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TO

NAME Ms. Ricki Tigert
AGENCY Associate General Counsel
U.S. Federal Reserve System
20th and C Sts., N.W.
Washington, D.C.

Mexico

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INTERNATIONAL MONETARY FUND
WASHINGTON, D C 20431

MANAGING DIRECTOR

CABLE ADDRESS
INTERFUND

September 18, 1989

Dear Sirs

I wish to inform you that on the basis of the information available to the Fund staff the Mexican economic program is proceeding satisfactorily. On September 14, 1989, and on the basis of the performance criteria for June 30, 1989, the Fund's Executive Board completed the first scheduled review contemplated under the extended arrangement for Mexico. Mexico is now in a position to make its second purchase under the arrangement

Very truly yours,

Michel Camdessus

Banco de España
Alcala 50
28014 Madrid
Spain

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WASHINGTON, D C 20431

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Bank for International Settlements
2 Centralbahnplatz
CH-4002 Basle
Switzerland

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WASHINGTON, D C 20431

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Michel Camdessus

Department of the Treasury
15th St. & Pennsylvania Ave., NW
Washington, DC 20220

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WASHINGTON, D C 20431

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CABLE ADDRESS
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Michel Camdessus

Board of Governors of the
Federal Reserve System
20th St. & Constitution Ave NW
Washington, DC 20551

WHD
Senior Staff

Office Memorandum

INTERNATIONAL MONETARY FUND
WESTERN HEMISPHERE DEPT.

1989 SEP 19 AM 11: 56

September 18, 1989

MEMORANDUM FOR FILES

SUBJECT: Mexico--Review under Extended Arrangement

The Executive Board met on Thursday, September 14, 1989 to consider the staff report (EBS/89/178) on the first review under the extended arrangement for Mexico.

At the outset of the meeting Mrs. Filardo distributed a communique describing the main elements of the term sheet for a financing package on which agreement had been reached between the Government of Mexico and the Bank Advisory Committee the previous day (Wednesday, September 13). The staff stated that the analyses in the staff report were consistent with the information contained in the communique. Mrs. Filardo stated that commercial bank creditors and the Government of Mexico had discussed the possibility of having an oil contingency facility (for $500 million over 3 years) attached to the extended arrangement under which the Fund would contribute pari passu with the banks' contribution. The Managing Director expressed his reservations on this issue, and indicated that further increase in Fund's exposure to Mexico would be difficult. Mrs. Filardo also stated that the Mexican authorities intend to request accelerated disbursements of set-asides when final agreement on the financing package was reached with the commercial bank creditors.

Directors noted that Mexico's economic performance in the initial months of the program had been highly satisfactory, and commended the authorities for their firm policy stance. However, they expressed concern that a lower level of commercial bank cash flow support had increased the vulnerability of the program, and called on the authorities to remain vigilant and be ready to move quickly to strengthen their adjustment effort.

Directors were pleased to note that all performance criteria for end-June had been observed, some with considerable margin. In particular, they emphasized that economic activity was recovering at a faster pace than envisaged in the program, stimulated by buoyant private sector investment; inflation had declined to its lowest level in recent years; the primary fiscal surplus was larger than programmed; and private sector financial savings was higher than expected. However, Messrs. Evans, Marcel, Masse, Menda, Nimatallah, Piantini, Warner, and Yamazaki stressed that the authorities need to stand ready to tighten credit policy if strong demand pressures should emerge as a result of developments in the private sector. Messrs. Evans, Menda, together with Mr. Posthumus, also expressed concern at the introduction of indexed bonds, and cautioned against their greater use Messrs Piantini and Warner observed that adjustment in public sector prices had lagged behind, and urged the authorities to take the necessary measures at an early date

Directors welcomed the agreement on the term sheet for the commercial bank financing package They noted that the progress made in negotiations with commercial banks, together with the firm policy stance of the authorities, had increased private sector confidence and stimulated investment and private capital inflows Mr Warner added that the financing package conformed to the Board guidelines, and that use of Fund resources in support of the debt and debt service reduction operations would be cost effective However, most Directors noted that the net cash flow relief to be provided by commercial banks was likely to be smaller than initially envisaged As a result, Mexico's external reserves was expected to decline over the medium term

Several Directors (notably, Messrs Cassell, Grosche, Yamazaki) noted that as the revised medium-term balance of payments projections were based on an average oil price of $15 per barrel, instead of $12 in the initial scenario, and given the lower projected reserves, the vulnerability of the program to a decline in oil price had increased Messrs Grosche, Fogelholm, and Praeder supported the Managing Director's position that Fund resources should not be made available for contingency financing, instead, Mexico should reopen discussion with commercial bank creditors Messrs Jalan and Posthumus expressed concern that Mexico's debt servicing capacity would weaken in the event of a decline in oil prices and the associated increase in financing

In the context of a less favorable outlook of Mexico's international reserves and weaker debt servicing capacity, a number of Directors remarked that the bank financing package resulted in a substitution of official debt for private debt However, Mr Warner disagreed with this view and emphasized that Mexico would also be contributing from its own resources to support debt and debt reduction operations Mr Praeder wondered if official uses were being used optimally since the cash flow benefits of debt reduction operations were small Mr Masse remarked that the benefit obtained through repatriation of flight capital was likely to be largely than that of debt service reduction

Mr Filosa stated that in view of the smaller net cash flow from commercial banks, higher growth was a mixed blessing, and wondered if the present level of growth could be maintained over the medium term Together with Mr Grosche, he noted that the recent increase in private capital inflows partly reflected a stock adjustment element and that these flows could not fully compensate for the shortfall in bank financing In this context, Messrs Cassell and Mr Nimatallah urged the Mexican authorities to join MIGA, to stimulate foreign investment

Mr Yamazaki also noted that the scope for effectively implementing a debt equity swap scheme had increased with the recent decline in inflation

In response to the observation on increased vulnerability of the program, Mrs Filardo stated that there was a trade-off between increased vulnerability and reaping the benefits of greater private sector confidence and private capital inflows resulting from a quick agreement with commercial banks The important thing was to follow a tight program and also to ensure that the debt overhang was removed

Biswajit Banerjee

Biswajit Banerjee
Economist, Division B
Asian Department

cc Senior Staff, ASD
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THE UNITED MEXICAN STATES

1989-92 FINANCING PACKAGE

September 15, 1989

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new

DRAFT
09/15/89
LX105/03700

TO: THE INTERNATIONAL BANKING COMMUNITY

FROM: MICHEL CAMDESSUS, MANAGING DIRECTOR
INTERNATIONAL MONETARY FUND

DATE: SEPTEMBER 15, 1989

RE: 1989-92 FINANCING PACKAGE FOR MEXICO

I WOULD LIKE TO INFORM YOU ABOUT DEVELOPMENTS UNDER THE ECONOMIC PROGRAM OF MEXICO WHICH IS BEING SUPPORTED BY A THREE-YEAR EXTENDED ARRANGEMENT FOR AN AMOUNT OF SDR 2,797.2 MILLION THAT THE FUND APPROVED IN MAY 1989, AND TO DISCUSS THE EXTERNAL FINANCING FOR THIS PURPOSE.

