Mexico

(F)

INTERNATIONAL MONETARY FUND
WASHINGTON, D. C. 20431

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MSG. NO. 6 (For Cable Room use only)	DATE July 31, 1989	PAGE 1 OF 4

TO

NAME: Mr. Remi Gros
Head of Banking Department

AGENCY: Bank for International Settlements

CITY/COUNTRY: Basle, Switzerland

FACSIMILE TELEPHONE NO.: 41 (Country Code) 61 (City Code) 238597 (Number)

DISPATCHED IMF
1989 JUL 31 P 1:0

TEXT

Attached is the final version of Mr. Erb's message to Mr. Lamfalussy on the Mexican request for interim financing.

INTERNAL DISTRIBUTION

MD
DMD
Mrs. Filardo
WHD
Mr. H. Simpson

FROM

NAME: S. T. Beza

DEPT./DIV.: Western Hemisphere Department/Immediate Office

ROOM NO. 10-100	EXTENSION 8631	ACCOUNT CODE 0043

AUTHORIZED BY (TYPE) S. T. Beza

SIGNATURE [signature]

SEC-56, REV. 2
2-18-88

PREPARATION OF FACSIMILE MESSAGE

Messages prepared for facsimile transmission should be of an **urgent** nature, and generally not exceed 20 pages.

Facsimile number - including country and city codes - **must be provided** by originating office.

The cover sheet should be completed in full and signed by **authorized persons only.**

Messages should be prepared individually **in full** for each separate addressee.

Papers must be printed only on **one side** using standard 8½" x 11" or 8½" x 14" paper.

Paper should be **originals** or **very clear** copies. Do not use fluid or tape in making corrections. Small or lightly printed text may not be legible to recipient.

Pages should be numbered to indicate page number and total pages (for a ten page message, the cover page should be marked 1 of 10, the next pages, 2/10, 3/10 etc.).

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Clip, **do not staple,** the original set.

The duplicate set will be dispatch/time stamped, forwarded to the Correspondence Unit for distribution, and returned to the originating office.

MR. ALEXANDRE LAMFALUSSY
GENERAL MANAGER
BANK FOR INTERNATIONAL SETTLEMENTS
BASLE, SWITZERLAND

THE GOVERNMENT OF MEXICO AND THE BANK ADVISORY COMMITTEE FOR MEXICO HAVE REACHED AGREEMENT ON THE MAIN POINTS OF A MULTI-YEAR FINANCING PACKAGE AIMED AT HELPING MEXICO ATTAIN THE OBJECTIVES LAID OUT IN ITS MEDIUM-TERM ECONOMIC PROGRAM SUPPORTED BY A THREE YEAR EXTENDED ARRANGEMENT APPROVED BY THE FUND ON MAY 26, 1989 FOR A TOTAL OF SDR 2.8 BILLION. THIS ARRANGEMENT INCLUDES SET-ASIDES AND CONTEMPLATES A POSSIBLE AUGMENTATION OF THE ARRANGEMENT OF UP TO SDR 466 MILLION (40 PERCENT OF QUOTA) IN SUPPORT OF DEBT REDUCTION AND DEBT SERVICE REDUCTION OPERATIONS. FURTHERMORE, MEXICO ALREADY HAS MADE USE OF SDR 453 MILLION UNDER THE COMPENSATORY AND CONTINGENCY

FINANCING FACILITY FINANCIAL SUPPORT FOR MEXICO'S ECONOMIC PROGRAM ALSO WAS PROVIDED BY OFFICIAL CREDITORS IN THE FORM OF A PARIS CLUB DEBT RESTRUCTURING AGREEMENT ON MAY 30, 1989 AND BY THE WORLD BANK IN THE FORM OF THREE LOANS TOTALING US$1 5 BILLION APPROVED ON JUNE 13, 1989 AND DESIGNED TO PROMOTE STRUCTURAL REFORMS IN KEY AREAS OF THE ECONOMY

WE ARE VERY PLEASED ABOUT THE PROGRESS THAT HAS BEEN MADE IN THE PROVISION OF FINANCIAL SUPPORT FOR MEXICO'S ECONOMIC PROGRAM, UNDER WHICH THE AUTHORITIES ARE CONTINUING TO PURSUE A COURAGEOUS AND WIDE-RANGING EFFORT TO ENSURE MACROECONOMIC EQUILIBRIUM AND TO RESTRUCTURE THE ECONOMY IT SHOULD BE NOTED THAT MEXICO HAS BEEN PURSUING THESE EFFORTS FOR A NUMBER OF YEARS, WITH THE SUPPORT OF THE INTERNATIONAL MONETARY FUND AND WITH POSITIVE RESULTS FURTHERMORE, WHILE MEXICO'S EXTERNAL FINANCES HAVE BEEN UNDER CONSIDERABLE STRAIN IN RECENT YEARS, IT HAS CONTINUED TO SERVICE ALL OF ITS EXTERNAL DEBT A

SUCCESSFUL IMPLEMENTATION OF THE CURRENT PROGRAM WITH SATISFACTORY EXTERNAL FINANCING SHOULD HELP STRENGTHEN THE CONDITIONS FOR THE GROWTH OF INVESTMENT AND OUTPUT IN AN ENVIRONMENT OF LOW INFLATION AND EXTERNAL BALANCE

UNTIL THE FINANCING PACKAGE WITH THE COMMERCIAL BANKS IS CONCLUDED, HOWEVER, INTERIM FINANCING NEEDS TO BE ARRANGED TO ENABLE MEXICO TO COVER ITS LIQUIDITY REQUIREMENTS FUND MANAGEMENT, THEREFORE, STRONGLY SUPPORTS THE REQUEST OF THE MEXICAN AUTHORITIES FOR SUCH FINANCING TO HELP MAINTAIN THE COUNTRY'S WORKING BALANCES AT AN APPROPRIATE LEVEL MOREOVER, TO ASSURE THAT THE PROGRAM IS CARRIED OUT IN A CLIMATE OF CONFIDENCE, IT WOULD BE DESIRABLE TO HAVE THE BROADEST PARTICIPATION POSSIBLE IN THE INTERIM FINANCING

BEST REGARDS,

RICHARD D ERB

ACTING MANAGING DIRECTOR

INTERFUND

OUTGOING MESSAGE FOR ELECTRONIC COMMUNICATION

TEXTNAME: Gurria-Telex

PAGE 1 OF 1

Mexico

STB

F

WDIAL
.LA2DR
OINFO

-SUBJECT: DINNER MR. GURRIA AND MR. HUSAIN
-DRAFTED BY: RAINER B. STECKHAN, DIRECTOR, LA2 EXT: 38074
-AUTHORIZED BY: \
-CC: MESSRS. PINTO (EDS18) AND HUSAIN (LACVP); KASHIWAYA (CFSVP); BEZA (IMF)

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383 1762130 =
-LIC. JOSE ANGEL GURRIA TREVINO
-SUBSECRETARIO ASUNTOS FINANCIEROS INTERNACIONALES
-SECRETARIA DE HACIENDA Y CREDITO PUBLICO
-MEXICO, D.F., MEXICO
BT
WASHINGTON DC - 28-JUL-89
ADDRESSED TO LIC. JOSE ANGEL GURRIA TREVINO (SHCP).
THIS IS TO CONFIRM MR. HUSAIN'S INVITATION FOR A SMALL DINNER ON THURSDAY, AUGUST 3 AT 7 PM. COULD WE MEET BEFORE THAT, SAY AT 5 PM, THURSDAY, AUGUST 3 TO TALK?
BEST REGARDS, RAINER STECKHAN.

SIGNATURES:

READY FOR TRANSMISSION: ____________ (Inputter's Initials)

DRAFTED BY: Rainer B. Steckhan

AUTHORIZED BY: ____________

TRANSMITTED BY: SMC

DATE: 07/28/89

DELIVERY NOTICES RECEIVED? ____________

THE NEW YORK TIMES, July 31, 1989

Files

Mexico

How the Mexican Debt Pact Was Achieved

By PETER T. KILBORN

Special to The New York Times

WASHINGTON, July 30 — About noon on Friday, July 21, the Finance Minister of Mexico, Pedro Aspe, placed a call to the Treasury Department.

Mr. Aspe told Charles H. Dallara, an Assistant Secretary, that President Carlos Salinas de Gortari had set a deadline of two days later for resolving the country's dispute with its foreign banks.

Otherwise, Treasury officials report, Mr. Aspe said President Salinas would consider, in Mr. Aspe's words, "other courses of action."

Mr. Aspe's telephone call set the stage for a major departure in Bush Administration third world debt policy. It broke the pattern of interminable negotiations between Mexico and its American and foreign banks. And it forced a compromise on the most difficult issue, how much Mexico could retain of any windfall it might receive should oil prices rise sharply.

"He drew a line at Sunday night," a Treasury official said of Mr. Salinas, who was elected in December with barely 50 percent of the vote because of public unhappiness with an economy stifled by the nation's payments on $100 billion in foreign debt.

The President's suggestion of "other courses of action" might have been no more than a bargaining ploy. But in the seven-year history of the third world debt problem, such threats have sometimes presaged moratoriums on debt payments — a troubling matter for the banks and the Bush Administration.

Treasury officials said that even if the Mexicans were bluffing, they welcomed the call as a lever to force the banks to give up some ground. Many banks, facing significant losses and writedowns on their Mexican debt, wanted the Bush Administration to provide some additional taxpayer support, but the Treasury had ruled that out.

The Treasury also needed something to lend credibil-

Continued on Page D10

Three Days in July: How the Agreement on Mexico's Debt Was Achieved

Continued From First Business Page

ity to Secretary Nicholas F Brady s plan to help relieve developing countries of some of their $1 3 trillion debt burden His plan was now four months old and Mr Brady had nothing to show for it.

How much Mexico has really gained from the agreement that was reached on Sunday, July 23 and how much this first application of the Brady plan will ease its debt burden are open questions

But the deal that was fashioned under the chandeliers of the Treasury s just restored third floor conference room at least provided some tangible evidence of how the Brady plan might work.

Phone Calls Bring A Turning Point

The final march toward the Mexico accord began the previous weekend during the summit conference of the world s leading industrial democracies in Paris The Bush Administration officials had said earlier had hoped to sail into Paris with a Mexican debt accord in hand But when this did not happen a chagrined Mr Brady turned up the heat on the banks

Snacking on Kellogg s Cracklin Oat Bran cereal straight from the box in his second floor suite at the Intercontinental Hotel in Paris Mr Brady placed calls to the chairmen of some leading American banks

An aide who was present recalled He said It is unacceptable simply unacceptable for the President and other heads of state to be personally focusing on the Mexican debt situation while the bank chairmen are leaving this in the hands of 35 year old computer jockeys in the bank advisory committee

The advisory committee is a team of negotiators from 15 banks who represent the 450 to 500 American and foreign banks that hold $54 billion or about half the money the Government has borrowed from abroad

The recipient of one call was John S Reed the chairman of Citicorp which heads the advisory committee Citicorp whose $2 3 billion in loans to Mexico are second only to the Bank of America s $2 34 billion has taken a less hostile view of the Brady plan and third world lending than most banks. Mr Reed promptly called a meeting in New York for Sunday July 16 of the chairmen of the other banks on the committee

This proved a turning point. The most pressing issue then dividing the advisory committee negotiators and the Mexicans concerned a proposal the banks had made to step up or raise at their own discretion the interest they could charge on some of their loans to Mexico some years hence

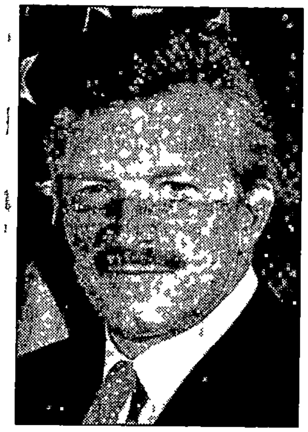
'Recapture' Plan Stymies Progress

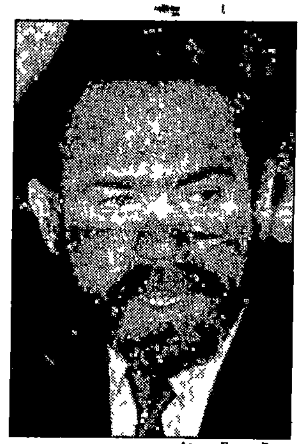
Under the Brady plan the banks had already agreed to accept a reduction in the interest rates on their Mexican loans from around 10 percent to 6 25 percent so making up some of that loss on future interest struck the banks as only fair

But the Mexicans had rejected the proposal in part because it took little account of the possibility that the Mexican economy might be even worse off in the future than it is now

Mr Reed and the other chairmen agreed to drop the step-up proposal a coup for the Mexicans. They left on the table a milder recapture provision to let the banks receive more interest if at some point Mexico started realizing significantly greater revenues from its exports of oil than it does now The Mexicans accepted the concept in principle so Mr Reed was able to get the discussions back on track early in the week of July 16

On Thursday four days later however with the bank chairmen back in





Agence France-Presse

David C Mulford left, Under Secretary of the Treasury for International Affairs is the actual architect of the Brady plan to help relieve developing countries of some of their $1 3 trillion debt burden Angel Gurria is the chief negotiator for the Mexican Government.

their offices and the negotiators at the table the talks struck another roadblock as the Mexicans studied the recapture proposal more closely They found that the banks were demanding much more interest much sooner than they could tolerate Neither side was willing to budge so the talks had struck yet another wall

Mexican Negotiator Recalled

At the end of the day President Salinas pulled his chief negotiator Angel Gurría back to Mexico City — a step that the banks and the Treasury considered ominous

It was the following noon on Friday, that Mr Dallara took the call from Mr Aspe Mr Brady had left for a brief respite in California and the Under Secretary for International Affairs David C Mulford the actual architect of the Brady plan was briefly out of his office

To discourage President Salinas s other courses of action they discussed convening a meeting with the banks at the Treasury the next day but no decision was made at that point, Treasury officials said

Mr Mulford and Mr Dallara then conferred by telephone with E Gerald Corrigan president of the Federal Reserve Bank of New York and determined that there might never be an agreement with Mexico or any other debtor country unless the Treasury and the Fed intervened and tried to alter the negotiating environment

Cyclical Pattern Of Difficult Issues

The talks kept crumbling officials explained because of two phenomena that were blocking progress

One was evidence that the banks and the Mexicans had become caught in a cycle of settling one issue after another but always finding new ones of diminishing importance to dispute as ferociously as they did the central issues

Well before the meeting in Washington the two biggest questions had been resolved These matters involved how much debt the banks would forgive Ultimately the negotiators had settled on giving the creditor banks a choice between rolling back interest rates or reducing the value of their loans by 35 percent

Two other important issues remained to be settled — the oil related recapture of interest and the matter of enhancements The latter concerned Mexico s desire for early disbursement of $7 billion in funds that the World Bank the International Monetary Fund and the Government of Japan had agreed to set aside in special escrow accounts to assure the banks that Mexico s renegotiated debts would be paid if the country reneged

Both the banks and the Mexicans were moving other questions onto the table too The challenge Mr Brady said in an interview with reporters came down to trying to stop the 11th most important point from coming up and then the 12th and determining instead when the essence of an accord had been reached

Interbank Bickering

There was one other potential complication — the possibility of the talks becoming derailed by bickering among chairmen of the banks and their negotiators The talks were complicated because what was being asked of the banks was unprecedented Mr Dallara said But inviting them all to the table might also have invited mayhem

So five bankers — Mr Reed and his top negotiator William R Rhodes A W Clausen chairman of Bank America and his negotiator Richard Bloom and Tony Spicijaric representing the Swiss Bank Corporation and all non American bank creditors — would be invited to the table at Treasury

Advisory committee members and other top bankers would gather at the seventh floor offices of the Bankers Association for Foreign Trade a few blocks away from the Treasury But the meeting itself was not yet certain

The Convergence On Washington

Late Friday however Mr Aspe called again reaching Mr Dallara at home in Falls Church Va Mr Dallara was on the phone to Mr Brady in California and a Treasury operator patched the three together

Officials said that Mr Aspe said to expect him and Mr Gurría in Washington by noon on Saturday The meeting was on

I think the implication of being so close to a deal and at the same time so far apart was that the deal could crater Mr Gurria said in an interview So there was a constructive effort on everybody s part — the banks the authorities obviously ourselves — to avoid that

Saturday morning July 22 around 10 Mr Corrigan arrived at the Treasury to meet with Mr Dallara and Mr Mulford and the chairman of the Federal Reserve Board Alan Greenspan joined them They appointed Mr Corrigan a man with a reputation as an honest broker as chairman

Mr Greenspan preferred to stay on the sidelines to meet privately with various negotiators

The Enhancements Issue

The American officials then met separately with the banks negotiators and in the early afternoon with the Mexicans At mid afternoon Saturday all 13 participants sat down together The first important issue was the matter of enhancements The banks wanted to be sure that public authorities — the I M F the World Bank the Government of Japan — would provide enough enhancement money to assure the payment of 24 months of interest if the Mexicans reneged on paying the debt on which the banks agreed to reduce their rates

It was impossible to determine whether the funds available would be sufficient because no one knows how much of the debt the banks will assign to interest reduction how much to principal reduction and how much to another option making new loans to Mexico

The negotiators agreed that if the enhancement money proved insufficient to support 18 months of debt payments the banks would be permitted to scale down the amount of debt to be forgiven

Complex Solution To Final Dispute

The recapture dispute came up next After a brisk debate it was resolved with a complex arrangement Starting on July 1 1996 if oil prices have risen significantly Mexico s oil exports are strong and other conditions are met banks that accepted the 6 25 percent interest rate on their loans can raise the rate — but not by much

The negotiators agreed that through their rate increases the banks could collect no more than 30 percent of the windfall Mexico would realize and that the banks could collect no more than 3 percent each year of the revenue they had relinquished in reducing their interest rate.

It is the latter provision the 3 percent clause that assures Mexico of holding on to most of an oil price windfall If for example sometime after 1996 the price of oil reaches $50 a barrel (it is now about $18), the 30 percent provision would allow the banks large rate increases But the 3 percent provision would hold the rates down and permit them to rise only very slowly

The date the recapture provision could start taking effect — 1996 — was much later than the banks wanted Mexico said a Mexican official close to the talks insisted on 1996 on the ground that the country deserved a seven year break to reap the benefits of an oil bonanza This gain he said would compensate for seven years of debt-crisis austerity Still, said an American banker If Mexico does particularly well we ll get some portion of that good fortune

An Atmosphere Full of Tensions

Dealing with the details and bickering over analyses of proposals by the negotiators teams of economists who were installed outside the conference room took the negotiators well into the night both Saturday and Sunday Tensions often rose

Mr Corrigan and Mr Gurría both heavy smokers found in their midst a third Saturday night Aspe lights up one participant said He said he had never smoked before

When the discussions at the Treasury Saturday ended after 1 A M the Mexicans returned to their rooms at the Watergate Hotel but for the bankers there was still more work

Bankers Explain Deal

Mr Reed Mr Clausen and Mr Spicijaric left to join their colleagues at the trade association and from there they called chairmen in the United States and abroad to explain the agreements

After still another day dealing mostly with secondary issues and leaving some unresolved Mr Brady shooed everyone out of his third floor office at 9 P M so a weary Mr Aspe could call Mr Salinas Mr Aspe who had had nothing to eat since the McDonald s Quarter Pounder that a Treasury aide had brought him at noon told the President he at last had a deal

As Mr Aspe and Mr Gurria left the Treasury Mr Aspe handed a pack of cigarettes and his lighter to his colleague He said he was quitting Mr Gurria said At midnight, Mr Salinas announced the accord on Mexican television

Participants in the Marathon Talks

Special to The New York Times

WASHINGTON July 30 — Thirteen men worked far into the night last weekend in the Treasury s third floor conference room to put together the Mexican debt accord

E Gerald Corrigan president of the Federal Reserve Bank of New York who served as chairman of the negotiations and was viewed as an honest broker

John S Reed chairman of Citicorp which leads the 15 bank Mexican Advisory Committee The committee in turn leads negotiations for 450 to 500 American and foreign banks that have made loans to Mexico Mr Reed is fluent in Spanish and more committed to continued lending to Mexico than most bankers

Pedro Aspe Mexico s Finance Minister an English speaking economist whom President Carlos Salinas de Gortari dispatches to negotiations to break deadlocks

Nicholas F Brady United States Treasury Secretary and author of the Administration debt plan that was at stake in the talks

Alan Greenspan Federal Reserve Board chairman He was present about half the time some times at the conference table sometimes meeting privately with participants in Mr Brady s office

David C Mulford Under Secretary of the Treasury for international affairs He infuriated some bankers by pushing them to join in the Brady plan and accept big losses

Charles H Dallara Assistant Secretary of the Treasury and Mr Mulford s top aide who has a softer touch than Mr Mulford He did the detail work in pulling the meeting together and served as the Treasury s note taker

Angel Gurria Mr Aspe s top negotiator who is fluent in English

Miguel Mancera head of the Central Bank of Mexico He assumed a secondary role to Mr Aspe and Mr Gurria

William R Rhodes of Citibank, head of the committee of creditor banks and as such the banks top negotiator since 1982

A W Clausen chairman of BankAmerica and former president of the World Bank His bank is the biggest lender to Mexico

Richard Bloom Mr Clausen s top negotiator

John S Reed, chairman of Citicorp, whose $2 3 billion in loans to Mexico is second only to the Bank of America's $2 34 billion

Tony Spicijaric, an emissary of the chairman of the Swiss Bank Corporation He represented the views of non American banks

THE NEW YORK TIMES, July 31, 1989

Mexico Sees Gains in Debt Accord

By LARRY ROHTER

Special to The New York Times

MEXICO CITY, July 30 — With a debt-reduction agreement in his pocket after seven months of difficult negotiations, President Carlos Salinas de Gortari is seeking to convince Mexican and foreign investors that the accord is not just another debt rescheduling but the start of a permanent economic recovery.

By itself, the $1.5 billion annual debt reduction, which fell far short of the ambitious goals Mr. Salinas had originally set, is unlikely to get Mexico's economy growing again. But Mr. Salinas's economic team is trying to use the accord to generate the confidence that would encourage the private sector, both foreign and domestic, to make up expected shortfalls of billions of dollars in Mexico's resources.

"The agreement is not exactly what the Government asked for, but it should be sufficient for the short-term objectives the Government has in mind," said Luis Pazos, a leading conservative economist here. "It is not in itself a solution to the problem, and the President knows that. But his hope is that it will create expectations so positive that money now abroad will return, which would in turn have a more positive effect than the negotiation of the debt itself."

Nestlé's Big Investment

There are already some signs of success from the effort. On Tuesday, the Nestlé Company announced that it would invest $300 million in Mexico in the next three years, a decision that company officials said was taken in June with the expectation that economic conditions here would soon improve after seven years of debt-induced austerity and recession.

"We, like other companies, have suffered the consequences of the economic crisis the country has lived through and the drop in purchasing power of the population," said Carlos Represas, president of the Nestlé group here. "But we feel Mexico has reached the end of the decade having carried out profound changes and structural transformations that open new perspectives of growth in the 1990's."

Mr. Represas said the new money would be funneled into expanding production, introducing new product lines and increasing exports to the United States, Central America and the Caribbean. He added that he was "sure more companies will follow suit" and that Nestlé's Mexican and foreign rivals here have "accelerated their own plans to do so" to remain competitive.

"Surfers say that when a wave is forming, it will pass you by unless your board is ready," he said. "We think this wave is going to grow, and that's why we've made the decision to get aboard it."

Officials think the agreement will raise confidence among investors.

In what the Government is calling another demonstration of confidence in Mr. Salinas and the agreement, 11 European banks announced this week that they would lend $210 million to a Mexican copper company that was once owned by the Government but is now in private hands. New foreign commercial bank loans to private companies have been virtually frozen since the debt crisis erupted in the summer of 1982.

Mexican stocks have also risen in the wake of the agreement, but the market is small and volatile. A more telling indication of the overall investor reaction has been the fall of interest rates on Mexican Treasury bonds. They have declined to 34 percent from 56 percent since the beginning of the month, with 12 points of that drop coming in Tuesday's auction.

