENT PROGRAM THE GOVERNMENT HAS ALSO UNDERTAKEN INITIATIVES IN A NUMBER OF OTHER CRITICAL AREAS WHICH INCLUDE (AAA) MAJOR REDUCTIONS IN SUBSIDIES ON KEY COMMODITIES AND SERVICES, (BBB) PRIVATIZATION OF NON-STRATEGIC PARASTATAL ENTERPRISES, (CCC) CLOSING INEFFICIENT INDUSTRIAL PLANTS DRAINING FISCAL RESOURCES, AND (DDD) IMPROVED PUBLIC ENTERPRISE MANAGEMENT, THROUGH INTRODUCTION OF A NEW LAW IN MAY 1986 DESIGNED TO INCREASE ENTERPRISE AUTONOMY AND ACCOUNTABILITY IN ALL OF THESE AREAS, IMPORTANT INITIAL ACTIONS HAVE BEEN TAKEN, INCLUDING SHARP REDUCTIONS IN SUBSIDIES, THE SALE OF HOTELS AND OTHER ENTERPRISES, AND THE CLOSING OF A MAJOR STEEL PLANT THE PROCESS OF REFORM IN THESE AND OTHER AREAS WILL CONTINUE

IN ADDITION, UNDER A GENERAL INTEREST RATE AGREEMENT WITH THE WORLD BANK, THE GOVERNMENT HAS RAISED INTEREST RATES FOR

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FORM NC 77 OC8
(Modified -- 1/85)

WORLD BANK OUTGOING MESSAGE FORM Cable, Telex
IMPORTANT—PLEASE READ INSTRUCTIONS BELOW BEFORE TYPING FORM

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PREFERENTIAL CREDIT SCHEMES UNDER THIS AGREEMENT, BY THE END OF THE YEAR INTEREST RATES IN THE MAJOR SECTORS WILL BE AT OR ABOVE THE AVERAGE COST OF FUNDS BETWEEN 1983 AND 1985, PUBLIC INTEREST RATE SUBSIDIES CHANNELLED THROUGH DOMESTIC DEVELOPMENT BANKS AND TRUST FUNDS DECLINED BY MORE THAN HALF

A CENTRAL FEATURE OF THE MEDIUM-TERM ADJUSTMENT PROGRAM IS THE PUBLIC SECTOR INVESTMENT PROGRAM THE WORLD BANK AND THE MEXICAN GOVERNMENT COMPLETED A JOINT REVIEW OF MAJOR COMPONENTS OF THE COUNTRY'S MEDIUM-TERM PUBLIC SECTOR INVESTMENT PROGRAM IN LATE 1985 SUBSEQUENT TO APPROVAL OF THE 1986 BUDGET BY THE MEXICAN CONGRESS LATE LAST YEAR, THE GOVERNMENT INTRODUCED MAJOR CUTS AND DEFERRALS IN INVESTMENTS IN RESPONSE TO THE SHARP DECLINE IN INTERNATIONAL OIL PRICES THESE CUTS ARE BROADLY COMPATIBLE WITH THE CONCLUSIONS OF THE JOINT PUBLIC INVESTMENT REVIEW BUT, AS A RESULT, PUBLIC INVESTMENTS IN 1986 ARE EXPECTED TO FALL TO A PRECARIOUSLY LOW LEVEL OF 5 PERCENT OF GDP, LESS THAN HALF THE AVERAGE FOR THE PERIOD 1977-82 THE WORLD BANK BELIEVES THAT THE QUALITY OF MEXICO'S CURRENT PUBLIC SECTOR INVESTMENT PROGRAM IS GENERALLY SATISFACTORY AND WE PLAN TO CONTINUE OUR COLLABORATION WITH THE GOVERNMENT TO MONITOR

END OF TEXT

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IMPLEMENTATION, IN LINE WITH SECTORAL PRIORITIES INVESTMENT REVIEWS WITH THE GOVERNMENT ARE EXPECTED TO BE PARTICULARLY DETAILED IN SECTORS WHICH ARE RECEIVING SUBSTANTIAL SUPPORT FROM THE WORLD BANK OR ARE BEING CONSIDERED FOR MAJOR RESTRUCTURING AND NEW BANK LENDING, SUCH AS THE TRANSPORT, FERTILIZER, STEEL, AND AGRICULTURAL SECTORS WE WILL ALSO BE PLEASED TO WORK WITH THE GOVERNMENT TO DEFINE THE INCREMENTAL INVESTMENTS WHICH MIGHT BE ADDED TO THE CAPITAL BUDGET IN CASE OF RECESSION

MEXICO'S GROWTH STRATEGY WILL HINGE ON SUBSTANTIAL INCREASES IN NON-OIL EXPORTS AND DOMESTIC SAVINGS THE WORLD BANK IS PLACING PARTICULAR EMPHASIS ON HELPING THE GOVERNMENT TO STRENGTHEN THE NON-OIL EXPORTS AND INDUSTRIAL SECTORS THE BANK'S ASSISTANCE STRATEGY FOCUSSES ON THE REQUIRED POLICY REFORMS AND ON ASSOCIATED SPECIFIC INVESTMENT PROGRAMS DESIGNED TO PROMOTE EFFICIENCY AND INTENSIFY THE ECONOMY'S SUPPLY RESPONSE A US$698 MILLION LOAN PACKAGE TO SUPPORT TRADE POLICY REFORM, INDUSTRIAL EXPANSION, AND TECHNOLOGY DEVELOPMENT,RECENTLY APPROVED BY THE BANK'S BOARD, IS A KEY COMPONENT IN THIS STRATEGY THESE LOANS, TOGETHER WITH US$574 MILLION FOR FOUR OTHER LOANS ALREADY APPROVED EARLIER THIS YEAR (FOR EARTHQUAKE

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RECONSTRUCTION, TROPICAL AGRICULTURE, AND URBAN DEVELOPMENT) AND TWO FURTHER LOANS IN SUPPORT OF AGRICULTURAL CREDIT AND EXPORT DEVELOPMENT YET TO FOLLOW, ARE EXPECTED TO BRING THE WORLD BANK'S NEW COMMITMENTS FOR CALENDAR YEAR 1986 TO AN UNPRECEDENTED LEVEL OF US$2 BILLION DEPENDING ON THE PROGRESS MADE BY MEXICO TOWARDS AGREED OBJECTIVES, WHICH WILL BE CLOSELY MONITORED BY THE WORLD BANK, AND ON THE AGREEMENT BY THE OTHER CREDITORS--BOTH THE EXPORT CREDIT AGENCIES AND THE COMMERCIAL BANKS--TO PARTICIPATE ADEQUATELY IN THE PROGRAM, THE LEVEL OF NEW COMMITMENTS IN 1987 AND 1988 COULD BE OF A SIMILAR MAGNITUDE AND WOULD SUPPORT STRUCTURAL ADJUSTMENT AND INVESTMENT PROGRAMS FOR THE INDUSTRY, AGRICULTURE, FERTILIZER, HOUSING, STEEL, AND TRANSPORT SECTORS

SUCCESS OF THE STRUCTURAL REFORMS AND POLICY ADJUSTMENTS ANNOUNCED BY MEXICO WILL HINGE ON EFFICIENT AND ENERGETIC IMPLEMENTATION, AS WELL AS CLOSE MONITORING OF PROGRESS DURING THE REMAINDER OF THE PROGRAM PERIOD THROUGH 1988

I WISH TO CONCLUDE BY STRESSING THAT EFFECTIVE IMPLEMENTATION OF MEXICO'S COURAGEOUS EFFORTS TO DEAL WITH ITS PROBLEMS

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FORM NO. 27 OCR
(Modified -- 1/85)

WORLD BANK OUTGOING MESSAGE FORM Cable, Telex

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CONSTRUCTIVELY ON A SUSTAINED BASIS, WITHIN SEVERE ECONOMIC, FINANCIAL, AND SOCIAL CONSTRAINTS, WILL REQUIRE THE FULL COOPERATION OF THE COUNTRY'S CREDITOR BANKS AND OTHER CREDITORS WE LOOK FORWARD TO WORKING WITH YOU AND THE IMF IN SUPPORTING MEXICO'S EFFORTS BEST REGARDS, BARBER B CONABLE, PRESIDENT, THE WORLD BANK (INTBAFRAD)

END OF TEXT

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(Inputter's Initials)

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DATE

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CC: MR. PEREZ
WHD
ETR
SEC

INTERNATIONAL MONETARY FUND
WESTERN HEMISPHERE DEPT.
1986 SEP 19 AM 10: 13

mexico

SEP 17 1986

Sir:

I have pleasure in advising you that the Chairman concluded the 1986 consultation with Mexico under Article IV with the attached summing up, with which the Executive Board agreed.

I would like to take this opportunity to express the Fund's appreciation for the courteous cooperation of your Government during the course of this consultation, and to say that the Fund looks forward to a continuation of this close relationship.

Very truly yours,

Leo Van Houtven
Secretary

Attachment

Mr. Miguel Mancera
Director General
Banco de Mexico
Apartado Postal 98 Bis
5 de Mayo, No. 2
06059 Mexico 1, D.F.
Mexico

AA
AAkanda:ag 9/15/86

CENTRAL FILES

INTERNATIONAL MONETARY FUND

The Chairman's Summing Up at the Conclusion of the 1986 Article IV Consultation with Mexico
Executive Board Meeting 86/149 - September 8, 1986

Executive Directors welcomed the authorities' decision to engage in a new program to redress the major economic imbalances faced by Mexico. They recalled that the adoption of a strong economic program in late 1982 had brought substantial benefits to the economy in the following two years, including a recovery of economic activity and a major strengthening of the balance of payments Many Directors noted that even though the recent deterioration of economic conditions in Mexico was in large part the result of a very sharp worsening of the terms of trade, domestic prices and the balance of payments had come under pressure earlier because of a significant and unfortunate relaxation of fiscal, monetary and exchange rate policies in late 1984 and early 1985. Commendable attempts to redress these policy slippages had been in progress from mid-1985, but the combination of the September 1985 earthquakes and the weakening of the international petroleum market has severely complicated this task.

Directors, therefore, welcomed the adoption of a combination of fiscal and monetary measures with structural reforms, aimed at restoring the viability of the balance of payments, strengthening the savings performance of the economy, and improving overall economic efficiency as a means for re-establishing sustained growth. Directors drew attention to the importance of policies to improve supply conditions in order to foster growth

Directors noted that Mexico's economic program called for a strengthening of the public finances through adjustment in public sector prices, increases in taxes, and rationalization of public sector activities. They underscored that a major and lasting reduction of the public sector deficit was essential to the restoration of external balance and price stability in Mexico. Many Directors believed that the pace of fiscal adjustment should have been more ambitious. They observed with concern that the 1986 public sector borrowing requirement would be nearly as large in terms of GDP as in 1982, and that it was likely to be reduced under the present program at a significantly slower pace than under the previous Fund program. Moreover, the financing of the 1986 public sector borrowing requirement would be a heavy burden on monetary policy and add to inflationary pressures. A number of Directors noted with reservations the introduction of the operational balance as a complement to the public sector borrowing requirement in monitoring fiscal performance. Most

Directors warned that the use of various concepts of fiscal balance should not deter the authorities from continuing to focus primarily on the public sector borrowing requirement.

The program for adjusting public sector prices to realistic levels had been started under the previous extended arrangement, and Directors emphasized that it was important to complete the process of removing distortions in the existing price structure and of eliminating inefficiencies in the management of public sector enterprises Directors stressed, however, that until inflation was overcome, it would be necessary to keep administered public prices under close scrutiny to avoid slippages such as those that had occurred in the recent past.

Directors noted that, in addition to the fall in oil export receipts, the yield of certain taxes had diminished in importance in recent years, in part because of the impact of inflation, and they agreed on the need to reinforce the tax base A number of Directors urged the prompt and full implementation of the proposed tax reform, which was likely to have a favorable impact on revenue in the years beyond the period of the current arrangement. Such a development was important from the standpoint of strengthening capital formation while reducing the reliance on borrowing from abroad in the medium term Several Directors believed that, in addition to tax increases, the Mexican program should have included a stronger emphasis on further cuts in current outlays.

Directors observed that the implementation of structural change in the public sector, including the cessation of public operations in non-priority areas and industrial reconversion, was central to the improvement of economic efficiency and to the strengthening of domestic savings. They welcomed the steps that had already been taken by the authorities but pointed out that much still remained to be done. Directors underlined the importance of cooperation between the authorities and the World Bank in this area.

Directors noted that over the recent past monetary and credit policy, together with exchange rate policy, had carried the brunt of the adjustment effort. As a consequence, there had been a crowding out of the private sector in its access to credit, with adverse repercussions on capital formation and economic activity. Taking into account the magnitude of the public sector borrowing requirement and the strength of the inflationary pressures, Directors generally stressed that the monetary and credit policy that was planned would need to be forceful enough to ensure that it would lead to the much-needed improvement in price performance and the achievement of the international reserve target, while at the same time making room for more credit to the private sector.

A number of Directors emphasized that to achieve a reduction of inflation without high costs in terms of unemployment it was necessary to act in the area of incomes policy to complement the tightening of financial policies Directors regretted that the authorities were not in a position at this time to present their objectives for the reduction of inflation in 1987, and they urged them to develop a policy package for 1987 that would be consistent with a major and lasting improvement in price performance.

Directors emphasized the need to rely on market prices for the determination of interest rates and urged the authorities to maintain positive interest rates in real terms in order to strengthen the savings performance as well as the capital account of the balance of payments.

Directors commended the steps taken since mid-1985 to improve the international competitiveness of the Mexican economy and to make exchange rate policy more flexible. Directors noted that private capital flows had responded favorably to the tightening of credit policy and to the greater flexibility of the exchange rate, and that non-oil exports had reacted very positively to the more active exchange rate policy. Directors remarked that the large loss of export earnings that had resulted from the drop in oil prices meant that exchange rate policy, together with financial and structural policies, would have to play an important role in shifting resources to the export sector and to areas of efficient import substitution Thus, a flexible approach would need to be taken toward exchange rate policy to ensure that external competitiveness would be not only restored but also maintained.

Directors observed that the differential between the controlled and the free market rates had narrowed significantly in recent months They welcomed this development but stressed both the distortions and adverse effects on confidence associated with the maintenance of a dual exchange market Thus, a number of Directors urged the authorities to adopt a timetable for the prompt unification of the exchange rate system.

Directors were encouraged by the steps that were being taken by the Mexican authorities to liberalize trade policy They viewed with particular satisfaction the entrance of Mexico into the GATT and the support that the World Bank was giving to Mexico's initiatives for trade liberalization They viewed the joining of the GATT as a sign of the Mexican authorities' commitment to an efficient economy, open to trade and capable of competing in international markets

Directors noted that steps were being taken by the authorities to encourage export-oriented foreign investment and the new guidelines had just been issued for implementing debt/equity swap operations Directors stressed the importance of direct foreign investment in the financing of Mexico's external capital requirements in the future Thus, Directors urged Mexico to move boldly in removing administrative requirements that hamper the flow of direct investment to Mexico

Directors noted that the authorities planned to deal with their external payments and debt problems through a combination of adjustment and further financial assistance from abroad They remarked that Mexico's economic program involved a substantial amount of external financing, which was to be seen in the light of the extremely fast and large drop in export earnings that had been experienced. They also noted that the official financing that was contemplated was sizable in relation to outstanding credits to Mexico from these sources. It was important that the contribution of the private financial institutions to the financing package be completed without further delay, and Directors hoped that Mexico and its private external creditors would come to a realistic agreement very soon.