IN DECEMBER 1987 THE MEXICAN AUTHORITIES INTRODUCED A COMPREHENSIVE ECONOMIC PROGRAM BASED ON A PACT WITH LABOR AND BUSINESS, WHICH WAS AIMED AT RESTORING ECONOMIC GROWTH, CONSOLIDATING EARLIER GAINS IN THE BALANCE OF PAYMENTS, AND IN BRINGING DOWN THE RATE OF INFLATION. IN THE EVENT, THE RATE OF INFLATION FELL SHARPLY IN 1988 BUT ECONOMIC ACTIVITY REMAINED DEPRESSED AND THE BALANCE OF PAYMENTS WEAKENED.

THE PROGRAM FORMULATED BY THE AUTHORITIES FOR 1989-92 IS DESIGNED TO CONTINUE THE RECENT GAINS MADE IN RESPECT OF INFLATION, TO STRENGTHEN THE BALANCE OF PAYMENTS, AND TO PROVIDE THE BASIS FOR SUSTAINED MULTILATERAL AND BILATERAL CREDITORS, AND DESERVES THE ENDORSEMENT OF THE INTERNATIONAL FINANCIAL COMMUNITY AT LARGE.

A CENTRAL ELEMENT OF THE PROGRAM IS THE PLANNED INCREASE IN THE PRIMARY FISCAL SURPLUS AND IN PUBLIC SECTOR SAVINGS. THIS IS BEING ACHIEVED THROUGH IMPROVEMENTS IN THE TAX SYSTEM AND IN THE OPERATIONAL EFFICIENCY OF THE PUBLIC ENTERPRISE SECTOR, INCLUDING THE DIVESTITURE OF SOME PUBLIC ENTITIES AND THE STREAMLINING OF THE OPERATIONS OF THOSE KEPT IN THE PUBLIC SECTOR. MONETARY POLICY IS DIRECTED TO ENSURING THAT PRIVATE SECTOR FINANCIAL SAVINGS ARE PROMOTED AND ALLOCATED IN AN EFFECTIVE MANNER. THE PROCESS OF FINANCIAL INTERMEDIATION HAS BEEN IMPROVED BY THE RECENT REFORMS OF THE FINANCIAL SYSTEM, PARTICULARLY THE LIBERALIZATION OF INTEREST RATES, THE DEVELOPMENT OF NEW FINANCIAL INSTRUMENTS, AND THE SIMPLIFICATION OF RESERVE REQUIREMENTS.

STRUCTURAL POLICIES SEEK TO ENSURE THE OUTWARD ORIENTATION OF THE ECONOMY, TOGETHER WITH AN INCREASE IN FOREIGN INVESTMENT AND PRIVATE CAPITAL REFLOWS. THE IMPROVEMENT IN EXTERNAL COMPETITIVENESS AND THE MAJOR LIBERALIZATION OF THE TRADE SYSTEM AND TARIFF REGIME SINCE MID-1985 HAVE CONTRIBUTED TO A RAPID EXPANSION IN EXTERNAL TRADE, WITH SIGNIFICANT BENEFITS IN TERMS OF IMPROVED EFFICIENCY OF DOMESTIC PROCEDURES AND DAMPENING OF INFLATIONARY PRESSURES. FURTHERMORE, THE AUTHORITIES RECENTLY ANNOUNCED IMPORTANT CHANGES IN FOREIGN INVESTMENT REGULATIONS WHICH, COMBINED WITH THE REFORMS OF THE TAX SYSTEM, ARE EXPECTED TO LEAD TO A MAJOR EXPANSION OF THE ROLE OF FOREIGN DIRECT INVESTMENT IN PROMOTING THE GROWTH OF EMPLOYMENT AND THE MODERNIZATION OF PLANT AND EQUIPMENT.

ECONOMIC PERFORMANCE THIS YEAR HAS BEEN FAVORABLE. THE MONTHLY RATE OF INFLATION DECLINED FROM 2.4 PERCENT IN JANUARY 1989 TO UNDER 1 PERCENT IN AUGUST, AND THE 12-MONTH RATE OF PRICE INCREASE DECLINED FROM 52 PERCENT IN DECEMBER 1988 TO LESS THAN 17 PERCENT IN AUGUST 1989. FURTHERMORE, ECONOMIC ACTIVITY IS RECOVERING, MAINLY AS A RESULT OF INCREASED PRIVATE SECTOR INVESTMENT, WITH INDUSTRIAL PRODUCTION 6 PERCENT HIGHER IN THE FIRST HALF OF 1989 THAN IN THE SAME PERIOD A YEAR EARLIER. REAL GDP IS EXPECTED TO INCREASE BY AT LEAST 2 PERCENT IN 1989.

THE PUBLIC FINANCES HAVE STRENGTHENED MARKEDLY IN THE FIRST HALF OF 1989. THE PRIMARY BALANCE OF THE NONFINANCIAL PUBLIC SECTOR REGISTERED A SIZABLE SURPLUS THAT MORE THAN OFFSET THE IMPACT OF HIGH REAL INTEREST RATES ON DOMESTIC DEBT PREVAILING DURING THE PERIOD AND, AS A CONSEQUENCE, THE PUBLIC SECTOR BORROWING REQUIREMENT DECLINED SHARPLY.

DOMESTIC PRIVATE FINANCIAL SAVINGS ROSE MARKEDLY IN REAL TERMS TO THE FIRST HALF OF 1989. DURING THIS PERIOD REAL DOMESTIC INTEREST RATES REMAINED HIGH BECAUSE OF THE SHORTFALL IN FOREIGN FINANCING AND UNCERTAINTIES CONCERNING THE SETTLEMENT OF THE FINANCIAL PACKAGE WITH MEXICO'S EXTERNAL PRIVATE CREDITORS. HOWEVER, AS DOMESTIC POLICIES WERE MAINTAINED ON A STEADY COURSE AND EXPECTATIONS ABOUT THE AGREEMENT ON A DEBT-REDUCTION PACKAGE WITH COMMERCIAL BANKS IMPROVED, INTEREST RATES DECLINED SHARPLY IN LATE JULY AND HAVE REMAINED AT LOWER LEVELS SINCE THEN. MEANWHILE, MEXICO'S COMPETITIVENESS HAS BENEFITED FROM THE POLICY OF DAILY ADJUSTMENTS OF THE PESO IN RELATION TO THE U.S. DOLLAR.