A drop in domestic interest rates is crucial to the success of Mr. Salinas's program, not only as a gauge of public confidence but also in concrete terms. Mexico's internal debt has grown to more than $50 billion, and drains three times as much from the economy each year as repayment of foreign debt obligations.

Capital Outflows

Nevertheless, one diplomat said, "It takes more than a few swallows to make a spring." As much as $50 billion in capital is estimated to have fled the country since the economic crisis began, and continued doubts about the true benefits of the debt-reduction package could encourage Mexican investors to keep their money in banks and real estate in California and Texas.

The new agreement permits banks to choose among three options: a 35 percent reduction on the value of existing loans, a 6.25 percent interest-rate cap on those loans or lending new money. As a result, several months are expected to pass before it is clear just how much debt reduction Mexico has actually achieved. In the meantime, Mr. Salinas has to begin preparing next year's budget, uncertain of what the cash-flow situation will be and with every move being watched by skeptics.

"He's got some problems on the 1990 budget, since they need a minimal amount of new money," an American banker said. "If everyone goes for debt reduction, then you have to worry about the deal blowing up or being cut back. The distribution is very important."

Finance Minister's Estimate

On July 17, Finance Minister Pedro Aspe said the new accord would immediately reduce Mexico's net annual outflow of capital to 2.7 percent of gross domestic product from the current level of 6.3 percent, a calculation that implies that the vast majority of bank creditors will grant debt reduction instead of new loans. Even so, Mr. Aspe's estimate of the effect of the relief was viewed by many here as too optimistic.

"This agreement is not the last word on this theme," said Rogelio Ramírez de la O, a Mexican economist and the head of a consulting firm whose clients include many large companies. "In a year or two, Mexico will have to return and negotiate again. Two years ago, the banks rejected the principle of debt reduction, so who knows, in two years they may accept principles they will not accept today."

By raising expectations in his speech announcing the agreement a week ago, Mr. Salinas has encouraged demands that could lead to a new surge of inflation. Already, the labor unions and peasant groups that are important constituencies of his Institutional Revolutionary Party are clamoring for increases in social spending.

Modernization Program

Government officials, however, said Mr. Salinas would continue to move ahead with the economic modernization program that won Mexico its model-debtor status. A liberalization is said to be in the works for the rules governing the booming maquiladora industry, which assembles components brought into Mexico duty-free and then exports them at a reduced tariff rate back to the United States. And the process of cutting Government spending and selling state companies is expected to continue.

"To recover, we need confidence, and you gain confidence not only with a debt settlement but with good economic policies, good economic policies and more good economic policies," a senior Government official said. "We are certainly not going to change our approach now."

1. Mexico
2. IMF/IBRD

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FORM NO. 75
(6-83)

THE WORLD BANK/IFC

ROUTING SLIP	DATE: July 28, 1989

NAME	ROOM NO.
Messrs. Rao, Steers	
Bock, Flannery, Toft	
Ishrat Husain, Duval	
Loser, Bonvicini	IMF-10-100
Varallyay, van Wijnbergen Quijano/Dolenc	

	APPROPRIATE DISPOSITION		NOTE AND RETURN
	APPROVAL		NOTE AND SEND ON
	CLEARANCE		PER OUR CONVERSATION
	COMMENT		PER YOUR REQUEST
	FOR ACTION		PREPARE REPLY
	INFORMATION		RECOMMENDATION
	INITIAL		SIGNATURE
	NOTE AND FILE		**URGENT**

REMARKS:

Mr. Conable decided that a brief paper for the Board be prepared for Board discussion at the end of August. Mr. van Wijnbergen will have primary responsibility for drafting it but he will need your support.

FROM:	ROOM NO.:	EXTENSION:
Rainer B. Steckhan	I-8060	38074

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE July 26, 1989

TO Mr Barber B Conable

FROM S Shahid Husain

EXTENSION 39001

SUBJECT Mexico's Debt Negotiations

I An Outline of the Deal

1 Mexico and its creditors have agreed on a package offering all commercial creditors the choice of three options or a combination thereof

A Discount bonds, to be exchanged against existing debt at at 35% discount,
B Par bonds, exchanged at par but carrying 6 25% fixed interest rate,
C New money, at LIBOR+13/16, with a 7 year grace period and maturity of 15 years, the commitment should equal 25% of the amount brought under this option Disbursment will be 7% at effectiveness and 6% each in 1990,1991 and 1992

Banks have to provide all necessary waivers to make such transactions feasible

2 On the discount and par bonds, principal has to be fully secured, in addition to at least 18 months of interest coverage Banks holding loans contracted in the 83-88 period will reschedule them to 6 years grace/15 years maturity to the extent they are not swapped for par or discount bonds

3 Banks choosing the debt relief options I and II are eligible for recovering some of the money given up through a "recapture clause" Under this clause, beginning 1996 30% of the extra oil revenues Mexico gets if oil rises above $14 per barrel (to be adjusted for US inflation), will accrue to the banks that have granted debt service relief The final draft of the "draft term sheet" does not provide for a scaling back of this amount if less than all of the base debt is exchanged for par or discount bonds This amount is in no year to exceed 3% of the nominal value of the debt exchanged for these bonds at the time of the exchange (i e there is no indexation of this cap) In addition, banks participating in debt relief are eligible to participate in a debt/equity program of at most $1 bUS per year This program would involve public sector companies being privatized and qualified infrastructure projects

4 A bridge loan of up to $2 bUS may be provided by the US ($1 25 bUS) and other G-7 members ($0 75 bUS) to cover the period between now and January 1990 when the package becomes effective

5 In addition, a 10 year contingent facility conditional on unfavorable oil price developments is under consideration This could include $400 million CCFF money from the IMF and $300-$400 from a select group of major banks, Mr Stern has told the negotiators that the Bank would consider giving a non-accelerable guarantee for the loan beginning in the seventh year of that loan

II Enhancement

6 The banks want a total of $7 bUS to be provided up front in January 1990 to secure debt service and debt reduction instruments The sources are indicated in Table 1, and the likely timing of disbursments under current commitments These moneys are to be used for full collateralization of principal through purchase of zero coupon bonds, whatever is left of the $7 bUS after this is to be used for interest guarantees Discussions with the IBRD, IMF and Japan are envisaged to advance scheduled set asides to the extent possible Bridging facilities are to be worked out for those parts that cannot be advanced to January 1990

Table 1		Money available as of Jan 1990	Later	Total	+ Extra-	New Total
World Bank	Set Asides	0 375	0 375	0 750		0 750
	Interest G	0 950		0 950	0 300	1 250
IMF	Set Asides	0 352	0 704	1 050		1 050
	Interest G	0 600		0 600		0 600
Mexico (own reserves)		1 0		1 0	0 300	1 300
Japan	COF IMF	0 352*	0 650			1 0
	COF IBRD	0 450*	0 600			1 050
Total		4 1	2 3	6 4	0 600	7 000

Total Available for Debt Reduction only (IMF and Bank Set Asides) 1 8
Total Available for Debt Reduction and interest reduction 5 2

* As yet tentative

III Preliminary Evaluation

7 The purpose of the negotiations was, to provide Mexico with around $3 bUS financing per year on a medium term basis, either through debt relief or through new money committed ahead for a sufficient number of years With the package outlined above, Mexico's financing gap will in fact be almost covered by any of the three options open to the banks If only New Money is chosen, the financing gap is closed, but there will be no debt relief If only principal reduction would be chosen, there would be substantial debt relief (35% of $54 bUS, or $19 bUS), but lack of guarantee funds make this outcome infeasible The interest rate reduction provides less debt relief (at current interest rate projections 28%), but would reduce Mexico's exposure to future interest fluctuations On balance, with the proportions expected by the participants, the package seems to provide an acceptable deal, with some debt relief and enough financing if at least recent favorable developments in oil

prices and interest rates persist

8 Full use of the set asides for principal reduction requires that at least 20% is chosen as principal reduction In addition participants seem to expect that 60% will be brought under interest reduction, with the rest going towards new money In that case, total debt relief would be $13 bUS in present value, we estimate the value of the recapture clause in that case at $2 bUS, making for a NET debt relief under this scenario of about $11 bUS, or 20% of the amount under negotiation ($54 bUS) Interest savings would be about $1 bUS a year on average The enhancement amount of $7 bUS would however be too small (by $1 bUS) to provide full principal and 18 months interest coverage

9 20% debt relief is less than envisaged at an early stage of the negotiations It would however meet Mexico's financing needs as currently projected and is compatible with a gradual recovery of growth in Mexico during the current Sexenio Thus the stage for renewed growth in Mexico seems set, if at least the enhancement funds can be brought together in time

IV <u>Implications for the Board</u>

10 The Board has been informally briefed about the outcome of the negotiations We should provide the Board with a preliminary evaluation of the package at the earliest opportunity, but final details are not likely to be available before the end of August

11 The final term sheet is not likely to be available until October Then we should provide the board with a full evaluation of the package and ask Board authorization for

A Use of the existing set asides,

B Modification of the existing three "link loans" (SECALS for the steel, fertilizer, and agricultural sectors) to provide the remaining set asides from them, if the second tranche of set asides were to be US$375 million, we would have totally front-loaded the set asides in the first two years (FY89 and FY90)

C Additional resources for debt and debt service reduction for up to 20% of the approved lending program for the next three years This is 5% more than the Board recently approved in principle, something the Board said would be possible in exceptional cases only

D Waiving the Bank's negative pledge restrictions so that Mexico can be freed to put up collateral for the issue of the new debt instruments

E Providing guaranties covering the last three years of debt service on the Commercial Bank Contingency Financing Facility, if it becomes a reality

12 As a result of the additive and front-loading effects of the Bank's debt enhancements, our exposure in Mexico would rise from 8 8% of total lending outstanding and disbursed at the end of 1988 to 11 6% at the end of 1990

Maximum exposure of 11 8% would occur in 1992, before declinıng by 1997 to 10 0%

cc Mr E Stern, Mr A Karaosmanoglu, Mr K Kashiwaya
Mr M Qureshı O/R

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

IMF-10-100

INTERNATIONAL MONETARY FUND
WESTERN HEMISPHERE DEPT.

1989 JUL 31 PM 4 39

1. Mexico STB
2. Int/IBRD
3. Debt JB

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F

DATE: July 28, 1989

TO: Files

FROM: Rainer B. Steckhan, Director, LA2DR Steckhan

EXTENSION: 38074

SUBJECT: MEXICO - Debt Negotiations

After the agreement between Mexico and the commercial banks we are now entering into a very active and delicate period of contacts with commercial banks and other interested parties. I will chair a group consisting of Messrs. Flannery, Steers, Duvall and van Wijnbergen to coordinate contacts and to guide the Bank's contribution to the financial package. We shall keep our supervisors and members of the Debt Task Force briefed on developments. In my absence Mr. van Wijnbergen will chair the group. I expect every member of this group to keep a brief record of outside contacts on Mexico debt relief and copy it to other members.

cc: Mr. Husain
Messrs. Flannery, Steers, Duvall, van Wijnbergen
Ishrat Husain, Bock, Toft
Beza, Loser (IMF)
Quijano, Varallyay

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STB
CL

Mexico

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NUMERO DE DOCUMENTOS (INCLUYE HOJA DE CONTROL)	NUMERO DE TELEFONO FACSIMIL	FECHA
TRES HOJAS	95 (202) 623 7499	27 de julio de 1989

PARA:

SR. CLAUDIO LOSER
INTERFUND
WASHINGTON, D.C.

DE:

SR. ELIOT KALTER
INTERFUND
BANCC DE MEXICO
MEXICC, D.F.

INSTRUCCIONES ESPECIALES DEL SOLICITANTE

MUY URGENTE. POR FAVOR AVISAR EN CUANTO SEA TRANSMITIDO AL 518 31 12.

PARA USO EXCLUSIVO DE LA OFICINA DE TELECOMUNICACIONES

OBSERVACIONES DE LA TRANSMISION	RESPONSABLE DE LA TRANSMISION

DEPENDENCIA SOLICITANTE

NOMBRE	TELEFONO/EXTENSION	FIRMA AUTORIZADA
GERENCIA DE INVESTIGACION ECONOMICA INTERNACIONAL.- D-20	518 31 12	[signature]

July 26, 1989

Table Mexico: Fund Transactions

	Proposed Availability: Purchases Total	Proposed Availability: Purchases o/w set aside	Proposed Availability: Augment.	Utilization Scenario: Purchases Total	Utilization Scenario: Purchases o/w set aside	Utilization Scenario: Augment.	Repurchases
	(in millions of SDRs)						
Q 2 89	686.6	69.9	0.0	616.7	0.0	0.0	196.3
Q 3 89	233.1	69.9	0.0	163.2	0.0	0.0	140.9
Q 4 89	233.1	69.9	0.0	163.2	0.0	0.0	198.0
Q 1 90	233.1	69.9	466.2	652.7	489.5	466.2	169.0
Q 2 90	233.1	69.9	0.0	163.2	0.0	0.0	240.1
Q 3 90	233.1	69.9	0.0	163.2	0.0	0.0	193.5
Q 4 90	233.1	69.9	0.0	163.2	0.0	0.0	274.4
Q 1 91	233.1	69.9	0.0	442.9	279.7	0.0	199.7
Q 2 91	233.1	69.9	0.0	163.2	0.0	0.0	219.2
Q 3 91	233.1	69.9	0.0	163.2	0.0	0.0	188.2
Q 4 91	233.1	69.9	0.0	163.2	0.0	0.0	200.4
Q 1 92	233.1	69.9	0.0	233.1	69.9	0.0	141.3
Total	3,251	839	466	3,251	839	466	2,361
	(in millions of US$)						
Q 2 89	876.8	89.3	0.0	787.5	0.0	0.0	250.7
Q 3 89	296.0	88.8	0.0	207.2	0.0	0.0	179.0
Q 4 89	296.0	88.8	0.0	207.2	0.0	0.0	251.4
Q 1 90	296.0	88.8	592.1	828.9	621.7	592.1	214.7
Q 2 90	296.0	88.8	0.0	207.2	0.0	0.0	305.0
Q 3 90	296.0	88.8	0.0	207.2	0.0	0.0	245.7
Q 4 90	296.0	88.8	0.0	207.2	0.0	0.0	348.5
Q 1 91	296.0	88.8	0.0	562.5	355.2	0.0	253.6
Q 2 91	296.0	88.8	0.0	207.2	0.0	0.0	278.3
Q 3 91	296.0	88.8	0.0	207.2	0.0	0.0	239.0
Q 4 91	296.0	88.8	0.0	207.2	0.0	0.0	254.4
Q 1 92	296.0	88.8	0.0	296.0	88.8	0.0	179.4
Total	4,133	1,066	592	4,133	1,066	592	3,000

July 27, 1989

Claudio:

Please find attached a table summarizing the availability of Fund resources (1989-92) under the current EFF, compensatory facility and possible augmentation for debt service reduction purposes (first three columns). The table also presents an utilization scenario based on the assumption that the set-aside resources for a given year can be front loaded. Thus, assuming compliance with the performance criteria and presentation of a credible program for the year, Mexico would have access in Q 1 1990 to the set asides available with the Feb, May, Aug and Nov 1990 purchases, as well as those accumulated in 1989. In Q 1 1991, set asides associated with the Feb, May, Aug, and Nov 1991 purchases would be available. The augmentation is assumed to be granted in Q 1 1990.

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INTERNATIONAL MONETARY FUND
WASHINGTON, D.C. 20431

DEPUTY MANAGING DIRECTOR

CABLE ADDRESS
INTERFUND

July 27, 1989

MEMORANDUM

TO: Members of the Executive Board

FROM: The Acting Managing Director MBZ

SUBJECT: Mexico's Financing Package

The attached provides background for this afternoon's Informal Board meeting on the status of Mexico's financing package.

Att:

Mexico   Fund Operations Related to Purchases for Debt and Debt Service Reduction

1 The Extended Arrangement for Mexico, approved on May 26, 1989 (EBM/89/65), contemplates set-asides for SDR 839 16 million (equivalent to 30 percent of total available resources) with access of up to SDR 279 72 million in each of the three years of the arrangement In addition to the set-asides, the extended arrangement decision indicates that the Fund will be prepared to consider an augmentation of the arrangement by an amount up to the equivalent of 40 percent of Mexico's quota, to the extent that appropriate debt service reduction operations are part of the financing arrangements for Mexico and the Fund determines that such arrangements are consistent with the objectives of the program The expected schedule of purchases under the Extended Arrangement (including the availability of set-asides) is presented in Table 1

2 Based on the agreement between Mexico and representatives of the commercial banks, the Mexican authorities can be expected to request that Fund resources for enhancements to secure debt reduction and debt service reduction instruments be made available at an early stage Specifically, it is now projected that debt and debt service reduction operations would begin on January 1, 1990, and for this purpose Mexico is expected to seek advancement of all set-asides scheduled to become available through the end of 1990 and to request an augmentation of the arrangement by the equivalent of 40 percent of quota

3 Acceleration of all set-aside purchases scheduled through the end of 1990 would involve four set-aside purchases (each equivalent to 6 percent of quota), i e , the fourth purchase available within the first year of the arrangement (SDR 69 93 million), and the first three purchases available in the second year (SDR 209 79 million), as noted in Table 1 This would be in addition to the three set-aside purchases that would have accumulated by then 1/

4. If the course of action just described were followed, the use of set-aside resources in 1990 would no longer be dependent on observance of performance criteria for December 1989 through September 1990, and would give rise to use of Fund resources in the first program year in the amount of 98 percent of quota, the amount would be raised to 138 percent of quota with full augmentation (40 percent of quota) for debt service reduction

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1/ Existing provisions in the arrangement would make it possible to have a front loading of the set-asides within each annual segment under the arrangement (EBS/89/91, Supplement 1, 6/6/89, paragrah 2 (e)) It may be noted that the summing up on Fund involvement in the Debt Strategy (EBM/89/61) allowed for front loading of set-asides without specifying annual segments but made reference to the relationship of phasing to program performance

5 Because the bulk of the resources subject to accelerated use would have been expected to be released on the basis of an agreed economic program for 1990 and performance through September 1990, it would seem appropriate to take the steps feasible to ensure the continuation of satisfactory performance under the program before the release of any such set-asides For example, it would be desirable that a special review of progress under the program and of the policies and objectives for 1990 be undertaken in December 1989, before any release of the set-asides in question This review would be in addition to the review scheduled to be completed in February 1990 to reach policy understandings for 1990 and establish the quantitative performance criteria for that year

6. The staff is reviewing at present the features of the financing package Mexico has developed with representatives of the commercial banks in order to assess whether the resources made available for debt and debt service reduction would be used effectively A preliminary assessment on the basis of information available to date indicates that the terms of the package reflect prices in the secondary market for Mexico's debt and appear to make effective use of the enhancements that are in prospect, in other words, it would appear that the resources available for debt and debt service reduction produce relief that is consistent with the prices of Mexico's debt in the market Nonetheless, it will be necessary to analyze further the characteristics of the package once all of its provisions have been defined

7 It also will be necessary to examine the implications of the package for the overall balance of payments A preliminary assessment suggests an adequate but tight cash flow, provided that oil prices and external interest rates stay around present levels, which are more favorable for Mexico than was assumed in the baseline scenarios of the program. It would therefore seem desirable that Mexico arrange contingency financing with commercial banks (or at least reach understandings on how cash flow shortfalls would be dealt with) if oil prices or interest rates were to be less favorable than at present

8. There are a number of stages in the development of the financing package between Mexico and its commercial bank creditors The term sheet is expected to be ready in the course of the coming month, and this would provide a firmer basis for evaluating the financing package The issuance of the term sheet would be followed by a period in which the authorities and the advisory committee would be presenting the package to the community of banks In the last quarter of this year the banks would be choosing from the options available to them in the package, and at the end of this round the precise components of the package and their implications would be clarified with a view to bringing it to a conclusion by the end of 1989

9 Insofar as the work of the Fund is concerned, a staff mission already has initiated the discussions that will be the basis for the review to be completed before the next purchase under the arrangement

This review will take into account, to the extent possible, developments in the financing package As noted, a further review would seem advisable for December 1989 if there is to be an acceleration of set-asides and request for augmentation

10. The World Bank is considering proceeding along similar lines

Attachment

Table 1 Mexico Expected Schedule of Purchases Under Extended Arrangement 1/

(In millions of SDRs)

Availability Date	Total Purchases	Purchases Excluding Set-Asides	Set-Asides	Possible Advances of Set-Asides to January 1, 1990
First Year				
May 26, 1989	233 10	163 17 2/	69 93	—
August 31, 1989	233 10	163 17 3/	69 93	—
November 30, 1989	233 10	163 17	69 93	—
February 28, 1990	233 10	163 17	69 93	69 93
Second Year				
May 31, 1990	233 10	163 17	69 93	69 93
August 31, 1990	233 10	163 17	69 93	69 93
November 30, 1990	233 10	163 17	69 93	69 93
February 28, 1991	233 10	163 17	69 93	
Third Year				
May 31, 1991	233 10	163 17	69 93	
August 31, 1991	233 10	163 17	69 93	
November 30, 1991	233 10	163 17	69 93	
February 29, 1992	233 10	163 17	69 93	

Source Fund staff estimates

1/ Excluding possible augmentation of SDRs 466 million (40 percent of quota)
2/ Purchase effected in May 1989
3/ Purchase expected in September 1989

Mexico

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Office Memorandum

INTERNATIONAL MONETARY FUND
WESTERN HEMISPHERE DEPT.

1989 JUL 27 AM 10:51

TO: Mr. Beza DATE: July 27, 1989

FROM: Jacob A. Frenkel J.F

SUBJECT: Evaluation of the Mexican Agreement

As discussed, I attach a memorandum prepared by Mr. Dooley containing a preliminary evaluation of the Mexican Agreement. The bottom line is that the terms of the package are broadly consistent with market pricing.

Attachment

cc: Mr. Loser

Office Memorandum

TO Mr Frenkel DATE July 27, 1989

FROM M P Dooley mD

SUBJECT Value of Preliminary Term Sheet for Mexico

This is a complex preliminary agreement The main problem in valuing the proposed new bonds lies in assigning a value to the enhancements and to the recapture provisions An interesting feature of the problem is that in the event that real oil prices are very high in six years, the value of remaining funds for interest and all of the principal guarantees is likely to be low Conversely, if real oil prices are very low, the value of interest and principal enhancements will be relatively high Thus, we can not simply add the present values of the enhancements and the recapture provision in calculating the value of various menu items

A very rough first pass at evaluating the proposal follows

1 It is expected that between $40 and $50 billion of existing debt will be exchange for par or non-par new bonds If $40 is exchanged, the $7 billion in enhancements mentioned will be sufficient to guarantee principal and 24 months of interest If $50 billion is exchanged, the $7 billion will cover principal and 18 months interest For the following calculations we assume a $45 exchange implying principal plus 21 months interest

2 The recapture clause kicks in in 1996 If $45 billion in debt is exchanged, the maximum extra payment starting in 1996 would be 3 percent of $45, or $1 35 billion But this is unlikely for two reasons

First, oil prices would have to rise sufficiently to generate $4 5 billion in additional oil revenue for Mexico (measured in 1989 dollars) from a current base of about $6 5 billion This would suggest a real price increase of about 50 percent in six years If prices are about as likely to fall as to rise in real terms, and if we take the 50 percent increase as a maximum, we might guess that the "average" value of the additional payments in six years to be 0 25 of $1 35, or about $0 33 billion This extra payment would start after six years and last another 24 years The present value of the recapture would thus be about $1 7 billion

But in this case, it is also likely that Mexico would be in a strong position to make contractual interest and principal payments which means that remaining funds in the interest support fund and all the principal support would have little additional value to the banks

Remember, in valuing the $7 billion put aside for interest and principal support, the creditor may expect to get some part of the present value of this $7 billion rather than the whole amount It seems very unlikely that the bank would expect to get <u>both</u> the full present value of the $7 billion and the $1 7 billion present value of the recapture clause Not to put too fine a point on it, we split the difference and say the package of enhancements and the recapture provision might have a present value of $8 billion With this in hand, the implicit market price at which the new Mexican risk is priced can be found The banks are asked to give up old debt with a market value of

$45 billion * P

where P is the market price

The banks in return receive either par or non-par bonds with a contractual value of 65 percent of the $45 billion they surrender Thus, any combination of a 35 percent discount of face value (at LIBOR + 13/16) or no discount with 6¼ interest will yield a new contractual value of $29 25 billion The banks, therefore, receive

$29 25 P + $8 0 billion

The implicit market price of Mexican risk is about $0 50 which compares closely with the current market price of $0 45

cc Mr Goldstein

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INTERNATIONAL MONETARY FUND
WASHINGTON, D. C. 20431

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Mexico

MSG. NO. (For Cable Room use only)	DATE July 27, 1989	PAGE 1 OF 4

TO

NAME: Mr. Remi Gros
Head of Banking Department

AGENCY: Bank for International Settlements

CITY/COUNTRY: Basle, Switzerland

FACSIMILE TELEPHONE NO.: 41 (Country Code) 61 (City Code) 238507 (Number)

TEXT

Attached is a draft of the communication from the management of the Fund in support of Mexico's request for interim financing. Please contact me on this as soon as convenient: telephone (202) 623-8631 or fax (202) 623-7499.