Directors noted that the program presented by the authorities incorporated two new contingency mechanisms to meet the special circumstances of Mexico. While a number of reservations have been expressed today regarding these mechanisms, it is fair to say that Directors generally felt that they had been tailored to the very special circumstances of Mexico and should facilitate the implementation of the program. It was observed that the oil contingency mechanism provided the economy with some temporary protection if the price of oil were to fall below $9 a barrel, and stipulated a reduction of the reliance on external financing if the price of oil were to rise above $14 a barrel. Directors commented favorably on this symmetry. Directors also stressed that purchases under the oil contingency mechanism would be regarded as compensation for export shortfalls in the event Mexico were to request use of Fund resources under the compensatory financing facility. With regard to the second contingency mechanism, which would come into place in the event that economic recovery should fail to materialize, notwithstanding the pursuit of all the agreed policies, Directors emphasized the importance of using the additional financial resources to support projects that would yield satisfactory returns on capital investment.

In sum, Directors were of the view that the Mexican authorities--under exceptionally adverse circumstances--were showing their determination to strengthen their efforts in dealing with the problems that would need to be solved to provide the conditions for sustained growth and adjustment However, today's discussion has clearly shown that most Directors believe that a stronger fiscal effort would be appropriate. Moreover, some doubts have been expressed whether the planned financial policies would be fully consistent with the targeted acceleration of growth and the braking of inflation. Even with the full implementation of the program, the balance of payments position will remain vulnerable for a number of years to come and there will be further additions to the already exceptionally heavy foreign debt burden. Directors therefore emphasized the need for total adherence to the program and continued strengthening of financial and structural policies to ensure that inflation will be brought down, capital formation raised, resource use improved, and external debt management put on a solid footing.

It is expected that the next Article IV consultation with Mexico will be held on the standard 12-month cycle.

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INTERNATIONAL MONETARY FUND
WESTERN HEMISPHERE DEPT.

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TREASURER
INTERFUND
WASHINGTON DC

ORIG: TRE
CC: MR. P. PEREZ
WHD

NO. 22

REF JACG/86/T-57

[redacted]

MEXICO WISHES TO ACQUIRE SDR 21,100,000 AGAINST A FREELY USABLE CURRENCY PREFERABLY US DOLLAR TO MEET THE REPURCHASE DUE SEPTEMBER 28 IN A TRANSACTION TO BE ARRANGED BY THE FUND, VALUE SEPTEMBER 26, 1986.

BANXICO

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REPLY VIA ITT

TEST NUMBER:

☑ CHECKS

☐ DOES NOT CHECK, IT HAS BEEN SERVICED.

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INTERNATIONAL MONETARY FUND
WASHINGTON, D.C. 20431

MANAGING DIRECTOR

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CABLE ADDRESS
INTERFUND

September 12, 1986

Dear Bill:

I was most interested to hear that the IFC is discussing the formation of an equity fund for Mexico which could serve to facilitate conversions of debt to equity. I warmly welcome this news and congratulate you on a constructive and timely initiative which I am sure will be of considerable help in our efforts to resolve Mexico's debt problems, especially over the medium term. I have for some time been an advocate of such country specific funds as a way of reducing the interest burden of indebted countries in a manner which could prove attractive to creditors. I wish you every success with this endeavor.

Sincerely,

J. de Larosiere

Sir William Ryrie
Executive Vice President
IFC
Room I-12015

INTERNATIONAL MONETARY FUND
WESTERN HEMISPHERE DEPT.
1986 SEP 15 PM 2:26

cc: Mr. Erb
Mr. Finch
Mr. Wiesner
Mr. Beza

DOCUMENT OF INTERNATIONAL MONETARY FUND AND NOT FOR PUBLIC USE

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SUR/86/93

CONFIDENTIAL

September 12, 1986

The Chairman's Summing Up at the Conclusion of the
1986 Article IV Consultation with Mexico
Executive Board Meeting 86/149 - September 8, 1986

Executive Directors welcomed the authorities' decision to engage in a new program to redress the major economic imbalances faced by Mexico. They recalled that the adoption of a strong economic program in late 1982 had brought substantial benefits to the economy in the following two years, including a recovery of economic activity and a major strengthening of the balance of payments. Many Directors noted that even though the recent deterioration of economic conditions in Mexico was in large part the result of a very sharp worsening of the terms of trade, domestic prices and the balance of payments had come under pressure earlier because of a significant and unfortunate relaxation of fiscal, monetary and exchange rate policies in late 1984 and early 1985. Commendable attempts to redress these policy slippages had been in progress from mid-1985, but the combination of the September 1985 earthquakes and the weakening of the international petroleum market has severely complicated this task.

Directors, therefore, welcomed the adoption of a combination of fiscal and monetary measures with structural reforms, aimed at restoring the viability of the balance of payments, strengthening the savings performance of the economy, and improving overall economic efficiency as a means for re-establishing sustained growth. Directors drew attention to the importance of policies to improve supply conditions in order to foster growth.

Directors noted that Mexico's economic program called for a strengthening of the public finances through adjustment in public sector prices, increases in taxes, and rationalization of public sector activities. They underscored that a major and lasting reduction of the public sector deficit was essential to the restoration of external balance and price stability in Mexico. Many Directors believed that the pace of fiscal adjustment should have been more ambitious. They observed with concern that the 1986 public sector borrowing requirement would be nearly as large in terms of GDP as in 1982, and that it was likely to be reduced under the present program at a significantly slower pace than under the previous Fund program. Moreover, the financing of the 1986 public sector borrowing requirement would be a heavy burden on monetary policy and add to inflationary pressures. A number of Directors noted with reservations the introduction of the operational balance as a complement to the public sector borrowing requirement in monitoring fiscal performance. Most

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Directors warned that the use of various concepts of fiscal balance should not deter the authorities from continuing to focus primarily on the public sector borrowing requirement.

The program for adjusting public sector prices to realistic levels had been started under the previous extended arrangement, and Directors emphasized that it was important to complete the process of removing distortions in the existing price structure and of eliminating inefficiencies in the management of public sector enterprises. Directors stressed, however, that until inflation was overcome, it would be necessary to keep administered public prices under close scrutiny to avoid slippages such as those that had occurred in the recent past.

Directors noted that, in addition to the fall in oil export receipts, the yield of certain taxes had diminished in importance in recent years, in part because of the impact of inflation, and they agreed on the need to reinforce the tax base. A number of Directors urged the prompt and full implementation of the proposed tax reform, which was likely to have a favorable impact on revenue in the years beyond the period of the current arrangement. Such a development was important from the standpoint of strengthening capital formation while reducing the reliance on borrowing from abroad in the medium term. Several Directors believed that, in addition to tax increases, the Mexican program should have included a stronger emphasis on further cuts in current outlays.

Directors observed that the implementation of structural change in the public sector, including the cessation of public operations in nonpriority areas and industrial reconversion, was central to the improvement of economic efficiency and to the strengthening of domestic savings. They welcomed the steps that had already been taken by the authorities but pointed out that much still remained to be done. Directors underlined the importance of cooperation between the authorities and the World Bank in this area.

Directors noted that over the recent past monetary and credit policy, together with exchange rate policy, had carried the brunt of the adjustment effort. As a consequence, there had been a crowding out of the private sector in its access to credit, with adverse repercussions on capital formation and economic activity. Taking into account the magnitude of the public sector borrowing requirement and the strength of the inflationary pressures, Directors generally stressed that the monetary and credit policy that was planned would need to be forceful enough to ensure that it would lead to the much-needed improvement in price performance and the achievement of the international reserve target, while at the same time making room for more credit to the private sector.

A number of Directors emphasized that to achieve a reduction of inflation without high costs in terms of unemployment it was necessary to act in the area of incomes policy to complement the tightening of financial policies. Directors regretted that the authorities were not in a position at this time to present their objectives for the reduction of inflation in 1987, and they urged them to develop a policy package for 1987 that would be consistent with a major and lasting improvement in price performance

Directors emphasized the need to rely on market prices for the determination of interest rates and urged the authorities to maintain positive interest rates in real terms in order to strengthen the savings performance as well as the capital account of the balance of payments

Directors commended the steps taken since mid-1985 to improve the international competitiveness of the Mexican economy and to make exchange rate policy more flexible Directors noted that private capital flows had responded favorably to the tightening of credit policy and to the greater flexibility of the exchange rate, and that non-oil exports had reacted very positively to the more active exchange rate policy Directors remarked that the large loss of export earnings that had resulted from the drop in oil prices meant that exchange rate policy, together with financial and structural policies, would have to play an important role in shifting resources to the export sector and to areas of efficient import substitution Thus, a flexible approach would need to be taken toward exchange rate policy to ensure that external competitiveness would be not only restored but also maintained

Directors observed that the differential between the controlled and the free market rates had narrowed significantly in recent months They welcomed this development but stressed both the distortions and adverse effects on confidence associated with the maintenance of a dual exchange market Thus, a number of Directors urged the authorities to adopt a timetable for the prompt unification of the exchange rate system

Directors were encouraged by the steps that were being taken by the Mexican authorities to liberalize trade policy They viewed with particular satisfaction the entrance of Mexico into the GATT and the support that the World Bank was giving to Mexico's initiatives for trade liberalization They viewed the joining of the GATT as a sign of the Mexican authorities' commitment to an efficient economy, open to trade and capable of competing in international markets

Directors noted that steps were being taken by the authorities to encourage export-oriented foreign investment and the new guidelines had just been issued for implementing debt/equity swap operations Directors stressed the importance of direct foreign investment in the financing of Mexico's external capital requirements in the future Thus, Directors urged Mexico to move boldly in removing administrative requirements that hamper the flow of direct investment to Mexico

Directors noted that the authorities planned to deal with their external payments and debt problems through a combination of adjustment and further financial assistance from abroad They remarked that Mexico's economic program involved a substantial amount of external financing, which was to be seen in the light of the extremely fast and large drop in export earnings that had been experienced They also noted that the official financing that was contemplated was sizable in relation to outstanding credits to Mexico from these sources It was important that the contribution of the private financial institutions to the financing package be completed without further delay, and Directors hoped that Mexico and its private external creditors would come to a realistic agreement very soon

Directors noted that the program presented by the authorities incorporated two new contingency mechanisms to meet the special circumstances of Mexico While a number of reservations have been expressed today regarding these mechanisms, it is fair to say that Directors generally felt that they had been tailored to the very special circumstances of Mexico and should facilitate the implementation of the program It was observed that the oil contingency mechanism provided the economy with some temporary protection if the price of oil were to fall below $9 a barrel, and stipulated a reduction of the reliance on external financing if the price of oil were to rise above $14 a barrel Directors commented favorably on this symmetry Directors also stressed that purchases under the oil contingency mechanism would be regarded as compensation for export shortfalls in the event Mexico were to request use of Fund resources under the compensatory financing facility With regard to the second contingency mechanism, which would come into place in the event that economic recovery should fail to materialize, notwithstanding the pursuit of all the agreed policies, Directors emphasized the importance of using the additional financial resources to support projects that would yield satisfactory returns on capital investment

In sum, Directors were of the view that the Mexican authorities--under exceptionally adverse circumstances--were showing their determination to strengthen their efforts in dealing with the problems that would need to be solved to provide the conditions for sustained growth and adjustment However, today's discussion has clearly shown that most Directors believe that a stronger fiscal effort would be appropriate Moreover, some doubts have been expressed whether the planned financial policies would be fully consistent with the targeted acceleration of growth and the braking of inflation Even with the full implementation of the program, the balance of payments position will remain vulnerable for a number of years to come and there will be further additions to the already exceptionally heavy foreign debt burden Directors therefore emphasized the need for total adherence to the program and continued strengthening of financial and structural policies to ensure that inflation will be brought down, capital formation raised, resource use improved, and external debt management put on a solid footing

It is expected that the next Article IV consultation with Mexico will be held on the standard 12-month cycle

INTERNATIONAL MONETARY FUND

September 12, 1986

Mr. Finch:

I attach a summary of linkages in the draft financing principles for Mexico, prepared by Mr. Hansen.

Attachment

cc: Mr. Beza
Mr. Beveridge
Mr. Guitian

C. Maxwell Watson

File Mexico

Office Memorandum

Memorandum for Files September 12, 1986

Subject Mexico--Linkages in Proposed Bank Agreement

Only incomplete information on the proposed financial agreement between Mexico and commercial banks is available at the present time, but from the documentation which has been provided it seems that disbursements of new money and restructurings will be closely tied to financing provided from other sources including IMF, IBRD, IDB, Paris Club restructuring, and aggregate levels of new usage of bilateral credits Covenants and events of default are not specified in detail, but seem to imply the same type of linkages as for conditions precedent.

New money will be provided under seven different categories, with the amounts in the different categories yet to be decided (i) in parallel financing with the World Bank, (ii) in cofinancing with the World Bank, (iii) with a put option to the World Bank, 1/ (iv) loans convertible into equity, (v) in the form of an on-lending facility, (iv) in the form of petroleum indexed debt, and (vii) in other forms

The type of linkage varies slightly from category to category For the parallel financing the total amount will be divided into tranches for parallel disbursement with World Bank sectoral loans (five specified and one category other) Conditions for drawdown of such loans will include parallel disbursement by the World Bank under specific sectoral loans but also IMF purchases, multiyear Paris Club restructuring, actual aggregate levels of new usage of bilateral credits, implementation of program financed by World Bank structural adjustment loans, and several other references to World Bank loans.

For the cofinancing loans, the conditions for the drawdown of these B-loans will include, in addition to those mentioned for parallel financing, prior or simultaneous disbursement of World Bank A loans which are being cofinanced. Drawdown of A-loans is conditioned on there being no payment default or acceleration under any B-loan to Mexico There is also mandatory sharing of principal and interest payments by the World Bank, and a mandatory World Bank cross default on the commercial bank B-loans

As far as amendments to the restructuring agreements on existing debt are concerned, there seem to be similar linkages in the covenants and events of default as for new money In addition, there is an amendment relating to linkages in the US$23 6 billion (1982-84 maturities) agreement The conditions for the second tranche extension

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1/ In return for payments of the World Bank fee, the commercial banks will have the option to put any unpaid principal to the World Bank at the time of the scheduled final maturity under the facility date (now to be tested at end 1988 rather than at end 1987) have been amended to include IMF drawdowns (presumably under the new stand-by arrangement), World Bank drawdowns, Paris Club restructurings for the years 1986 - 19__, and levels of actual usage of bilateral credits.