IN LATE MAY 1989 MEXICO REACHED AGREEMENT WITH ITS OFFICIAL BILATERAL CREDITORS ON THE RESCHEDULING OF DEBT-SERVICE OBLIGATIONS FALLING DUE OVER THE PERIOD FROM

JUNE 1, 1989 TO MAY 31, 1992. THE PARIS CLUB AGREEMENT COVERS ALL PRINCIPAL PAYMENTS FALLING DUE ON ACCOUNT OF MOST NONRESTRUCTURED LOANS CONTRACTED BEFORE DECEMBER 31, 1985, AND A GRADUALLY DECLINING PORTION OF INTEREST OBLIGATIONS. PAYMENTS WERE RESCHEDULED OVER A PERIOD OF 10 YEARS INCLUDING SIX YEARS OF GRACE. TOTAL DEBT RELIEF ASSOCIATED WITH THE PARIS CLUB AMOUNTS TO ABOUT US$2.2 BILLION, OF WHICH SOME U.S.$0.5 BILLION BECAME AVAILABLE IN 1989.

WITH A CONTINUATION OF STRONG POLICIES AND IN THE ABSENCE OF UNFAVORABLE EXTERNAL EVENTS, MEXICO'S BALANCE OF PAYMENTS CAN BE EXPECTED TO STRENGHTEN DURING THE PERIOD OF THE PROGRAM. THE TRADE BALANCE SHOULD SHOW AN IMPROVEMENT, AND THERE SHOULD BE A DECLINE IN SCHEDULED INTEREST OBLIGATIONS BECAUSE OF THE EFFECT OF DEBT AND DEBT-SERVICE REDUCTION OPERATIONS. BASED ON CURRENT PROJECTIONS FOR OIL PRICES AND INTEREST RATES, THE CURRENT ACCOUNT DEFICIT IS PROJECTED TO FALL FROM US$5 BILLION IN 1989 TO SOME US$2.3 BILLION IN 1992. BASED ON THE OIL PRICE AND INTEREST RATE ASSUMPTIONS MADE AT THE TIME WHEN THE ECONOMIC PROGRAM WAS DEVELOPED, THE CURRENT ACCOUNT DEFICIT WOULD HAVE FALLEN FROM US$7.4 BILLION IN 1989 TO US$4.4 BILLION IN 1992.

TO SUPPLEMENT DOMESTIC RESOURCES IN THE EFFORT TO ATTAIN SOUND ECONOMIC GROWTH AND STRENGTHEN THE BALANCE OF PAYMENTS AND RESERVES, THE PROGRAM ENVISAGES NET INFLOWS FROM OFFICIAL SOURCES (INCLUDING THE FUND) OF AROUND US$13 BILLION DURING 1989-92, PART OF WHICH IS TO FINANCE THE COLLATERALIZATION OF PROSPECTIVE DEBT AND DEBT-SERVICE REDUCTION OPERATIONS. IN ADDITION TO PURCHASES FROM THE FUND, NET DISBURSEMENTS OF US$6 BILLION ARE EXPECTED FROM MULTILATERAL SOURCES AND NET DISBURSEMENTS OF A SIMILAR AMOUNT ARE EXPECTED FROM BILATERAL SOURCES AND SUPPLIER CREDITS AIDED BY OPEN EXPORT COVER OF MEXICO'S OFFICIAL CREDITORS. FURTHERMORE, OFFICIAL CREDITORS ARE EXPECTED TO PROVIDE BRIDGE FINANCING OF ABOUT US$1.9 BILLION IN 1989.

WHILE THE CONTRIBUTION OF COMMERCIAL BANKS TO THE VARIOUS COMPONENTS OF THE MEXICAN PACKAGE CANNOT BE DETERMINED PRECISELY AT THIS STAGE, THE CASH FLOW RELIEF RESULTING FROM THE COMBINATION OF NEW MONEY AND INTEREST SAVINGS MAY BE EXPECTED TO BE AROUND US$8 BILLION OVER THE PERIOD 1989-92, WHICH WOULD BE TANTAMOUNT TO ONLY A MODERATE INCREASE IN EXPOSURE OVER THE PERIOD. THE ADDITIONAL RESOURCES NEEDED TO COVER THE CURRENT ACCOUNT AND A LIMITED ACCUMULATION OF RESERVES WOULD COME FROM PRIVATE CAPITAL INFLOWS THAT ARE EXPECTED TO CONTINUE TO REACT FAVORABLY TO THE FINANCING PACKAGE, INCLUDING DEBT REDUCTION, AND THE MORE LIBERAL REGULATIONS NOW GOVERNING FOREIGN DIRECT INVESTMENT. SUCH POSITIVE REACTIONS WOULD BE STRENGTHENED BY AN EARLY

COMPLETION OF THE FINANCING PACKAGE. OVERALL, MEXICO'S EXTERNAL FINANCIAL POSITION DOES NOT ALLOW ANY ROOM FOR SLIPPAGES IN THE EXTERNAL FINANCING AND OF COURSE IT WILL DEPEND ON CONTINUED FAVORABLE DEVELOPMENTS IN OIL PRICES AND INTEREST RATES.

TO CONCLUDE, THE MEXICAN AUTHORITIES ARE PURSUING THE MACROECONOMIC AND STRUCTURAL POLICIES REQUIRED TO RESTORE SUSTAINED ECONOMIC GROWTH IN THE CONTEXT OF REDUCED FINANCIAL IMBALANCES, AND IT IS ESSENTIAL THAT THIS EFFORT BE BACKED BY ADEQUATE FINANCIAL SUPPORT. MEXICO'S PROPOSED FINANCING PACKAGE WITH COMMERCIAL BANKS CONTAINS NEW ELEMENTS THAT REFLECT THE ADAPTATION OF THE DEBT STRATEGY TO CURRENT CIRCUMSTANCES. VOLUNTARY DEBT AND DEBT-SERVICE REDUCTION IS A KEY COMPONENT OF THE NEW STRATEGY, AND THEREFORE I URGE THE EARLY SUPPORT FOR THE MEXICAN PROGRAM.

MICHEL CAMDESSUS
MANAGING DIRECTOR
INTERNATIONAL MONETARY FUND

New

DRAFT
09/15/89
LX105/03710

TO: THE INTERNATIONAL BANKING COMMUNITY

FROM: BARBER B. CONABLE, PRESIDENT
THE WORLD BANK

DATE: SEPTEMBER 15, 1989

RE: MEXICO

THE PURPOSE OF THIS COMMUNICATION IS TO GIVE AN OVERVIEW OF MEXICO'S ADJUSTMENT PROGRAM AND TO EMPHASIZE THE URGENT NEED FOR EXTERNAL FINANCIAL SUPPORT TO ENSURE THE SUCCESS OF THE PROGRAM.