INTERNAL DISTRIBUTION

FROM

NAME: S. T. Beza

DEPT./DIV.: Western Hemisphere Department/Immediate Office

ROOM NO. 10-100	EXTENSION 8631	ACCOUNT CODE 0043
AUTHORIZED BY *(TYPE)* S. T. Beza	SIGNATURE [signature]	

SEC-56, REV. 2
2-18-88

A FEW DAYS AGO THE GOVERNMENT OF MEXICO AND THF BANK ADVISORY COMMITTEE FOR MFXICO REACHED AGREFMENT ON THF MAIN POINTS OF A MULTI-YEAR FINANCING PACKAGE AIMED AT HELPING MEXICO ATTAIN THE OBJECTIVFS LAID OUT IN ITS MEDIUM-TERM ECONOMIC PROGRAM SUPPORTED BY A THREE YEAR FXTENDFD ARRANGFMENT APPROVFD BY THE FUND ON MAY 26, 1989 FOR A TOTAL OF SDR 2.8 BILLION WHICH INCLUDFS SET-ASIDES AND CONTEMPLATES A POSSIBLE AUGMENTATION OF THE ARRANGEMENT OF UP TO SDR 466 MILLION (40 PERCENT OF QUOTA) IN SUPPORT OF DEBT REDUCTION AND DFBT SERVICF REDUCTION OPERATIONS. FURTHERMORE, MEXICO ALREADY HAS MADE USE OF SDR 453 MILLION UNDER THE COMPENSATORY AND CONTINGENCY FINANCING FACILITY. FINANCIAL SUPPORT FOR MEXICO'S FCONOMIC PROGRAM ALSO WAS PROVIDED BY OFFICIAL CRFDITORS IN THF FORM OF A PARIS CLUB DEBT RESTRUCTURING AGREEMENT ON MAY 30, 1989 AND BY THE WORLD BANK IN THE FORM OF THREF LOANS TOTALING US$1.5 BILLION APPROVFD ON JUNF 13, 1989 AND DESIGNED TO PROMOTE STRUCTURAL REFORMS IN KFY AREAS OF

J.BONVICINI 8482 WHD 7.27 89

RICHARD D. ERB

THE ECONOMY.

WE ARE VERY PLEASED ABOUT THE PROGRESS THAT HAS BEEN MADE IN THE PROVISION OF FINANCIAL SUPPORT FOR MEXICO'S ECONOMIC PROGRAM, UNDER WHICH THE AUTHORITIES ARE CONTINUING TO PURSUE A COURAGEOUS AND WIDE-RANGING EFFORT TO ENSURE MACROECONOMIC EQUILIBRIUM AND TO RESTRUCTURE THE ECONOMY. IT SHOULD BE NOTED THAT MEXICO HAS BEEN PURSUING THESE EFFORTS FOR A NUMBER OF YEARS, WITH THE SUPPORT OF THE INTERNATIONAL MONETARY FUND AND WITH POSITIVE RESULTS. FURTHERMORE, WHILE MEXICO'S EXTERNAL FINANCES HAVE BEEN UNDER CONSIDERABLE STRAIN IN RECENT YEARS, IT HAS CONTINUED TO SERVICE ALL OF ITS EXTERNAL DEBT. A SUCCESSFUL IMPLEMENTATION OF THE CURRENT PROGRAM WITH SATISFACTORY EXTERNAL FINANCING SHOULD HELP STRENGTHEN THE CONDITIONS FOR THE GROWTH OF INVESTMENT AND OUTPUT IN AN ENVIRONMENT OF LOW INFLATION AND EXTERNAL BALANCE.

UNTIL THE FINANCING PACKAGE WITH THE COMMERCIAL BANKS IS CONCLUDED, HOWEVER, INTERIM FINANCING NEEDS TO BE

J BONVICINI 8482 WHD 7.27 89

RICHARD D. ERB

ARRANGED TO ENABLE MEXICO TO COVER ITS LIQUIDITY REQUIREMENTS. FUND MANAGEMENT, THEREFORE, STRONGLY SUPPORTS THE REQUEST OF THE MEXICAN AUTHORITIES FOR SUCH FINANCING TO HELP MAINTAIN THE COUNTRY'S WORKING BALANCES AT AN APPROPRIATE LEVEL. MOREOVER, TO ASSURE THAT THE PROGRAM IS CARRIED OUT IN A CLIMATE OF CONFIDENCE, IT WOULD BE DESIRABLE TO HAVE THE BROADEST PARTICIPATION POSSIBLE IN THE INTERIM FINANCING.

WE HAVE CONSULTED WITH WORLD BANK MANAGEMENT ON THIS MATTER, AND THEY AGREE FULLY ON THE IMPORTANCE OF ASSURING A STEADY FLOW OF FINANCING TO SUPPORT THE ORDERLY DEVELOPMENT OF MEXICO'S ECONOMIC PROGRAM

BEST REGARDS,

RICHARD D ERB

ACTING MANAGING DIRECTOR

INTERFUND

**

STB
CL
JB

Mexico

Formulario No. B[illegible]F01

BANCO DE MEXICO AV. 5 DE MAYO NO. 2 MEXICO, D.F. CODIGO POSTAL 06059	IO F	FOLIO **16984** NUMERO TELEFACSIMIL GRUPO 2/3 5129990

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NUMERO DE DOCUMENTOS (INCLUIR HOJA DE CONTROL)	NUMERO DE TELEFONO FACSIMIL	FECHA
SEIS HOJAS	95 (202) 623 7499	26 julio de 1989

PARA:
SR. CLAUDIO LOSER
INTERFUND
WASHINGTON, D.C.

DE:
ELIOT KALTER
INTERFUND
BANCO DE MEXICO
MEXICO, D.F.

JUL 27 '89 ... MEXICO
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INSTRUCCIONES ESPECIALES DEL SOLICITANTE

MUY URGENTE. POR FAVOR AVISARNOS AL 518 31 12 EN CUNTO SE HAYA HECHO LA TRANSMISION.

PARA USO EXCLUSIVO DE LA OFICINA DE TELECOMUNICACIONES

OBSERVACIONES DE LA TRANSMISION	RESPONSABLE DE LA TRANSMISION

DEPENDENCIA SOLICITANTE

NOMBRE	TELEFONO/EXTENSION	FIRMA AUTORIZADA
GERENCIA DE INVESTIGACION ECONOMICA INTERNACIONAL.- D-20	518 31 12 761 84 88 Ext. 4040	[signature]

July 26, 1989

Claudio:

Please find attached revised cash flow and balance of payments scenarios based on the additional information you provided to us this morning on the commercial bank financing package. The tables are organized as follows:

Table 1 summarizes the parameters used in the calculations. Please note that the Mexican banks, holding reported claims of some US$5 billion, are assumed to be in a position to pursue the new money route, along with foreign commercial banks holding 20 percent of the residual eligible claims (i.e., US$49.5 billion).

Table 2 presents the gross and net cash flow relief provided by the package. It is assumed that the gross cash flow relief provided by the debt and debt service reduction operations are back-dated to July 1, 1989. The analysis covers only the direct first round effects (viz. no account is taken of the second round savings due to lower borrowings than assumed in the original BOP), and assumes that the interest earned on the interest collateralization account accrues to Mexico.

In **table 3**, we have reproduced the baseline program BOP, adjusting for higher petroleum prices (US$15 a barrel) and lower international interest rates (9.5 percent). The program reserve target is maintained, with capital flow from the commercial banks treated as the residual. As a result, the net commercial bank financing amounts to an annual average of US$2.4 billion (1989-92), compared with US$4.3 billion in the program. You will note that the BOP does not incorporate information concerning recent developments and revised prospects, but rather maintains the program as the reference point--the table left with you on Monday was an initial attempt to include available information on first quarter developments and treated reserves as the residual.

Table 4 incorporates the impact of the commercial bank financing package (first and second round effects), treating net international reserves as the residual. No account has been taken of the potential bridge loan and the associated financing costs. The results should be interpreted with caution as we expect that information made available to us over the next few days will lead to revisions in some of the BOP components.

Table1 Mexico: Parameters
for Analysis

July 26, 1989

Parameters

Total eligible debt (US$bn)		54.5
Foreign commercial banks		49.5
Mexican banks		5.0
Assumed distribution of restr. operations (base of US$ 49.5 bn)		
New money		0.20
Debt reduction		0.20
Debt service reduction		0.60
New money package		
increase in exposure (in percent)	1989	7.0
	1990	6.0
	1991	6.0
	1992	6.0
Eligible debt (US$bn)	For. bks	9.9
	Mex. bks	5.0
Interest rate (in percent)		10.0
Debt and debt service reduction operations		
Eligible debt		39.6
Maturity of bonds (yrs)		30.0
US bond rate (percent)		8.3
Interest on Mex. claims (in percent)		10.0
Coupon on fixed int. bond (in percent)		6.25
Creditors discount rate (in percent)		9.0
Costs of funds (in percent)		9.25
Rate of return on escrow (in percent)		8.25
Exchange (debt red.)		35.0
Cost of principal coll. (per US$)		0.091
Cost of 18 mths int coll. (per US$)		
at 10 percent		0.146
at 6.25 percent		0.091
Debt offered for debt reduction		9.9
Debt offered for debt service reduction		29.7
Check: Debt Stock		0.0

Table 2 Mexico. Cash Flow Impact
of Proposed Package
(In billions of US dollars)

SCENARIO 1A. Debt Operations made retroactive to July 1, 1989 (Relief only)
costs effective Jan 1, 1990

July 26, 1989	1989	1990	1991	1992
Gross Cash Flow	1.77	2.35	2.35	2.35
New money	1.04	0.89	0.89	0.89
Foreign banks	0.69	0.59	0.59	0.59
Mexican Banks	0.35	0.30	0.30	0.30
Debt Service Savings	0.73	1.46	1.46	1.46
Debt reduction	0.17	0.35	0.35	0.35
Debt service reduction	0.56	1.11	1.11	1.11
Enhanc. costs (cash flow) *	0.00	0.34	0.34	0.34
New money **	0.00	0.00	0.00	0.00
Debt operations ***	0.00	0.34	0.34	0.34
Debt reduction	0.00	0.06	0.06	0.06
Principal component	0.00	0.05	0.05	0.05
Interest component	0.00	0.01	0.01	0.01
Debt Service Reduction	0.00	0.28	0.28	0.28
Principal component	0.00	0.25	0.25	0.25
Interest component	0.00	0.03	0.03	0.03
Net Cash Flow	1.77	2.01	2.01	2.01
Memorandum item				
Phasing of debt opers (annl csts)	0.0	1.0		
Debt reduction	0.0	1.0		
Debt Service Reduction	0.0	1.0		
Phasing of debt opers (annl rlf)	0.5	1.0		
Debt reduction	0.5	1.0		
Debt Service Reduction	0.5	1.0		

* First round effects.

** Assumes new money facility carries same spread as old debt.

*** Assumes interest on funds for interest guarantee accrues to Mexico.

26-Jul-89

Table 3. Mexico: Balance of Payments (Base scenario; oil $15 and interest rate of 9.5%; commercial banks as residual)

updated 7-26-89

In US$ millions	Est. 1988	1989	1990	1991	1992
Current account	-2777.3	-2900.0	-2420.0	-2830.0	-3340.0
Merchandise trade	4080.1	5700.0	5790.0	5480.0	5070.0
Exports	22983.4	26460.0	28170.0	30050.0	32320.0
Petroleum	6709.0	7960.0	7900.0	7850.0	7800.0
Crude oil	5883.4	7120.0	7060.0	7010.0	6980.0
Other	825.6	840.0	840.0	840.0	840.0
Nonpetroleum	16274.4	18500.0	20270.0	22210.0	24520.0
In-bond	2325.8	3000.0	3340.0	3720.0	4140.0
Other	13948.6	15500.0	16930.0	18490.0	20380.0
Imports	-18903.3	-20760.0	-22380.0	-24580.0	-27250.0
Public sector	-3551.2	-3830.0	-4120.0	-4520.0	-5010.0
Private sector	-15352.1	-16930.0	-18260.0	-20060.0	-22240.0
Factor income	-7442.2	-8980.0	-8990.0	-9230.0	-9480.0
Interest on public debt	-6921.2	-8440.0	-8560.0	-8950.0	-9360.0
Other interest payments	-1955.6	-1680.0	-1700.0	-1650.0	-1600.0
Other	1434.6	1140.0	1270.0	1370.0	1480.0
Oth. services & transfer	584.8	380.0	780.0	920.0	1070.0
Travel	1438.0	1550.0	1680.0	1820.0	1970.0
Border transactions	-642.0	-600.0	-700.0	-700.0	-700.0
Other	-211.2	-570.0	-200.0	-200.0	-200.0
Capital account	-4079.5	4391.0	3318.0	4058.0	4177.0
Official capital	-1243.7	4241.0	2776.0	3427.0	2932.0
Commercial banks	-1483.2	2406.0	1972.0	2763.0	2528.0
Disbursements	1176.5	3551.0	4006.0	5051.0	5140.0
Amortization	-2659.7	-1145.0	-2034.0	-2288.0	-2612.0
Multilaterals	776.4	1387.0	1316.0	927.0	1029.0
Disbursements	1720.9	2400.0	2400.0	2100.0	2300.0
Amortization	-944.5	-1013.0	-1084.0	-1173.0	-1271.0
Bilaterals & suppliers	721.1	1137.0	477.0	475.0	436.0
Disbursements	1791.3	2286.0	1671.0	1788.0	2187.0
Amortization	-1070.2	-1149.0	-1194.0	-1313.0	-1751.0
CCC	221.3	100.0	140.0	120.0	98.0
Disbursements	582.3	188.0	260.0	290.0	400.0
Amortization	-361.0	-88.0	-120.0	-170.0	-302.0
Other long-term borr.	1388.8	-289.0	-379.0	-58.0	-309.0
Disbursements	2556.1	0.0	0.0	0.0	0.0
Amortization	-1167.3	-289.0	-379.0	-58.0	-309.0
Debt/equity swaps	-1287.1	0.0	0.0	0.0	0.0
Long-term trade lending	-1800.0	-500.0	-750.0	-800.0	-850.0
Short-term off. capital	219.0	0.0	0.0	0.0	0.0
Private capital	-2835.8	150.0	542.0	631.0	1245.0
Interest held abroad	-1340.7	-1500.0	-1550.0	-1630.0	-1710.0
Direct investment	1693.2	2100.0	2180.0	2270.0	2360.0
Debt/equity swaps (net)	1287.1	0.0	0.0	0.0	0.0
Net external credits	-2950.4	-900.0	-798.0	-909.0	-385.0
Other (incl. e & o)	-1525.0	450.0	710.0	900.0	980.0
Overall balance	-6856.8	1491.0	898.0	1228.0	837.0

26-Jul-89 Table 4 Mexico: Balance of Payments (Debt reduction scenario; as per Scenario 1A - (retro to 7/1/89)

updated 7-26-89

In US$ millions	Est. 1988	1989	1990	1991	1992
Current account	-2777.3	-2090.0	-760.0	-1010.0	-1330.0
Merchandise trade	4080.1	5700.0	5790.0	5480.0	5070.0
Exports	22983.4	26460.0	28170.0	30060.0	32320.0
Petroleum	6709.0	7960.0	7900.0	7850.0	7800.0
Crude oil	5883.4	7120.0	7060.0	7010.0	6960.0
Other	825.6	840.0	840.0	840.0	840.0
Nonpetroleum	16274.4	18500.0	20270.0	22210.0	24520.0
In-bond	2325.8	3000.0	3340.0	3720.0	4140.0
Other	13948.6	15500.0	16930.0	18490.0	20380.0
Imports	-18903.3	-20760.0	-22380.0	-24580.0	-27250.0
Public sector	-3551.2	-3830.0	-4120.0	-4520.0	-5010.0
Private sector	-15352.1	-16930.0	-18260.0	-20060.0	-22240.0
Factor income	-7442.2	-8170.0	-7330.0	-7410.0	-7470.0
Interest on public debt	-6921.2	-7630.0	-6900.0	-7130.0	-7350.0
Other interest payments	-1955.6	-1680.0	-1700.0	-1650.0	-1600.0
Other	1434.6	1140.0	1270.0	1370.0	1480.0
Oth. services & transfer	584.8	380.0	780.0	920.0	1070.0
Travel	1438.0	1550.0	1680.0	1820.0	1970.0
Border transactions	-642.0	-600.0	-700.0	-700.0	-700.0
Other	-211.2	-570.0	-200.0	-200.0	-200.0
Capital account	-4079.5	3025.0	2236.0	2185.0	2539.0
Official capital	-1243.7	2875.0	1694.0	1554.0	1294.0
Commercial banks	-1483.2	1040.0	890.0	890.0	890.0
Disbursements	1176.5	2185.0	2924.0	3178.0	3502.0
Amortization	-2659.7	-1145.0	-2034.0	-2288.0	-2612.0
Multilaterals	776.4	1387.0	1316.0	927.0	1029.0
Disbursements	1720.9	2400.0	2400.0	2100.0	2300.0
Amortization	-944.5	-1013.0	-1084.0	-1173.0	-1271.0
Bilaterals & suppliers	721.1	1137.0	477.0	475.0	436.0
Disbursements	1791.3	2286.0	1671.0	1788.0	2187.0
Amortization	-1070.2	-1149.0	-1194.0	-1313.0	-1751.0
CCC	221.3	100.0	140.0	120.0	98.0
Disbursements	582.3	188.0	260.0	290.0	400.0
Amortization	-361.0	-88.0	-120.0	-170.0	-302.0
Other long-term borr.	1388.8	-289.0	-379.0	-58.0	-309.0
Disbursements	2556.1	0.0	0.0	0.0	0.0
Amortization	-1167.3	-289.0	-379.0	-58.0	-309.0
Debt/equity swaps	-1287.1	0.0	0.0	0.0	0.0
Long-term trade lending	-1800.0	-500.0	-750.0	-800.0	-850.0
Short-term off. capital	219.0	0.0	0.0	0.0	0.0
Private capital	-2835.8	150.0	542.0	631.0	1245.0
Interest held abroad	-1340.7	-1500.0	-1550.0	-1630.0	-1710.0
Direct investment	1693.2	2100.0	2180.0	2270.0	2360.0
Debt/equity swaps (net)	1287.1	0.0	0.0	0.0	0.0
Net external credits	-2950.4	-900.0	-798.0	-909.0	-385.0
Other (incl. e & o)	-1525.0	450.0	710.0	900.0	980.0
Overall balance	-6856.8	935.0	1476.0	1175.0	1209.0

INTERNATIONAL MONETARY FUND
WASHINGTON,D.C.

7/25/89

Ted Beza

Attached is latest (revised) term sheet. Table attached to earlier version has no status now.

With the Compliments of

Donald C. Templeman DCT

Advisor to Executive Director

MEXICAN TERM SHEET
(July 23, 1989)

On an informal basis.

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The package consists of debt reduction, debt service reduction, debt-equity swaps and new money.

I. Debt and Debt-Service Reduction.

Pricing

-- Discount bonds (Debt Reduction Bonds) to be issued in exchange for existing debt at 65% of face value (a 35% discount), carrying an annual interest rate of LIBOR plus 13/16. Bonds are 30-year bullets in registered form.

-- Par bonds (Debt Service Reduction Bonds) to be issued for existing debt at a fixed interest rate of 6.25 per annum. Bonds are 30-year bullets in registered form.

Enhancements

-- $7 billion of enhancements to secure debt reduction and debt service reduction instruments. All parties will make a best effort to have the $7 billion available up front.

-- Principal to be fully collateralized by 30-year zero-coupon bonds; interest payments to be guaranteed on a rolling 24 month basis.

  o In the event that $7 billion is insufficient to provide 100% collateralization of principal and 24 months of interest support, interest coverage would be reduced accordingly, but in no event to less than 18 months.

  o In the event that $7 billion is insufficient to provide 18-months of interest support, the banks agree to re-balance their participation in the debt reduction, debt service reduction and new money options.

- Mexican banks opting for par and discount bonds are to be eligible for enhancement only after full enhancement has been provided to international banks.

II. New Money.

-- Equivalent to 25% of new money base over 4 years, as follows: 7% when agreement becomes effective, 6% per year in 1990, 1991, and 1992. Disbursements linked to IMF purchases.

-- Tenor: 15 years, 7 years grace.

-- Interest rate: LIBOR plus 13/16.

-- Interest recycling: lenders may fund new money commitments either by advancing fresh funds or by recycling interest from base debt, subject to conditionality.

-- New money options allowing banks to meet part of their new money commitments through several instruments:

o Up to 50% of the 1989 commitment, but not more than $500 million, in the form of registered bonds.

o Up to 20% of commitment in the form of onlending to public sector borrowers.

o Up to 20% of commitment in the form of a medium-term trade credit deposit facility.

III. Recapture (Value Recovery).

-- This mechanism would permit those banks that choose debt and debt service reduction bonds the possibility of recovering a portion of income foregone in the event that Mexican oil prices and revenues increase.

-- Starting date of provision: July 1996.

-- Sharing formula Quarterly cash payments equal to the following formula. [Benchmark Oil Price - Reference Oil Price] x Reference Volume x 91 days x 30%.

-- Benchmark price: average price of Mexican oil over the four prior quarters.

-- Reference price: $14 per barrel, adjusted for U.S. inflation.

-- Reference Volume: Average of four prior quarters

-- Ceilings on sharing formula:

o To protect Mexico from making payments under the formula when oil export volumes decline while oil prices are above the reference level, cash payments to the banks will not occur when oil export revenues are less than 1989 levels, adjusted for inflation.

o Annual payments cannot exceed 3% of the amount of base debt exchanged for bonds.

IV. Waivers.

-- Appropriate amendments and waivers to permit issuance of discount and par bonds and to provide flexibility for other debt reduction exercises within specified parameters.

V. Rescheduling of Loans Contracted between 1983-88.

-- Terms of Amortization would be amended on following terms

  o Tenor: 15 years, 7 years grace.

  o Interest: 13/16 plus LIBOR.

VI. Debt-Equity Swap Program.

-- Up to $1 billion of original base debt per year during the period January 1990 through June 1993 for a total of $3.5 billion.

-- Banks participating in debt/debt service reduction and new money options will be eligible for participation in the debt-equity swap program.

-- Available investments restricted to qualified infrastructure projects and up to 50% of the equity of public sector companies to be privatized.

-- Conversion rates to be determined through auction mechanism.