It should be noted that in the remaining existing restructuring agreements (and perhaps also in the one referred to above although this is not specifically stated) the covenants have been revised to make purchases from the IMF refer to the new stand-by arrangement and the disbursement schedule under this arrangement Also, the monitoring procedures (which no doubt refer to the enhanced surveillance by the Fund) have been revised to begin in 1988 and to end with the payment in full of 1983 and 1984 new money agreements and, in addition, new money extended in 1986-87 This would probably imply a later final date for the enhanced surveillance procedure

Leif Hansen /LH
Senior Economist

Mr. Beze 10-100

FONDO MONETARIO INTERNACIONAL
WASHINGTON, D.C. 20431

File

Con atentos saludos de

Guillermo Ortiz

Director Ejecutivo Alterno

DRAFT: 9/14/86

MEMORANDUM: RATIONALE FOR MEXICAN WORKING PROPOSAL
(Draft: 9/13/86)

1. Desire to accommodate September 29 deadline

2. Commercial banks themselves have advised us that there is merit in a number of our original ideas, but that it will take time to develop them further and secure their acceptance.

3. Commercial bank proposal (a) is not responsive to Mexico's fundamental concerns, (b) envisions an unprecedented degree of conditionality and linkage to domestic policy matters, and (c) is itself fantastically complex.

4. The two weeks remaining until September 29 provide insufficient time to develop and agree upon a compromise likely to be acceptable to both sides.

5. We are not looking for a one-time, ultimate solution, but the issues at stake are so important (on both sides) that they cannot be ignored -- that is, they must be dealt with appropriately in the 1986-1987 package.

6. In reality, neither side is seeking a conventional deal. The two-step approach permits Mexico to attain a level of international reserves consistent with the payment in full of all interest owing to banks in 1986, and avoid the uncertainties and inevitable pressures associated with reaching September 29 without an acceptable deal.

7. The new Mexican proposal attempts to respect these concerns and provide banks with reasonable terms (when compared with prior new money deals) as reflected in its salient features:

- new money to be provided in parallel with drawings by Mexico under its World Bank Trade DPL, with drawings conditional upon disbursements from the World Bank as well as from the IMF

- incorporation of World Bank "put" feature (to the extent agreement can be reached with the World Bank)

- proposal deals only with issues that must be addressed immediately and permits both Mexico and the banks to address in subsequent negotiations the issues raised by their initial proposals, free from the artificial constraints of a September 29 deadline

- does not disadvantage either side in future negotiations: Mexico's need for new money, IMF drawings and World Bank disbursements in 1987 is ample incentive to ensure the expeditious continuation of negotiations in good faith; neither side need, at this point, retreat from the basic elements of its initial proposal or manifest acceptance of the proposal of the other side.

- commercial bank bridge loan, if drawn, to be repaid from first disbursement of 1986 new money

- simplicity of package should permit prompt completion with first disbursement in early December, 1986

- applicable features of 1987 package can be retroactively incorporated into 1986 package to the extent appropriate (as has been done before)

8. Approaching the commercial banks in successive and interrelated stages does not imply a fragmentation of Mexico's 1986-1987 economic program. Even if a comprehensive term sheet were negotiated now, many significant substantive issues would (as always) be left unresolved until negotiation of the underlying contractual documentation which would extend into 1987 regardless of the approach taken.

9. IMF programs are not without their own year-by-year approach -- e.g., negotiation of annual performance criteria.

10. Acceptance of conditionality in anything like the form proposed by the banks would almost certainly require us to renegotiate package in order to be entitled to draw new money in 1987.

11. Gives us adequate time to make a responsible effort to secure terms needed for domestic political purposes.

12. 82 EFF: BANK MONEY FOR 1984 DONE SEPARATELY FROM 1983 NEW MONEY

13. ONE NEGOTIATION IN TWO STEPS.

14. SEVERE PROBLEMS FOR MEXICO IN PUTTING OFF DEADLINE.

File Mexico

INTERNATIONAL MONETARY FUND

September 8, 1986

Mr. Sugita:

Attached for your records is a corrected version of the questions I sent you last Friday regarding Mexico, i.e., the reference to the Philippines has been corrected.

We will be meeting with the bank economic subcommittee on Mexico tomorrow morning at 8 a.m., and any answers we could get today, however partial, would be very helpful.

Once again, we would like to thank you for your assistance on this matter.

cc: Mr. Beza
Mr. Pujol
Mr. Duran-Downing

K. Burke Dillon KBD

DRAFT
9/8/86

According to Berne Union reports, as of March 31, 1986, EID/MITI was open for new medium- and long-term cover in Mexico, subject to an annual limit on new commitments With respect to short-term business, EID/MITI was open, subject to certain restrictions, including maximum credit terms, transaction limits, and a reduced percentage cover (70 percent) We would appreciate a description of EID/MITI's present cover policy stance with indications as to when any important changes introduced since March 1986 took effect It would be useful if any differences in stance with respect to public and private buyers in Mexico could be noted We would also appreciate an assessment as to how restrictive these terms were in practice, e g , was there room available for substantial new business under the annual commitment limit for medium- and long-term business? How did the pace of approvals of new medium- and long-term cover during the first eight months of 1986 compare with the first eight months of 1985? What is EID/MITI's perception of trends in demand for new cover with respect to public and private buyers in Mexico? Would a less restrictive policy during 1986 have resulted in a substantially higher level of new commitments?

We would also appreciate indications as to how EID/MITI's cover policy stance might evolve on the assumption that the stand-by arrangement with the Fund takes effect and is implemented and that a Paris Club rescheduling is successfully concluded Although we understand that it is difficult to be specific ex ante, we would appreciate any indications that could be given regarding possible changes in instruments such as annual commitment limits, country exposure limits, and percentage cover, as well as a view on the possible impact of those changes on the volume and timing of new commitments.

To provide a basis for our analysis, we would appreciate it if you could also provide us with information on outstanding amounts of medium- and long-term cover (principal only) as of end-1984, end-1985, and the most recent date available, and similarly for short-term cover Also, the Berne Union data indicates that total outstanding EID/MITI commitments as of March 31, 1986 were US$1 0 billion and total outstanding offers were zero We would appreciate more recent data on these two concepts Finally, any information that EID/MITI could provide on the pipeline of undisbursed medium- and long-term commitments would be useful, with respect to total amounts and possible timetable for disbursement

drmex09
9/8/86

File Mexico

MEXICO - Calendar of Recent Events

July 20-21:	MD sends telex to G-10 and other countries on bridge.
July 21:	MD briefs EDs on concluding stages of negotiation of economic program with Mexico.
July 22:	Mexico's Secretary of Finance and Public Credits signs letter of intent.
July 23:	MD, DMD, and staff brief EDs on program. MD, DMD, and staff travel to New York to accompany Mexican authorities on presentation of program and its financing to leading officials of commercial banks.
July 24:	MD, DMD, and staff meet with Advisory Committee of banks.
July 29:	IBRD Board meets and approves the US$500 Trade Development Loan. The first drawing under this loan is to take place once assurances are obtained that the total financial package is in place.

August 1-2	MD, DMD, and staff meet with economic subcommittee of the Advisory Committee to discuss program and its financing [From this time, management and staff have had frequent contacts and meetings with economic subcommittee]
August 3-6	Staff travel to Mexico to discuss medium-term with officials and economic subcommittee
August 15	Staff Report on Mexico circulated to EDs
August 18	Work on official bridge is completed
	Bank Advisory Committee circulates to some 50 banks proposals for commercial bank portion of the bridge
August 18-22	Mexican officials meet with economic subcommittee on financing of program
August 25-29	Mexican officials meet with Bank Advisory Committee on terms of financing from commercial banks
	Work on commercial bank bridge is completed
	Disbursement of US$850 million from official bridge is prepared (occurs on August 31)

August 28	DMD and staff meet informally with the Executive Directors representing the main creditor countries of the Paris Club
September 3-5	Mexican officials met with Bank Advisory Committee on terms of financing from commercial banks
September 5	MD indicates to EDs that will seek approval in principle of Mexico's arrangement on September 8

INTERNATIONAL MONETARY FUND
WESTERN HEMISPHERE DEPT.

1986 SEP 16 PM 4: 56

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SEP 12 1986

Gentlemen:

I am enclosing herewith the text of the Stand-by Arrangement for Mexico approved by the Executive Board on September 8, 1986.

Sincerely yours,

Alfred Mathuran
Senior Operations Officer
Operations Division
for General Resources

Enclosure

Banco de Mexico
Apartado Postal 98 Bis
5 de Mayo, No. 2
06059 Mexico 1, D.F.
Mexico

CC: TRE
MR. PEREZ
WHD

/jg
9/12/86

CENTRAL FILES

ADVANCE COPY

Fik Mexico

CLEARY, GOTTLIEB, STEEN & HAMILTON
One State Street Plaza, New York, New York 10004 (212) 344-0600

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1986 SEP 10 PM 4:50

FACSIMILE MESSAGE TO:

Fax Number(s): 202-623-4661 or 4662

Name: Mr. Sterie Beza

Company: International Monetary Fund

City: Washington, D.C.

State/
Country:

Telephone
Number: 202-623-8631

From: Mark A. Walker

Date: September 13, 1986

Number of Pages
(including cover): 2

Our File Number: 24636-050

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212-269-5724	(GR. I, II & III)		

(This space to be used for short or supplemental messages)

Re: Commercial Bank Contingency Support Facility

Dear Ted:

Subject to the comments of Shearman & Sterling, we would propose that the condition to drawing from the commercial banks relating to critical mass be deemed satisfied by the delivery by the Fund of a confirmation substantially in the form of the attached.

I would appreciate any thoughts you might have.

Mark

Mark A. Walker

cc: G. Alfred Mudge, Esq.

DRAFT - September 10, 1986

TO: CITIBANK, N A , AS AGENT UNDER THE COMMERICAL BANK FACILITY FOR CONTINGENCY SUPPORT FOR MEXICO'S INTERNATIONAL RESERVES

FROM: J DE LAROSIERE, MANAGING DIRECTOR, INTERNATIONAL MONETARY FUND

DATE: ______________________, 198_

I AM PLEASED TO CONFIRM THAT A CRITICAL MASS OF COMMERCIAL BANKS HAVE COMMITTED TO A 1986-87 COMMERCIAL BANK FINANCING PACKAGE FOR MEXICO ON THE BASIS ON WHICH I HAVE PROPOSED TO THE EXECUTIVE BOARD OF THE FUND THAT THE MEXICAN REQUEST FOR A STAND-BY ARRANGEMENT FOR SDR 1,400 MILLION FOR A PERIOD OF 18 MONTHS, APPROVED IN PRINCIPLE BY THE EXECUTIVE BOARD, BECOME EFFECTIVE, IT BEING UNDERSTOOD THAT I HAVE CONSIDERED COMMITMENTS OF APPROXIMATELY 90% TO CONSITITUTE A CRITICAL MASS

REGARDS,

J. DELAROSIERE
MANAGING DIRECTOR
INTERNATIONAL MONETARY FUND

Office Memorandum

DMD ①
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① Mexico
② Paris Club
Mr. Wiesner
P2
CK

TO: The Managing Director
The Deputy Managing Director

DATE: September 11, 1986

FROM: E. Wiesner E.W.

SUBJECT: Mexico--Statement for Paris Club

Sept. 14, 1986

Attached for your consideration is the statement for the Paris Club meeting that is to be held early next week. This statement has been reviewed by Mr. Beza, Mr. Guitián, and myself.

Attachment

cc: Mr. Brown

1986 SEP ? AM 8:55
OFFICE OF THE
DEPUTY MANAGING DIRECTOR

1986 SEP 15 PM 5:26
INTERNATIONAL MONETARY FUND
WESTERN HEMISPHERE DEPT.

Statement by the Fund Staff at the Paris Club Meeting on Mexico - September 15-16, 1986

1. Background

To deal with the external and internal problems that led to the financial crisis of 1982, in the latter part of that year Mexico embarked on a three-year adjustment program that was supported with Fund resources. Mexico made important gains in reducing imbalances in the first two years of the program, but by late 1984 it became apparent that slippages in policy implementation, compounded by a weakening of oil prices, were having adverse effects on economic performance.

In 1985 the pace of economic activity started to slow down, the rate of inflation accelerated, and net international reserves declined. In an effort to arrest the loss in foreign reserves, the currency was devalued substantially in July 1985 and steps were taken to make the management of the exchange rate more flexible. Concurrently, a widespread liberalization of the import regime was enacted, a number of cuts were announced in public sector expenditures, and credit policy was tightened. The earthquakes of September 1985 compounded the problems already being confronted.

The sharp decline in oil prices that has occurred since the beginning of 1986 has exacerbated Mexico's difficulties. The loss in petroleum revenue for 1986 has been estimated at more than US$9 billion, which is equivalent to some 6 1/2 percent of GDP. The deterioration in the fiscal revenue has given rise to a rapid rate of domestic credit expansion and the rate of inflation has increased sharply. The authorities have tried to limit the pressures on prices and on the balance of payments by tightening credit to the private sector and by depreciating the currency in real terms In the process, interest rates have moved up sharply, and interest payments on the public debt are now estimated to exceed 18 percent of GDP in 1986, up from some 12 percent of GDP in 1985

2 The program for 1986-87

The Mexican authorities have adopted a new program designed to redress the economic imbalances being faced by Mexico, and on this basis they have requested a stand-by arrangement from the Fund in the amount of SDR 1 4 billion, on September 8, 1986, the Executive Board approved the program in principle, pending completion of the package to finance the program

The program aims at creating the conditions for sustained economic growth in a context of financial stability It envisages the implementation of financial and structural policies designed to restore balance of payments viability, to help break the inflationary trend, to strengthen the savings performance of the economy, and to improve efficiency

Beyond those already implemented in the context of the 1986 budget developed at the end of 1985

Adjustment in the public finances is a key component of the program, and fiscal measures to be implemented in 1986-87 are to yield the equivalent of 3 percentage points of GDP The measures include increases in taxes, adjustment in public sector prices and tariffs, and curbs on spending The authorities plan to reduce current expenditure in relation to GDP in order to make room for an increase in capital outlays

Beyond those already implemented in the context of the 1986 budget developed at the end of 1985

Monetary and credit policies are to be geared to the objective of reducing inflation and attaining the balance of payments targets, while at the same time making room for more credit to the private sector to support the recovery of economic activity Net international reserves are projected to recover substantially in the fourth quarter of 1986 and to increase by US$0 5 billion in 1986 as a whole, this is to be followed by a gain in reserves of US$0 9 billion in 1987

A large role has been assigned in the program to policies that would improve use of resources The Government is taking steps to realign prices and tariffs of public sector enterprises, to increase the scope of market forces in the determination of interest rates, and to improve efficiency of public enterprises Also, important advances are being made in the area of trade liberalization Prior import licensing requirements, as well as other nontariff barriers, will continue to be removed, while the customs tariff is being simplified In addition, the promotion of foreign direct investment in Mexico is being sought The World Bank has provided substantial technical and financial assistance to Mexico in its efforts to achieve structural reforms