FOLLOWING EIGHT YEARS OF FALLING PER CAPITA INCOME, THE MEXICAN GOVERNMENT HAS EMBARKED ON A NUMBER OF POLICY REFORMS AIMED AT THE RESTORATION OF ECONOMIC GROWTH AND MONETARY STABILITY. THIS STABILIZATION PROGRAM HAS ALREADY SHOWN SIGNIFICANT RESULTS, AS DOMESTIC INFLATION DECLINED FROM 159% IN LATE 1987 TO 17% DURING THE TWELVE MONTHS ENDING IN JULY 1989. WHILE DEEPENING THE ADJUSTMENT EFFORT, THE GOVERNMENT HAS BEEN IMPLEMENTING MAJOR STRUCTURAL REFORM MEASURES IN TRADE POLICY, TAXATION, THE FINANCIAL SECTOR, AND PUBLIC ENTERPRISE MANAGEMENT. THE PROGRAM RELIES ESPECIALLY ON CREATING A DYNAMIC PRIVATE SECTOR AND INCLUDES KEY MEASURES FOR ACCELERATED PRIVATIZATION, AND FOR STREAMLINING FOREIGN INVESTMENT REGULATIONS.

TO PROVIDE CONTINUING SUPPORT TO STRUCTURAL REFORMS, ON JUNE 13, 1989 THE EXECUTIVE DIRECTORS OF THE WORLD BANK APPROVED THREE QUICK DISBURSING LOANS OF US$ 500 MILLION EACH TO SUPPORT THE GOVERNMENT'S ADJUSTMENT PROGRAM IN THE FINANCIAL AND INDUSTRIAL SECTORS AND PUBLIC ENTERPRISE REFORM. THESE RESOURCES, TOGETHER WITH THE RESOURCES PROVIDED BY THE IMF, ARE PROVIDING UP-FRONT SUPPORT FOR MEXICO'S ADJUSTMENT EFFORTS.

WITHOUT MACROECONOMIC STABILITY AND ACCESS TO EXTERNAL FINANCE IN ADEQUATE FORM AND AMOUNTS, SUSTAINABLE GROWTH WILL BE DIFFICULT TO ACHIEVE. TO STABILIZE THE ECONOMY AN ADEQUATE MACRO-ECONOMIC POLICY FRAMEWORK HAS BEEN PUT IN PLACE, TYING TOGETHER TIGHTENED FISCAL AND MONETARY POLICIES,

AS WELL AS WAGE AND PRICE RESTRAINT. EXCHANGE RATE POLICY IS DESIGNED TO ATTAIN THE BALANCE OF PAYMENTS AND INFLATION OBJECTIVES OF THE PROGRAM, WHILE TAKING INTO ACCOUNT RESERVE LEVELS, THE TRADE BALANCE AND THE REAL EFFECTIVE EXCHANGE RATE. AN IMPORTANT COMPONENT OF THE PROGRAM HAS BEEN THE GOVERNMENT'S DETERMINED FISCAL ADJUSTMENT EFFORT, BASED ON CUT-BACKS IN SPENDING AND STEPPED-UP REVENUE MEASURES. NON-INTEREST FISCAL SURPLUS IN THE PUBLIC SECTOR REACHED ALMOST 6% OF GDP IN 1988 AND IS PROJECTED AT 8.9% IN 1989, UP FROM A DEFICIT OF 7.1% OF GDP IN 1981.

PUBLIC EXPENDITURE CUTS WERE MADE POSSIBLE BY A SERIES OF STRUCTURAL REFORMS, INCLUDING A REDUCTION IN THE SIZE OF THE PUBLIC SECTOR. INTEREST SUBSIDIES HAVE BEEN ALMOST ELIMINATED AND PUBLIC PRICES ARE BEING ADJUSTED.

A CENTRAL ELEMENT IN THIS STRATEGY HAS BEEN THE RESTRUCTURING AND PRIVATIZATION OF PARASTATAL ENTITIES, COVERING SOME 700 ENTERPRISES. PROGRESS IN TRADE LIBERALIZATION REDUCED IMPORT LICENSING COVERAGE TO A LEVEL THAT IS ONE QUARTER OF THE 1985 LEVEL, CUT MAXIMUM TARIFFS TO 20%, AND HELPED KEEP MEXICO'S GATT COMMITMENTS ON TARGET. FORCED LENDING TO THE GOVERNMENT ON DISCRETIONARY TERMS HAS BEEN ELIMINATED SINCE 1988, DEPOSIT RATES HAVE BEEN FREED AND, AS RESULT, THE FINANCIAL SECTOR IS BECOMING MORE COMPETITIVE. REGULATIONS FOR DIRECT FOREIGN INVESTMENTS HAVE BEEN RELAXED, INCREASING THE PROPORTION OF INVESTMENT PROPOSALS WHICH WOULD BE APPROVED AUTOMATICALLY. SEVERAL AREAS OF THE ECONOMY WILL BE OPEN TO 100% PRIVATE OWNERSHIP BY FOREIGN INVESTORS.

THE GOVERNMENT RECOGNIZES THAT GROWTH IN THE NEXT STAGE OF MEXICO'S DEVELOPMENT SHOULD BE PRIVATE SECTOR BASED, WITH THE GOVERNMENT PLAYING A SUPPORTIVE ROLE. THE WORLD BANK SHARES THIS VIEW. CONTINUED GOVERNMENT EFFORTS ARE EXPECTED TO BE MADE TOWARD A RATIONALIZED INCENTIVE REGIME FOR THE PRIVATE SECTOR, IMPROVEMENT OF RESOURCE ALLOCATION AND ENCOURAGEMENT OF PRIVATE SECTOR INVESTMENTS BY FOREIGNERS AND DOMESTIC ENTREPRENEURS ALIKE. TO PLAY A SUPPORTIVE ROLE IN PRIVATE SECTOR-LED GROWTH, THE GOVERNMENT INTENDS TO INCREASE THE EFFICIENCY OF PUBLIC INSTITUTIONS, FOCUS ITS INVESTMENTS IN AREAS WHICH COMPLEMENT PRIVATE INITIATIVES, INCLUDING PUBLIC INFRASTRUCTURE AND SOCIAL SECTOR PROGRAMS, AND UNDERTAKE ADDITIONAL PRIVATIZATION OF PRODUCTIVE ASSETS.

TO ALLOW THE GROWTH-ORIENTED PROGRAM TO TAKE OFF, MEXICO NEEDS, IN ADDITION TO SOUND MACRO-ECONOMIC MANAGEMENT AND THE STRUCTURAL REFORMS ALREADY IN PLACE, ADEQUATE EXTERNAL RESOURCES. IF THE CAPITAL REQUIREMENTS OF THE PROGRAM ARE NOT MET, THE RECOVERY OF GROWTH WOULD REMAIN OUT OF REACH. A FULLY FUNDED PACKAGE WOULD HELP REDUCE UNCERTAINTY, AS NET

TRANSFERS ABROAD ARE REDUCED IN A MANNER CONSISTENT WITH MEXICO'S NEED TO MAINTAIN A MODERATE CURRENT ACCOUNT DEFICIT.