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Facsimile Service Cover Sheet
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Mexico

MSG NO (For Cable Room use only)	DATE July 25, 1989	PAGE 1 OF 2

TO

NAME Mr. Remi Gros
Head of Banking Department

AGENCY Bank for International Settlements

CITY/COUNTRY Basle, Switzerland

FACSIMILE TELEPHONE NO 41 (Country Code) 61 (City Code) 238507 (Number)

TEXT

As discussed by Mr. Lamfalussy and Mr Erb, attached please find a table that presents the dates, amounts and conditions for the forthcoming purchases under the Extended Arrangement for Mexico. Tomorrow we will send the communication in support of Mexico's request for interim financing.

INTERNAL DISTRIBUTION

FROM

NAME S. T Beza

DEPT /DIV Western Hemisphere Department

ROOM NO 10-100	EXTENSION 8631	ACCOUNT CODE 0043

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Mexico Schedule for Forthcoming Purchases Under
the First Year of the Extended Arrangement

Date of Purchase	Purchase Dependent on	Amount (in millions of SDRs)	
		Total	Excluding Set-Aside
August 31, 1989 1/	Compliance with quantitative performance criteria for June 30, 1989 and completion of first program review	233 1	163 2
November 30, 1989	Compliance with quantitative performance criteria for September 30, 1989	233 1	163 2
February 28, 1990	Compliance with quantitative performance criteria for December 31, 1989 and completion of second review, to reach understandings on policies for 1990	233 1	163 2

1/ Expected to take place in mid-September 1989

CLOSED DOCUMENT

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File title and date(s) **MEXICO January - July 1989 [Folder 2 of 2]**

Document title and date(s) **final judgement documents related to Arriba Limited v The Petroleum Workers Union of the Republic of Mexico, et al from law firm of Black and Ewart, P C**

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Office Memorandum

TO: The Acting Managing Director

DATE: July 24, 1989

FROM: S. T. Beza

SUBJECT: Mexico--Implications of Accelerated Purchases Under Extended Arrangement

The Extended Arrangement for Mexico contemplates set-asides of about SDR 280 million a year (30 percent of the total of Fund resources available) for each of the three years of the arrangement. Furthermore, the total amount available under each annual segment of the set-aside could be made available in a single purchase. Therefore, as illustrated in Table 1, Mexico could obtain the total of about SDR 280 million for the first year of the program on January 1, 1990, on the merits of the proposed debt reduction operations and performance under the program.

As shown in Table 1, the acceleration of all potential set-aside purchases available in 1990 to the beginning of that year--as is being suggested by the Mexican authorities and the banks--would in fact bring forward from the second program year (available on May 31) about SDR 210 million. With such acceleration, the availability of the set-aside resources would no longer be dependent on the approval of the 1990 program (scheduled for February) and on observance of the performance criteria for December 1989 and March 1990. In these circumstances, as a minimum, a review of progress under the program (including discussion of the 1990 program targets) just before the release of the set-asides (say, in December 1989) would be needed.

Attachment

cc: The Managing Director (o/r)
Mr. Frenkel
Mr. Whittome
Mr. Gianviti
Mr. Laske
Mr. H. Simpson

Table 1 Mexico Expected Schedule of Purchases Under Extended Arrangement

(In millions of SDRs)

Availability Date	Total Purchases	Purchases Excluding Set-Aside	Set-Aside: Scheduled Availability	Set-Aside: Accelerated Availability Within Guidelines	Set-Aside: Requested Accelerated Availability
First Year					
May 26, 1989 1/	233 10	163 17 1/	69 93	--	--
August 31, 1989 2/	233 10	163 17	69 93	--	--
November 30, 1989	233 10	163 17	69 93	279 72 3/	489 51 3/
February 28, 1990	233 10	163 17	69 93	--	--
Second Year					
May 31, 1990	233 10	163 17	69 93	279 72	69 93
August 31, 1990	233 10	163 17	69 93	--	--
November 30, 1990	233 10	163 17	69 93	--	--
February 28, 1991	233 10	163 17	69 93	--	--
Third Year					
May 31, 1991	233 10	163 17	69 93	279 72	279 72
August 31, 1991	233 10	163 17	69 93	--	--
November 30, 1991	233 10	163 17	69 93	--	--
February 29, 1992	233 10	163 17	69 93	--	--

Source Fund staff estimates

1/ Purchase effected in May 1989
2/ Purchase expected in September 1989
3/ Purchase expected January 1, 1990, does not include possible augmentation of SDRs 466 million (40 percent of quota)

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INTERNATIONAL MONETARY FUND

July 24, 1989

Mr Erb

Attached is a cover note for distributing the two press releases attached The note could be from you to Executive Directors or from the Secretary

Attachments

S T Beza

Mexico

Attached for your information are the text of the press release summarizing the agreement in principle reached between the Government of Mexico and the Bank Advisory Committee for Mexico on the 1989-92 financing package for Mexico and the statement by U S Treasury Secretary Brady on that agreement and on the possibility of interim financing for Mexico

The Government of Mexico and the Bank Advisory Committee for Mexico today reached agreement on the main points of a financing package designed to help Mexico attain sustainable economic growth, Angel Gurria, Under-Secretary of the Ministry of Finance of Mexico, and William R. Rhodes, co-chairman of the 15 member committee, announced.

Mr. Gurria said that the commercial-bank financing package, which will be implemented over the period 1989-1992, along with support from creditor governments and the multilateral institutions, should "provide Mexico with the debt reduction and financial resources it needs to support its program of economic recovery."

Mr. Rhodes said that the agreement is the first since the international debt crisis began in 1982 to emphasize voluntary debt and debt-service reduction.

The financing package will offer each creditor bank a range of options to support Mexico, including principal reduction, interest reduction and new money options. Each creditor bank will be asked to choose one or more of the options.

Under the principal-reduction and interest-reduction options, creditor banks could exchange their medium- and long-term loans for 30-year bonds to be issued by the Government of Mexico. Principal payments would be collateralized by U.S. Treasury zero-coupon obligations or comparable collateral purchased by Mexico with the enhancements. Interest payments would be partially backed by a collateral account established by Mexico.

Principal-reduction bonds would be issued in exchange for existing loans at a discount of 35%, with a floating interest rate of London Interbank Offered Rate (LIBOR) plus 13/16%. The interest-reduction bonds, which would be issued in exchange for existing loans at par, would bear interest at a fixed rate of 6.25%.

The principal-reduction and interest reduction bonds will be supported by $7 billion of enhancements and guarantees from the International Monetary Fund, the World Bank, the Government of Mexico, as well as development loans from the Government of Japan.

Creditor banks that provide new money will be asked to commit over a four-year period a total of 25% of their existing medium- and long-term loans that are not exchanged for principal-reduction of interest-reduction bonds. The new loans would be repayable in 15 years, with seven years of grace, and would bear interest at LIBOR plus 13/16%. New-money options would include facilities for trade finance and on-lending, as well as new-money bonds. Each creditor bank selecting a new-money option would have the choice of funding its commitment either by advancing fresh funds or by recycling interest payments received on loans previously extended to Mexico.

The agreement also provides that creditor banks selecting debt and debt-service reduction options will be provided with recapture opportunities starting in 1996 subject to certain limitations.

Debt-equity conversions will be available to creditor banks under Mexico's privatization program, as well as for certain infrastructure projects to be determined by the Mexican Government, in an aggregate amount equivalent to U.S. $1 billion of debt annually, over a three and one-half year period.

Today's agreement anticipates the successful negotiation of the remaining details of the financing package and the acceptance by Mexico's approximately 500 creditor banks worldwide.

Mr. Gurria and Mr. Rhodes said that they expect that the financing package will be completed, and sent to Mexico's creditor banks shortly.

TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-2041

FOR IMMEDIATE RELEASE
July 23, 1989

STATEMENT BY SECRETARY BRADY

Treasury Secretary Nicholas F. Brady today welcomed the announcement by Mexico and its major creditor banks that agreement had been reached on a multi-year financial package to support Mexico's economic reform program:

"The agreement between Mexico and its creditor banks will provide significant debt and debt-service reduction for Mexico, as well as new money, to support Mexico's economic growth. It represents a major step forward in the implementation of the strengthened debt strategy. In recognition and support of this progress, and Mexico's continued sound economic policies, the United States Treasury and the Federal Reserve will work with other monetary authorities to develop a short-term bridge loan of up to $2 billion. This interim financing would provide Mexico with added liquidity pending disbursements from the IMF, World Bank and commercial banks."

57B

Office Memorandum

TO: Mr. Beza DATE: July 21, 1989

FROM: Eliot Kalter EK

SUBJECT: Mexico--Debt Reduction Calculations with Collateral of US$6 1/2 billion

Mexican and bank representatives reportedly are negotiating a new financing package where banks have agreed, inter alia, to exchange new enhanced bonds for old debt at a discount of 35 percent. Mexican representatives have indicated that they anticipate that the US$6 1/2 billion available for enhancements would be consistent with about 70-75 percent of eligible debt being converted into the new instruments. 1/ The calculations below conclude that the amount of debt relief achieved through the exchange of enhanced bonds for old debt is the same as the amount of debt relief obtained in a direct cash buy-back. The anticipated transaction would only be consistent with a discount of 35 percent after taking into account the value to commercial banks of the recapture clauses and debt-equity swap options.

Case A

A discount of 35 percent would be consistent with a conversion of 70 percent of eligible debt only if enhancements totaled US$8.9 billion. 2/ This can be seen by the following: 70 percent of eligible debt is US$38.2 billion. This old debt would be exchanged for a new bond with a value of US$24.8 billion if the exchange is at a discount of 35 percent, for a net debt reduction of US$13.4 billion. An exchange at this discount would require that 36 percent of the value of the new bond be enhanced or that collateral total US$8.9 billion (see attachment). 3/

Case B

If enhancements of only US$6.5 billion are available than either a smaller percentage of eligible debt can be converted, or the exchange of new enhanced bonds for old debt would occur at a lower discount. A discount of 35 percent would be consistent with enhancements of US$6.5 billion only if 51 percent of eligible debt was

---

1/ This is consistent with the U.S. Treasury indication that the US$6 1/2 billion available for collateral would enhance 80 percent of eligible debt less the US$5 billion owed to Mexican banks.

2/ The following assumes a secondary market price of US$0.40 for old debt.

3/ This enhancement is equivalent to collateral on principal and slightly over 3 years of interest payments on the new bond with a value of US$24.8 billion. The enhancement of US$8.9 billion also could be used in the secondary market to buy US$22.3 billion of debt for an equivalent net debt reduction of US$13.4 billion.

converted. This can be seen by the following 51 percent of eligible debt is US$27.8 billion. This old debt would be exchanged for a new bond with a value of US$18.1 billion if the exchange is at a discount of 35 percent for a net debt reduction of US$9.7 billion. An exchange at this discount would require that 36 percent of the value of the new bond be collateralized or that collateral total US$6.5 billion (see attachment). 1/

Case C

A conversion of 70 percent of eligible debt would be consistent with enhancements of US$6.5 billion only if the exchange of new bonds for old debt is at a discount of 25.4 percent This can be seen by the following 70 percent of eligible debt is US$38.2 billion. This old debt would be exchanged for a new bond at a discount of 25.4 percent for a value of US$28.5 billion and a net debt reduction of US$9.7 billion. An exchange at this discount would require that 22.8 percent of the value of the new bond be collateralized or that collateral total US$6.5 billion (see attachment). 2/

Attachment

cc Mr. Loser
Mr. Bonvicini

1/ This enhancement is also equivalent to collateral on principal and slightly over 3 years of interest payments on the new bond with a value of US$18 billion. The US$6 5 billion also could be used in the secondary market to buy US$16.2 billion of debt for an equivalent net debt reduction of US$9.7 billion.

2/ This enhancement is equivalent to collateral on principal and slightly less than 2 years of interest payments on the new bond with a value of US$28.5 billion. The US$6.5 billion also could be used in the secondary market to buy US$16 2 billion of debt for an equivalent net debt reduction of US$9.7 billion.

Mexico - Pricing of Debt Exchange

Calculations are based on a framework where the price of debt is equal to the bond's expected present value of total debt service payments. The expected present value of debt service is equal to the expected present value of principal payments plus the expected present value of interest payments. The probability of full payment of either principal or interest is unity for that proportion of debt service payment that is creditor guaranteed and is represented by the secondary market price of unguaranteed debt for that proportion of debt service payment that is not creditor guaranteed.

The calculations that follow are based on the following:

(1) Old debt is exchanged for new debt at a discount defined by:

$$1 - \frac{\text{price old debt}}{\text{price new debt}}$$

(2) The price of new debt equals the proportion of the present value of total debt service of the new bond that is creditor guaranteed (valued at unity) plus the proportion of the present value of total debt service of the new bond that is not creditor guaranteed (valued at the secondary market price of old debt).

Cases A and B

In cases A and B above, the old debt is exchanged for new debt at a discount of 35 percent while the price of old debt is 0.40. From relationship (1) above, it can be derived that:

(1) $$\text{Price new debt} = \frac{0.40}{1 - 0.35} = 0.615$$

From relationship (2) above:

(2) $0.615 = X \times 1 + Y \times 0.40$

where $X + Y = 1$; and
where X = proportion of the new bond that is guaranteed;
where Y = proportion of the new bond that is not guaranteed

Solving the equations give:

$X = 0.36$; and
$Y = 0.64$

Case C

The old debt is exchanged for new debt at a discount of 25 4 percent while the price of old debt is 0 40 From relationship (1) above it can be derived that

(1) Price new debt $= \dfrac{0\ 40}{1 - 0\ 254} = 0\ 536$

From relationship (2) above

(2) $0\ 536 = X \times 1 + Y \times 0\ 40$

where $X + Y = 1$, and
where X = proportion of new bond that is guaranteed,
where Y = proportion of new bond that is not guaranteed

Solving the equations give

$X = 0\ 228$
$Y = 0\ 772$

Office Memorandum

G Mr. Baga

TO: The Acting Managing Director DATE: July 20, 1989

FROM: S. T. Beza

SUBJECT: Mexico--Briefing for Mission

Attached is the briefing paper for the review mission to Mexico. Performance under the arrangement to date has been satisfactory, but several issues arise in connection with the review.

A first issue relates to the performance criteria for end-June (p.3 of the brief). Mexico is expected to have observed the fiscal targets for end-June, but deviations are likely for the performance criteria for credit to the public sector from the Bank of Mexico and for the net international reserves because of shortfalls in financing from commercial banks. In line with the understandings incorporated in the technical memorandum of understanding, an adjustment for these shortfalls would be made in the context of the review.

A second issue relates to the possibility that higher than projected domestic interest rates may result in deviations in fiscal performance in the second half of the year (p.4 of the brief). The staff would propose that the performance criteria remain unchanged at present, and that efforts should continue to be made to offset the adverse effects of high domestic interest rates, as has been occurring so far. At a later stage of the year, however, it may be necessary to contemplate some modification of the criteria in this area.

A third issue--as described on page 4 of the brief, is that it is almost certain that commercial bank financing will fall short of the amount included in the program for 1989 as a whole (and probably for future years). Although international oil prices are higher and external interest rates lower than originally projected, the expectation had been that the effects of such favorable external developments would be channeled in part into reserves in order to provide protection against adverse developments in subsequent years. In light of the lower than programmed bank financing, the Mexican authorities are likely to seek to modify the net international reserve targets to exclude the more stringent performance called for because of improved external conditions, on the grounds that preserving the original objective would require an unreasonable tightening of fiscal policy (beyond any effort involved in offsetting the impact of high domestic interest rates).

The mission will try to persuade the authorities to take additional measures to preserve at least a part of the gains from the better external conditions. But it has to be recognized that under the financing package that is emerging the program will be more vulnerable than contemplated originally. Thus, it will need to be understood that if the financing package now emerging is accepted, there is a risk that it may need to be reopened in the event that the present favorable external situation does not persist. Because much of the package is likely to take the form of exit bonds, reopening it would mean having to renegotiate the terms of bonds. These kinds of risks would need to be taken into account by the Executive Board in deciding whether the financing package qualifies for Fund support for debt and debt-service reduction.

This paper has been reviewed by the following departments

Exchange and Trade Relations	Mr. Brau
Fiscal Affairs	Ms. Ter-Minassian and Mr. Katz
Legal	Mr. Surr
Research	Messrs. Aghevli and Calvo
Treasurer's	Mr. Coats
Western Hemisphere	Messrs. Quirk, Stephens, van Beek, and myself

Mr. Loser's last day in the office will be Thursday, July 27.

Attachments

cc The Managing Director (o/r)
Mr. H. Simpson

MEXICO

Summary of the Briefing Paper

1 Mission head Mr Loser

2 Date of the mission July 28-August 11, 1989

3. Purposes of the mission

The mission will review developments under the program and will evaluate the effects of external financing package that is being developed The next purchase under the arrangement is dependent on observance of end-June performance criteria and completion of the review

4 Background

Economic performance has been in line with expectations Economic activity has recovered somewhat and the rate of inflation has come down to 1 2 percent a month in June The peso has depreciated a little in real effective terms since early 1989 Domestic interest rates have been higher than programmed, but it is estimated that fiscal targets have been observed, on the strength of domestic efforts, higher oil prices and lower foreign interest rates Developments in the external current account have been as expected, but net international reserves declined by more than programmed because of shortfalls in bank financing

5 Issues

An adjustment will be needed on some performance criteria for the end of June because external financing has been less than included in the program

The mission will take the position that fiscal targets should not be changed at present to accommodate the effect of higher domestic interest rates However, at a later stage the ceilings may have to be modified for deviations in this area

Commercial banks will provide less financing than programmed in 1989 (and probably in future years also) This could be offset by the effect of improved external conditions (higher oil prices and lower interest rates) but at the expense of the programmed additional accumulation of reserves The mission will try to persuade the authorities to preserve some of the prospective gains in reserves, but the authorities may argue that an additional accumulation of reserves beyond the original targets will not be possible because it would require impossible additional fiscal efforts

The financing package with commercial banks will need to be appraised to establish whether it can be supported by Fund resources The terms seem broadly consistent with the limited available resources for enhancements, but could result in financing shortfalls for 1989 The mission will review the implications of the package for the macroeconomic targets of the program

CONFIDENTIAL

INTERNATIONAL MONETARY FUND

Briefing for Mission to Mexico

Prepared by the Western Hemisphere and
Exchange and Trade Relations Departments

(In consultation with the Fiscal Affairs, Legal, Research,
and Treasurer's Departments)

Approved by S T Beza and Eduard Brau

July 20, 1989

A staff mission consisting of Messrs Loser (Head), Kalter, Khor (all WHD), Sheehy and El-Erian (ETR), Ms Rojas-Suarez (RES), and Ms Karkas (Secretary--BUR) will visit Mexico City for two to three weeks beginning on July 26, 1989 to review developments under the extended arrangement with Mexico Mr Loser will join the mission on July 28

Under the terms of the arrangement, the next drawing under the program, scheduled to take place after August 30, 1989, is dependent upon compliance with the June performance criteria and conclusion of the forthcoming review The mission will evaluate performance under the arrangement through June and will assess the impact on the program of changes in the timing and amount of available financing, including that from commercial banks The mission also will review the possible impact of debt/debt-service reduction operations on the program, to the extent that such operations have been agreed by the time of the review

On May 26, 1989, the Fund approved the three-year extended arrangement for the equivalent of SDR 2,797 2 million (240 percent of quota) including a set aside of 30 percent of access for debt-reduction operations, in addition, the Executive Board expressed its willingness to consider favorably a possible augmentation of the arrangement for up to 40 percent of quota in support of debt-service reduction operations The Executive Board approved a purchase equivalent to SDR 453 5 million under the decision on the compensatory and contingency financing facility As of June 30, 1989 Fund credit to Mexico, including drawings under the EFF, the CCFF, and the enlarged access policy, stood at SDR 3,886 1 million 1/

1/ Further details about Mexico's financial relations with the Fund are presented in Attachment II

I. Background and developments under the program

In line with policies followed since the end of 1987, a new pact for economic growth and stability (PECE) was announced in December 1988, with specific guidelines for wages, prices of certain goods and services, and the exchange rate through end-July 1989 Minimum wages were increased by 8 percent and public sector prices and tariffs were raised, except those of gasoline, diesel, and electricity and gas for residential use. Since January 1, 1989 the peso has been depreciated at a daily rate of 1 peso per U.S dollar (initially 1 3 percent a month)

The authorities announced on June 18 that the PECE would be extended through March 31, 1990 The peso will continue to be depreciated at a rate of one peso a day (at present equivalent to 1.2 percent a month), resulting in a total depreciation of 16 percent against the U S dollar during 1989 Public sector prices and tariffs will be kept unchanged along with the prices for a basket of selected goods. The authorities announced a 6 percent increase in the minimum wage (effective July 1) for a cumulative total for the year of 14 5 percent. Collective wage negotiations may now be pursued freely

Economic performance has been broadly in line with expectations Economic activity has recovered somewhat, with industrial production around 3 1/2 percent higher in the first four months of the year than in the same period of 1988 Consumer prices rose by 1.2 percent in June 1989, broadly in line with the increases of previous months, and the 12-month rate of price increase fell to less than 18 percent The peso depreciated by 8 percent relative to the U S dollar in the first six months of the year and depreciated somewhat in real effective terms (Chart 1). Domestic interest rates remained higher than programmed during the first half of 1989, and in June were about 4 1/2 percent a month, equivalent to a real rate of about 3 percent a month, reflecting the shortfall in foreign financing and related concerns about the viability of current economic policies.

Oil export prices averaged US$15 4 a barrel for the first half of the year, compared with the central price of US$12 a barrel under the program Furthermore, LIBOR has averaged 9 8 percent compared with 10 1/2 percent assumed under the program These developments along with higher non-oil revenues and expenditure restraint contributed to a stronger than expected fiscal performance, notwithstanding high domestic interest rates, in the first quarter of 1989. The fiscal primary surplus reached about 10 percent of GDP, the operational outcome was in balance and the PSBR was less than 5 percent of GDP On the basis of partial information, it is estimated that all fiscal performance criteria for end-June were observed, as a stronger primary surplus offset the effect of high domestic interest rates

In the first half of 1989, financing for the PSBR was obtained mainly from domestic sources, including higher than programmed use of credit from the Bank of Mexico because of the shortfalls in bank financing Available data indicate a relatively strong growth of private sector financial savings and credit to the private sector, including the effects of the intermediation of some private capital inflows

In the first quarter of 1989, the merchandise trade balance was in surplus by over US$900 million, while the external current account registered a deficit of US$930 million The trade performance was as programmed, with slightly higher imports and lower nonpetroleum exports offset by higher than projected petroleum exports Foreign interest payments were in line with projections--as changes in international interest rates affect payments with a lag--but the nonfactor service account was weaker than expected because of lower net receipts from tourism and border transactions Higher than expected private capital inflows made it possible to achieve approximate overall payments balance Even though the current account tended to strengthen in the second quarter, lower capital inflows due to delays in the negotiations with the commercial banks resulted in a loss of net international reserves of some US$1 5 billion during the first half of the year, compared with a programmed loss of US$1 billion

II Policy issues

The authorities have implemented their program in line with their commitments, and economic performance has been aided by higher oil prices and lower foreign interest rates than had been programmed These two factors, if they persist, would result in an improvement in the external current account of some US$2 2 billion (some 1 percentage point of GDP) with respect to the initial projection for 1989, on this basis, the current account deficit would be US$2 6 billion, compared with US$4 8 billion under the program Nevertheless, the delay in completion of an agreement with foreign commercial banks has resulted in a shortfall in foreign financing and has put pressure on domestic interest rates, with implications for the public finances and private savings and investment Moreover, while the extension of the PECE provides clear signals as to the intended course of policies through early 1990, it may result in further real declines in some public sector prices

Three major operational issues are of relevance in current circumstances, namely the shortfalls in performance for end-June on account of the delays in the completion of the financing package, the possible deviations in fiscal performance due to the higher domestic interest rates, and the possible implications for the program of a lower than planned value of financing from commercial banks

In line with the understanding contained in the arrangement, a modification would be introduced in the context of the review for some end-June performance criteria (net international reserves, net credit of the Bank of Mexico to the public sector, and possibly, net domestic assets) on account of delays in financing Furthermore, the quantitative performance criteria should be modified for specific features of the foreign financing package to the extent that an agreement has been reached at the time of the mission, and the impact is neutral with respect to the program objectives.