3 External financial requirements and medium-term balance of payments prospects

The program seeks to strike a reasonable balance between financing and adjustment Mexico's position on current account is expected to shift from a surplus of US$0 5 billion in 1985 to deficits of US$3 5 billion in 1986 and of US$2 9 billion in 1987, thus the deterioration in the current account is much smaller than the drop in oil export earnings As a result of the increased flexibility in exchange rate management and the demand policy being followed, non-oil exports are

expected to grow significantly over the 1986-87 period, offsetting in part the decline in oil exports Imports are expected to drop considerably in 1986, reflecting both the slowdown in economic activity and reduced import requirements by the public sector, while imports are projected to rise in 1987 as economic activity recovers and the trade regime is liberalized, the rise from 1985 to 1987 will be quite limited In the service account, interest payments abroad are expected to fall from 1985 to 1986 and to decline further in 1987, reflecting the reduction in international interest rates

To finance the deficit in current transactions, permit the replenishment of international reserves, and cover certain net repayments of public and private debt, net official capital inflows would need to amount to US$12 5 billion in the two-year period 1986-87 An important component of this financing package would be net credits of US$6 billion from commercial banks Official sources, including the Fund, are expected to provide the equivalent of US$6 5 billion in 1986-87 Besides the drawings from the Fund, net disbursements from the World Bank and the Inter-American Development Bank are projected at US$2 7 billion over the two-year period Concerning official creditors, a significant portion of the financing is expected to come from the rescheduling of public sector debt service falling due during the program period, in addition, substantial financing is expected to come from the continued flow of new credits related to imports

Given the vulnerability of the Mexican economy to changes in petroleum export receipts, the program contains a special mechanism

linking some of its targets and the size and structure of the financing package to the evolution of oil prices This mechanism calls for a combination of additional foreign financing and adjustment during the program period if the price of oil should fall below US$9 a barrel, if the price should rise above US$14 a barrel, external financing would be reduced accordingly Another special mechanism included in the program provides for the possibility of additional financing for certain investment projects--screened and reviewed by the World Bank--if, despite the implementation of the policies called for under the program, there should be evidence that the economy is failing to recover from recession

For the period beyond the present economic program, two points should be emphasized First, if Mexico continues with the effort to strengthen financial policies and to deepen structural reform as initiated under the present arrangement, the external account deficit would show a sizable improvement even assuming the maintenance of the current level of oil prices in real terms The second one is that, given the previous heavy reliance on external borrowing, the burden of external debt service will continue to pose a severe constraint in the future While implementation of the policies envisaged in the program should lead to an improvement in the performance of the Mexican economy and should permit a reduction over time in the dependence on external borrowing, the Mexican authorities nevertheless envisage that borrowing on commercial terms by the public sector will need to continue throughout the projected period, albeit at a declining rate

As noted, the Executive Board of the International Monetary Fund has considered Mexico's request for a stand-by arrangement on the basis of the program presented by the authorities However, since the external financing package required to support the program has not been completed, the Executive Board decided to approve the arrangement in principle, within the period until September 29, 1986, the arrangement will become effective when it is found that the financing of the program is assured

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Mr. Brown

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1986 SEP 11 PM 6: 58
OFFICE OF
THE MANAGING DIRECTOR

Office Memorandum

TO: The Managing Director
The Deputy Managing Director

DATE: September 11, 1986

(1) Mexico
(2) Paris Club
see p. 1, 4, 5
9/14/86

FROM: E. Wiesner E.W.

SUBJECT: Mexico--Statement for Paris Club

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Attachment

cc: Mr. Brown

st6mex01 (09/11/86)

Statement by the Fund Staff at the Paris Club Meeting on Mexico - September 15-16, 1986

1 Background

To deal with the external and internal problems that led to the financial crisis of 1982, in the latter part of that year Mexico embarked on a three-year adjustment program that was supported with Fund resources Mexico made important gains in reducing imbalances in the first two years of the program, but by late 1984 it became apparent that slippages in policy implementation, compounded by a weakening of oil prices, were having adverse effects on economic performance

In 1985 the pace of economic activity started to slow down, the rate of inflation accelerated, and net international reserves declined In an effort to arrest the loss in foreign reserves, the currency was devalued substantially in July 1985 and steps were taken to make the management of the exchange rate more flexible Concurrently, a widespread liberalization of the import regime was enacted, a number of cuts were announced in public sector expenditures, and credit policy was tightened The earthquakes of September 1985 compounded the problems already being confronted

and rapid

and rapid

The sharp decline in oil prices that has occurred since the beginning of 1986 has exacerbated Mexico's difficulties The loss in petroleum revenue for 1986 has been estimated at more than US$9 billion, which is equivalent to some 6 1/2 percent of GDP The deterioration in the fiscal revenue has given rise to a rapid rate of domestic credit expansion and the rate of inflation has increased sharply The authorities have tried to limit the pressures on prices and on the

expected to grow significantly over the 1986-87 period, offsetting in part the decline in oil exports Imports are expected to drop considerably in 1986, reflecting both the slowdown in economic activity and reduced import requirements by the public sector, while imports are projected to rise in 1987 as economic activity recovers and the trade regime is liberalized, the rise from 1985 to 1987 will be quite limited In the service account, interest payments abroad are expected to fall from 1985 to 1986 and to decline further in 1987, reflecting the reduction in international interest rates

To finance the deficit in current transactions, permit the replenishment of international reserves, and cover certain net repayments of public and private debt, net official capital inflows would need to amount to US$12 5 billion in the two-year period 1986-87 An important component of this financing package would be net credits of US$6 billion from commercial banks which are presently under negotiation between with the authorities and the banks Official sources, including the Fund, are expected to provide the equivalent of US$6 5 billion in 1986-87 Besides the drawings from the Fund, net disbursements from the World Bank and the Inter-American Development Bank are projected at US$2 7 billion over the two-year period Concerning official creditors, a significant portion of the financing is expected to come from the rescheduling of public sector debt service falling due during the program period, in addition, substantial financing is expected to come from the continued flow of new credits related to imports

which are previously under negotiation between the Mexican authorities and the banks

Given the vulnerability of the Mexican economy to changes in petroleum export receipts, the program contains a special mechanism

linking some of its targets and the size and structure of the financing package to the evolution of oil prices This mechanism calls for a combination of additional foreign financing and adjustment during the program period if the price of oil should fall below US$9 a barrel, if the price should rise above US$14 a barrel, external financing would be reduced accordingly Another special mechanism included in the program provides for the possibility of additional financing for certain investment projects--screened and reviewed by the World Bank--if, despite the implementation of the policies called for under the program, there should be evidence that the economy is failing to recover from recession

For the period beyond the present economic program, two points should be emphasized First, if Mexico continues with the effort to strengthen financial policies and to deepen structural reform as initiated under the present arrangement, the external account deficit would show a sizable improvement even assuming the maintenance of the current level of oil prices in real terms The second one is that, given the previous heavy reliance on external borrowing, the burden of external debt service will continue to pose a severe constraint in the future While implementation of the policies envisaged in the program should lead to an improvement in the performance of the Mexican economy and should permit a reduction over time in the dependence on external borrowing, the Mexican authorities nevertheless envisage that borrowing on commercial terms by the public sector will need to continue throughout the projected period, albeit at a declining rate

Is this a condemnation of the previous views?

As noted, the Executive Board of the International Monetary Fund

Is this a condemnation of the Mexican view?

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1986 SEP 11 PM 6:58
OFFICE OF
THE MANAGING DIRECTOR

Office Memorandum

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(1) Mexico
(2) Paris Club

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TO: The Managing Director
The Deputy Managing Director

DATE: September 11, 1986

FROM: E. Wiesner E.W.

SUBJECT: Mexico--Statement for Paris Club

Attached for your consideration is the statement for the Paris Club meeting that is to be held early next week. This statement has been reviewed by Mr. Beza, Mr. Guitián, and myself.

See my observations
on other copy.
JdL
Sept. 14, 1986

Attachment

cc: Mr. Brown

INTERNATIONAL MONETARY FUND
WESTERN HEMISPHERE DEPT.
1986 SEP 15 AM 9:49

Statement by the Fund Staff at the Paris Club Meeting on Mexico - September 15-16, 1986

1 Background

To deal with the external and internal problems that led to the financial crisis of 1982, in the latter part of that year Mexico embarked on a three-year adjustment program that was supported with Fund resources Mexico made important gains in reducing imbalances in the first two years of the program, but by late 1984 it became apparent that slippages in policy implementation, compounded by a weakening of oil prices, were having adverse effects on economic performance

In 1985 the pace of economic activity started to slow down, the rate of inflation accelerated, and net international reserves declined In an effort to arrest the loss in foreign reserves, the currency was devalued substantially in July 1985 and steps were taken to make the management of the exchange rate more flexible Concurrently, a widespread liberalization of the import regime was enacted, a number of cuts were announced in public sector expenditures, and credit policy was tightened The earthquakes of September 1985 compounded the problems already being confronted

The sharp decline in oil prices that has occurred since the beginning of 1986 has exacerbated Mexico's difficulties The loss in petroleum revenue for 1986 has been estimated at more than US$9 billion, which is equivalent to some 6 1/2 percent of GDP The deterioration in the fiscal revenue has given rise to a rapid rate of domestic credit expansion and the rate of inflation has increased sharply The authorities have tried to limit the pressures on prices and on the balance of payments by tightening credit to the private sector and by depreciating the currency in real terms In the process, interest rates have moved up sharply, and interest payments on the public debt are now estimated to exceed 18 percent of GDP in 1986, up from some 12 percent of GDP in 1985

2 <u>The program for 1986-87</u>

The Mexican authorities have adopted a new program designed to redress the economic imbalances being faced by Mexico, and on this basis they have requested a stand-by arrangement from the Fund in the amount of SDR 1 4 billion, on September 8, 1986, the Executive Board approved the program in principle, pending completion of the package to finance the program

The program aims at creating the conditions for sustained economic growth in a context of financial stability It envisages the implementation of financial and structural policies designed to restore balance of payments viability, to help break the inflationary trend, to strengthen the savings performance of the economy, and to improve efficiency

Adjustment in the public finances is a key component of the program, and fiscal measures to be implemented in 1986-87 are to yield the equivalent of 3 percentage points of GDP The measures include increases in taxes, adjustment in public sector prices and tariffs, and curbs on spending The authorities plan to reduce current expenditure in relation to GDP in order to make room for an increase in capital outlays

Monetary and credit policies are to be geared to the objective of reducing inflation and attaining the balance of payments targets, while at the same time making room for more credit to the private sector to support the recovery of economic activity Net international reserves are projected to recover substantially in the fourth quarter of 1986 and to increase by US$0 5 billion in 1986 as a whole, this is to be followed by a gain in reserves of US$0 9 billion in 1987

A large role has been assigned in the program to policies that would improve use of resources The Government is taking steps to realign prices and tariffs of public sector enterprises, to increase the scope of market forces in the determination of interest rates, and to improve efficiency of public enterprises Also, important advances are being made in the area of trade liberalization Prior import licensing requirements, as well as other nontariff barriers, will continue to be removed, while the customs tariff is being simplified In addition, the promotion of foreign direct investment in Mexico is being sought The World Bank has provided substantial technical and financial assistance to Mexico in its efforts to achieve structural reforms

3 <u>External financial requirements and medium-term balance of payments prospects</u>

The program seeks to strike a reasonable balance between financing and adjustment Mexico's position on current account is expected to shift from a surplus of US$0 5 billion in 1985 to deficits of US$3 5 billion in 1986 and of US$2 9 billion in 1987, thus the deterioration in the current account is much smaller than the drop in oil export earnings As a result of the increased flexibility in exchange rate management and the demand policy being followed, non-oil exports are

expected to grow significantly over the 1986-87 period, offsetting in part the decline in oil exports Imports are expected to drop considerably in 1986, reflecting both the slowdown in economic activity and reduced import requirements by the public sector, while imports are projected to rise in 1987 as economic activity recovers and the trade regime is liberalized, the rise from 1985 to 1987 will be quite limited In the service account, interest payments abroad are expected to fall from 1985 to 1986 and to decline further in 1987, reflecting the reduction in international interest rates

To finance the deficit in current transactions, permit the replenishment of international reserves, and cover certain net repayments of public and private debt, net official capital inflows would need to amount to US$12 5 billion in the two-year period 1986-87 An important component of this financing package would be net credits of US$6 billion from commercial banks Official sources, including the Fund, are expected to provide the equivalent of US$6 5 billion in 1986-87 Besides the drawings from the Fund, net disbursements from the World Bank and the Inter-American Development Bank are projected at US$2 7 billion over the two-year period Concerning official creditors, a significant portion of the financing is expected to come from the rescheduling of public sector debt service falling due during the program period, in addition, substantial financing is expected to come from the continued flow of new credits related to imports

Given the vulnerability of the Mexican economy to changes in petroleum export receipts, the program contains a special mechanism

linking some of its targets and the size and structure of the financing package to the evolution of oil prices This mechanism calls for a combination of additional foreign financing and adjustment during the program period if the price of oil should fall below US$9 a barrel, if the price should rise above US$14 a barrel, external financing would be reduced accordingly Another special mechanism included in the program provides for the possibility of additional financing for certain investment projects--screened and reviewed by the World Bank--if, despite the implementation of the policies called for under the program, there should be evidence that the economy is failing to recover from recession

For the period beyond the present economic program, two points should be emphasized First, if Mexico continues with the effort to strengthen financial policies and to deepen structural reform as initiated under the present arrangement, the external account deficit would show a sizable improvement even assuming the maintenance of the current level of oil prices in real terms The second one is that, given the previous heavy reliance on external borrowing, the burden of external debt service will continue to pose a severe constraint in the future While implementation of the policies envisaged in the program should lead to an improvement in the performance of the Mexican economy and should permit a reduction over time in the dependence on external borrowing, the Mexican authorities nevertheless envisage that borrowing on commercial terms by the public sector will need to continue throughout the projected period, albeit at a declining rate

As noted, the Executive Board of the International Monetary Fund has considered Mexico's request for a stand-by arrangement on the basis of the program presented by the authorities However, since the external financing package required to support the program has not been completed, the Executive Board decided to approve the arrangement in principle, within the period until September 29, 1986, the arrangement will become effective when it is found that the financing of the program is assured

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Office Memorandum

September 10, 1986

To: Treasurer
Internal Auditor
Director, Exchange and Trade Relations Department
Director, Fiscal Affairs Department
Director, Legal Department
Director, Research Department
Director, Western Hemisphere Department

From: For The Secretary B. J. Owen

Subject: Mexico - Stand-By Arrangement and Exchange System

At EBM/86/149 (9/8/86), the Executive Board agreed in principle to the request of Mexico for an 18-month stand-by arrangement to become effective when the Fund finds that satisfactory arrangements for financing balance of payments deficits have been made, but no later than September 29, 1986 as set forth in EBS/86/161, Supplement 4, waived the limitation in Article V, Section 3(b)(iii), and granted approval of Mexico's restrictive multiple currency practice until December 31, 1986.