I BELIEVE THAT THE PROPOSED FINANCING PACKAGE (PARTICULARLY THE DEBT AND DEBT SERVICE REDUCTION OPTIONS) WHICH IS BEING PRESENTED TO YOU PROVIDES A FRAMEWORK FOR OFFERING THE REQUIRED DEBT RELIEF AND NEW FINANCING THAT MEXICO NEEDS TO SUSTAIN ITS ADJUSTMENT AND DESERVES YOUR FULL SUPPORT.

AS A SIGN OF OUR COMMITMENT TO MEXICO'S DEVELOPMENT PROCESS AND OUR RECOGNITION OF THE GOVERNMENT'S ADJUSTMENT EFFORTS, THE WORLD BANK HAS PUT TOGETHER A SUBSTANTIAL LENDING PROGRAM IN SUPPORT OF THE INITIATIVES OF THE MEXICAN ADMINISTRATION. IN THE FISCAL YEAR ENDING ON JUNE 30, 1989, WE APPROVED LOANS TOTALLING US$2.2 BILLION. OF THIS AMOUNT US$1.5 BILLION IS SUPPORTING REFORM MEASURES IN THE FINANCIAL SECTOR AND THE INDUSTRIAL SECTOR, AND PUBLIC ENTERPRISE MANAGEMENT, AND IS CONDITIONED ON CUTTING BACK REMAINING SUBSIDIES, STREAMLINING INSTITUTIONS, RATIONALIZING CREDIT POLICIES AND THE INCENTIVE REGIME IN INDUSTRY, AND STRENGTHENING PRUDENTIAL REGULATIONS IN THE BANKING SECTOR. WORLD BANK LENDING IS ALSO ASSISTING WITH TARGETED SOCIAL SECTOR PROGRAMS WHICH ARE DESIGNED TO ALLEVIATE THE COST OF ADJUSTMENT AND TO REDUCE POVERTY. WE PLAN TO MAINTAIN ANNUAL LENDING LEVELS FOR MEXICO CLOSE TO US$ 2 BILLION, SUBJECT, OF COURSE, TO CONTINUED SOUND MACRO-ECONOMIC MANAGEMENT AND SUFFICIENT PROGRESS IN STRUCTURAL REFORMS BY MEXICO AND THE APPROVAL OF OUR EXECUTIVE DIRECTORS. THE WORLD BANK WOULD THUS SHARE THE BURDEN OF MEXICO'S EXTERNAL FINANCING AND PLAY ITS ROLE AS A DEVELOPMENT INSTITUTION IN MEXICO'S ATTEMPT TO RECOVER ECONOMIC GROWTH, GENERATE EMPLOYMENT AND PROMOTE SOCIAL DEVELOPMENT.

WORLD BANK LENDING IS EXPECTED TO SUPPORT FURTHER ADJUSTMENT INITIATIVES IN AREAS CRITICAL TO A FAVORABLE INCENTIVE REGIME FOR PRIVATE INVESTMENT. WE INTEND TO ASSIST MEASURES DESIGNED TO RELAX DOMESTIC REGULATIONS AND CONTROLS IN SECTORS SERVICING INDUSTRY, CREATE EFFECTIVE INCENTIVES FOR NON-TRADITIONAL EXPORTS, MAKE PRODUCTION IN AGRICULTURE EFFICIENT, AND HELP DEVELOP NEW TECHNOLOGY IN ALL SECTORS OF THE ECONOMY, INCLUDING EFFICIENT PUBLIC INFRASTRUCTURE IN POWER, UTILITIES, TRANSPORTATION AND AGRICULTURE. SINCE WELL TARGETED SOCIAL SERVICES AND IMPROVED ENVIRONMENTAL CONDITIONS ARE EXPECTED TO CONTRIBUTE TO SOCIAL WELFARE AND BETTER LIVING AND WORKING CONDITIONS, THE WORLD BANK INTENDS TO EXPANDS ITS ASSISTANCE IN THESE SECTORS. THE WORLD BANK IS ALSO PLANNING, IN THE ABOVE AREAS, TO SUPPORT SECTOR INVESTMENT PROGRAMS, TO ENSURE THAT PUBLIC INVESTMENT OUTLAYS ARE WELL DESIGNED AND IN PLACE ON TIME TO COMPLEMENT PRIVATE INVESTMENT IN THE PRODUCTIVE SECTORS OF THE ECONOMY.

IN ADDITION TO THE LENDING PROGRAM OUTLINED ABOVE, THE WORLD BANK STANDS READY TO SUPPORT THE 1989-92 FINANCING PACKAGE, PROVIDED THAT THE FULL SUBSCRIPTION BY MEXICO'S CREDITORS ASSURES AN ACCEPTABLE FINANCING PACKAGE INCLUDING NEW MONEY AND DEBT RELIEF. OUR EXECUTIVE DIRECTORS HAVE AGREED, IN PRINCIPLE, THAT ADDITIONAL FUNDING WOULD BE AVAILABLE TO MEXICO TO ENABLE IT TO PROVIDE CREDIT ENHANCEMENT OF NEW SOVEREIGN MEXICAN OBLIGATIONS WHICH WOULD BE ISSUED TO ACHIEVE THE DEBT AND DEBT SERVICE REDUCTION OBJECTIVES OF THE GOVERNMENT. FINAL FORMAL APPROVAL OF OUR EXECUTIVE DIRECTORS OF SUCH FINANCIAL SUPPORT FOR CREDIT ENHANCEMENT WILL BE SOUGHT AFTER THE RESPONSE OF THE CREDITORS IS KNOWN.

WE RECOGNIZE, AS DOES THE GOVERNMENT, THAT MEXICO'S RECOVERY IS NOT WITHOUT RISKS. THE COUNTRY'S GROWTH PROSPECTS DEPEND, TO A CONSIDERABLE EXTENT, ON THE EXTERNAL ENVIRONMENT. INTERNATIONAL OIL PRICES AND INTEREST RATES CAN HAVE A SUBSTANTIAL EFFECT ON THE CURRENT ACCOUNT AND EXTERNAL FINANCING REQUIREMENTS. WE BELIEVE, HOWEVER, THAT THE CONTINGENT OIL FACILITY THAT IS UNDER NEGOTIATION WILL PROVIDE A CUSHION TO MEXICO AGAINST LOW OIL PRICES, IF IT IS BASED ON MEANINGFUL PARAMETERS. IN THE WORLD BANK'S VIEW THE GOVERNMENT'S RESOLVE TO IMPLEMENT ADDITIONAL EFFICIENCY MEASURES CONDUCIVE TO PRIVATE INVESTMENT IS AN IMPORTANT ELEMENT THAT SHOULD HELP MANAGE THE EXTERNAL RISKS THAT MAY BE ASSOCIATED WITH THE PROPOSED PROGRAM. SUCH ADDITIONAL MEASURES ARE LIKELY TO ENCOURAGE GRADUAL BUT STEADY INCREASES IN INVESTMENTS WHICH ARE EXPECTED TO LEAD TO A RECOVERY OF GROWTH. THIS WOULD IMPROVE MEXICO'S DEBT INDICATORS AND THE COUNTRY'S ABILITY TO SERVICE ITS EXTERNAL OBLIGATIONS. WITH THE DEBT RELIEF AND FINANCING SOUGHT IN THIS FINANCING PACKAGE, THE GOVERNMENT WOULD BE IN BETTER POSITION TO DEAL WITH ADVERSE DEVELOPMENTS IN THE 1990-92 PERIOD, AND TO ADDRESS THE DOMESTIC STRUCTURAL CAUSES OF THE CRISIS OF THE EARLY EIGHTIES AND THE STAGNATION THAT FOLLOWED.