The mission will take the position that, at present, the quantitative performance criteria for the remainder of the year should not be changed to accomodate the effect of higher domestic interest rates. It will, therefore, discuss with the authorities the actions to be taken to offset the effects of high interest rates on the public finances. It can be expected that as financing is assured, pressures on financial markets will subside and interest rates will decline, indeed, some positive effects may be now in evidence. However, domestic interest payments may still end up higher than planned, and it may not be feasible to offset their effects by policy tightening. In that event, performance criteria may have to be modified at a later stage.

A central operational issue relates to the possible adaptation of the program to a lower level of financing by banks (an estimated US$2 billion a year) than was assumed under the program (US$4 4 billion), as described below. Within the program, Mexico is required to increase net international reserves (and correspondingly adjust other quantitative performance criteria) to the extent that the revenue from higher petroleum prices and lower interest rates exceeds the baseline projections, net of a margin of US$950 million a year As noted, the total additional resources over the baseline due to favorable developments are now likely to amount to US$2 billion this year. This amount (including available margins under the band) would offset the shortfall in foreign financing assumed in the program baseline. However, the protection against unfavorable developments built into the program will be reduced and the program would become more vulnerable, to the extent that additional resources resulting from favorable external conditions are reflected in lower bank financing and not in a higher reserve accumulation as programmed. Furthermore, there might be an unfavorable response from official sources because of the low contribution by banks

On the basis of existing margins, about US$1 billion of the shortfall in bank financing could be covered by Mexico without the need to modify performance criteria. To offset the lower financing, however, the authorities can be expected to request the modification of performance criteria, seeking to exclude the more stringent performance criterion to accumulate reserves beyond the bands on account of favorable conditions. The mission will try to persuade the authorities to commit themselves to take additional measures to preserve some of the gains from these improved conditions. However, the authorities will most likely argue that they already are attaining a stronger than programmed primary fiscal surplus in order to offset the effect of high domestic interest rates, that the macroeconomic targets of the baseline scenario would be preserved under present conditions, and that a further tightening is not feasible.

1 Fiscal policy

The fiscal targets for 1989, based on a petroleum price of US$12 a barrel and LIBOR at 10 1/2 percent a year, are a primary surplus of 7 3 percent of GDP, an operational deficit of 2 5 percent of GDP, and a PSBR of 7 percent of GDP, if the price of petroleum and LIBOR were to remain at their current levels, the provision of the program would require the primary fiscal target to be adjusted to 7 7 percent of GDP, the operational deficit to 1 9 percent, and the PSBR to 6 4 percent 1/ However, as noted, a stronger performance at the level of the primary balance may not be sufficient to offset the impact on the operational balance and the PSBR of higher than expected domestic interest rates in the second half of the year The mission will suggest that among the possible fiscal measures to compensate for any deviations, the authorities should consider in particular increases in public sector prices and tariffs, taking into account the extended PECE The mission also will begin discussions on fiscal policies for 1990

2 Exchange rate policy

The peso has remained unchanged in real effective terms during the first half of the year On the basis of the guidelines announced under the extension of the PECE, the nominal depreciation would be enough to maintain or improve external competitiveness, provided the rate of inflation stays under 1 1/2 percent a month and the U S dollar remains stable in real terms against other major currencies Although prospects for an adequate performance of the external sector are good, the mission will examine the appropriateness of the current exchange rate policy in light of, among other factors, the performance of non-oil exports and imports, and, if warranted, it will suggest to the authorities a policy modification to secure the external and growth objectives of the program Furthermore, the mission will discuss the eventual abandonment of the current exchange rate rule, in the context of a relaxation of existing price and wage guidelines

3 Wage and pricing policies

Wage increases granted following the extension of the PECE will be reviewed in relation to recent developments in inflation The increases in minimum wages appear consistent with the objectives of the program, but a moderate wage policy will continue to be required to ensure attainment of the program targets, and to help create an adequate framework for a market-based wage determination in the private sector The mission will discuss with the authorities their strategy for moving away from price and wage guidelines

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1/ The gains from oil and international interest rates are expected to amount to 1 1 percentage points of GDP, but ceilings under the program would be adjusted only by 0 6 percentage point of GDP, because of the operation of the band

4. Monetary and credit policy

Preliminary data suggest a weaker than programmed performance of Bank of Mexico credit to the nonfinancial public sector and of net international reserves. The PSBR was lower than programmed but the authorities made greater use of Bank of Mexico financing, reflecting the shortfall in foreign financing. However, the excess in the credit to the public sector and the deviations in net international reserves are estimated to have been smaller than the shortfall in disbursements from commercial banks and other sources over the period.

In July the Government began offering treasury bills with interest rates indexed to either the consumer price index or the exchange rate in the free market Although this may result in lower real interest rates in the short run, and thereby reduce fiscal imbalances, rigidities may be introduced that may have an adverse impact on financial policies because of risks associated with future shocks The staff will advise the authorities to proceed cautiously in their use of the new financial instruments to avoid compromising the flexibility of monetary policy

5. External financing

In addition to the resources provided by the Fund, the Paris Club agreed to a rescheduling of principal and interest in late May, and in June the World Bank approved three loans totalling US$1.5 billion in support of Mexico's structural reforms.

Mexico's original request for financing from foreign commercial banks of about US$4 4 billion a year for 1989-92, equivalent to 60 percent of interest due to banks for the period as a whole, was in line with financing sought from official sources Mexican and bank representatives are currently negotiating a new financing package with financial benefits which banks had estimated at some US$3.0 billion a year. Indications are that banks have agreed to exchange new enhanced bonds for old debt either at a discount of 35 percent, or at par with a reduced fixed interest rate of 6 1/4 percent Banks choosing the new money option would increase their exposure by a total of 25 percent through end-1992. No details have been announced yet about enhancements or the recapture of resources if external circumstances improve, but indications are that the banks are putting pressure in these areas, thereby reducing the relief included in the agreed package. No agreement on interim financing has been reached yet.

Under the terms of an agreement with banks, along the lines described above, commercial banks may actually provide resources for some US$2 2 billion a year (assuming that 70-75 percent of eligible debt is converted, as expected by Mexican officials, into lower principal or lower interest rate instruments) This would fall considerably short of the US$4.4 billion included in the program The staff estimates that the amount of enhancements available (about US$6 1/2 billion) 1/ would be broadly consistent with a discount of some 30-35 percent for 70-75 percent of eligible debt. Total debt could effectively be reduced by some US$10 billion, providing annual net relief on interest payments of about US$1.0 billion starting in 1990. New money (on the basis of 30 percent of eligible debt) would provide an average of US$1.2 billion a year after 1989. If external developments (oil prices and interest rates) remain more favorable than originally planned, Mexico's current account deficit would be lower than projected by some US$2.0 billion a year. In addition, reduced interest payments, because of lower borrowing, would average some US$0.8 billion a year.

Under these assumptions, total resources available (US$5 billion a year) would exceed the original financing requirement from banks under the program. As noted, however, the outcome would have a weakness as compared with the initial program because the additional resources from unforeseen improved external conditions would be used to reduce bank financing requirements and not to increase reserves.

The mission will discuss with the authorities the implications of possible revised scenarios. In particular, the mission will review the banks' proposal in order to assess the appropriateness of Fund financing of debt/debt service reduction operations, and will discuss the procedures for the mobilization of Fund resources in support of these operations. In addition, the mission will review the implications of the proposed financial package for the macroeconomic targets of the program, particularly focusing on the medium-term growth prospects relative to those assumed in the original program.

Attachments

cc Mr. Frenkel
Mr. Gianviti
Mr. Laske
Mr. Tanzi
Mr Whittome
Mr. H. Simpson

1/ Within the extended arrangement, total Fund resources for debt reduction would amount to the equivalent of US$1 1 billion under the set-aside provisions, while US$600 million would be available for debt service reduction operation if the amount of the arrangement is augmented. In addition, about US$1 7 billion of IBRD disbursements may be used for these operations Also, Japan may make available US$2 billion to Mexico, of which half would be provided through parallel lending with the Fund. With some additional funds from Mexico's reserves, the total amount of enhancements for debt reduction operations would be about US$6 1/2 billion.

Mexico Selected Economic and Financial Indicators

	1984	1985	1986	1987	Prel 1988	Prog 1989
	(Annual percentage change unless otherwise specified)					
Income and prices						
Real GDP	3 6	2 6	-3 8	1 5	1 1	1 5
GDP deflator	59 1	56 7	74 4	139 3	103 8	21 1
Consumer prices (end of year)	59 2	63 7	105 7	159 2	51 7	18 0
Consumer prices (average)	65 4	57 7	86 2	131 9	114 2	21 9
Consumer prices (monthly average)	4 0	4 2	6 2	8 3	3 7	1 4
External sector						
Exports (f o b)	9 7	-9 5	-24 4	28 3	3 4	8 9
Export volume	8 0	-4 6	7 4	13 4	1 4	4 7
Imports (f o b)	31 6	17 4	-13 5	6 9	54 7	9 8
Import volume	27 1	17 2	-11 7	4 3	43 2	5 6
Terms of trade (debt -)	-1 9	-5 3	-28 2	10 4	-5 6	--
Nominal effective exchange rate						
Average (depreciation -)	-24 4	-28 7	-59 3	-57 8	-37 6	-6 5
End of period	-19 9	-48 0	-61 8	-55 5	-9 2	-8 5
Real effective exchange rate						
Average (depreciation -)	16 9	2 9	-30 0	-8 1	23 2	
End of period	18 5	-20 6	-23 5	3 3	28 7	
Nonfinancial public sector						
Receipts	63 1	56 1	62 7	135 5	100 0	12 3
Outlays	56 9	66 4	89 3	139 3	84 9	-2 0
Money and credit 1/						
Domestic credit (net)	62 1	58 0	89 3	120 5	75 2	15 2
Public sector (net)	26 2	44 9	81 1	75 9	29 3	4 3
Private sector	35 6	23 5	29 3	62 9	39 2	11 3
Money and quasi-money (M-2)	70 1	46 3	94 4	141 0	42 4	10 3
Velocity (GDP/M-2)	4 1	4 3	4 1	4 4	5 3	5 2
Real growth in M-4	6 0	-7 6	-0 9	-0 4	6 8	4 5
Velocity (GDP/M-4)	3 6	3 7	3 4	3 4	3 7	3 3
Interest rate on 1-month treasury bill (percent per month)	4 0	5 0	6 6	7 8	5 8	3 5
	(Percent of GDP)					
Public sector savings	0 3	-2 7	-9 3	-9 6	-6 0	-0 7
Public sector savings (adjusted) 2/	6 9	4 9	3 7	7 4	0 9	2 6
Public sector economic deficit	-7 1	-8 6	-14 8	-15 0	-11 3	-5 8
Primary balance	4 8	3 3	2 3	5 0	5 9	7 3
Operational balance	0 3	-1 0	-1 8	2 0	-4 4	-2 5
Public sector borrowing requirement	8 4	9 5	15 6	15 9	12 9	7 0
Gross domestic investment	19 9	21 2	18 1	18 6	20 5	21 3
Gross national savings	22 3	21 6	17 2	20 4	18 9	18 9
Current account deficit (-)	2 4	0 4	-0 9	2 9	-1 6	-2 4
Public external debt (including IMF) 3/	38 8	38 6	57 8	59 5	47 2	44 8
Interest payments on public debt 4/	4 7	4 1	4 7	4 3	4 0	4 4
	(In percent of exports of goods and nonfactor services)					
Public debt service 5/						
Before rescheduling	47 7	66 6	78 2	89 9	86 8	69 8
After rescheduling	37 8	39 8	44 3	41 9	49 0	41 6
	(In billions of U S dollars)					
Overall balance of payments	3 0	-3 4	-1 1	6 6	-6 9	1 5
Gross official reserves (months of imports) 6/	9 6	5 6	7 4	13 5	4 2	4 2

Sources Bank of Mexico Secretariat of Programming and Budget and Fund staff estimates

1/ Changes are effective flows adjusted for exchange rate changes in relation to total liabilities to the private sector at the beginning of the period
2/ Adjusted for the inflation component of interest payments which is treated as debt amortization but includes inflation tax
3/ Includes short-term debt but net of gross international reserves
4/ Interest paid on external public debt net of interest earned on gross international reserves
5/ Includes debt service on use of Fund credit
6/ Excluding gold and payments agreements

Fund Relations with Mexico
(As of June 30, 1989)

I. Membership Status

(a) Member since December 31, 1945
(b) Status - Article VIII

A. Financial Relations

II. General Department (General Resources Account)

(a) Quota SDR 1,165.5 million
(b) Total Fund holdings of Mexican pesos
SDR 5,051 7 million
(c) Fund credit SDR 3,886.1 million or 333 4 percent of quota
Of which SDR 637 8 million or 54.7 percent of quota under credit tranche
SDR 1,069.8 million or 91.7 percent of quota under EFF
SDR 1,725.6 million or 148 1 percent of quota under EAR
SDR 453 5 million or 38 9 percent of quota under CCFF
(d) Reserve tranche position None

III Stand-by or Extended Arrangement and Special Facilities

(a) Current extended arrangement
(i) Duration May 26, 1989 until May 25, 1992
(ii) Amount SDR 2,792.2 million
(iii) Utilization SDR 163 2 million
(iv) Undrawn balance SDR 2,634 0 million
(b) Compensatory and contingency financing facility
(i) Purchased on June 1, 1989
(ii) Amount SDR 435.3 milion
(iii) Utilization SDR 453.5 million
(c) Previous stand-by arrangement
(i) Duration November 19, 1986 until April 1, 1988
(ii) Amount SDR 1,400 million
(iii) Utilization SDR 1,400 million
(d) Emergency assistance
(i) Purchase in January 1986
(ii) Amount SDR 291 375 million
(iii) Utilization SDR 291 375 million
(e) Previous extended arrangement
(i) Duration from January 1, 1983 to December 31, 1985
(ii) Amount SDR 3,410.6 million
(iii) Utilization SDR 2,502.7 million
(iv) Undrawn balance 907.9 million

IV. SDR Department

(a) Net cumulative allocation SDR 290 million
(b) Holdings SDR 354.3 million or the equivalent of 122.2 percent of net cumulative allocation

V. Financial Obligations due to the Fund (In millions of SDRs) 1/

	Overdue Financial Obligations (6/30/89)	Principal and Interest Due 7/1-12/31 1989	1990	1991	1992
Principal					
Repurchases	--	338.9	877 1	807.4	518.5
Trust Fund Repayments	--	--	--	--	--
Charges and Interest including SDR and TF (provisional)	--	141.9	238 2	164 9	101.2
Total	--	480.8	1,115 3	972 4	619 7

B. Nonfinancial Relations

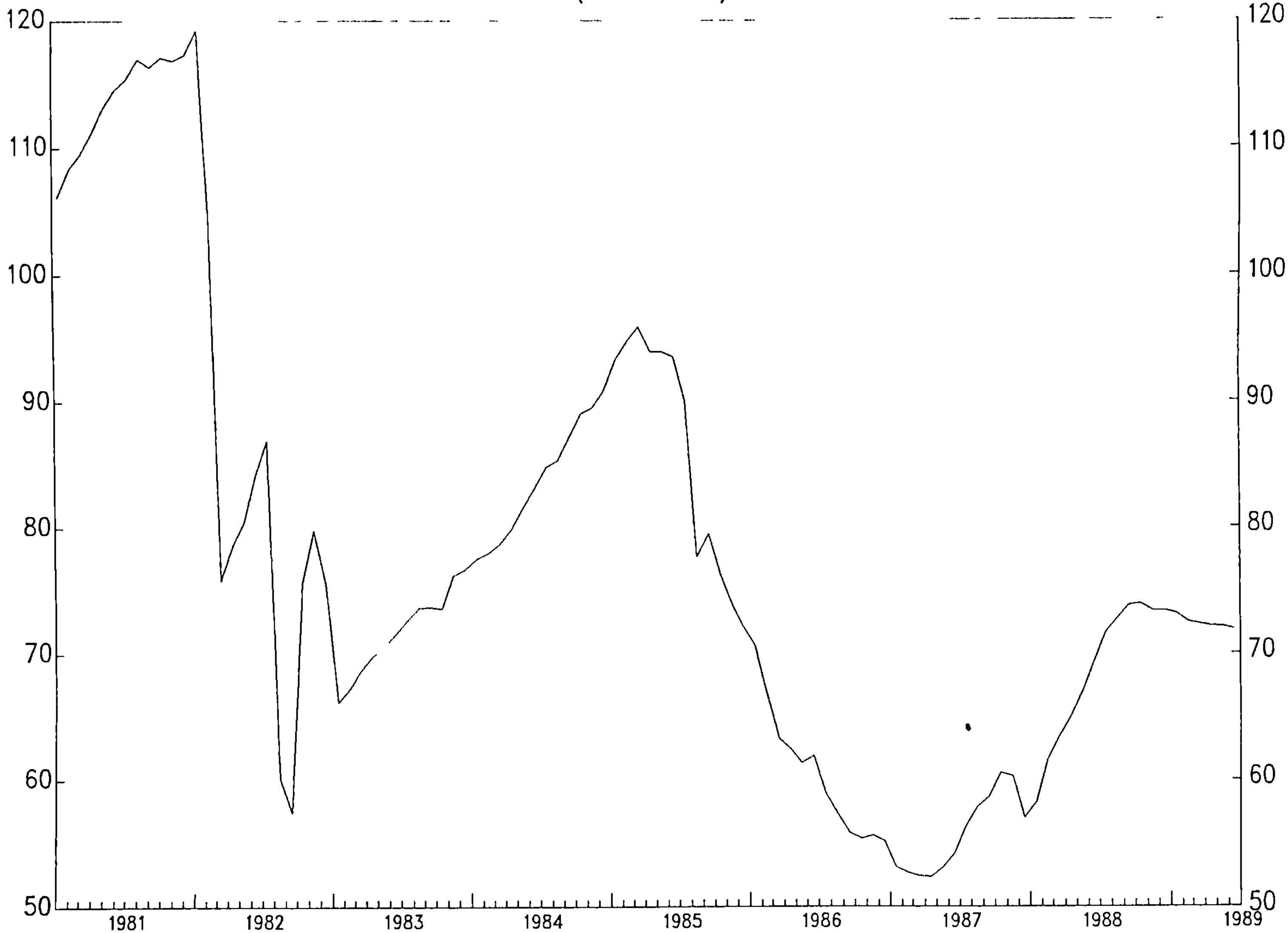
VI. Exchange rate arrangement Since August 5, 1985 two official markets have been operative in Mexico a controlled market covering specified transactions amounting to about 80 percent of all trade and payments transactions, and a free market. The controlled market rate is determined under a managed float system guided by a set of indicators, whereas the free market rate is established by market forces. Parties eligible to utilize the controlled market (with the exception of offices and agencies of the public administration) can choose to complete any transaction at a retail rate agreed between the parties and the financial institutions authorized to operate in this market, or at the equilibrium exchange rate" of the day The daily equilibrium exchange rate" is determined each day at a fixing session at the central bank, where representatives of the various financial institutions operating in the market exchange bids for purchases and sales of foreign exchange the Central Bank may also submit bids in these sessions. For transactions exceeding US$50,000, the parties concerned may make completion of the transaction contingent upon the equilibrium exchange rate achieving a particular minimum or maximum value As of June 15, 1989 the

1/ Projected on the basis of transactions through June 30, 1989 "controlled market equilibrium exchange rate was Mex$2,449 per U.S. dollar, the average "free rate was Mex$2,461 per U S. dollar, and the differential between the ratio in the controlled and the free market was less than 1 percent.

VII. Last Article IV consultation The last Article IV consultation, requests for extended Fund arrangement for 1989-91, and purchase under the CCFF were completed by the Executive Board on May 26, 1989 (EBM/89/65). The relevant supporting documents were EBS/89/91, Supplement 1, SM/89/94, EBS/89/66, and EBS/89/94 For consultation purposes Mexico is on the 12-month cycle

VIII. Technical Assistance At the request of the Mexican authorities, during 1985 two teams from the Fiscal Affairs Department provided technical assistance in the fields of direct and indirect taxation, followed by a staff visit in January 1986. In October 1988, a technical team provided assistance in the area of external debt and international banking

CHART 1
MEXICO
REAL EFFECTIVE EXCHANGE RATE
(Base 1980 = 100)



Source Mexican authorities and Fund staff estimates

THE WORLD BANK / INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

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INTERNATIONAL MONETARY FUND
WESTERN HEMISPHERE DEPT.

1989 JUL 19 PM 3:44

DATE: July 18, 1989

TO: R. Steckhan, Director LA2

FROM: R. Lamdany, DFS RL

EXTENSION: 72945

SUBJECT: Mexico: Task Force Meeting

The Mexico Debt Task Force met on 7/18/89. The meeting was chaired by R. Steckhan and the participants included T. Duvall (Legal), I. Husain (PPR), C. Loser (IMF), F. Kilby (FRS), A. Toft (CFS) and van-Wijnbergen (LA2). Attached is a copy of the agenda.

The following are the main issues discussed and decisions reached:

- The Bank and the IMF shared information on development on the negotiations between Mexico and the banks. The Bank and the IMF agreed to exchange information on the negotiations on a daily basis. CFS will try to brief Mr. Steckhan on a daily basis, on any information it may obtain from creditor banks.

- It is unlikely that the IFIs may be able to veto any agreement once it has been agreed by Mexico and the banks. Therefore, it is important that the IFIs obtain and comment on any preliminary term sheet before it gets final approval by Mexico and the Advisory Committee.

- R. Steckhan will circulate a copy of a series of questions addressed to the Bank by the commercial banks (through A. Bauer from Citibank) on the conditions for disbursement for debt reduction and other loans to Mexico. R. Steckhan asked the Legal Department's opinion on these questions. The Legal Department stated that the questions addressed by the commercial banks raised primarily policy rather than legal issues.

- Task force members should brief Senior Management on the evolution of the negotiations, and on the potential effects of different facilities being mentioned. The van-Wijnbergen can be the basis for such briefings. FRS and CFS stated that the van-Wijnbergen paper should address downside risks for Mexico and their consequences for the IBRD.

- R. Steckhan asked CFS and LA2 staff to begin working on a Board Paper on the Interest Support/Additional Funds Facility. The Legal Department stated that additional funds provided for interest support could be provided either as a component of an adjustment loan that includes a set aside component or as a free standing loan.

- Issues related to a possible bridge loan were also discussed.

cc: K. Kashiwaya, D. Bock, T. Duvall (Legal), I. Husain (PPR), C. Loser (IMF), F. Kilby (FRS), A. Toft (CFS) and van-Wijnbergen (LA2).

July 18, 1989

MEXICO - Meeting of Debt Task Force 7/18 at 11 00

AGENDA

(i) Exchange of information on state of Mexico - commercial bank discussion and implications for acceptable "debt relief" and filling the financing gap

(ii) Is there (and should there be) any way we can have some influence on the final shape of the package, again so as to avoid problems later on when we will be asked to assess what has been negotiated?

(iii) Can we get some advance warning mechanism about the type of deal being negotiated, since we will be asked to asses it as soon as it is struck?

(iv) Can daily contacts with the commercial banks be centralized? More in general, how can we get better information from the commercial banks?

(v) Do we know how "hard" the constraints on available "guarantee" funds are? What is the likely flexibility of the IFI's, Japan, US Treasury?

(vi) Who will in the end do the Board papers on interest support facility?

(vii) Where is the Flannery contribution?

Rainer B Steckhan

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Office Memorandum

TO: Mr. Loser DATE: July 17, 1989

FROM: B.B. Aghevli and G. Calvo

SUBJECT: Briefing for Mission to Mexico

Overall, we are in full agreement with the position taken in the briefing. The Mexican program is strong and the authorities have implemented significant macroeconomic policies and structural reforms. In light of the delays of negotiations with commercial banks, we support a technical waiver of the June performance criteria for the Bank of Mexico net credit to the nonfinancial public sector and net international reserves.