1986 SEP 10 PM 5:04
INTERNATIONAL MONETARY FUND
WESTERN HEMISPHERE DEPT.

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Office Memorandum

Mexico

TO: The Managing Director — September 10, 1986

FROM: K. Burke Dillon DJB for KBDillon

SUBJECT: Meeting with Bank Subcommittee Concerning Export Credits for Mexico

You have asked me to make an assessment, based on my contacts with export credit agencies and their authorities, of the realism of the staff's projections regarding export credits for Mexico. While, as you are aware, it is difficult to make such a projection with any precision, particularly for a period that would go through the end of 1987, my overall assessment is that the staff projection is appropriately cautious.

I assume that you have been informed on the meeting with the Bank Subcommittee and are aware of the figures in the attached table. This memo is to provide further background on my discussions with agencies or their authorities. I also assume that you are aware about the uncertainties concerning the special Japanese facility.

Some of the main pieces of "evidence" that I think we need to take into account in our assessment are listed below. We cannot, however, in our discussions with banks cite information provided by individual agencies/governments or by the Berne Union about individual agencies. An exception to this might be EXIM, since the United States itself is talking very openly with the banks.

Overall the impression I have gained from my conversations is that approvals have slowed in 1986--sharply in some cases--and that this is expected to be reflected in a continued low level of disbursements over the coming months. For some agencies this may reflect their more restrictive policy stance during 1986, but even those agencies that were completely open for new medium- and long-term business (e.g., United States and United Kingdom) have seen a drop in demand.

While none of Mexico's four major creditors (France, Japan, the United States and the United Kingdom) formally tightened their policy stance, quarterly Berne Union reports indicate that from March 1985 to March 1986 seven other agencies either went off cover or formally introduced restrictions. Others may have implemented existing policies more restrictively.

The United Kingdom (Mr. Foot and Mr. Mountfield) told me that they have plenty of room under their ceiling for Mexico, but business has been very slow. In fact, they have only one application under consideration and that may not qualify on commercial grounds If demand increased today, normal lags would mean no significant upturn in disbursements until the second half of 1987

The Germans went off cover in February and told us (via Mr. Grosche) that they have approved almost no new medium- and long-term business in 1986 They thought the staff numbers for 1987 were optimistic and considered it unlikely that they could get disbursements back to 1985 levels during 1987

Although they had no precise numbers at hand, EXIM (Mr. Arnold) said approvals had slowed in 1986 (Berne Union data also indicate that the U S pipeline is down) The U S Treasury has been assuming that EXIM disbursements would double from 1986 to 1987 I asked EXIM how this was going to happen with no change in policy stance. They had no answer

The Japanese did not get back to us on our questions on approvals and the pipeline, but at the Berne Union they have reported tightening since February 1986

My talks with the French Treasury did not get beyond the problem of the base, the Mexican disbursement numbers for 1985 are double what France says

While this information is impressionistic, it would imply--given normal lags--that disbursements would fall further in the second half of 1986 and could recover only slowly over 1987 A pattern such as the following might be reasonable for medium- and long-term public sector disbursements, abstracting from any impact of the Japanese special facility

1986	First half	US$350 million
1986	Second half	US$300 million
1987	First half	US$400 million
1987	Second half	US$500 million

This pattern would give the numbers for Scenario A in the attached table Scenario B, which I consider optimistic, assumes the pickup in disbursements is sufficiently rapid to bring the total for calendar 1987 back to the 1985 level The banks' numbers imply a 60 percent increase between the two 18-month periods They can cite no evidence of any pickup to date, so their case rests entirely on a hoped for future pickup in applications that will somehow produce a very rapid acceleration in disbursements (The banks also question the base numbers provided by the Mexicans, but those are the only numbers we have and do not seem inconsistent with what the agencies are saying)

Attachment

Mexico Official Bilateral Credits, Excluding CCC

(In millions of U S dollars)

	Jan 1985-June 1986	July 1986-December 1987		
		Scenario A	Scenario B	Banks
Export credits, excluding Japan special facility	1,450	1,200	1,450	2,300
Japan special facility	--	600	350	800
Total	1,450	1,800	1,800	3,100
Japan total	350	900 1/	700 1/	1,200
Other agencies	1,100	900	1,100	1,900
Total	1,450	1,800	1,800	3,100

1/ If Japanese operations, excluding facility, maintained the same ratio to lending of other creditors as in January 1985-June 1986 base period

ATTACHMENT

IMF OFFICIAL MESSAGE
WASHINGTON, D. C. 20431

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Mexico

START ADDRESS IN THE BOX

MR. WILLIAM RHODES
BANK ADVISORY COMMITTEE FOR MEXICO
SHEARMAN AND STERLING
153 EAST 53RD ST.
NEW YORK, NEW YORK

dispatched IMF
1986 Sep 9 PM
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CC: MD
DMD
MR. PERES/
MR. ORTIZ
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MR. BROWN

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YESTERDAY THE EXECUTIVE BOARD OF THE FUND CONSIDERED MEXICO'S REQUEST FOR AN 18-MONTH STAND-BY ARRANGEMENT FOR SDR 1.4 BILLION, WITH THE POSSIBILITY OF AUGMENTATION TO SDR 2.2 BILLION IN CONNECTION WITH THE OIL CONTINGENCY MECHANISM. THE EXECUTIVE BOARD APPROVED THE ARRANGEMENT SUBJECT TO A FINDING THAT COMMERCIAL BANK FINANCING, TOGETHER WITH PARTICIPATION FROM OFFICIAL SOURCES, WILL BE AVAILABLE IN THE AMOUNTS NECESSARY TO FINANCE THE PROGRAM. THE EXECUTIVE BOARD DECIDED THAT THIS FINDING SHOULD BE MADE NO LATER THAN SEPTEMBER 29, 1986, WHICH MEANS THAT FOR THE STAND-BY ARRANGEMENT TO ENTER INTO EFFECT WE WILL NEED TO BE INFORMED BY THAT DATE THAT THE CRITICAL MASS OF BANK FINANCING HAS BEEN ACHIEVED.

REGARDS,

J. DE LAROSIERE

INTERFUND

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INTERNATIONAL MONETARY FUND
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C TELEX NO.: 126698 WU CABLE ADDRESS:

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E AUTHORIZED BY NAME (TYPE): S. T. BEZA AUTHORIZED BY NAME (TYPE): J. DE LAROSIERE (**)

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Office Memorandum

Mexico

September 9, 1986

MEMORANDUM FOR FILES

Subject Mexico Statement to the Press

After the Board meeting on September 8, the Managing Director instructed us to read the following statement to the press, attributable to a Fund spokesman

"Today the Executive Board of the Fund considered Mexico's request for an 18-month stand-by arrangement for SDR 1.4 billion.

The Executive Board approved the arrangement subject to a determination that commercial bank financing, together with participation from other sources, will be available in the amounts necessary to finance the program. It is expected that the Executive Board decision will come into effect by September 29, 1986."

Hernan Puentes

cc Mr. Beza
Mr. Gardner
Mr. Hartmann o/r
Mr. Newman

IMF OFFICIAL MESSAGE

WASHINGTON, D. C. 20431

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Mr. Miguel Mancera, Director General
Banco de Mexico
Apartado Postal 98 Bis
5 de Mayo, No. 2
06059 Mexico, 1, D.F., Mexico

INTERNATIONAL MONETARY FUND
WESTERN HEMISPHERE DEPT.
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Executive Board took following decisions September 8: Quote

I. Stand-By Arrangement

1. The Government of Mexico has requested a stand-by arrangement for a period of eighteen months in an amount equivalent to SDR 1.4 billion, with the possibility of augmentation of SDR 2.2 billion.

2. Subject to paragraph 5 below, the Fund approves the stand-by arrangement set forth in EBS/86/161, Supplement 4.

3. The Fund waives the limitation in Article V, Section 3(b)(iii).

4. Purchases of amounts by which the amount of the arrangement is augmented will be regarded as compensation for export shortfalls of equivalent amounts in respect of the period of the arrangement under the Fund's policy on the Compensatory Financing of Export Fluctuations.

5. The stand-by arrangement set forth in EBS/86/161, Supplement 4, shall become effective on the date on which

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MEXICO - Page 2

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the Fund finds that satisfactory arrangements have been made with respect to the financing of the estimated balance of payments deficits for the period of the stand-by arrangement, but provided that such finding shall be made not later than September 29, 1986.

II. Multiple Currency Practice

Mexico retains a restrictive multiple currency practice as described in EBS/86/161, Sup. 1. The Fund encourages Mexico to remove this practice. In the meantime, and in light of the adoption by Mexico of comprehensive policies for balance of payments adjustment, the Fund approves the retention of this practice until December 31, 1986.

Unquote

Leo Van Houtven, Secretary

INTERFUND

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Statement by Mr. Jacques de Groote on
MEXICO
EBM/86/148, September 8, 1986

Mr. Chairman,

The quality of the information given by Mr. Ortiz and by the staff is well matched to the importance of the subject. It helps us cover, I would say convincingly, all aspects of a program which, for many reasons, will remain a landmark in the Fund's history. Convincing this Board that it is legitimate and proper to increase the Fund's exposure substantially, in a country that has failed so seriously to implement the previous program in which such strong hopes had been invested, was surely far from an easy task. Convincing the Mexican authorities that there was no alternative besides a Fund-supported solution, and showing them that they could count on several important innovations that might protect them against slippages beyond their control, has been a remarkable exercise in persuasion and creative imagination on your part and on the part of the staff, and we all know that Mr. Ortiz has brilliantly demonstrated, in this case, the dual nature of the function that is ours.

Three main reasons justify, in my view, our support for Mexico's request. First, it has been demonstrated, during the two first years of the program initiated on December 23, 1982, that the adoption of strong corrective measures can yield, in Mexico, the expected results. The dramatic turnaround in the current account and public sector deficits during those two years, accompanied by the simultaneous recovery of output and a sharp decline in inflation, amply show the resilience and responsiveness to adjustment policies of the Mexican economy. Though the present program includes many aspects of structural reform which were absent from the December 1982 program, the demand management measures now before us are of the same nature as those which led to remarkable results in 1983 and 1984. We can thus expect them to be effective again. Specifically, the reduction of the public sector deficit, at the level of the primary balance, by 3 percent of GDP, is of a magnitude which should produce, based on experience under the previous program, an important correction in the current account. On this point, I find it particularly welcome that this reduction of the public sector deficit will result from fiscal revenue increases, an approach which permits a small but much needed recovery in public investment after the drastic cuts it had to undergo under the previous program. The recent adjustments in public sector prices, which are the main source of additional revenue, are indeed large, but nevertheless might have to be followed by additional increases, since they represent in large part only a catching-up with the ongoing inflation.

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INTERNATIONAL MONETARY FUND
WESTERN HEMISPHERE DEPT.

The possibility of implementing the public finance aspects of this program will be reinforced by the use, I believe for the first time in the design of a Fund program, of the concept of operational balance for the non-financial public sector, and the concept of primary balance The use of these notions is particularly appropriate under inflationary conditions, as observed by Mr Ortiz and demonstrated in SM/86/53, the study we discussed in the Board on inflation and the measurement of fiscal deficits However, as Mr Tanzi noted in his basic study of the deficit experience in the industrial countries, published in 1985 by the American Enterprise Institute, a study whose sample of countries evidently does not include Mexico, we should not forget that the concepts used to adjust the deficit for the effect of inflation, as is the case for the primary balance, have their own shortcomings, just as do the more conventional measures, so that both need to be used jointly Indeed, even if it is true that a country with a high rate of inflation and a high domestic debt ratio does not need to adjust up to the magnitude of the deficit, because the reduction in the inflation rate will also reduce interest payments, a definition subtracting the effects of inflation on interest payments is still not equivalent to a situation with low inflation, because measures that were expected to be restrictive can themselves result in inflation We should use these important conclusions of our Fiscal Affairs Department as we very closely monitor Mexico's achievements in the area of public finance, under the alternative definitions available, especially with a view to determining the financing modalities of the public deficit

The second reason for confidence in the program is that it is based on a major structural reform of trade practices and of the government's involvement in the economy It therefore does address the principal weaknesses we had found in the previous program, which was too exclusively centered on demand management measures, though this was an understandable shortcoming given the paramount importance at that time of rapidly correcting the external situation in order to restore the country's capacity to meet its rescheduled debt obligations This time, a broad basis for sustained recovery is embodied in the program The experience we have had with similar policies in Turkey and several other countries allows us to expect that the trade liberalization measures will have a large effect on exports The decline in the economic role of the government and the measures envisaged to improve the efficiency of state enterprises are, on the other hand, decisive contributions to more efficient resource allocation, and they are the more significant in that they radically change what had come to be regarded as a traditional and untouchable characteristic of the Mexican economy the importance of the public sector in the production process The World Bank is to be congratulated for its successful role in the adoption and financing of these measures, and for having organized its action quickly enough for it to become an essential component of a Fund-Bank approach, jointly based on demand management and structural reform, in the true spirit of the Baker initiative

Third, the program's chances for success are considerably enhanced by the relationships established between the behavior of the price of oil, the performance targets, and the size of the Fund's financial assistance on the one hand, and between the rate of recovery of the economy and access to additional financing on the other hand. These relationships were essential in order to ensure that the program would not again derail due to price behavior outside Mexico's control, and also to ensure that there would be, without undue delay, a resumption of growth I am particularly happy that Mexico's importance in international banking relations has made it possible to put into practice an approach we have recommended for a long time I hope that Mexico's creditors might also consider a similar approach in the upcoming rescheduling exercise by accepting a deceleration of the reimbursements if the price of oil should fall further, a provision complemented by an acceleration of reimbursements if the price should increase above a certain level I was especially interested in the staff's justification for the oil and growth contingency mechanisms only the degree of Mexico's vulnerability to the unit price of its main export commodity, and the need to insure that adjustment would quickly lead to growth, are given as reasons for introducing these useful new mechanisms I presume we can therefore conclude that we should also favorably consider the adoption of such mechanisms in other cases, similarly vulnerable to export price fluctuations and to the risk that adjustment would not lead rapidly enough to growth I would have great difficulty in going along with these newly introduced mechanisms if they were regarded as only applicable to the Mexican case, since the arguments given in favor of their introduction are not specific to the Mexican case.

The only question I have on the working of these new mechanisms relates to the fact that the adjustment in the ceilings on the public sector's net use of foreign credit, on the PSBR, and on the operational balance of the non-financial public sector, by an amount of $500 million, is related to the 12-month rate of change in the index of manufacturing production ending in March 1987 Is a worse than expected performance of manufacturing production the only trigger we should retain for these mechanisms? Is it not possible to suppose that on the occasion of a program review, when we will have become more familiar with these mechanisms, a worse than expected performance of investment could also trigger an adjustment of those ceilings? If we admit the possibility, we will take better account of the forces on which the medium-term performance of the economy depends. I know that by taking this position, I differ with Mr Polak on the validity of this aspect of the contingency mechanisms Directing additional Fund financing, in circumstances of income decline, towards public investment, a sector which cannot benefit from increased funding under the constraints of the program and which remains crucial for sustained growth, seems fully in line with the purpose of a program aiming at adjustment through growth, as was stressed a moment ago by Mr Dallara I would simply like to see the behavior of total investment included for consideration as a possible trigger mechanism, though I admit that figures on this item may not be as readily available as figures on manufacturing production

Still on the question of our first use of these contingency mechanisms, I was most interested in a point raised this morning by Mr Nimatallah, when he wondered if we should not first have had a general discussion on the implications of these mechanisms I would certainly have welcomed this, having frequently asked that such an approach should be examined by the Board But I also know that new techniques are seldom accepted except under the pressure of events, a fact which, by the way, makes me extremely optimistic as to future allocations of SDRs, increases in Fund quotas, and the ultimate triumph of virtue The Mexican case has made possible what long discussions could not have accomplished Still, it might be useful to examine in the not too distant future the general aspects of this new mechanism, in the light of the experience the Mexican case will help us gather.