IN SUMMARY, THE PROSPECTS FOR RECOVERY OF SUSTAINABLE GROWTH LOOK PROMISING. WITH APPROPRIATE DEBT RELIEF AND NEW FINANCING REQUESTED FROM THE INTERNATIONAL BANKING COMMUNITY, MEXICO COULD CARRY ON WITH THE REFORMS AND KEEP SUPPORTIVE MACRO-ECONOMIC POLICIES IN PLACE.

IMPLEMENTATION OF THE GOVERNMENT PROGRAM IS EXPECTED TO INDUCE INVESTMENT AND HELP RECOVER GROWTH THAT IS NECESSARY TO PROVIDE JOBS TO A GROWING LABOR FORCE.

I WOULD LIKE TO CONCLUDE BY STRESSING THAT THE INTERNATIONAL BANKING COMMUNITY NOW HAS AN OPPORTUNITY TO ASSIST MEXICO

IN ADDRESSING THE TASKS OF ECONOMIC RECOVERY. MEXICAN SOCIETY HAS SUSTAINED THE BURDEN OF FAR REACHING ADJUSTMENT THAT WAS UNDERTAKEN TO CREATE THE PRECONDITIONS FOR RENEWED GROWTH, IMPROVED SOCIAL WELFARE AT HOME AND OVERCOMING THE EXTERNAL DEBT PROBLEM. THE FULL COOPERATION OF THE INTERNATIONAL COMMUNITY IS REQUIRED TO ASSIST MEXICO IN ACHIEVING THESE GOALS AND WE AT THE WORLD BANK LOOK FORWARD TO WORKING WITH YOU IN THE MONTHS AHEAD TO TURN THESE EXPECTATIONS INTO REALITY.

BEST REGARDS,

BARBER B. CONABLE
PRESIDENT
THE WORLD BANK

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DRAFT
09/14/89

TO: THE INTERNATIONAL BANKING COMMUNITY

FROM: ENRIQUE V. IGLESIAS, PRESIDENT
INTER-AMERICAN DEVELOPMENT BANK

DATE: SEPTEMBER 15, 1989

RE: 1989-92 FINANCING PACKAGE FOR MEXICO

SINCE THE INTRODUCTION BY THE MEXICAN AUTHORITIES, IN LATE 1987, OF A COMPREHENSIVE STABILIZATION PROGRAM COUPLED WITH STRONG STRUCTURAL ADJUSTMENT POLICIES, THE MEXICAN ECONOMY HAS PRODUCED VERY POSITIVE DEVELOPMENTS.

THE OBJECTIVE OF PRICE STABILIZATION SET FORTH IN THE ECONOMIC PROGRAM HAS BEEN AMPLY ACHIEVED, WITH THE INFLATION RATE FALLING TO ITS LOWEST LEVELS IN MANY YEARS, WHILE SIGNIFICANT CURBS IN PUBLIC SPENDING HAVE RESULTED IN THE SPECTACULAR IMPROVEMENT OF PUBLIC SECTOR FINANCES.

MEXICO'S CONTINUED EFFORTS, OUTLINED IN THE 1989-92 ECONOMIC ADJUSTMENT AND GROWTH PROGRAM, TO CONSOLIDATE AND BUILD UPON THESE ACCOMPLISHMENTS IN ORDER TO DEVELOP THE BASIS FOR LONG-TERM ECONOMIC GROWTH, NEED THE ACTIVE BACKING OF THE INTERNATIONAL BANKING COMMUNITY.

A MAJOR STEP WAS ACCOMPLISHED IN JULY 1989, WHEN AN AGREEMENT ON MAIN POINTS WAS REACHED BETWEEN THE GOVERNMENT OF MEXICO AND THE BANK ADVISORY COMMITTEE FOR MEXICO ON A COMMERCIAL BANK FINANCING PACKAGE WHICH WOULD OFFER BOTH MEANINGFUL DEBT REDUCTION AND THE ADDITIONAL RESOURCES THE COUNTRY NEEDS TO SUPPORT ITS ECONOMIC PROGRAM. A DETAILED TERM SHEET FOR THE PACKAGE HAS SINCE BEEN AGREED UPON WHICH PRESENTS MEXICO'S COMMERCIAL BANK CREDITORS WITH THREE VOLUNTARY OPTIONS, DEBT-PRINCIPAL REDUCTION, DEBT-SERVICE REDUCTION, OR NEW MONEY.

THE IMPORTANCE OF THIS EVENT CANNOT BE OVERSTATED FOR IT SIGNALS THE DAWNING, WITHIN THE INTERNATIONAL FINANCIAL COMMUNITY, OF A NEW AND MORE REALISTIC ASSESSMENT OF THE EXTERNAL DEBT PROBLEM IN DEVELOPING COUNTRIES WHICH, IN TURN, SHOULD BE CONDUCIVE, AS IS THE CASE OF THE MEXICAN FINANCING PACKAGE TO SOLUTIONS MORE ATTUNED TO THE REALITIES FACING THESE COUNTRIES.

CLEARLY, THIS AGREEMENT IS BOTH TIMELY AND NEEDED FOR THE CONTRIBUTION IT CAN MAKE TO MEXICO'S BALANCE OF PAYMENTS. FURTHERMORE, IT IS ALREADY PLAYING A MAJOR ROLE IN SENDING POSITIVE SIGNALS TO MEET INTERNAL AND EXTERNAL EXPECTATIONS. THIS ROLE, IN TURN, WILL HAVE A UNIQUE IMPACT ON THE COUNTRY'S KEY MACROECONOMIC INDICATORS, ON INTERNAL AND FOREIGN INVESTMENT AND ON CAPITAL REPATRIATIONS.

THIS PACKAGE, HOWEVER, IS ONLY THE FIRST STEP. WE MUST NOT STOP THERE. THE SUCCESS OF MEXICO'S STRATEGY HINGES ON THE TIMELY AVAILABILITY OF ADEQUATE EXTERNAL FINANCING. IN ITS EFFORTS TO STEER THE COURSE TOWARD SUSTAINED ECONOMIC GROWTH, THE COUNTRY MUST NOT BE LEFT ON ITS OWN. PROMPT ACTION IS REQUIRED. THE INTER-AMERICAN DEVELOPMENT BANK, FOR ITS PART, WILL CONTINUE TO SUPPORT MEXICO'S ENDEAVOR THROUGH THE FINANCING OF CREDIT OPERATIONS AND TECHNICAL COOPERATION. WITH THE INCEPTION OF THE BANK'S SEVENTH REPLENISHMENT PERIOD, THE IDB WILL STEP UP MARKEDLY ITS FINANCIAL CONTRIBUTION TO MEXICO.