As stated in the briefing, a major difficulty that the Mexican authorities face is the persistence of relatively high real interest rates. It would be extremely useful if the mission could clarify to what extent those developments are associated with the public expectations about a devaluation of the peso in the near future. If indeed high interest rates in Mexico are due to expectations of a devaluation, we do not fully understand the mission's concerns about indexing government bonds to the market exchange rate. To the extent that debt negotiations are successful, indexation of government bonds could only help to strengthen the outcome of the program as it would aid to restore the credibility of the economic policies undertaken by the Mexican authorities. This logic, however, only follows if the mission is prepared to support the authorities in their announced policy for the exchange rate (and we believe it should, in the context of all the advances already undertaken with fiscal and monetary policies). A reading of the briefing, however, seems to suggest that this is not the case. At the bottom of page 7 it says "...the mission will examine the appropriateness of the current exchange rate policy in light of understandings under the program, and, if needed, it will suggest to the authorities a modification of exchange rate policy to secure the external and growth objectives of the program." If the mission takes that position, it might well validate the public expectations about a devaluation and, as a result, interest rates will remain high before the actual devaluation takes place. It is true that real interest rates on outstanding nonindexed government obligations will decline following the devaluation, but this will only be a temporary phenomenon since the public will realize that any misalignment of a key nominal variable under the program will be followed, sooner or later, by an additional devaluation. As a consequence, the program might be self-defeating by generating an inefficient cycle of devaluations and high interest rates.

Having said that, it is also important to acknowledge a caveat to the indexation policy. Real shocks, such as changes in the price of oil, might require a change in the real exchange rate which will affect the domestic real interest rate. However, in the absence of reliable predictors of exogenous real shocks, and the already sizeable stock of domestic government debt it appears that the net benefits from indexing government bonds more than justify the mission's support for such instruments

cc Mr Frenkel
Mr Beza
Mr Gianviti
Mr Tanzi
Mr Brau
Mr Coats

F

Office Memorandum

TO The Acting Managing Director DATE July 14, 1989

FROM S T Beza

SUBJECT Mexico--Balance of Payments Implications of Agreement with Banks

The attached note sought to describe the main balance of payments implications of the agreement that we thought was emerging from the discussions between the banks and Mexico Since the note was prepared some of the concerns reflected in it seem to have materialized, in particular requests by commercial banks for recapture of future favorable developments and generally tighter conditions It appears that these requests by the banks would raise the level of required enhancements far above the resources available, thereby reducing the effective discounts of the proposed package

Although the note may have been overtaken by events in some respects, we thought it useful to circulate it, particularly to show the effects of a package in which the discounts were broadly in line with the enhancements considered to be available

Attachment

cc The Managing Director (o/r)
Mr Frenkel
Mr Whittome
Mr H Simpson

July 14, 1989

Mexico--Balance of Payments Implications of Agreement with Banks

The attached table for Mexico provides a preliminary estimate of the effects on the balance of payments of the agreement that appears to be emerging between the Mexican authorities and commercial banks.

The estimate is based on what we understand are key principles of the agreement that appears to be evolving. It assumes that new money is provided for the equivalent of 4 percent of exposure in 1989 as proposed by the Mexican authorities. For subsequent years, the projection assumes a discount of 35 percent on Mexico's paper, with 70 percent of eligible debt being replaced by enhanced new bonds under this option. For the remaining 30 percent of eligible debt, exposure is assumed to increase by 7 percent a year over 3 years. (Banks may be reluctant to choose the new money option because of a perceived risk of additional requests for financing in the future; the debt reduction option is seen effectively as an exit bond.)

On the basis of the above assumptions, it is estimated that commercial banks would provide financial support averaging some US$2.2 billion a year in the period 1989-92, while the program originally envisaged new money averaging US$4.4 billion a year. The resulting gap could be closed if the currently favorable effects of around US$2 billion a year from higher oil prices and lower interest rates (compared with the baseline scenario) were utilized for this purpose; this additional US$2 billion would result from an oil price US$3 a barrel higher than in the baseline and a LIBOR one percentage point lower than in the baseline. Indeed, there would be a net financing gain compared with the baseline scenario for the period 1989-92. However, under the baseline scenario the more favorable external environment just referred to would have been expected to result in additional reserve gains of around US$2 billion a year (or a minimum of US$1 billion, once allowance was made for the functioning of the bands).

There are certain other points that should be made about the above projections:

First, it should be emphasized that the exercise has been developed without allowing for features of the package that might involve a cost to Mexico. If the package were to include recapture clauses for future favorable developments or features aimed at replenishing interest guarantees, as is being requested by the banks, the effective discount under the arrangement would be reduced; in the end it might involve a solution resembling new money with enhancements, thus resulting in higher interest payments Of course, it will be necessary to assess the appropriateness of the financing package, once it is known, to determine whether it can be supported by the Fund through financing for debt and debt service reduction

Second, it should be noted that the amount of debt reduction that is assumed in the projection is broadly in line with the availability of enhancements (about US$6 1/2 billion) Only with larger enhancements would it be possible to obtain a deeper discount, and full (or nearly full) collateralization would be needed to approximate the discount of the market

Finally, if the proposed package is along the lines described above, the program would be more vulnerable than in the baseline This would be so because a significant proportion of the gains from higher oil prices and lower interest rates would result in reduced financing from banks rather than being reflected in higher net international reserves as programmed, and because of the absence of contingent arrangements from banks to address possible future lower oil prices or higher interest rates Such a package might be objected to by the Board because of the possible future pressures for additional financing from official sources and considerations of burden sharing

Attachment

Mexico Balance of Payments, Revised Scenario

(In billions of U S dollars)

		1989	1990	1991	1992
I	Financing				
	1 Proposed bank financing	2 1	2 3	2 4	2 3
	a Lower debt service due to debt/debt service reduction 1/	(--)	(1 2)	(1 3)	(1 2)
	b New money (increase in exposure on 30 percent of banks' restructurable debt) 2/	(2 1)	(1 1)	(1 1)	(1 1)
	2 New money in baseline scenario	4 3	4 0	4 7	4 4
	3 Shortfall in bank financing (1-2)	-2 2	-1 7	-2 3	-2 1
	4 Effect of higher oil prices and lower LIBOR	2 1	2 1	2 1	2 1
	5 Lower debt service due to lower borrowing 3/	0 1	0 4	0 8	1 3
	6 Net financing result (3 + 4 + 1), excess (+), shortfall (-) 4/	--	0 9	0 6	1 4
II	Net international reserve changes (increase +)				
	1 Program target	1 5	0 9	1 2	0 8
	2 Program target (adjusted for net financing result)	1 5	1 8	1 8	2 2
	3 Program target (adjusted for deviations in oil prices and LIBOR)	3 6	3 0	3 3	2 9
III	External current account				
	1 Baseline scenario	4 8	4 4	4 8	5 2
	2 Revised scenario (baseline -I1a -I4 -I5)	2 6	0 6	0 6	0 5
IV	Cumulative debt reduction with respect to baseline scenario (end period)	2 2	18 3	21 9	25 2
	1 Outstanding debt in baseline	102 2	107 0	112 3	116 9
	2 Outstanding debt in revised scenario	100 0	88 7	90 4	91 7

Source Fund staff estimates

1/ Based on a 35 percent discount on 70 percent of restructurable debt (or equivalent debt service reduction) Assumes full reduction in early 1990

2/ Exposure to increase by 4 percent on US$54 billion in 1989 and by an annual 7 percent in 1990-92 on 30 percent of restructurable debt

3/ Interest savings from lower debt accumulation as compared with baseline scenario, which had been developed on the assumption of new money

4/ Net international reserve gain relative to baseline scenario

F

Office Memorandum

Mexico

TO: The Managing Director

DATE: July 7, 1989

FROM: S. T. Beza

SUBJECT: Mexico Bridge Financing

Information from the World Bank indicates that from next week to end-November some US$460 million would be available in drawings by Mexico from the three recently approved loans in support of the program.

In our case, the amount is some US$410 million (SDR = 1.27 U.S. dollars today), covering drawings available at end-August and end-November.

cc: The Deputy Managing Director
Mr. H. Simpson

Office Memorandum

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(1) Mexico
(2) Travel
cl approved memo
PPE

TO: The Deputy Managing Director (Cleared with Administration)

DATE: July 6, 1989

7/6/89

FROM: S.T. Beza

SUBJECT: Mission to Mexico--Request to Designate Mission Head

The current travel schedule includes a staff visit to Mexico (No. 90046300) for discussions related to the first review under the Extended Arrangement that was recently approved. The schedule does not name a mission chief, and we wish to designate Mr. Claudio Loser, Senior Advisor (WHD), as the head of this mission.

cc: ADM
Mr. Caiola
Mrs. Braña

Mission ID: 90046300 (Already assigned)

Pgm No: 420

1989 JUL -6 PM 2:24
OFFICE OF THE DEPUTY MANAGING DIRECTOR

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JUL 06 1989
DY. DIR. ADM.

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TELEFAX / FACSIMILE

INTERNATIONAL MONETARY FUND
WESTERN HEMISPHERE DEPT.
1989 JUN 26 PM 12:55

MINISTRY OF FINANCE.
UNDERSECRETARY FOR INTERNATIONAL FINANCIAL AFFAIRS.
M E X I C O .

mexico

DATE: JUNE 26, 1989.

NUMBER OF PAGES
(INCLUDING COVER SHEET):

TO: NAME OF ADDRESSEE:

MR. TED BEZA,
IMF,
WASHINGTON, D. C.

TELEFAX/FACSIMILE TELEPHONE NUMBER: 95-202-623-7499.

FROM: NAME OF SENDER:

MR. ANGEL GURRÍA.
MEXICO.

TELEFAX/FACSIMILE TELEPHONE NUMBER: (905) - 542-45-81.

PLEASE DELIVER COPIES TO MR. LOZER AND MR. BONVICINI.

IF THERE IS ANY PROBLEM WITH THE TRANSMISSION, PLEASE CALL BACK:
(905) - 542-13-00, 522-56-22, 542-39-04 AND 542-98-39.

FINANCING PACKAGE

Mexico's Financing Package would consist of a broad menu of options including at least three Debt and Debt-Service Reduction Exchange Options and six New Money/Interest Recycling Options, together with changes in the terms of Mexico's existing debt agreements.

All Lenders with MYRA debt would be asked to participate in the Financing Package. Any Lender could voluntarily allocate amounts of its MYRA debt as well as any of its Old New Money (other than Facilities 2 and 3 of the 1987 MFA) to one or more of the Debt and Debt-Service Reduction Exchange Options. Because both MYRA and Old New Money (other than Facilities 2 and 3 of the 1987 MFA) are eligible for inclusion in the Debt and Debt-Service Reduction Options, such debt is referred to herein as "Eligible Debt". Each Lender with Base Debt (an asset base consisting of MYRA) would be asked to make a New Money commitment equal to 4.75% of its Base Debt (per year) that has not been allocated by the Lender to one or more of the Debt and Debt-Service Reduction Options. Any resulting New Money commitment of any Lender may be allocated by such Lender to any one or more of the New Money/Interest Recycling Options.

<u>Debt and Debt-Service Reduction Options</u>

<u>Pricing</u>: (a) <u>Discount Bonds</u>

<u>Principal</u>: 70% of MYRA debt;
80% of Old New Money

<u>Interest</u>: LIBOR plus 1-1/4%

<u>Collateral</u>:

(i) <u>Principal</u>: Fully collateralized with zero-coupon U.S. Treasury obligations or comparable collateral.

(ii) <u>Interest</u>: 2 year rolling guaranty of payment, available for up to 30 years.

(b) <u>Par Bonds</u>

<u>Principal</u>: 100% of Eligible Debt

<u>Interest</u>: 7-1/4% fixed for MYRA debt;
7-7/8% fixed for Old New Money (in U.S dollars) (or comparable yield in other currencies) (indicative terms only)

LX105/1564Q

Collateral:

(i) Principal: Fully collateralized with zero-coupon U.S. Treasury obligations or comparable collateral.

(ii) Interest: 2 year rolling guaranty of payment, available for up to 30 years.

(iii) Alternative Collateral Packages: Alternatively, Lenders could select among two other collateral packages for the Par Bonds, each of which would have collateral of equivalent value to the collateral for the Par Bonds as described above:

(1) All resources for enhancements would be dedicated to the rolling guaranty of interest (in which case the Bond would amortize in equal installments over years 20 through 30).

(2) Principal collateralized up to the level of the exchange price for the Discount Bonds, with the remaining resources for enhancements dedicated to a rolling guaranty of interest.

(c) Hybrid Bonds

Would combine elements of debt and debt-service reduction as specified in clauses (a) and (b) above on a comparable basis to be determined.

Replenishment of Interest Collateral: From its own sources, Mexico will replenish amounts paid under the rolling interest guaranty.

Optional Exchange: After five years, each Lender would have an annual option to release its interest and principal collateral for any Bonds by exchanging such Bonds for unsecured instruments with the following terms:

	Principal: 100% of Eligible Debt exchanged for such Bonds Interest: 13/16% plus LIBOR Repayment: On a basis comparable to MYRA debt.
Currency:	Appropriate currencies to be discussed
Tenor:	30 year bullet
Conditionality:	Appropriate linkage to IMF (EFF or other funded program for at least 4 years), IBRD and IDB programs, Paris Club agreement, New Money facilities and availability of appropriate enhancements. Bonds would be issued, and benefits conferred, upfront if (and only to the extent that) enhancements are made available upfront.
Form:	Bonds to be issued in bearer form and to be designed as an exit instrument.
Debt Conversion:	Bonds will be eligible for conversion under Mexico's debt conversion programs.

New Money/Interest Recycling Options

Aggregate Amount:	4.75% of the Base Debt per year (subject to reduction for Lenders participating in Debt and Debt-Service Reduction Options).
Lenders:	Lenders who have allocated Base Debt to one or more of the New Money Options.
Commitment Period:	4 years
Interest Recycling Feature:	Lenders may fund their Commitments under the New Money Options either by advancing fresh funds or by recycling interest from Eligible Debt, subject to conditionality.

Options:

(a) Cofinancing linked to specified IBRD and IDB loans by IBRD and IDB guaranty of payment and mandatory cross-default and sharing clauses.
- (i) Amount: At least 20% of Maximum Aggregate Amount
- (ii) Tenor: Same as IBRD and IDB loans
- (iii) Interest Rate: 13/16% plus LIBOR

(b) New Money Floating Rate Notes designed as a marketable instrument and in bearer form.
- (i) Amount: Up to 100% of Maximum Aggregate Amount
- (ii) Tenor: 10 years/5 years' grace
- (iii) Interest Rate: 1% plus LIBOR

(c) New Money Bonds designed as a marketable instrument and in bearer form.
- (i) Amount: Up to 100% of Maximum Aggregate Amount
- (ii) Tenor: 12 years, 7 years' grace
- (iii) Interest Rate: 11% fixed (in U.S. dollars) (or comparable yield in other currencies) (indicative terms only)

(d) Onlending Deposit Facility from which amounts on deposit may be onlent to Mexican public or private sector borrowers in negotiated transactions.
- (i) Amount: At least 20% of Maximum Aggregate Amount
- (ii) Tenor: 9 year bullet
- (iii) Interest Rate: 13/16% plus LIBOR

(e) Medium-Term Trade Deposit Facility from which amounts on deposit are available to finance Eligible Trade Credits (to be defined to include specified trade transactions in addition to the unguaranteed portion of bilateral credits) to public and private sector borrowers in negotiated transactions.

(i) Amount: At least 20% of Maximum Aggregate Amount
(ii) Tenor: 9 year bullet
(iii) Interest Rate: 13/16% plus LIBOR

(f) Equity Investment Facility under which Lenders may establish Mexican investment trusts and make equity investments in Mexican entities.
(i) Amount: At least 20% of Maximum Aggregate Amount
(ii) Period: 12 years
(iii) Mechanism: Lenders would initially fund individual trusts in Mexico for the purpose of making subsequent equity investments in Mexican entities through the trusts.
(iv) Restrictions: Investments in the trusts would be subject to restrictions on capital repatriation consistent with "Period" above. Trusts would be subject to periodic reporting to Mexican authorities and would in all respects be subject to Mexican law and regulations.

Conditionality: Appropriate linkage, on a quarterly basis, to IMF (EFF or other funded program for at least 4 years), IBRD and IDB programs, Paris Club agreement, Debt and Debt-Service Reduction Options, etc.

Currencies: Appropriate currencies to be discussed.

Pari Passu: All New Money debt instruments to be at least pari passu in priority of payment with all other Mexican public sector external debt, with appropriate exceptions to permit the collateralization of the Discount, Par and Hybrid Bonds.

Debt Conversion: All New Money debt instruments will be eligible for conversion under Mexico's debt conversion programs.

Value Recovery

Additional value to be provided to all participants (on a basis other than the prepayment of future interest installments at their net present value) under specified favorable economic circumstances defined by levels of oil prices and/or interest rates (to be allocated among New Money and Debt and Debt-Service Reduction participants on a satisfactory basis to be determined).

Early Participation Fee

Participants sending early allocations would receive an early participation fee (calculated on a satisfactory basis to be determined).

Existing Debt Agreements

The existing debt agreements would be amended to give effect to certain exceptions to cross-defaults and other matters of a conforming nature. Appropriate amendments and waivers would be requested to permit the issuance of the Discount Bonds, Par Bonds and Hybrid Bonds, but there would be no general amendments or waivers to permit the additional flexibility (cash buybacks, etc.) requested in the Mexican Proposal of June 14, 1989.

Old New Money

In addition, the amortization of the Old New Money (other than Facilities 2 and 3 of the 1987 MFA) would be amended on the following terms:

Tenor:	12 years/5 years' grace
Interest:	13/16% plus LIBOR

Debt Conversion Programs

The Financing Package would need to be accompanied by active and viable voluntary debt conversion programs which operate for at least 6 years in addition to, and independent from, Mexico's privatization program. There should be a general program available to all investors and a special program available only to full participants in the Financing Package on a preferential basis. The general program would either involve periodic public auctions, or be similar to the prior Mexican program but with an open reporting mechanism. Under the special program, each full participant in the Financing Package would receive a right, transferable only to other full participants, to convert a specified amount of public sector debt into equity at Par (meaning that Discount Bonds would be converted at par and all other instruments would be converted on a basis giving effect to the discount applicable to the Discount Bonds). Such debt conversion programs would provide for an annual minimum volume of at least

U.S. $3 billion (split equally between the general and special programs) and would be designed to facilitate the development of the private sector, including the financial sector.

Implementation

In order to make the proposed changes in the existing debt agreements referred to above (including the changes in the Old New Money), and in part to consolidate existing debt agreements, the Eligible Debt of all participating Lenders (including Lenders participating only in New Money Options) would be exchanged for new debt instruments in debt-for-debt exchanges under Section 5.11. To the extent of their participation in New Money Options, the Eligible Debt of Lenders would be so exchanged for new instruments with payment terms substantially similar to such Eligible Debt, except for the proposed changes referred to above.

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Office Memorandum

TO The Managing Director
The Deputy Managing Director

DATE June 21, 1989

FROM S. T. Beza

SUBJECT Mexico - Extension of Growth and Stabilization Pact

On June 18 it was announced that the new pact for economic growth and stability (PECE)--put in place at the end of December 1988 to run through July 31, 1989--will be extended through March 31, 1990.

The following are key features of the agreement among business, labor, and the Government

1. The peso will continue to be depreciated at a rate of one peso a day in relation to the U.S. dollar (equivalent initially to about 1.2 percent a month). This will be enough to maintain competitiveness if inflation stays under 1 1/2 percent a month and the U.S. dollar does not appreciate in real terms, reviews will need to address the issue whether the level of competitiveness is appropriate.

2. Public sector prices and tariffs will, on average, be kept unchanged.

3. The enterprise sector will continue to respect price controls with prices remaining frozen for a basket of goods.

4. Collective wage negotiations may be pursued freely under the extension of the PFCE. It was reported that an increase in the minimum wage will be announced on July 20 (to become effective August 1), which is expected to be equivalent to 5-6 percent, the minimum wage was last raised by 8 percent at the beginning of 1989.

5. Import regulations will be revised to establish stricter quality control measures. It was stressed that this is not a protectionist action.

These announcements are not inconsistent with Mexico's economic program supported by the extended arrangement. In particular, the program's fiscal projections for 1989 do not assume changes in public sector prices and tariffs. However, in the forthcoming review of Mexico's economic program under the EFF there will be an examination of whether additional fiscal actions are needed in the light of developments

In a conversation with Mr. Gurria today, he said that the exchange market and stock market had reacted positively to the extension of the PECE. He added, however, that interest rates had stayed roughly unchanged

cc Mr. Frenkel
Mr. Tanzi
Mr. Brau
Mr. H. Simpson

DOCUMENT OF INTERNATIONAL MONETARY FUND AND NOT FOR PUBLIC USE

SUR/89/39

CONFIDENTIAL

June 19, 1989

The Chairman's Summing Up at the Conclusion of the 1989
Article IV Consultation with Mexico
Executive Board Meeting 89/65, ~~May 26, 1989~~

Executive Directors expressed their support for the strategy of growth-oriented medium-term adjustment being followed by the Mexican authorities They welcomed the tightening of macroeconomic policies, particularly as reflected in the marked improvement in the primary fiscal balance, as well as the breaking of wage indexation, and structural reforms, including the measures taken by the authorities to integrate Mexico more closely into the world economy The progress made in reducing inflation since the previous consultation was commented on favorably by Directors They observed, however, that real GDP growth had been slow

Directors also noted that Mexico's heavy debt service burden had been a severe constraint on the country's economic performance In that connection, some Directors thought that existing conditions might have affected adversely investment and the prospects for private sector capital reflows

Directors were of the view that the policy stance that had been put in place, with its emphasis on growth-oriented adjustment, was appropriate Directors stressed that the program required adequate external financing and sustained expansion in Mexico's export markets The success of the program hinged on effective control of inflation, a major increase in domestic savings, and effective debt reduction

Directors said that the fiscal adjustment being sought, including the proposed primary fiscal surplus, was essential to the achievement of the objectives of the economic program for 1989-92 A number of Directors wondered, however, whether real interest rates would fall as projected, if this did not occur, it would have adverse implications for the operational fiscal deficit and its financing Nevertheless, Directors were reassured by the authorities' commitment to take whatever additional measures were needed to ensure the achievement of the program objectives They stressed the importance of continued vigilance on the part of the authorities to adapt the program to changing circumstances, and in this regard some Directors said that the pricing of goods and services provided by the public sector had to be monitored carefully Directors supported the tax reform being carried out They also supported the efforts of the authorities to reform or divest a number of public sector enterprises, and urged them to accelerate and broaden the scope of these reforms

- over -

Directors were in general agreement with the prudent stance of monetary policy which is to provide an essential support for containing inflation in Mexico's program The liberalization of the financial system, including a freeing of interest rates, and the development of new instruments were expected to provide an environment conducive to an effective implementation of policy in this area In this regard, Directors noted the recent strong growth of private sector financial savings, however, they emphasized the importance of reduced pressure on the financial system from the public sector

The progress in reducing the pace of wage increases and the reduced incidence of indexation was welcomed Directors emphasized the importance of wages being consistent with the anti-inflation objectives of the authorities, particularly if the growth of output and employment was to be supported In that regard, a number of Directors expressed concern about the prospects for wage increases following the end of the Pacto de Solidaridad Económica in July and stressed the vital role of incomes policies supported by tight fiscal and monetary policies

Several Directors expressed concern about the real effective appreciation of the peso in 1988 even though the adverse effects of the appreciation on external competitiveness were reduced by the beneficial impact on costs of the trade liberalization and the behavior of wages in relation to prices A number of Directors observed that the exchange rate policy pursued since the beginning of 1989 has been helpful, and emphasized the importance of a satisfactory competitive position being maintained by Mexico Thus, the authorities needed to monitor developments in the balance of payments very closely, and they had to stand ready to adopt promptly any corrective measures that might be required It also was noted that pursuit of an adequate exchange rate policy was essential for the consolidation of the major trade liberalization that had been undertaken Directors gave strong support to the liberalization of foreign investment regulations that was being introduced, and they saw this as an important element in the achievement of balance of payments objectives and in promoting efficient growth

Directors stressed the need for adequate external financing, including a realistic program of voluntary market-oriented debt reduction Directors drew attention to the support that was expected to be provided by the World Bank and official creditors under the Paris Club, and they emphasized the importance of Mexico and its commercial bank creditors reaching agreement promptly on a suitable financing package Directors generally called for close monitoring of developments while financing assurances were not present Directors expressed their support for the 30 percent set-aside and eventual augmentation of the extended arrangement by up to 40 percent of Mexico's quota They also expressed their willingness, if the need arises at the time of their decision on this augmentation, to apply to Mexico the exceptional circumstances clause of the Fund's access policy

It is proposed that the next Article IV consultation be held on the standard 12-month cycle

F

Office Memorandum

TO The Managing Director DATE June 19, 1989

FROM S T. Beza MB

SUBJECT Mexico - Proposed Debt/Debt Service Reduction Instruments

We have reviewed the proposal of Mr. Corrigan about alternative assumptions for debt and debt-service reduction. The attached table gives possible market valuations of these assumptions and the resulting balance of payments' impact.