My conviction that the Mexican program can be achieved is matched by my belief that it can be achieved only if the agreed policies are strictly adhered to, and additional measures adopted without delay at the first sign of slippage The medium-term projections to the 1991 horizon assume an annual growth rate of the U S economy of 3 percent, an assumption which, though it is shared by the World Economic Outlook, few observers of the American scene would be ready to underwrite The expected substantial increase in real terms of the demand for financial assets is predicated on a decline of the inflation rate to 10 percent rate in 1991 Not only will this be hard to achieve, but after so many years of pronounced inflation, there is also no guarantee that households will perceive it as a sufficiently good motive for increasing financial savings to the desired level And even if they do, there will remain an important financing gap that is supposed to be covered by external resources, which implies continuing, though declining, recourse to financing by banks and multilateral official institutions, since neither any large increase in direct foreign investment nor any large reflow of private capital can be expected The difficulty Mexico is now experiencing in convincing the banks to fully assume their part in the financial package clearly shows that this continued dependence on bank financing will leave exceedingly small leeway for underperformance Finally, an annual increase by 4 percent in the price of crude through 1991 is an assumption which could just as easily be too high as too low, given the nature of that market It might therefore be prudent to admit already, now, the possibility that the contingency mechanisms will have to be strengthened if the price of oil fails to increase as expected, and conversely, that the process of adjustment will accelerate if the oil price behavior is more robust The successive reviews of the program should primarily be based on the examination of those possibilities, on which the whole concept of the program depends

More generally speaking, the case of Mexico might lead us to reconsider the problem of access limits, including cumulative limits Indeed, even without the oil contingency mechanisms, the total credit outstanding at the end of February 1988 will reach 335 percent of quota, and given the uncertainties of the situation after 1987, it seems probable that the Fund's involvement will have to be continued It does therefore seem important to protect the flexibility of the access limits, so that the Fund can remain in a position to play its catalytic role effectively.

Even if everything goes according to plan and schedule, per capita income can only be restored to 1980 levels in 1991 at soonest This fact, more than any other, shows how determined the Mexican authorities must be in implementing the program, how ready we must remain to reconsider the program in the light of circumstances, and how crucial is the contribution of the banks to the maintenance of the value of the funds they have already invested, sometimes too eagerly, in the economic future of Mexico Contrary to some highly counterproductive presentations given in the press, what is required of the banks is not an effort of stunning magnitude, since their exposure would increase only by just over 2 percent for the period 1985-1987 and by just over 3 percent for the whole period through 1991 Confirming today the Fund's confidence in the Mexican program should confort the banks and lead them rapidly to make a positive contribution of a magnitude commensurate with the responsibility they bear for Mexico's situation It should be well understood by the banks that if today, we can only agree in principle to Mexico's request, it is because our decision cannot materialize until the banks come up with their own share of the solution

Thank you, Mr Chairman

* * *

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MR. WERNER BLESSING
MEMBER OF THE BOARD OF MANAGING DIRECTORS
DEUTSCHE BANK AG
FRANKFURT, FEDERAL REPUBLIC OF GERMANY

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MR.PEREZ/
MR.ORTIZ
ETR
WHD
MR. BROWN

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THANK YOU FOR YOUR TELEX OF SEPTEMBER 2, 1986. I AGREE WITH YOU THAT IT IS OF CRUCIAL IMPORTANCE THAT THE BANKS BE CONVINCED ABOUT THE APPROPRIATENESS OF THE GOALS AND DESIGN OF MEXICO'S ECONOMIC PROGRAM AND UNDERSTAND THE BASIS OF THE EXTERNAL FINANCING OF THE PROGRAM.

FOR THESE REASONS, THE DEPUTY MANAGING DIRECTOR, THE STAFF OF THE FUND, AND I HAVE MET FREQUENTLY AND AT GREAT LENGTH WITH THE ECONOMIC SUBCOMMITTEE OF THE ADVISORY COMMITTEE TO PROVIDE THEM WITH THE INFORMATION THAT THEY HAVE REQUIRED TO ASSESS MEXICO'S PROGRAM AND FINANCING NEEDS. OUR AIM HAS BEEN TO BE OPEN AND COOPERATIVE WITH THE ECONOMIC SUBCOMMITTEE WITH A VIEW TO HELPING IT INFORM THE ADVISORY COMMITTEE AS FULLY AS POSSIBLE ON THE IMPORTANT ISSUES RAISED IN YOUR TELEX. WE HAVE BEEN CAREFULLY EXAMINING THE WORK AND JUDGEMENTS OF THE ECONOMIC SUBCOMMITTEE AND WE WILL BE RESPONDING SHORTLY TO THE COMMITTEE.

WITH MY BEST PERSONAL REGARDS,

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Mr. Wiesner

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Office Memorandum

/ Paris Club
WHD4W

INTERNATIONAL MONETARY FUND
WESTERN HEMISPHERE DEPT

1986 SEP -5 PM 4 59

TO The Deputy Managing Director (via ADM)

September 5, 1986

FROM C. David Finch

SUBJECT Staff Travel in Connection with Paris Club Meetings, September 15-19, 1986

We expect to receive shortly from the Chairman of the Paris Club an invitation for the staff to participate in the following meetings

Monday, September 15	Technical meeting on Mexico and Delegation Head's Dinner
Tuesday, September 16	Paris Club meeting on Mexico
Wednesday, September 17	Possible continuation of meeting on Mexico Tour d'horizon
Thursday, September 18	Paris Club meeting on Tanzania
Friday, September 19	Paris Club meeting on The Gambia

The area departments have proposed that Mr Pujol (WHD) and Mr Duran-Downing (ETR) attend the meeting on Mexico, that Mr Bhatia (AFD) attend the meeting on Tanzania, and that Mr Donovan (AFD) attend the meeting on The Gambia

You will recall that, as you have approved, Mr Keller of ETR will be attending these meetings along with Ms Dillon. Mr Keller is the new assistant chief of the External Finance Division, and it is intended that he will take over part of Ms Dillon's responsibilities with respect to the Paris Club It is proposed that Mr Keller attend the first four days as an observer, and he is not, therefore, listed on the attached Board notifications At Friday's meeting on The Gambia, Mr Keller would take over the role of the ETR representative and Ms Dillon would return to Washington These meetings would also be attended by a staff member from the Office in Europe

All of the travel in connection with these meetings has already been approved except Mr Donovan's travel to the meeting on The Gambia, which is requested herewith Ms Dillon's travel for a September Paris Club meeting and area department travel to a Paris Club meeting on Tanzania were approved in the six-month mission schedule Travel by Mr. Pujol and Mr Duran-Downing to the meetings in Brussels and Paris were approved by you on August 30 in response to my memorandum of August 27. Mr Keller's travel to these meetings en route from home leave was approved by you on July 23 in response to Mr Beveridge's memorandum of July 21

If you approve of these arrangements, the attached notifications regarding the Paris Club meetings on Mexico, Tanzania, and The Gambia would be issued to Executive Directors

Attachments

cc Managing Director
Mr Ouattara
Mr Wiesner
Office in Europe
Mr Brown

DRAFT

EBD/ /

To Members of the Executive Board

From The Secretary

Subject Mexico--Meeting on Debt Rescheduling

The Fund has received an invitation for the staff to attend a Paris Club meeting on the rescheduling of Mexico's external debt which is scheduled to take place on September 16, 1986 This invitation has been accepted and management has arranged for Mr Joaquin Pujol, Assistant Director, Western Hemisphere Department, Ms K Burke Dillon, Division Chief, Exchange and Trade Relations Department, Mr Luis Duran-Downing, Senior Economist, Exchange and Trade Relations Department, and a staff member from the Office in Europe to attend this meeting

Distribution

Department Heads

DRAFT

EBD/ /

To Members of the Executive Board

From The Secretary

Subject <u>Tanzania--Meeting on Debt Rescheduling</u>

The Fund has received an invitation for the staff to attend a Paris Club meeting on the rescheduling of Tanzania's external debt which is scheduled to take place on September 18, 1986 This invitation has been accepted and management has arranged for Mr Rattan Bhatia, Deputy Director, African Department, Ms K Burke Dillon, Division Chief, Exchange and Trade Relations Department, and a staff member from the Office in Europe to attend this meeting

Distribution

Department Heads

DRAFT

EBD/ /

To Members of the Executive Board

From The Secretary

Subject The Gambia--Meeting on Debt Rescheduling

The Fund has received an invitation for the staff to attend a Paris Club meeting on the rescheduling of The Gambia's external debt which is scheduled to take place on September 19, 1986 This invitation has been accepted and management has arranged for Mr Donal Donovan, Senior Economist, African Department, Mr Peter Keller, Assistant Division Chief, Exchange and Trade Relations Department, and a staff member from the Office in Europe to attend this meeting

Distribution

Department Heads

MR. WERNER BLESSING

MEMBER OF THE BOARD OF MANAGING DIRECTORS

DEUTSCHE BANK AG

FRANKFURT, FEDERAL REPUBLIC OF GERMANY

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WITH MY BEST PERSONAL REGARDS,

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INTERNATIONAL MONETARY FUND

September 5, 1986

Mr Caiola
Mr Guitian/Mr Hino

For your information

AB

Avinash Bhagwat

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

CC: Mr. Pujol

DATE September 5, 1986

TO Files S. H Choi

file

FROM S. H Choi, Adviser, SEC

EXTENSION 76441

SUBJECT **Proposed Attendance of Bank Staff at IMF Board Meeting**

Place of Meeting	:	IMF-12-120 (Fund Board Room)
Date of Meeting	:	Monday, September 8, 1986
Agenda Item		Mexico - 1986 Article IV Consultation and Request for Stand-By Arrangement (EBS/86/161)
Bank Staff Attending	:	Rainer B Steckhan (74621) Director Latin American Region

cc.: Regional Vice President - Mr A David Knox
IMF Secretary's Dept. - Mr Bhagwat
Vice President, OPS - Mr. Husain
Bank Representative - Mr. Steckhan

NOTE: For details in timing of this item, please contact Mrs. Dejean (Ext. 56682), IMF Secretary's Department

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September 5, 1986 - 86/172

Statement by Mr. Ortiz on Mexico
Executive Board Meeting/86/148
September 8, 1986

1. My authorities wish to express their appreciation to the staff for the competent and professional task performed--often under severe time pressure--in connection with the 1986 Article IV consultation and the request for a stand-by arrangement. They are also very appreciative of the management's imaginative and active involvement in the several stages of the setting of the financial arrangements contemplated under the program. In what follows, I will first comment briefly on the economic performance of Mexico during 1985. The second part deals with the significance of the oil shock, the response of the authorities, and some recent developments. My concluding comments will focus on the program for 1986-87 and the economic strategy for the medium term.

The problems of 1985

2. The year 1985 began on a note of moderate optimism due to the favorable results obtained with the application of the adjustment program of 1983-84, although the signs of weakening of the world economic activity and, particularly of the oil market, were worrisome. An additional cause for concern, was that the external surplus resulting from the implementation of the adjustment policies during the previous two years was achieved at a cost much higher than expected--in terms of foregone output and declining living standards. Inflationary pressures, although substantially abated from the peak of 1983, remained stubbornly high.

3. Partly due to the severity of the recession, the economy reacted with surprising vigor to the export (non-oil) and investment demand prompted by an expanding world trade in an improved business climate since mid-1984. The reactivation of public expenditures which took place in the last quarter of 1984 and the first quarter of 1985--albeit from a very low base--coincided with this period of robust private demand. The domestic banking system was initially able to finance the associated demand for credit from both the public and private sectors, since it had been accumulating excess reserves. However, renewed pessimism on the balance of payments outlook motivated by a negative flow of external financial credit during the first months of 1985 and the bleak prospects of the oil market, provoked private capital outflows and a reduction of savings channeled through the domestic financial system. In turn, this resulted in a higher expansion of primary credit from the Central Bank and a loss of international reserves.

4. The authorities reacted forcibly--if not swiftly--to the deteriorating trend of the international reserve position. In mid-1985 a comprehensive policy package including expenditure cuts (beyond those made earlier in the year in response to a first decline in oil prices, and including the cancellation of all public sector vacancies, a reduction in the number of employees and the elimination of 15 Under-Secretary posts),

as well as exchange and trade liberalization measures was implemented. A severe tightening of credit policies was introduced at a later stage. The September earthquakes aggravated an already difficult situation. In addition to the human dimension, the negative impact on public finances, inflation, and output was quite significant. The measures resulted in a reversal of the losses of international reserves, although the deviations in fiscal and monetary figures from the original targets could not be entirely corrected. The balance for the year was mixed: the economy grew at a slower rate than in 1984 (2.7 percent in 1985 vs. 3.7 percent in 1984); inflation was slightly higher (CPI increased 63.7 percent in 1985 vs. 59.2 percent in 1984). Employment was maintained and private investment grew at a vigorous pace (23 percent in real terms, including changes in inventories). The public sector borrowing requirements as a proportion of GDP increased from 8.6 percent in 1984 to 10.0 percent in 1985, reflecting much higher interest payments on domestic debt than those contemplated under the original budget and its subsequent revision. In turn, these payments resulted from the impact of an inflation rate which turned out to be much higher than forecast under the program. In fact, this effect explains about one third of the deviations of the fiscal target.

5. In sum, the deviations of the program's objectives observed in 1985 can be attributed to an unexpectedly strong reactivation of economic activity which became difficult to control in the midst of a deteriorating external environment. Lags in the availability of the relevant economic information hindered the implementation of more timely actions. But as evidenced by the strong corrective measures taken to prevent a significant setback, the deviations were not the result of a change in economic strategy motivated by political reasons as it sometimes has been claimed.

The oil shock and recent developments

6. Consistent with the aim of reinforcing the economic strategy drafted at the outset of the current administration, the 1986 budget presented to Congress had three main objectives: (a) to strengthen the fiscal position of the public sector with a view to reducing inflation and promoting economic efficiency; (b) to secure a wide social participation in the orderly implementation of the various tasks of reconstruction associated with the natural disasters; and (c) to accelerate the ongoing process of structural change and industrial reconversion, increasing the productivity of state enterprises.