INCREASED NET DISBURSEMENTS FROM THE IDB AND OTHER MULTILATERAL SOURCES, HOWEVER, CANNOT ALONE ENSURE THE SUCCESS OF MEXICO'S STRATEGY. THE EARLY COMMITMENT OF COMMERCIAL BANKS TO THE FINANCING PACKAGE, IN THE FORM OF VOLUNTARY DEBT-PRINCIPAL REDUCTION, DEBT-SERVICE REDUCTION OR NEW MONEY IS THE CRITICAL PREREQUISITE TO THE SUCCESS OF THE NEW STRATEGY. I THEREFORE CALL UPON THE INTERNATIONAL BANKING COMMUNITY TO RESPOND AFFIRMATIVELY TO THE PROPOSAL JOINTLY AGREED BY MEXICO AND THE BANK ADVISORY COMMITTEE AND TO TAKE POSITIVE ACTION WITHOUT DELAY.

ENRIQUE V. IGLESIAS, PRESIDENT
INTER-AMERICAN DEVELOPMENT BANK

Draft
9/14/89

New

TO: THE INTERNATIONAL BANKING COMMUNITY

FROM: BANK ADVISORY COMMITTEE FOR MEXICO

DATE: SEPTEMBER 15, 1989

RE: 1989-92 FINANCING PACKAGE FOR MEXICO

(1) WE REFER TO OUR TELEXES TO YOU OF JULY 24 AND AUGUST 2, 1989 REGARDING THE FORMULATION OF THE 1989-92 FINANCING PACKAGE FOR MEXICO. THROUGHOUT THIS PERIOD, WE HAVE RECEIVED CONSTRUCTIVE INPUT FROM MANY BANKS ON MANY ISSUES.

(2) THE BANK ADVISORY COMMITTEE FOR MEXICO HAS JUST CONCLUDED MEETINGS IN NEW YORK CITY WITH REPRESENTATIVES OF THE MEXICAN GOVERNMENT. DURING THESE MEETINGS, A DETAILED PROPOSAL FOR THE 1989-92 FINANCING PACKAGE WAS FINALIZED AND IS BEING DISTRIBUTED TO YOU FOR YOUR CONSIDERATION.

(3) COMMUNICATIONS FROM PEDRO ASPE ARMELLA, MINISTER OF FINANCE AND PUBLIC CREDIT OF THE UNITED MEXICAN STATES, MICHEL CAMDESSUS, MANAGING DIRECTOR OF THE INTERNATIONAL MONETARY FUND, BARBER B. CONABLE, PRESIDENT OF THE WORLD BANK, AND ENRIQUE V. IGLESIAS, PRESIDENT OF THE INTER-AMERICAN DEVELOPMENT BANK, ACCOMPANY THIS COMMUNICATION.

(4) THE COMMUNICATION FROM THE MEXICAN MINISTER OF FINANCE SUMMARIZES MEXICO'S ECONOMIC PROGRAM AND REQUESTS YOUR PARTICIPATION IN THE 1989-92 FINANCING PACKAGE.

(5) THE 1989-92 FINANCING PACKAGE CONSISTS OF THE FOLLOWING INTERRELATED PARTS:

- PART I- ONE DEBT REDUCTION OPTION AND ONE DEBT-SERVICE REDUCTION OPTION;
- PART II- FOUR NEW MONEY OPTIONS, INCLUDING AN OPTIONAL INTEREST RECYCLING FEATURE;
- PART III- AMENDMENTS TO MEXICO'S EXISTING DEBT AGREEMENTS;
- PART IV- NEW DEBT AGREEMENTS TO IMPLEMENT CERTAIN DEBT-FOR-DEBT EXCHANGES FOR ALL NEW MONEY PARTICIPANTS; AND
- PART V- CERTAIN INTERIM MEASURES.

(6) AS NOTED IN THE MINISTER'S COMMUNICATION, THE 1989-92 FINANCING PACKAGE IS INTENDED TO SUPPORT MEXICO'S MEDIUM-TERM GROWTH-ORIENTED ECONOMIC PROGRAM.

(7) THE COMMUNICATIONS FROM THE MANAGING DIRECTOR OF THE IMF AND THE PRESIDENT OF THE WORLD BANK COMMENT ON MEXICO'S ECONOMIC PROGRAM AND DESCRIBE THE EXTERNAL FINANCING AVAILABLE TO MEXICO DURING THE PERIOD 1989-1992 FROM SOURCES OTHER THAN COMMERCIAL BANKS, INCLUDING THE FUNDS TO BE MADE AVAILABLE TO MEXICO BY THE IMF, THE WORLD BANK AND THE EXPORT-IMPORT BANK OF JAPAN FOR THE ENHANCEMENT OF THE DISCOUNT AND PAR BONDS TO BE ISSUED BY MEXICO IN EXCHANGE FOR ELIGIBLE DEBT UNDER PART I OF THE 1989-92 FINANCING PACKAGE.

(8) IN THIS CONTEXT, EACH OF THE BANKS ON THE BANK ADVISORY COMMITTEE FOR MEXICO INTENDS TO RESPOND POSITIVELY TO MEXICO'S REQUEST TO PARTICIPATE IN THE 1989-92 FINANCING PACKAGE. WE ASK EACH OF YOU TO RESPOND IN A SIMILARLY POSITIVE FASHION IN THE CONTEXT OF CONTINUING THE CONSTRUCTIVE COOPERATION OF ALL. THE COMMUNICATION FROM THE MEXICAN MINISTER OF FINANCE REQUESTS YOUR POSITIVE RESPONSE BY OCTOBER __, 1989.

(9) AS NOTED IN THE MINISTER'S COMMUNICATION, MEXICO HAS REQUESTED THAT THE AMENDMENTS TO ITS EXISTING DEBT AGREEMENTS AND ITS NEW DEBT AGREEMENTS UNDER THE 1989-92 FINANCING PACKAGE EXTEND UNTIL DECEMBER 31, 1992 THE EXISTING EVENT OF DEFAULT CLAUSES RELATING TO THE AGGREGATE LEVEL OF LIABILITIES OF THE FOREIGN AGENCIES AND BRANCHES OF THE MEXICAN BANKS TO NON-MEXICAN COMMERCIAL BANKS. THIS EXTENSION IS INTENDED TO PERMIT ADEQUATE TIME FOR THE MEXICAN BANKS TO CONTINUE TO DEVELOP AND IMPLEMENT SPECIFIC PROPOSALS, ON A VOLUNTARY CASE-BY-CASE BASIS, FOR CONVERTING EXISTING SHORT-TERM PLACEMENTS INTO LONGER-TERM ARRANGEMENTS. THE BANK ADVISORY COMMITTEE SUPPORTS MEXICO'S CONTINUING EFFORTS TO ACHIEVE A MORE STABLE FUNDING BASE FOR THE MEXICAN BANKS ON THE VOLUNTARY CASE-BY-CASE BASIS DESCRIBED IN THE MINISTER'S COMMUNICATION.