The main point arising from the table is that the Federal Reserve Bank of New York (NY Fed) is optimistic concerning the possible market valuation of the alternative assumptions. For example, in the case of the proposed reduction in the principal to 55 percent of original face value, the NY Fed outcome implies that the US$7 billion that the Mexican officials have been assuming is available for enhancement (collateralization of principal and a 30-month rolling guarantee on interest payments) would yield a net reduction in Mexico's external debt of the order of US$19.8 billion with a debt-service reduction of US$2 billion a year. However, our estimates suggest that the proposed enhancements to the new debt instrument would provide only for a reduction in the principal to 70 percent of original face value. To obtain the net debt reduction of US$19.8 billion implied by the NY Fed proposal, it would be necessary to have enhancements valued at over US$13 billion.

The NY Fed outcome implies that the enhancements provide substantially greater leverage than that obtainable from cash buybacks while our results are equivalent to those obtainable from a cash buyback, with US$7 billion yielding a net reduction in Mexico's external debt in the order of US$10.5 billion. This would indicate a debt-service reduction of US$1.05 billion a year, leaving Mexico's remaining net external financing requirements at US$3.25 billion a year. Similarly, the NY Fed is optimistic concerning the market valuation of instruments offering reduced interest rates

These results are, of course, dependent on the markets' perception of the value of the enhancements and the impact of these debt operations on Mexico's likelihood of paying its unguaranteed interest obligations. A particular problem is how to value a rolling guarantee. In the estimates presented by the staff, it is assumed that the guarantee has full effect in enhancing interest payments.

Attachment

cc The Deputy Managing Director (o/r)
Mr. Brau
Mr. Dooley
Mr. H. Simpson

Mexico Impact of Various Instruments on Debt Reduction 1/

(In billions of U.S dollars, unless otherwise indicated)

Proposed Face Value of Instrument (Impact of Original Debt)	Zero Coupon Bond (Percentage of Principal Covered)	Interest Rate	Months of Rolling Interest Guarantee	N Y. Fed Expected Impact From Use of US$7 billion in Collateral: Net Debt Reduction	N Y. Fed Expected Impact From Use of US$7 billion in Collateral: Debt Service Reduction	Fund Staff Expected Impact From Use of US$7 billion in Collateral 2/: Net Debt Reduction	Fund Staff Expected Impact From Use of US$7 billion in Collateral 2/: Debt Service Reduction
55	100	10	30	19.8	1 98	10.5	1.05
65	100	10	18	18 6	1.86	10.5	1.05
100	55	5	18	--	1.86	--	1 26 3/
100	65	7	12	--	1.46	--	1.15 3/

1/ Assumes that debt is transacted at a discount of 60 percent in the secondary market.
2/ Assumes that the market expects that the interest guarantee is used immediately after issuance of instrument.
3/ This is a centerpoint for a range that allows for differing market valuation of the new instrument. The low side of the range would reflect a market discount of 60 percent of the reduced interest obligation

Office Memorandum

TO: The Managing Director
The Deputy Managing Director

DATE: June 15, 1989

FROM: S.T. Beza

SUBJECT: Mexico - Negotiations with Commercial Banks

In their continuing negotiations with commercial banks, the Mexican representatives have proposed certain new elements for a term sheet. The most important features are:

1. A reduction to 45 percent in the discount asked in the debt reduction alternative of the menu. Initially the proposed discount was 55 percent, but this was later reduced to 50 percent. Also, the interest rate of the new debt instruments would be LIBOR plus 13/16, instead of LIBOR flat as originally proposed.

2. An increase to 5 percent in the interest rate of the new debt instruments in the debt service reduction alternative of the menu. Initially the proposed rate was 4 percent, but was later raised to 4 1/2 percent.

3. Collateral would be equivalent to two years interest and principal at maturity (30 years) for the new debt instruments.

4. Debt reduction instruments would not be restructured, would be excluded from the base for future new money exercises, and would be senior in right of payment to other debt (the last-mentioned feature is a particularly controversial one, and its meaning in the case of large operations is unclear).

5. Debt reduction instruments would be eligible for conversion into equity of public sector companies that are being privatized.

6. Contingency mechanisms related to oil prices and external interest rates have been added to the term sheet. Outside the bands the adjustments are only partial (which suggests that Mexican officials have left themselves some room for bargaining).

Mexican representatives reportedly have indicated to members of the steering committee that the proposal outlined above goes as far as they can in improving the offer on debt and debt service reduction. They also have noted that perhaps it will be necessary to focus future discussions on the financing needs in the form of new money, with waivers arranged as required to permit market-related debt reduction operations. Banks' participation in these market-related operations would result in a reduction in their share in new money obligations.

cc: Mr. Brau
Mr. Dooley
Mr. Watson
Mr. H. Simpson

'89-06-15 09:39 I M F PARIS 33 1 47 23 40 89

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INTERNATIONAL MONETARY FUND
66 AVENUE D'IÉNA, 75116 PARIS
FRANCE
PRINCIPAL OFFICE, WASHINGTON, D.C. 20431

OFFICE IN EUROPE

mexico

CABLE ADDRESS
INTERFUND PARIS
TELEPHONE: (1) 47.23.64.21
TELEX: INFUND 610712F
FACSIMILE: (1) 47.23.40.89

Facsimile Service Cover Sheet

Number of pages (including cover sheet)	Message number	Date
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To	Name of addressee (type) Mr. Claudio Loser. WHD. Room 10-100. Facsimile telephone number
From	Name of sender (type) Mr. H. Arbulu-Neira. Paris Office.

850866

1989 JUN 14 AM 7:03

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STRATEGY FOR SOVEREIGN DEBT

FOR A NEW OPTION UNDER THE BRADY INITIATIVF, AND FOR A BETTER LEVERAGE OF THE CREDITOR BANKS' SUPPORT

1/ Pursuant to the Brady initiative, and in the middle of the Mexican Debt negotiations, the International Banking Community is subject to increasing pressure to accept an important debt forgiveness

In such circumstances, a most unexpected fact needs to be emphasized the present negotiations could result in having banks suffer a financial sacrifice much greater than the debt benefit it will bring to Mexico

This conclusion is simply the result of the financial analysis of several schemes which - in one way or another - imply an exchange of mexican loans for securities at a lesser amount but with a better quality, due to their guarantees on principal and, partially, on interest payments

Used as major instruments for the debt settlement the performance of these schemes appear poor, for two key reasons

they force the debtor - in order to constitute the necessary guarantees - to freeze for a long period of time the proceeds of multilateral credits with interests payable annually

Moreover, since the new securities cannot be fully secured, they force the debtor to pay - at least partially - the current price of its signature which is obviously most costly (and will result in the discount of the new security on the market)

It can easily be demonstrated that an exchange of USD 100 bank debt for USD 80 new bond (which is traded with a 20% discount in the secondary market i e assuming a market price of the bond of USD 64) implies a 36% loss for the banks while it reduces the debt service burden for Mexico by only 19% (i e 20% minus the annual financial cost of the zero coupon)

Consequently, any debt restructure negotiation which relies primarily on a similar scheme increases mechanilly the gap between the creditor banks and Mexico

Therefore, the result will most likely be whether an unfair solution from the creditor's point of view, whether an insufficient one for the debtor , a choice between what is unacceptable and what is shortlived needs to be avoided

2/ In summary, the alternative today is the following

If Governments and Multilateral Institutions seek an immediate and significant reduction in both the debt service burden and the debt amount as well, it is necessary they dedicate much more financial ressources and allow bank-debt buy-backs with fresh money coupled with a partial forgiveness of the public debt One can question whether this is desired

The other solution would therefore consist in recognizing that New Money will remain as the core of the debt issue for the future in order to achieve within the objectives of the Brady initiative, two main goals

- To maximize the cash-flow improvement resulting from 1 USD from Banks as well as from multilateral agencies (one couldn't expect less)

- To ensure the maintenance of the debt amount at its current level and then its progressive reduction during the next 10/15 years and pursuant to a schedule previously agreed on between banks and Mexico, until a drastic debt ratio inflexion can be achieved.

The major disadvantage of the previous debt restructures was their inflating impact on the LDC'S debt level the challenge we face today is to find the way to reverse this situation while keeping the best of the 'old way'

We need to find new financial instruments which will help to reach those objectives

3/ We hereby propose, as an option to the present schemes, a new instrument a Multi-Year Debt Reduction Agreement (MYDRA) with the following characteristics ·

Banks and Mexico first conclude a Multi-Year New Money agreement, whereby banks accept a long term committment under which the amount of new credits equals to a percentage of interest received on the "eligible" debt

In order to eliminate the disadvantages of previous debt restructures, i e the debt increase resulting from the New Money, banks simultaneously contribute, pari-passu with the multilateral institutions, to a SPECIAL FUND the funding of which ensures the periodic full repayment of the New Moneys Banks contribution to the fund is not redeemable, unless a very significant improvement of Mexico's economy permits a cash-recapture

In this way, there will be an "auto-reimbursable New-Money, under the terms of which

Mexico will satisfy its cash-flow requirements and at the same time its debt level will be frozen in nominal terms (thus it will reduce its debt amount, in real terms, by 35% over a 12 year period, with a GNP growth of 3 5% p a) , this real debt relief could be accelerated over the period with additionnal debt buy-backs

Banks will be compensated for their contribution to the SPECIAL FUND in different ways

- They will receive full interest payment, direct or indirectly (through the repayment of New-Moneys)

- They will maintain their existing exposure at its current level, unless they voluntarily decide to give new credits

- They will contribute to a debt ratio improvement for the country and thus will increase over the time the value of their Mexican exposure

4/ The ideas contained herein, in our opinion, better respond to Mexico's needs , we believe they also respond to bank's needs with regards to their accounting and balance sheet requirements , furthermore, MYDRA optimizes the leverage of the financial support provided by the international community

As an example, Mexico could save annually USD 1 5 billion, under a securitization scheme, resulting in a USD 11 to USD 15 Million loss for the banks while, under MYDRA, their loss though important, would be reduced to USD 6 Million assuming, in both cases, a USD 6 billion guaranty from the multilateral agencies

Such a difference results from two factors . one which is the fact that Mexico does not need to 'freeze" part of its financial ressources for 30 years more importantly, the second one which prevents Mexico from refinancing its existing debt on the basis of its own and expensive signature

This difference in "savings" for the banks represents a significant benefit to them, even more important than no one pays the price for it, but everyone can expect to benefit from it

One could object that this new instrument would enhance the New Moneys, and, therefore is likely to be rejected by the multilateral agencies

In fact, the principles of the proposed scheme herein are quite different first, it prevents the debt amount from increasing secondly banks themselves contribute to the funding of the special fund

Mexico will obviously need fresh money we must face today the issue of their reimbursement, consistent with the Brady initiative

Moreover, unlike the securitization scheme MYDRA, which leaves the old debt unchanged, does not imply risk-transfer from Banks to public entities as such it should better address the Governments' concerns.

* * *
*

No political decision can force the spending of more money if it is obviously useless. If that was the case, it could only mean that a scape goat will be made out of the Banking Community

One can question whether this is the best way to solve the debt question

(1) Taking into consideration whether the present value of the loss of income during the next 12 years (i e the MYDRA term) or the immediate capital loss

Paris, June 7th, 1989

COMPARISON BETWEEN A SECURITIZATION SCHEME AND 'MYDRA"

1/ Assumptions

Annual target cash-flow savings . USD 1.5 billion on USD 38 billion debt (medium-term bank debt excluding New-Moneys)

2/ Option 1

Exchange of USD 38 billion bank debt for 30 year term bonds bearing an interest rate of Libor + 13/16 with guaranty on principal and 2 year (revolving) interest payments

Rate of exchange required to achieve the targetted savings	60/100
Banks'loss	
- on principal	USD 15 2 bn (38 X 40 %)
- on interest (p v for the next 12 years)	USD 11 3 br (1 64 bn p a with Libor=10%)
- financial support from multilateral agencies (guaranty on principal + interests) ·	USD 6 5 bn (interest rate at market)

3/ Option 2

12 year terms MYDRA option, with New Moneys reimbursed on year 6 and 12 from proceeds of the SPECIAL FUND constituted 50/50 by Banks and Multilateral Institutions

% of New Money necessary to achieve the targetted savings (% of interests on USD 38 bn)	50 %
Funding of SPECIAL FUND to cover New Moneys	USD 12 6 bn
Banks'loss	USD 6 3 bn
Support from Multilateral Agencies	USD 6 3 bn (interest rate at market)

* * *
*

La banque française explore une voie conduisant à un plafonnement réel de la dette du Mexique, tout en assainissant le bilan des institutions bancaires

■ *« Nous n avons pas la pretention d arriver avec une solution revolutionnaire mais simplement de proposer une solution technique qui optimiserait l effort financier en faveur du Mexique et aurait pour ce dernier un meilleur rendement que les projets actuels »* C'est ainsi que Michel Pebereau PDG du CCF a decrit l'option proposee par sa banque pour l'application de l'initiative Brady au Mexique, qui sert actuellement de véritable banc d'essai à la reflexion internationale. Pour le CCF, les creances sur le Mexique representent quelque 0 3 % du total de la dette bancaire de ce pays et environ 4 % des creances detenues par les seules banques françaises

Les schemas actuels de reduction de dette explique Michel Pebereau, ne resolvent pas le probleme de l insuffisance de *cash flow* pour le pays concerne L'echange de creances integrant une decote, avec garantie partielle ne fait qu'aggraver *« de façon mecanique le fossé a combler entre les banques et le Mexique »* Il exige toujours un apport d'argent frais, de *new money* qui permettra le rachat des creances bancaires Resultat apres avoir ete « casse » pendant quelques mois l envol de l'endettement global repart de plus belle

L idee du CCF est de demander aux banques de verser à un « fonds special » a egalite absolue avec les institutions multilaterales, une certaine somme cette dernière serait utilisee pour rembourser integralement a echeance reguliere les *new moneys* accordes *New moneys* « autoremboursables » en quelque sorte, et qui ne viendraient donc pas alourdir l endettement mexicain

La condition première pour la mise en place de ce que le CCF baptise un « mydra » (*multi-year debt reduction agreement* accord pluriannuel de reduction de dette) est que les banques et le Mexique concluent d'abord un accord de restructuration et d apport de *new money* de type classique, mais de caractere pluriannuel les *new moneys* feraient l'objet d'un engagement à long terme (douze ans) et seraient fixes en fonction d un pourcentage des interets annuels dus aux banques

Mais quel interêt ont les banques à payer ainsi en partie le remboursement de leurs propres credits ? L'avantage est multiple, repond le CCF contre ce qui apparaît comme le versement d'une sorte de « prime d'assurance », les banques reçoivent, directement ou indirectement, l intégralite des intérêts dus sur leurs creances existantes de plus, elles bloquent leurs engagements aux niveaux d'aujourd'hui, sauf nouveaux crédits librement consentis, enfin, elles ouvrent une perspective d'amelioration continue des ratios d'endettement du Mexique, donc de revalorisation de leurs creances anciennes

Une veritable prime d'assurance

Bien sûr, leur contribution au Fonds est enregistree en « pertes » — sauf exercice d'une clause de *« retour a meilleure fortune »* du Mexique Mais le CCF donne un exemple comparatif chiffre qui demontre que la situation serait pire dans l option classique Avec le meme support des agences internationales (de l ordre de 6 milliards de dollars) et sur une dette bancaire restructurée qui atteint, pour le Mexique 38 milliards de dollars (hors *new money*), une reduction de 1 5 milliard de dollars en cash flow annuel entrainerait pour les banques 11 à 15 milliards de dollars de pertes par une operation de titrisation (échange de creances bancaires contre obligations) , 6 milliards « seulement » de pertes par une operation « mydra » portant sur la meme dette Montant certes enorme, note le CCF, mais sans commune mesure avec le precedent

Quant au Mexique, il devrait y trouver avantage son probleme central, a souligne Michel Pébereau, est moins celui de l'endettement que de l'ajustement de sa balance des paiements

La banque est restée plus discrete sur l un des avantages du mecanisme proposé il permet aux banques d enregistrer des pertes tout à fait compatibles avec leur niveau de provisions et prélevables sur ces provisions En France au moins, ou les provisions sont defiscalisees, l'effort bancaire resterait donc en partie celui du contribuable D'autre part, les banques, assurees d'être remboursées par le Fonds, assainissent leur bilan en nettoyant les creances de leur caractere douteux Le CCF avait, il y a trois mois, annoncé la creation d'une société qui lui a permis de se debarrasser d'une partie de ses risques pays Voila une banque qui sait ôter de son chemin tout ce qui tirerait ses resultats vers le bas !

DANIELE GERVAIS

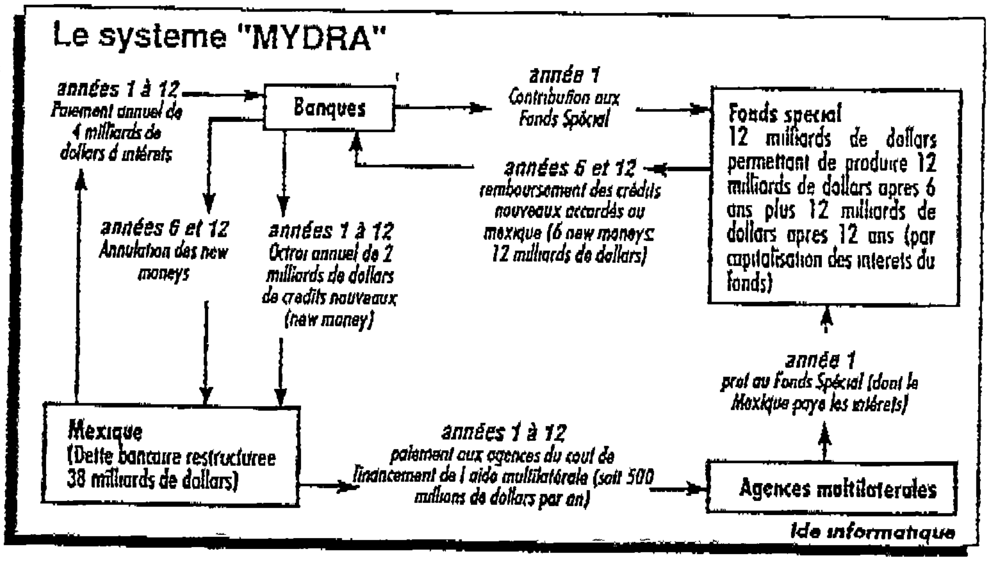
Dette

L'initiative d'une banque française

■ Le Credit Commercial de France propose une technique applicable au Mexique qui permettrait à la fois de plafonner la dette de ce pays et d assainir le bilan banques (Page 8)

Reduction de la dette mexicaine

Le CCF propose un système de crédits « autoremboursables »



◇ Hypothèse de départ réalisation d une économie pour le Mexique de 1 5 milliard de dollars par an Le schéma Mydra permet un apport au Mexique de crédits nouveaux de 2 milliards de dollars par an d ou il faut déduire le paiement de 500 millions de dollars d intérêts aux agences multilatérales Reste bien un apport net annuel en *cash flow* de 1 5 milliard — utilisable parallèlement à d autres ressources pour le remboursement des intérêts dus aux banques sur la dette existante mais l accroissement de cette dette est annulé tous les six ans grâce aux remboursements des *new moneys* par le Fonds spécial

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FACSIMILE MESSAGE

INTERNATIONAL MONETARY FUND
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1989 JUN 14 PM 3 03

CLEARY, GOTTLIEB, STEEN & HAMILTON
One State Street Plaza, New York, New York 10004 (212) 344-0600
Telecopy number: (212) 269-4978 (Gps I, II & III)

Fax Number(s): (202) ~~[illegible]66~~ 623-4952
Name: Mr. Ted Beza
Company: International Monetary Fund
City: Washington, D.C.
State/Country:
Tel. No.:

mexico

From: Lic. Angel Gurria and Mark Walker
Date: June 14, 1989
No./Pgs. (incl. cover): 6
Our File Number: 24636-080

IF COPY IS ILLEGIBLE OR INCOMPLETE, PLEASE CALL (212) 344-0600, Extension 2700 or 2738, IMMEDIATELY FOR RETRANSMISSION.

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

Please deliver to:

Ted Beza
Jorge Bonvicini
Leonor Filardo
Sylvia Charpentier

The following is the only version of the term sheet delivered to the Bank Advisory Committee. Please disregard and discard the previous version.

COMMUNICATIONS
89 JUN 14 PM 2:02

Mexican Proposal. June 14, 1989

Target Debt	Public restructured debt (including the FICORCA Facility Agreement) and the 1983, 1984 and 1987 new money packages, totalling approximately \$54 5 billion. Each bank will be free to elect how to allocate its existing portfolio among one or more of the restructuring alternatives, but will be required to commit 100 percent of its holdings of Target Debt to one or more of the alternatives.

Debt Reduction Instruments

Pricing	(a) Debt Service Reduction: interest equal to 5% fixed; (b) Debt Reduction. exchange price equal to 55% of outstanding principal amount, interest equal to LIBOR plus 13/16%; (c) linear combination of (a) and (b).
Currency	U.S. Dollars.
Tenor	30-year bullet.
Collateral	For debt reduction, two years interest and principal at maturity only; for debt service reduction, collateral to have equivalent value per dollar of Target Debt Assuming 100% participation in debt and debt service reduction exchanges, enhancements will be available as follows: 40% at closing, 30% eighteen months after closing, and 30% thirty months after closing. To the extent possible, Mexico will deliver enhancements earlier. In the event that Mexico fails to deliver required enhancements on a timely basis, the payment terms of the unenhanced Debt Reduction Instruments will revert to their original terms prospectively

Form

Debt Reduction Instruments will be issued as bonds in registered form.

Mandatory prepayments

Interest installments will be prepayable in inverse order of maturity at their present value, determined by discounting each installment at an agreed rate representing the banks' average return on investment. The amount to be applied to the prepayment of interest installments in any calendar quarter will be equal to the Oil Surplus Amount (if any) allocable to Debt Reduction Instruments for that calendar quarter, as provided below.

Excluded and Senior Debt

Debt reduction instruments will be non-restructurable and excluded from the base for future new money exercises, and will be senior in right of payment to the Target Debt and the New Money Instruments.

Debt to Equity Conversion

Debt Reduction Instruments will be eligible for conversion into equity of public sector companies being privatized.

Switching

Debt reduction instruments will be exchangeable for debt service reduction instruments (and vice versa) at any time after five years on a basis such that the instruments exchanged would be equivalent in net present value terms at the time of the exchange. The amount of debt reduction (in the case of an exchange for new debt reduction instruments) or the interest rate (if debt reduction instruments are surrendered) would, therefore, depend on the prevailing market interest rate at the time of the exchange.