7. In addition to the structural policies, the backbone of the adjustment process was to be a sharp reduction of the public sector deficit. Expenditures were scheduled according to a much tighter calendar from that implied by the historical seasonal pattern, and sizable inflows of foreign capital were planned for the beginning of the year. These measures, together with consistent monetary and exchange policies, were to be reflected in a

substantial slowdown of monetary aggregates and an abatement of inflationary pressures A slowdown of economic activity--but not an outright recession--was deemed an inevitable by-product of the anti-inflationary efforts

8 The beginning-1986 oil price shock forced a reconsideration of the economic program The first step was to evaluate the impact of the oil shock on both public finances and the balance of payments, and to assess--to the extent that this was possible--whether the shock could be considered transitory or of a more permanent nature This was no easy task given the rapidly changing conditions of the oil market and the uncertainty surrounding the evolution of petroleum prices even in the immediate future Compared with the figures corresponding to 1985, the loss of petroleum export earnings for 1986 is now estimated at approximately US$9 billion, or about 6 1/2 percent of GDP This is equivalent to more than 20 percent of all public sector receipts and to 39 percent of total exports To put these figures in perspective, in the context of domestic production, the oil shock is equivalent to the total agricultural production of the country, in terms of the budget, it exceeds the total wage bill of the Central Government plus the parastatal sector

9 Although the initial estimates of the revenue loss were not as large, after a few weeks it became evident that the magnitude of the shock was much greater than anticipated, and that the country could not possibly absorb it in the short term , Since it was not foreseen that market developments would lead to a recovery of previous revenue levels, it was considered essential to formulate a strategy for the medium term Meanwhile, given the fact that Mexico had received practically no external finance since late 1984, and that prospective negotiations with foreign creditors would take a long time, the protection of international reserves was considered essential To this end, the strict credit policy implemented at the end of 1985 consisting of a practical freeze of credit granted by the banking system--which was to be only of a temporary nature--has been continued during 1986 In addition, a flexible interest rate policy has resulted in positive domestic real rates of interest in spite of rising inflation At the same time, exchange rate policy has been very active, resulting in an estimated real effective depreciation of 34 percent during the first six months of the year On the budget side, expenditure cuts and reschedulings have resulted in a drop of 22 percent in real terms of the outlays of the Federal Government during the first semester of 1986, while non-oil fiscal revenue has increased 1 2 percent in real terms

10 What have been the results of these contention policies? On the external front, policy implementation has succeeded in limiting reserve losses <u>while maintaining punctual debt service payments to date with negative net financial inflows from abroad</u> 1/ This has been possible

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1/ During 1986, net payments on the principal of public and private debt in the order of US$1 7 billion dollars have been registered due to a rapid non-oil export growth, a reduction of imports and significant inflows of private capital Non-oil merchandise exports have increased 30 percent during the first semester of 1986, partially compensating for the drop of 57 2 percent of oil exports Total imports fell 9 6 percent during the same period, while those corresponding to the public sector dropped 29 percent Banco de México has purchased about US$1 3 billion in the free market, which has been almost continuously offered at the quoted exchange rate This explains the narrow margins existing between the controlled and free market rates during most of the year Of course, the domestic absorption of the oil shock has not been costless Industrial production during the first four months of the year has fallen 2 percent, while inventories have risen, indicating the possibility of a further, more pronounced drop Employment in the manufacturing sector has also shown signs of weakness in spite of the continued reduction of real wages Inflation has risen as a natural consequence of the depreciation of the exchange rate and other cost-related factors aggravated by the credit stringency During the first eight months of the year, the consumer price index increased 47 6 percent, compared with 30 1 percent for the corresponding period of 1985 In a sense, inflation is a mechanism that allows for the transfer of real resources abroad In view of these developments, the staff's appraisal (last paragraph of page 43, EBS/86/161, 7/23/86) that The actions taken (referring to the credit/exchange rate policy mix) have not been sufficient, however, to avert a sizable loss of international reserves and an acceleration of inflation, is somewhat perplexing If this is taken to be a normative statement in the sense that the authorities should have done more, a pertinent question would be to ask, in the context of a counterfactual exercise, what would have been the required output/real wage drop consistent with the maintenance of, for instance, end-1985 reserve and inflation levels?

<u>The program for 1986/87 and the medium-term strategy</u>

11 The fundamental objective of the economic program designed by the authorities (PAC) 1/ is the restoration of growth rates of the Mexican economy between 3 and 4 percent for 1987-88 in conditions of financial stability This objective should be achieved through a combination of structural policies and demand management measures on the domestic front, as well as adequate external financing The authorities envisage a substantial reduciton of resource transfers abroad in the context of co-responsibility and burden sharing on the part of Mexico's creditors Growth should be investment and export led Investment resources should become available both from an increased domestic saving effort of the public sector and a reduction of transfers abroad The greater resource availability should permit an easing of credit conditions to the private sector and a lowering of interest rates which, in turn, are expected to stimulate private investment The maintenance of an adequate exchange

1/ <u>Programa de Aliento y Crecimiento</u> This program was announced jointly by the Secretaries of Finance and Public Credit and of Programming and Budgeting in July rate policy, together with fundamental changes in commercial policy aimed at liberalizing foreign trade, ought to establish a favorable and more permanent environment for export growth The planned reduction of the public sector deficit, the alleviation of the tight financial situation of the economy, and an improved climate of expectations resulting from a more realistic perspective of the servicing of the external debt should contribute to abate inflationary pressures and propitiate an environment of financial stability In carrying through with this program, my authorities consider that it is essential to isolate the economy--at least on a temporary basis--from further shocks of the oil market Given the adjustment efforts already undertaken, it was important to ensure that the program would not be frustrated by additional negative developments on Mexico's most important export product In addition, given the priorities of the program, a mechanism was incorporated to facilitate economic reactivation if it had failed to materialize early in 1987 Thus the rationale for the oil and growth contingencies

12 The core of the demand management measures envisaged in the program is a reduction of 3 percentage points of GDP at the level of the primary balance As stated by this chair on several occasions in the past, inflation creates several distortions in the measurement of the public sector deficit, which hinders an appropriate evaluation of the progress made in the fiscal area and may result in the setting of unrealistic targets based on excessively optimistic assumptions about the future course of inflation This is the motivation for proposing the monitoring of the fiscal effort at the level of the primary balance The fiscal objectives are projected to be met mostly through revenue measures that include both, yields from a tax reform estimated to reach 1 3 percent of GDP, and adjustment in the prices and tariffs of public enterprises which should produce about 1 2 percentage points of GDP over a period of 18 months In addition, total expenditures will be cut in relation to GDP by 0 5 percent, although current expenditures will be reduced by a full percentage point to allow for an increase in investment of 0 5 percent Given the magnitude of past expenditure cuts and the urgent need to increase investment expenditures, it is the view of the authorities that the major thrust of the fiscal effort must come from the revenue side These measures will be accompanied by the continuation of monetary and credit policies designed to maximize the contribution of the fiscal impact on the attainment of the macroeconomic objectives Some recent adjustments in public sector prices (taken in July and August) are Gasoline (47 1 percent), diesel (38 6 percent), liquid gas (46 2 percent), railroads (55 percent freights and 60 percent passengers), airlines (50 percent), Mexico City metro (2,000 percent), telephones (15 percent), etc In addition, the prices of petroleum products will be periodically adjusted with a view to keeping them in line with international prices and, in general, the authorities intend to avoid the emergence of significant slippages of the real prices of goods and services provided by state enterprises

13 Structural policies constitute an essential element of the program Trade policy and the public sector are the two main areas encompassed by the authorities' medium term-oriented structural reform plans Regarding

trade policy, it is important to point out Mexico's decision to enter GATT and to participate in the new round of trade negotiations which are scheduled to begin shortly In addition, the IBRD Executive Board approved a Trade Policy loan for US$500 million which will support Mexico's effort to continue reducing quantitative restrictions, tariffs, and to eventually eliminate reference prices These actions underscore the authorities' decision to transmit a firm signal to investors and exporters that the opening of the Mexican economy to foreign trade will not be reversed This is not a riskless strategy, especially in view of the current state of the world protectionist environment and the extremely adverse evolution of the terms of trade (see Attachment 1) Nevertheless, the steps already taken have no precedent in Mexico's modern history Approximately 89 percent of the import tariff, accounting for about 65 percent of the value of imports, is now free from quantitative restrictions, compared with less than 20 percent in 1982 The range of import tariffs has been cut by over one half, and it is expected that by the end of 1988 the maximum tariff level will be in the order of 30 percent The combination of exchange rate and trade policies has already yielded tangible results, as evidenced by the dynamic performance of non-oil exports mentioned earlier Although total imports have fallen during the first five months of 1986, the value of temporary imports (import components to be incorporated in export goods) increased 42 percent

14 The structural reforms of the public sector are aimed at trimming the size of the Government and improving the efficiency of state enterprises As mentioned in the staff paper, public expenditures other than interest payments have declined by more than 10 percentage points of GDP since 1982, and they are expected to reach less than 25 percent of GDP in 1986 This has implied drastic cutbacks in both investment and current expenditures The share of public investment in GDP has fallen about 4 percentage points of GDP, a reduction of about 70 percent in real terms During the previous year, per capita public investment expenditures were below those levels registered in the 1975-79 period The wage bill of the public sector has dropped two percentage points of GDP, resulting in a steeper fall of real earnings of government employees in relation to the rest of the economy The share of value-added by the government has dropped from 9 3 percent of GDP in 1982 to 6 percent in 1985 If all public enterprises are considered, of every peso of value added produced in the Mexican economy in 1985, the public sector contributed only 22 cents while the private sector produced the remaining 78 cents These figures are in sharp contrast to others that have occasionally appeared in the press indicating almost opposite weights

15 The authorities have proceeded to improve the efficiency of public enterprises along three major lines desincorporación, the reduction of subsidies and industrial reconversion The policy of desincorporación includes the selling, merging, closing and/or transferring of public enterprises The number of public enterprises and agencies has been reduced from 1,155 at the beginning of the present Administration to less than 700 at present A major modification in the strategy followed thus far, designed to further this process, is the expected publication of a

list of strategic and/or priority entities to remain under state control Thus, in contrast to previous practice, the Government will define which entities will be kept, while the rest will be sold, merged, closed or transferred To date, the Government has divested from its interests on the automobile industry and from its holdings in hotels and restaurants Many other companies in the areas of textiles, porcelain tableware, electrical appliances, and conductors, etc , have been sold to the private sector The Government is also in the process of divesting its controlling interest on Mexico's largest airline The system of subsidies has been completely revised with a view to eliminating those benefiting high- and medium-income groups Government transfers to state enterprises, other than those related to debt service, have declined by 3 percentage points of GDP between 1982 and 1985--a reduction of 40 percent in real terms Subsidies granted through the national marketing board (CONASUPO) have been totally overhauled subsidies on most foodstuffs have been eliminated while those granted on the consumption of basic staples have been drastically cut CONASUPO's operating subsidy has been cut by 70 percent in real terms over the last four years The areas covered by the initiatives on industrial reconversion aimed at modernizing and improving the efficiency of the parastatal sector are steel, sugar, energy, fertilizers, shipbuilding, and railroads Actions taken include (steel) the Fundidora de Monterrey plant was closed and more than 6,000 workers lost their jobs In addition, measures to increase profitability in other enterprises have resulted in a decrease of 38 4 percent in real terms of transfers to this sector over the past 3 1/2 years, (sugar) two mills have been shut down and the rest are being totally overhauled, eliminating 2,500 administrative jobs in the holding company, (fertilizers) three low-yield plants have been closed and a fourth one is in the process of liquidation, (railroads) unprofitable passenger routes have been canceled and transfers have declined 82 percent, (oil) non-priority projects have been canceled, resulting in a cut of 40 percent in real terms of PEMEX budget since 1981, (electricity) more efficient use of installed capacity and higher energy prices to consumers have permitted a transfer reduction of 72 percent in real terms

16 An agreement on the restructuring of the Mexican public debt with commercial banks was reached in 1984, and the MYRA was formally concluded in 1985 The main objectives of debt management policy were spreading over time the maturities of the public debt, with a view to creating sufficient space for the normalization of Mexico's relations with its creditors, and reducing the cost of debt servicing At the time, based on a favorable balance of payments outlook, the various indicators that measure the country's debt service capacity were foreseen to improve substantially over time For instance, the public debt/export ratio was envisaged to decline about 70 percentage points from 1985 to 1990 These projections were formulated on the basis of what were then considered conservative assumptions on the evolution of export growth, oil prices, and the expansion of world trade and the domestic economy For example, the Mexican authorities' projections of the evolution of petroleum prices in the medium term were lower than those corresponding to the baseline scenario of the 1984 World Economic Outlook exercise In the event, the

balance of payments picture worsened considerably, and so did Mexico's prospects of obtaining 'spontaneous financing from the capital markets Even before the recent oil shock, the evolution of the terms of trade had been most unfavorable As seen in Attachment 1, in 1985 alone the net terms of trade effect was in the order of US$6 9 billion, after discounting the favorable impact of lower interest rates In view of these developments, the Mexican authorities have again approached official and commercial creditors seeking both financial support for the present program and more realistic terms and conditions for the servicing of the public debt in the medium term In the ongoing negotiations with commercial banks regarding their contribution to the financial package foreseen under the program, the Mexican authorities are seeking to arrange debt service payments in accordance with Mexico's capacity to pay in the context of continued adjustment efforts and sustained economic growth In the same spirit of the provisions incorporated in the Fund arrangement, my authorities are of the view that Mexico's debt service capacity is essentially related to the evolution of oil prices and interest rates They regard the clearing of the medium-term horizon of the debt situation as a necessary condition for the re-establishment of a favorable climate for investment, both by residents and foreigners, in physical as well as financial assets Mexico has officially requested a restructuring of certain obligations to the Paris Club creditors, the authorities are expected to meet with them on September 16th The monetary authorities of 16 countries and the commercial bank creditors of Mexico have agreed on a stand-by facility for US$1 6 billion in support of the countries' international reserves of which US$1 1 billion is to be provided by official sources On August 31st, US$850 million of the official portion was made available and drawn by the Mexican monetary authorities My authorities attach special significance to export-oriented foreign investment, and consider that the beneficial effects of the transfer of technology may even be more important than the balance of payments contribution As stated in the letter of intent, a significant number of projects with 100 percent foreign-owned capital have been approved over the last four years My authorities vigorously intend to streamline the administrative procedures for the approval of investment projects, particularly those leading to non-oil export promotion In the context of the foreign investment and debt management policies, the Mexican authorities have recently issued precise guidelines and procedures for the implementation of debt/equity swap operations

* * * * *

In his fourth State of the Nation Report, delivered on September 1, President Miguel de la Madrid stated

> In the next two years, we shall continue to be temperate in our habits, but we shall not be pessimistic in our attitudes Our austerity effort is continuing, but now it affords promising prospects of vitality and growth The consolidation of our reordering measures will guarantee continuity in the development process The new impetus given to the strategy of structural change will enable us to raise the overall productivity of our economy, lay the groundwork for a gradual improvement in social welfare levels, and open up the prospect of a more promising future

Attachment 1

Implicit Resource Transfer

Resulting from Terms of Trade Movements

(In billions of dollars)

	1982	1983	1984	1985	Jan -June 1986
Exports of goods and services					
at current prices	26 1	27 2	30 1	27 7	10 6
at 1980 prices	29 2	33 7	35 0	34 2	16 5
implicit transfer	3 1	6 5	4 9	6 5	5 9
Imports of goods and services					
at current prices	20 3	12 8	16 2	18 8	8 6
at 1980 prices	18 0	11 1	13 7	15 8	7 3
implicit transfer	2 3	1 7	2 5	3 0	1 3
Interest payments					
current payment	12 2	10 1	11 7	9 9	4 4
payments at 1980 interest rates	11 6	12 3	12 5	12 5	6 4
interest rate effect	0 6	-2 2	-0 8	-2 6	-2 0
Total terms of trade related resource transfer	6 0	5 0	6 6	6 9	5 2

Source Banco de México, based on newly available series on unit import and export prices

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Office Memorandum

INTERNATIONAL MONETARY FUND
WESTERN HEMISPHERE DEPT.