New Money and Interest Capitalization

Amount

New Money

U.S. $4.3 billion per year (plus additional amounts equal to 80% of interest assumed to accrue on new money advanced in 1989 and succeeding years) for six years, subject to adjustment as set forth below.

Interest Capitalization

80% of interest due during each of the next six years (including interest on capitalized amounts), subject to adjustment as set forth below.

Adjustments

New Money and Interest Capitalization commitments for any calendar quarter will be adjusted upward or downward pro rata by the Oil Surplus (Deficit) Amount and the Interest Surplus (Deficit) Amount, if any, attributable to New Money and Interest Capitalization for such quarter, provided that in no event will the adjusted amount exceed the amount of interest otherwise payable in that calendar quarter to holders of New Money and Interest Capitalization Instruments.

If during any calendar quarter the average price of Mexican oil in constant 1989 dollars ("Oil Price") is less than $10 or greater than $14, the "Oil Surplus (Deficit) Amount" for the following calendar quarter shall be an amount determined as follows: for 1989-1991, if the Oil Price is between $14 and $16 or between $8 and $10, one-half of the difference between the Oil Price and $14 or $10, as the case may be, multiplied by the actual number of barrels exported in the preceding calendar quarter ("Oil Volume"); if the Oil Price exceeds $16, or is less than $8, (1) $1 times Oil Volume plus (2) 25% of the difference between the Oil Price and $16 or $8, as the case may be, times Oil Volume; after 1991, if the Oil Price is greater than $14 or less than $10, 25% of the difference between the Oil Price and $14 or $10, as the case may be, times Oil Volume. No Oil Deficit Amount shall be calculated for any period after 1994.

The Oil Surplus (Deficit) Amount shall be allocable as follows: During any calendar quarter in 1989-1994, if the Oil Price is less than $10, 100% of the Oil Deficit Amount shall be allocated pro rata to the New Money and Interest Capitalization Instruments; if the Oil Price is greater than $14, there shall be allocated to the New Money and Interest Capitalization Instruments a portion of the Oil Surplus Amount equal to the portion of the Target Debt participating in New Money and Capitalization, the remainder of the Oil Surplus Amount, but in no event more than the interest savings for such quarter resulting from the Debt Reduction Instruments, shall be allocated to the Debt Reduction Instruments. After 1994, 100% of any Oil Surplus Amount (as defined above), but in no event more than the interest savings resulting from the Debt Reduction Instruments, shall be allocated to the Debt Reduction Instruments.

In the event that average three-month LIBOR for any calendar quarter is greater or less than 10.5% per annum, the "Interest Surplus (Deficit) Amount" for the following calendar quarter shall be an amount equal to (1) the aggregate amount of New Money scheduled to be made available during such quarter, multiplied by (2) a fraction, the numerator of which is the difference between such average LIBOR and 10.5%, and the denominator of which is 10 5% The Interest Surplus (Deficit) Amount shall be allocable only to New Money.

Interest	LIBOR flat.
Tenor and Grace	Twenty years with seven years of grace.
Conditionality	The Debt Reduction Instruments continue to accrue interest at the reduced rate (i.e., the terms of such instruments have not reverted to their original terms as the result of Mexico's failure to deliver collateral).
Form	Loan agreements similar to those currently governing the outstanding debt.

Medium-term trade facility

Up to U.S $250 million of the New Money and Interest Capitalization amount may be put into a revolving medium-term trade facility to cover the unguaranteed portion of medium-term bilateral credits to the public sector.

On-lending

Up to U S. $250 million of the New Money and Interest Capitalization amount may be on-lent to public sector companies.

Miscellaneous

Additional Flexibility

The sharing, mandatory prepayment, default and debt exchange (§ 5.11) provisions in the restructure and new money agreements shall be amended to (i) provide Mexico with the flexibility to carry out a variety of debt reduction transactions (including, but not limited to, cash buy-backs and transactions involving the use of Mexican debt as collateral), and (ii) relax the requirement that certain offers to exchange outstanding debt for debt with a shorter average life to maturity be made on a pro rata basis.

Documentation

All outstanding debt of participating banks to be exchanged for new debt through § 5.11 exchanges of debt for debt.

Rescheduling of 1983, 1984 and 1987 new money

The amortization of the outstanding new money advances shall be amended to coincide with that of the restructured debt.

INTERNATIONAL MONETARY FUND

June 9, 1989

Mr. Caiola
Mr. Hino
Mr. Choi, IBRD
Mr. Bonvicini
Mr. Loser

For your information.

Robert Franklin

INTERNATIONAL MONETARY FUND

(F)

Mexico

Date June 9, 1989

MEMORANDUM FOR FILES

Subject Proposed Attendance of Fund Staff at World Bank Executive Board Meetings

Date of Meeting	Tuesday, June 13, 1989
Agenda Item	Mexico Industrial Policy Sector Loan and Financial Sector Adjustment Loan
Fund Staff Attending	Jorge Bonvicini Division Chief Western Hemisphere Department Tel 623-8482 Claudio M Loser Senior Advisor Western Hemisphere Department Tel 623-8373

NOTE For details in timing of this item, please contact Mr. Dirk Mattheisen (477-4008) IBRD Secretary's Dept.

Robert Franklin

INTERNATIONAL MONETARY FUND

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June 9, 1989

Mexico

Managing Director

I attach a set of talking points which you might wish to use to organize your remarks to the Board on Monday, June 12

Attachment

cc Deputy Managing Director
Mr H Simpson

MD

S T Beza

S
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June 9, 1989

Statement by the Managing Director on Mexico

On June 7 in Madrid I attended a meeting with the chairmen of the commercial banks constituting Mexico's Advisory Committee. The meeting, which was chaired by the President of the Federal Reserve Bank of New York, was not intended as a negotiating session but as a meeting in which information would be provided and views exchanged. The meeting also was attended by Mr. Conable, President of the IBRD; Mr. Iglesias, President of the IDB; and Mr. Aspe, Secretary of Finance and Public Credit of Mexico.

In the meeting the heads of the other multilateral agencies and I emphasized our strong support for the Mexican economic program and we described our several contributions to the financing package for Mexico. We stressed the importance of an early agreement between Mexico and its commercial bank creditors, particularly in view of the country's cashflow situation.

Mr. Aspe reaffirmed Mexico's commitment to strong adjustment policies and underscored the need for early and adequate financing for Mexico if it were to succeed with its growth-oriented strategy.
Mr. Aspe expressed a willingness to be flexible on various elements of the financing arrangements but he also noted the need for the program to have satisfactory financial support overall.

The representatives of the commercial banks said that they recognized that Mexico's performance had been commendable, and they also said that marketplace expectations underlined the importance of moving to bring the negotiations between Mexico and the banks to a very early conclusion. At the same time the representatives of the banks said that the package negotiated had to be one that could be sold to the international banking community as a whole since there was no other solution to the "free rider" problem.

My view is that the meeting was a much needed step in the process of arranging financing for Mexico, and it had several positive features. In particular, the parties agreed that the discussions had set the stage for rapid progress in the negotiations.

Mexican officials and the Advisory Committee are engaged in discussions on the issues of a term sheet, and we will report to you as soon as feasible on the progress being made.

Office Memorandum

M. Beza
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① mexico
② Ext debt

TO: The Managing Director
The Deputy Managing Director

June 6, 1989

FROM: Guillermo Calvo, M.P. Dooley and C.M. Watson

SUBJECT: Technical Assistance Visit to Mexico

At the request of the Mexican authorities we participated in meetings at the Ministry of Finance on May 31 and June 1, 1989. The object of these discussions was to assess technical characteristics of items in the menu of financing options that the authorities might include in their proposal to banks. The authorities were reviewing options in preparation for subsequent policy meetings in which the details of the financing plan would be decided. The policy meetings took place on the evening of May 31 and were presented to the minister and the president on the morning of June 1. Given the terms of reference of the mission, we did not participate in any of those meetings.

During the technical meetings, it was clear that a range of views still existed among officials about appropriate approaches to valuing menu items and assessing the scale of debt reduction that they might achieve. In particular, some participants in the discussions believed that the value of securities they were considering was substantially greater than present value calculations would suggest. During the course of the technical meetings, some degree of broader consensus on valuation approaches emerged.

A related issue was whether banks would give certain exchange assets seniority over other claims. The legal advisors to the Mexican authorities have suggested that a majority of banks would vote in favor of achieving seniority by subordinating some claims to others. During discussions, however, they were much less clear why banks might accept subordination of some claims. They acknowledged at one point that their approach depended, inter alia, on being able to eliminate free riders and arrive at a satisfactory legal framework for subordinating sovereign debt. But they then tended to abstract from these difficulties, and expressed confidence about the possibility of subordination on a market basis.

One conclusion suggested by these discussions was that some views among officials, or their professional advisors, may lead to overestimation of the debt reduction that can be achieved with given resources. This could result in proposals that are unduly ambitious in terms of market-based debt reduction. To the extent that staff become involved in monitoring negotiations in the context of financing assurances, there will be particular difficulty in evaluating the reasonableness of delays if there is no common understanding of valuation approaches exists, so that authorities' proposals for debt reduction are technically sound and their negotiating position realistically appraised at the outset.

Mr. Calvo also discussed indexation of domestic securities with representatives of the Finance Ministry and the Central Bank. The motivation behind these initiatives is to reduce the actual cost of servicing the debt, given that it is expected that interest rates will fall by more than the planned rates of inflation or devaluation. In other words, the presumption is that the private sector is expecting rates of inflation and devaluation which are higher than those anticipated by the economic program. Thus, if the planners are right, indexation may lower the cost of servicing the domestic public debt. Rough calculation showed that such savings could amount to 2 percent of GDP.

cc: Mr. Frenkel
Mr. Whittome (o/r)
Mr. Beza
Mr. H. Simpson

Office Memorandum

TO: The Managing Director
The Deputy Managing Director

DATE: June 6, 1989

FROM: S T Beza

SUBJECT: Mexico--Paris Club Rescheduling

Attached for your information is the back-to-office report on the Paris Club rescheduling for Mexico The agreed outcome of the negotiations was broadly in line with the assumptions underlying the extended arrangement The relief provided by the agreement would amount to about US$2 5 billion for the three-year period ending May 31, 1992, including about US$1 9 billion of principal and US$0 6 billion of interest

Attachment

cc Mr Brau
Mr H Simpson

Office Memorandum

TO: The Managing Director
The Deputy Managing Director

DATE: June 6, 1989

FROM: Claudio M. Loser

SUBJECT: Mexico--Paris Club Rescheduling

Creditor countries met in Paris under the aegis of the Paris Club on May 29-30 to consider the rescheduling of current maturities owed by Mexico. In the agreed minute (copy attached), creditor countries agreed to refinance 100 percent of principal falling due over the period June 1, 1989-May 31, 1992, excluding previously rescheduled debt and obligations contracted after December 31, 1985. Creditor countries also agreed to reschedule 100 percent of interest payments on these obligations from June 1, 1989 to March 31, 1990; 90 percent of interest due from June 1, 1990 to March 31, 1991; and 80 percent of interest due from March 31, 1991 to March 31, 1992. The restructuring covers only current obligations of the Mexican public sector; Mexico has no outstanding arrears with the Paris Club creditors. A goodwill clause for the period after the end of the extended arrangement is included. (A summary of the terms of the restructuring is attached.)

The outcome of the negotiations--which were complex and took longer than usual--was broadly in line with the assumptions underlying the extended arrangement. On the basis of available information, the relief provided by the agreement would amount to about US$2.5 billion for the three year period (including about US$1.9 billion of principal and US$0.6 billion of interest). Approximately US$0.5 billion of relief would be provided in 1989, US$0.9 billion in 1990, US$0.8 billion in 1991 and US$0.3 billion in 1992. The Fund-supported program had assumed relief amounting to about US$1.4 billion in 1989-90, with no assumption on restructuring in subsequent years. Although the relief provided in 1989-90 totals this amount, the program had assumed that somewhat more would be available in 1989, as the program had built in a restructuring of maturities falling due after April 1, 1989 rather than the agreed date of June 1, 1989.

The following features of the negotiation are worth noting:

a. The authorities sought to obtain restructuring of previously rescheduled maturities but creditors were adamantly opposed. The Mexican representatives dropped the request.

b. The extension of the restructuring beyond March 31, 1990 is contingent on the existence of an extended arrangement, the satisfactory completion of programmed reviews under the arrangement, and a positive assessment by the participating creditor countries on the negotiation of agreements with other creditors including commercial banks For the latter, the Paris Club would take into account the Fund's assessment Even though in principle creditors could take a different course of action, in practice they are likely to go ahead with restructuring if the Fund considers that continuation of an arrangement is warranted, even if negotiations are not completed with the commercial banks

The Paris Club creditors sought to give a clear signal to commercial banks about the need for strong support to Mexico They provided a letter to Mexico noting that all of Mexico's major trading partners remain on cover This letter is intended to indicate that bilateral creditors are willing to increase exposure beyond that resulting from the restructuring of interest payments In general, there was concern among the country representatives that the banks were too timid in their support for Mexico and other middle-income countries

Attachments

cc Mr Beza
Mr Brau
Mr H Simpson

June 6, 1989 ATTACHMENT

Mexico -- Terms of Paris Club Rescheduling

Coverage

A. Type of credit

1. Commercial credits with government guarantee or insurance.
2. Government loans.

B. Maturities

Credits and loans with maturities of over one year.

C. Cutoff date.

Credits and loans concluded before December 31, 1985.

Consolidation period

June 1, 1989 - May 31, 1992.

Debt relief

A. Maturities falling due during consolidation period except for previously rescheduled debt and obligations contracted after cutoff date.

1. 100 percent of principal due.
2. 100 percent of interest due between June 1, 1989 and March 31, 1990.
3. 90 percent of interest due between March 31, 1990 and March 31, 1991.
4. 80 percent of interest due between March 31, 1991 and March 31, 1992.

Repayment terms

1. Six years grace and semiannual payments over the subsequent four years.
2. Interest rate to be determined bilaterally on the basis of the appropriate market rate.

Deadline for signing bilateral agreements

February 28, 1990.

"De minimis" clause

Obligations falling due over the period of less than SDR 1,000,000.

Restructuring during second and third years

Restructuring of obligations after the first year, each year dependent on

a Continuation of an extended arrangement with the Fund,
b Positive assessment by creditor countries of progress in negotiation with other creditors, based on assessment by the Fund,
c Completion of annual reviews under extended arrangement

Goodwill clause

Goodwill clause for the period after May 31, 1992

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, the Netherlands, Norway, Spain, Sweden, Switzerland, the United Kingdom and the United States of America, hereinafter referred to as "Participating Creditor Countries", met in Paris on May 29 and 30, 1989 with representatives of the Government of Mexico in order to examine the request to alleviate Mexico's external debt service obligations. Observers of the Governments of 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., the Commission of the European Communities and the Organization for Economic Cooperation and Development also attended the meeting.

2. The Mexican Delegation described the policies and measures adopted by Mexico to redress the economic and financial imbalances and to attain the targets of the growth program supported by an Extended Arrangement with the International Monetary Fund.

3. The representatives of the International Monetary Fund described Mexico's economic situation and the major elements of the adjustment program undertaken by the Government of Mexico and supported by an Extended Arrangement with the International Monetary Fund approved by the Executive Board of the Fund on May 26, 1989. This arrangement covers the period ending on May 25, 1992.

4. The representatives of the Governments of the Participating Creditor Countries noted the measures of adjustment in the economic and financial program undertaken by the Government of Mexico and stressed the importance they attach to the continued and full implementation of this program, in particular, the revitalization of the productive sector of the economy and the strengthening of public finances.

II- RECOMMENDATIONS ON TERMS OF THE REORGANIZATION

In view of the external payment difficulties faced by Mexico as described in the above mentioned Fund arrangement, the representatives of the Participating Creditor Countries agreed to recommend to their Governments or their appropriate institutions that they provide, through rescheduling or refinancing, debt relief for Mexico on the following terms :

1. Debts concerned

The debts to which this reorganization will apply are the following :

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 one of its public sector agencies, organizations or institutions, pursuant to a contract or other financial arrangement concluded before December 31, 1985.

b) loans from Governments or appropriate institutions of the Participating Creditor Countries, 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 one of its public sector agencies, organizations or institutions, pursuant to an agreement concluded before 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 previous consolidations dated June 22, 1983 and September 17, 1986 is not affected by the present reorganization.

It is understood that debt service due as a result of debts described above in the present Minute and effected through special payment mechanisms or other external accounts is included in the present reorganization. Participating Creditor Countries will reschedule, refinance, or take other appropriate measures to ensure that this category of debt is treated in a manner comparable to other debt subject to this Agreed Minute.

2. Terms of the consolidation

Subject to the provisions of Article IV, the debt relief will apply as follows :

A/ As regards amounts due from June 1, 1989 up to March 31, 1990 inclusive :

100 % of the amounts of principal and 100 % of the amounts of interest (excluding late interest) due from June 1, 1989 up to March 31, 1990 inclusive and not paid on loans and credits mentioned in paragraphs 1 a) and 1 b) above will be rescheduled or refinanced.

Repayment by the Government of Mexico of the corresponding sums will be made in 8 equal and successive semi-annual payments, the first payment to be made on April 30, 1996 (end of the grace period) and the final payment to be made on October 31, 1999 (end of the repayment period).

B/ As regards amounts due from April 1, 1990 up to March 31, 1991 inclusive :

100 % of the amounts of principal and 90 % of the amounts of interest (excluding late interest) due from April 1, 1990 up to March 31, 1991 inclusive and not paid on loans and credits mentioned in paragraphs 1 a) and 1 b) above will be rescheduled or refinanced.

Repayment by the Government of Mexico of the corresponding sums will be made in 8 equal and successive semi-annual payments, the first payment to be made on April 30, 1997 (end of the grace period) and the final payment to be made on October 31, 2000 (end of the repayment period).

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The remaining 10 % of interest will be paid according to the original schedule

C/ <u>As regards amounts due from April 1, 1991 up to May 31, 1992 inclusive</u>

100 % of the amounts of principal and 80 % of the amounts of interest (excluding late interest) due from April 1, 1991 up to May 31, 1992 inclusive and not paid on loans and credits mentioned in paragraphs 1 a) and 1 b) above will be rescheduled or refinanced.

Repayment by the Government of Mexico of the corresponding sums will be made in 8 equal and successive semi annual payments, the first payment to be made on April 30, 1998 (end of the grace period) and the final payment to be made on October 31, 2001 (end of the repayment period)

The remaining 20 % of interest will be paid according to the original schedule

D/ Late interest charges are those interest charges accruing between the contractual payment dates of principal and interest due and not paid, and a date to be fixed in the bilateral agreements concluded for the implementation of the present Minute

3 <u>Rate of interest</u>

The rates and the conditions of interest on the financial arrangements covered by this Minute 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 <u>Guarantee of payment of the Government of Mexico</u>

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 or 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 - <u>GENERAL RECOMMENDATIONS</u>

1 In order to secure comparable treatment of public and private external creditors on their debts, the Government of Mexico commits itself to seek from external creditors, including banks and suppliers, rescheduling or refinancing arrangements on terms no less favourable to Mexico than those set forth in this Agreed Minute for credits of comparable maturity The Government of Mexico will inform in writing the Chairman of the Paris Club not later than February 28, 1990 of the progress made for this purpose in negotiation with other creditors

2 The Government of Mexico will seek to secure, from any creditor country 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 agrees that it will promptly negotiate 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 creditor countries with principal and interest falling due during the reorganization period on debts specified in Article II paragraph 1 of less than SDR 1,000,000 The payments owed to these countries should be made on the original due dates Any payment already due and not paid should be made as soon as possible and, in any case, not later than September 30, 1989

5 Each of the Participating Creditor Countries 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 of the Participating Creditor Countries agrees to indicate to the Chairman of the Paris Club 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.

7 The Government of Mexico will keep the Chairman of the Paris Club informed of the content of its bilateral agreements with creditors mentioned in paragraphs 1, 2 and 3 above

8 The Government of Mexico undertakes to pay any debt service due and not paid as at the date of the present Agreed Minute on loans or on credits extended 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 September 30, 1989 Late interest will be charged on those amounts

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 - <u>IMPLEMENTATION</u>

The detailed arrangements for the rescheduling or refinancing of the debts will be accomplished by bilateral agreements to be concluded by the Government or the appropriate institutions of each Participating Creditor Country with the Government of Mexico or its appropriate institutions on the basis of the following principles

1 The Government or the appropriate institutions of each Participating Creditor Country will

- either refinance debts by placing new funds at the disposal of the Government of Mexico or its appropriate institutions according to existing payment schedules during the reorganization period and for the above mentioned percentages of payment. These funds will be repaid by the Government of Mexico or its appropriate institutions according to the schedules mentioned above in paragraph II 2,

- or reschedule the corresponding payments

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 February 28, 1990

3 The provisions of the present Agreed Minute will continue to apply provided that the Government of Mexico continues to have an extended arrangement with the International Monetary Fund. 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 provisions of this Agreed Minute will apply for the period from April 1, 1990 to March 31, 1991 provided that :

a) Mexico continues to have an extended arrangement with the International Monetary Fund ;

b) The Chairman of the Paris Club has notified the Government of Mexico not later than March 31, 1990 of the positive assessment of the Participating Creditor Countries on the progress made in the negotiation of the agreements with other creditors mentioned in Article III paragraph 1, including banks, taking into account the consideration given to this point by the International Monetary Fund, in order to secure the orderly financing of the balance of payments on the period covered by the present Agreed Minute ;

c) The International Monetary Fund informs the Chairman of the Paris Club not later than March 31, 1990 that the Executive Board of the International Monetary Fund has completed the review of the extended arrangement that is scheduled to be completed by end-February 1990.

In the event the review has not been completed, the Participating Creditor Countries may decide to continue to apply the provisions of the present Agreed Minute.

5. The provisions of this Agreed Minute will apply for the period from April 1, 1991 to May 31, 1992 provided that :

a) Mexico continues to have an extended arrangement with the International Monetary Fund ;

b) The Chairman of the Paris Club has notified the Government of Mexico not later than March 31, 1991 of the positive assessment of the Participating Creditor Countries on the progress made in the negotiation of the agreements with other creditors mentioned in Article III paragraph 1, including banks, taking into account the consideration given to this point by the International Monetary Fund, in order to secure the orderly financing of the balance of payments on the period covered by the present Agreed Minute ;

c) The International Monetary Fund informs the Chairman of the Paris Club not later than March 31, 1991 that the Executive Board of the International Monetary Fund has completed the review of the extended arrangement that is scheduled to be completed by end-February 1991.

In the event the review has not been completed, the Participating Creditor Countries may decide to continue to apply the provisions of the present Agreed Minute.

6. In response to the request of the representatives of the Government of Mexico, the Participating Creditor Countries agreed in principle to a meeting to consider the matter of Mexico's debt service payments falling due after May 31, 1992 and relating to loans or credits pursuant to a contract or other financial arrangement concluded before December 31, 1985 provided :

- that Mexico continues to have an extended arrangement with the International Monetary Fund or an other arrangement involving the use of the Fund's resources in the upper credit tranches ;

- that Mexico has reached with banks and other creditors effective arrangements meeting the conditions described in Article III paragraphs 1, 2 and 3 above and has reported in writing to the Chairman of the Paris Club, pursuant to Article III paragraphs 1 and 7 above ;

- and that Mexico has complied with all conditions set out in this Agreed Minute.

7. For the purpose of the implementation of paragraphs 4, 5 and 6 above 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.

5. The representatives of the Governments of each of the Participating Creditor Countries 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, on May 30, 1989
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 Canada

Delegation of Belgium

Delegation of France

Delegation of the Federal Republic of Germany

Delegation of Spain

Delegation of Italy

Delegation of Sweden

Ruth Jacoby

Delegation of Japan

Takehiko Kano

Delegation of Switzerland

Delegation of the Netherlands

Delegation of the United Kingdom

Peter Mountfield

Delegation of Norway

Delegation of the United States of America

William B. Milam