1986 SEP -5 PM 6:32

TO: The Managing Director

DATE: September 5, 1986

FROM: J.V. Surr JVS

SUBJECT: Mexico: Revisions Needed to Reflect Approval in Principle of Stand-by Arrangement

The attachment sets out the revisions that would be needed in the stand-by arrangement and the decisions proposed in EBS/86/161, Sup. 1, in order to approve the stand-by arrangement in principle.

These revisions could be circulated to Executive Directors on Monday morning before the Executive Board meets, or later when the Executive Board is in a position to act on the request.

Messrs. Gianviti, Beza and Beveridge have seen the draft revisions, which were developed in consultation with WHD and ETRD.

Attachment

cc: The Deputy Managing Director (2)
Mr. Gianviti
Mr. Finch
Mr. Wiesner
Mr. Habermeier
Mr. Beza
Mr. Beveridge
Mr. Brown (2)
Mr. Pujol
Mr. Silard
Mr. Duran-Downing

Paragraph 1 of the draft stand-by arrangement shall be changed to read as follows

1. For a period from its effective date until April 1, 1988, Mexico will have the right to make purchases from the Fund in an amount equivalent to SDR 1.4 billion, subject to augmentation as appropriate pursuant to paragraph 3 below, subject to paragraphs 2, 4, 5, 6, and 7 below, without further review by the Fund.

The following draft decisions are proposed for adoption by the Executive Board

I. Stand-by Arrangement

1. The Government of Mexico has requested a stand-by arrangement for a period of eighteen months in an amount equivalent to SDR 1.4 billion, with the possibility of augmentation to SDR 2.2 billion.

2. Subject to paragraph 5 below, the Fund approves the stand-by arrangement attached to EBS/86/161, Sup. 1, and Cor. 1, and Sup. 2.

3. The Fund waives the limitation in Article V, Section 3(b)(iii).

4. Purchases of amounts by which the amount of the arrangement is augmented will be regarded as compensation for export shortfalls of equivalent amounts in respect of the period of the arrangement under the Fund's policy on the Compensatory Financing of Export Fluctuations.

5. The stand-by arrangement set forth in EBS/86/161, Sup. 1, and Cor 1, and, Sup. 2, shall become effective on the date on which the Fund finds that satisfactory arrangements have been made with respect to the financing of the estimated balance of payments deficits for the period of the stand-by arrangement, but provided that such finding shall be made not later than September 29, 1986.

II. Multiple Currency Practice

Mexico retains a restrictive multiple currency practice as described in EBS/86/161, Sup. 1. The Fund encourages Mexico to remove this practice. In the meantime, and in light of the adoption by Mexico of comprehensive policies for balance of payments adjustment, the Fund approves the retention of this practice until December 31, 1986.

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Office Memorandum

September 5, 1986

CONFIDENTIAL

MEMORANDUM FOR FILES

SUBJECT: Export Credits to Mexico--German Response

I Received yesterday a phone call from Mr. Grosche responding to the Deputy Managing Director's question regarding possible volume of export credits to Mexico.

Mr. Grosche said that the staff's projections seemed, from the German perspective, to be somewhat on the optimistic side. He noted that Germany had been off cover for medium-term business in Mexico since February 1986; in the meantime, only short-term cover was being provided. If the Fund arrangement and the Paris Club agreement are both concluded and implemented successfully, Germany is likely to reopen for medium-term cover with, at least initially, a transactions limit of DM 20 million. Nevertheless, the actual volume of business during 1986-87 will be strongly affected by the long period off cover. For 1986 Germany will have approved almost no new medium- and long-term business and, although they remained open short-term, short-term business was down about 10 percent from 1985 levels. Overall, then, they consider the Fund numbers optimistic and the bank numbers to be "quite astray."

K Burke Dillon

K. Burke Dillon
Chief, External Finance Division
Exchange and Trade Relations Department

cc: Mr. Beza
Mr. Pujol
Mr. Duran-Downing

INTERNATIONAL MONETARY FUND
WESTERN HEMISPHERE DEPT.
1986 SEP -8 PM 12:47

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INTERNATIONAL MONETARY FUND
WASHINGTON, D.C. 20431

CABLE ADDRESS
INTERFUND

HP/pk
F-86/449

September 4, 1986

MEMORANDUM

To : Mr. Beza

From : Hélène Ploix HP

Subject: Mexico

My authorities confirm that no new development leads them to consider that the Fund's projections on Bilaterals and Suppliers should be modified.

INTERNATIONAL MONETARY FUND
WESTERN HEMISPHERE DEPT.
1986 SEP -5 AM 9:23

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INTERNATIONAL MONETARY FUND
WASHINGTON D C 20431

MANAGING DIRECTOR

CABLE ADDRESS
INTERFUND

September 3, 1986

Dear Mr Petricioli

Thank you for your very kind letter of August 7 which I deeply appreciated. I too am inclined to think that the negotiations between Mexico and the Fund have been fruitful and constructive.

I have been away for three weeks on vacation but I have followed very closely the discussions with the banks I have been trying to expedite them as much as I could although precious time has been lost. Now that agreement on the interim financing has been reached, it is essential that the banks move speedily to assemble the main financing package. You can be assured that I will do all I can to facilitate these negotiations.

As far as the Fund is concerned, we have planned to proceed with the Board discussion on September 8 in order to encourage the banks to complete their portion of the financing package as quickly as possible Please do not hesitate to call me at any time if you feel I could be of assistance

With my warmest personal regards,

Sincerely yours
Jacques de Larosière

J. de Larosière

Mr Gustavo Petricioli
Minister of Finance and Public Credit
Ministry of Finance and Public Credit
National Palace
Mexico 1, D.F , Mexico

Mexico 6

September 3, 1986

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With my warmest personal regards,

J. de Larosière

CC: MD
DMD
MR. PEREZ
MR. R. BROWN
WHD

Mr. Gustavo Petricioli
Minister of Finance and Public Credit
Ministry of Finance and Public Credit
National Palace
Mexico 1, D.F., Mexico

STBeza dz
9/3/86

SUBJECT COPY

Mr. Wiesner
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Office Memorandum

TO: The Managing Director

September 2, 1986

FROM: C. David Finch

SUBJECT: Mexico--Chairman's Opening Statement

The Legal Department has suggested a couple of modifications in the draft note sent to you on Friday, August 29. A revised version is attached.

Attachment

cc: The Deputy Managing Director
Mr. Habermeier
Mr. Hood
Mr. Gianviti
Mr. Wiesner/Mr. Beza
Mr. Brown

INTERNATIONAL MONETARY FUND
WESTERN HEMISPHERE DEPT.
1986 SEP -2 PM 2:51

Draft-September 2, 1986
scmex02

Statement by the Managing Director for
Board Meeting on Mexico

The financial support from the Fund and the international community to Mexico's adjustment effort has certain features tailored to the circumstances of the case One of these features--the contingency financing package to be provided by the Fund and other creditors in the event of a decline in crude oil prices below US$9 a barrel--deserves special attention Before today's discussion of Mexico, and tomorrow's discussion on access, it may be helpful if the rationale for this financing was described

The decline in crude oil prices, which contributed importantly to the extremely difficult balance of payments situation for Mexico, although halted at the time of the discussions, might still resume The Mexican authorities, aware of this possibility, stressed that such further decline could not be met by an immediate and equivalent domestic adjustment They therefore asked for recognition that a decline in the average price for Mexico's crude oil below a certain level--later agreed to be US$9 a barrel--should be accepted as creating a situation in which more financing would be needed They acknowledged, however, that this financing would have to be bounded and that it would be only to provide a breathing space during which the authorities would assess the depth and duration of the decline and undertake the necessary corrective action They also proposed that there be symmetry in the mechanism, and that a rise in oil prices above the then existing basic range would provide an opportunity to reduce their dependence on external financing That price was later set at US$14 a barrel

The concern of Mexico about the potential impact of a further sudden loss of exports is a concern that has long been recognized by the Fund In the compensatory financing facility the appropriateness of using international financing to cushion the impact of temporary declines in export earnings is reflected in universally applicable procedures One important issue was how to incorporate this principle in the complex financial arrangements in the particular case of Mexico, and also to ensure that a persistent fall in oil prices would be increasingly reflected in enhanced adjustment efforts Given that oil accounted for some two thirds of Mexican merchandise exports and that instability in the price of oil could undermine the credibility of the program, there was a clear need to establish special financing arrangements to show that provision had been made for contingent additional needs, if and as they materialized, as a result of the price falling below US$9 a barrel, and to make these special arrangements an integral part of the proposed program

To underpin that financing and ensure the participation of other creditors, a catalytic Fund component was seen as essential As Mexico was likely to have, with the current oil prices, a sizable export shortfall in prospect which might qualify it for a compensatory financing facility purchase for the maximum of SDR 968 million, it seemed a relatively modest innovation that an aggravation of the shortfall through a decline in oil prices to below US$9 a barrel would trigger Fund support of up to SDR 800 million under the stand-by arrangement in addition to the SDR 1 4 billion requested The understanding included acceptance by Mexico that any CF purchase falling within the period of the arrangement would be considered as part of, and not additional to, the SDR 800 million contingency and that any use of the contingency under the stand-by arrangement would reduce the amount of compensation that Mexico might request under the CFF in respect of the period of the arrangement

As explained in the papers before the Board, the program will be fully protected only for a period of nine months against a drop in Mexico's crude oil prices below US$9 a barrel, beyond that period adjustment would have to be intensified progressively to make up for the additional shortfall Moreover, the contingency mechanism itself involves a measure of symmetry, with reliance on external financing reduced pro tanto for the effect of any strengthening of oil prices that would take Mexico's oil export price above the baseline range, i e , above US$14 a barrel

The access of Mexico, including the maximum amount under the oil contingency, would exceed both the annual access limit of 90 percent of quota and the higher limit of 110 percent Nevertheless, the amount available (126 percent on an annual basis) would remain significantly below that notionally available under enlarged access and the CFF combined Consequently, I regard the proposed overall Fund financing to be consistent with existing policies and to involve an adaptation directly fitted to Mexico's special circumstances, including arrangements to augment the concerted financing to accompany the contribution of the Fund to the oil price contingency I would therefore expect that in other cases, particularly those not featuring such a mechanism for a concerted financing contingency, it would be more appropriate to operate under each facility separately in accordance with its own rules--as was just done for instance in the case of Ecuador Thus, enlarged access amounts would be directly and unambiguously related to the criteria governing access in individual cases, and the additional financial support to meet export weaknesses would come from the compensatory financing facility, directly set by its own rules, including inter alia the behavior of overall export earnings and the reversibility of the fluctuations

Thus, I regard the formula for the Mexican case as one tailored not only to the successive shocks to which the Mexican economy has been subjected in the recent past, but also to the special conditions underlying the support available from the international community to help Mexico in its efforts to recover from these shocks

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CC: MD
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MR. DALLARA
MR. P. PEREZ
ETR
MR. R. BROWN

AN: INTERNATIONAL MONETARY FUND,
WASHINGTON D.C.,
ATTN: MR. JACQUES DE LAROSIERE,
MANAGING DIRECTOR

DEAR SIR,

MEXICO'S PROGRAM OF GROWTH ORIENTED ADJUSTMENT AND
STRUCTURAL REFORM

MAY I RECALL THAT SOME WEEKS AGO AT THE ''PIERRE MEETING'' MEXICO'S MAJOR CREDITOR BANKS AND IN PARTICULAR THE MEMBERS OF THE BANK ADVISORY GROUP FOR MEXICO HAVE BEEN GIVEN TO UNDERSTAND THAT THE COUNTRY IS ABOUT TO IMPLEMENT A STRONG AND INNOVATIVE PROGRAM. WHILST DEUTSCHE BANK AND THE BANKS OF OUR CONSTITUENCY WOULD BE PREPARED TO SUPPORT A CASE IN LINE WITH THE BAKER INITIATIVE, THERE IS DEEP CONCERN ABOUT THE SPARSE FLOW OF ECONOMIC INFORMATION NEEDED TO EVALUATE IN A RESPONSIBLE WAY THE JUSTIFICATION, EXTENT AND POSSIBLE FORMS OF COMMERCIAL BANK CONTRIBUTIONS. CONCERNS REGARDING THE PROGRAM AND A FINANCIAL PACKAGE HAVE MEANWHILE BEEN AGGRAVATED BY RENEGOTIATION PROPOSALS RECENTLY SUBMITTED BY THE MEXICAN DELEGATION TO THE ADVISORY GROUP. AGAIN IN ORDER TO EVALUATE AS TO WHICH EXTENT SUCH PROPOSALS MIGHT BE REFLECTED IN THE OVERALL PACKAGE (CONTRIBUTIONS BY THE IMF, IBRD/IDB, CREDITOR GOVERNMENTS ETC.) IT APPEARS IMPERATIVE THAT THE BANKS BE CONVINCED AS TO THE GOALS AND CONSISTENCY OF BOTH THE PROGRAM AND MEXICO'S FINANCIAL REQUIREMENTS.

YOUR PERSONAL SUPPORT IN THE MULTILATERAL INSTITUTIONS' PROVIDING THE ADVISORY GROUP WITH THE NECESSARY ECONOMIC INFORMATION WILL BE GREATLY APPRECIATED. MAY I COUNT ON YOUR UNDERSTANDING THAT DEUTSCHE BANK WILL ONLY BE ABLE TO PRESENT THE PROGRAM AND A PACKAGE TO ITS CONSTITUENCY AND DISCUSS IT WITH THE AUTHORITIES AFTER HAVING SATISFIED ITSELF AS TO THE VIABILITY THEREOF.

WITH BEST PERSONAL REGARDS,
SINCERELY YOURS,

WERNER BLESSING
MEMBER OF THE BOARD OF MANAGING DIRECTORS
DEUTSCHE BANK AG, FRANKFURT
++++
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Mr. Sch

Mr. Wittek

Please prepare an answer indicating that we have provided all information to the economic subcommittee (which I have received in Washington). Our desire is that of maximum transparency and cooperation.

AN: INTERNATIONAL MONETARY FUND,
WASHINGTON D.C.,
ATTN: MR. JACQUES DE LAROSIERE,
MANAGING DIRECTOR

INCOMING CABLE/TELEX

DEAR SIR,

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WERNER BLESSING
MEMBER OF THE BOARD OF MANAGING DIRECTORS
DEUTSCHE BANK AG, FRANKFURT
++++
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