(10) THE MEXICAN AUTHORITIES INTEND TO VISIT A NUMBER OF FINANCIAL CENTERS DURING THE WEEK(S) OF __________, 1989 TO RESPOND DIRECTLY TO QUESTIONS YOU MAY HAVE.

(11) WE ARE BEGINNING TO WORK WITH REPRESENTATIVES OF THE MEXICAN GOVERNMENT TO DEVELOP DOCUMENTATION TO IMPLEMENT THE 1989-92 FINANCING PACKAGE. AS SOON AS APPROPRIATE DOCUMENTATION IS PREPARED, DRAFTS WILL BE TRANSMITTED TO YOU FOR REVIEW.

(12) IF YOU HAVE ANY QUESTIONS ON THE FOREGOING, PLEASE CONTACT THE APPROPRIATE AREA CONTACT OR MEMBER OF THE BANK ADVISORY COMMITTEE.

REGARDS,

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

THE UNITED MEXICAN STATES

1989-92 FINANCING PACKAGE

THE UNITED MEXICAN STATES, acting through the Ministry of Finance and Public Credit, requests the international banking community to participate in its 1989-92 Financing Package.

The 1989-92 Financing Package consists of the following separate but interrelated parts:

Part I. Debt and Debt-Service Reduction Options

- Option A: Collateralized Floating Rate Discount Bond Exchange
- Option B: Collateralized Fixed Rate Par Bond Exchange

Part II. New Money Options

- Option C: 1989-92 New Money Credit Agreement
- Option D: New Money Bonds
- Option E: Onlending Facility
- Option F: Medium-Term Trade Credit Facility

Part III. Amendment of Debt Agreements

- 1983 U.S. $5 Billion Credit Agreement,
- 1984 U.S. $3.8 Billion Credit Agreement,
- 1987 Multi-Facility Agreement,
- 52 Restructure Agreements,
- 35 New Restructure Agreements and
- FICORCA Facility Agreement.

Part IV. Implementation of the Financing Package

Part V. Interim Measures

Annex A. Form of Commitment Telex

* * * * *

The distribution of the 1989-92 Financing Package has no legal effect on existing payment obligations. Except as specified in Part V below and in paragraph 9 of the Commitment Telex, all existing payment obligations shall continue to be governed by currently applicable agreements until amendments to existing agreements or new agreements are executed and become effective between Mexico and its bank creditors. Certain existing payment obligations are excluded from adjustment and amendment under the 1989-92 Financing Package. The basic business terms of the 1989-92 Financing Package are outlined below.

MEXICO'S 1989-92 FINANCING PACKAGE

SUMMARY OF TERMS

Menu of Options: Parts I and II of Mexico's 1989-92 Financing Package consist of a menu of options including:

I. Debt and Debt-Service Reduction Options (described in Part I below)

Option A: Collateralized Floating Rate Discount Bond Exchange
Option B: Collateralized Fixed Rate Par Bond Exchange

II. New Money Options (described in Part II below)

Option C: 1989-92 New Money Credit Agreement
Option D: New Money Bonds
Option E: Onlending Facility
Option F: Medium-Term Trade Credit Facility

Lenders: All lenders with Eligible Debt are requested to participate in the Financing Package.

Eligible Debt: The principal amount of all debt outstanding under

- 1983 U.S. $5 Billion Credit Agreement,
- 1984 U.S. $3.8 Billion Credit Agreement,
- 1987 Multi-Facility Agreement,
- 52 Restructure Agreements and
- 35 New Restructure Agreements.

Transfers of Eligible Debt: By submitting a Commitment Telex, each Lender will agree that it will not transfer any Eligible Debt except to an assignee that either agrees to be bound by such Commitment Telex or (in the case of assignments made before November 15, 1989) submits its own Commitment Telex with respect to such Eligible Debt.

Selection of Options:

Each participating Lender may commit any or all of its Eligible Debt to one or both of the Debt and Debt-Service Reduction Options described in Part I below. Under these Options, each Lender will exchange Eligible Debt for Discount or Par Bonds on the terms described in Part I.

Each Lender that does not commit all of its Eligible Debt to the Debt and Debt-Service Reduction Options is requested to make a New Money Commitment equal to 25% (over the period from 1989 through 1992) of its Eligible Debt not committed to the Debt and Debt-Service Reduction Options; provided that special rules apply to Facilities 2 and 3 of the 1987 Multi-Facility Agreement as described in "Treatment of Facilities 2 and 3" below. Any resulting New Money Commitment of any Lender may be allocated by such Lender among one or more of the New Money Options (subject to specified limitations for certain Options), as described in Part II below.

Treatment of Facilities 2 and 3:

Advances under Facilities 2 and 3 of the 1987 Multi-Facility Agreement (50% of which is guaranteed at final maturity by the World Bank) are eligible to participate in the Financing Package after their exchange for new advances, as described in Part IV below.

Any Lender that commits 100% of its Facilities 2 and 3 advances to the Debt and Debt-Service Reduction Options need only exchange the portion of such advances not guaranteed by the World Bank (the "Tranche A Advances") for Discount or Par Bonds. The additional exchange of the guaranteed portion of the Facilities 2 and 3 advances (the "Tranche B Advances") is optional.

A Lender's New Money Commitment in respect of Facilities 2 and 3 will be equal to 12.5% of the aggregate amount of its Facilities 2 and 3 advances (after reducing such aggregate amount of advances, if applicable, by an amount equal to twice the amount of such Lender's Facilities 2 and 3 advances allocated to the Debt or Debt-Service Reduction Options).

Each Lender that commits 100% of its Eligible Debt (including Facilities 2 and 3 on the basis specified above) to the Financing Package may allocate 100% of its New Money Commitment (if any) based solely on Facilities 2 and 3 as specified above to New Money Bonds (with the terms specified in Option D).

New Money Participation <u>Fee</u>: 0.125% flat fee on the total final New Money Commitment of each Lender that commits 100% of its Eligible Debt (including Facilities 2 and 3) to the Financing Package (in the case of Facilities 2 and 3, either by making a New Money Commitment in respect of the Tranche A and B Advances or by committing to exchange at least the Tranche A Advances for Discount or Par Bonds), <u>provided</u> that such Lender's Commitment Telex is received by the Closing Agent on or before October 31, 1989.

This fee will be payable in U.S. Dollars on the date of the first borrowing under the 1989-92 New Money Credit Agreement referred to in Part II below.

<u>Closing Agent</u>: Citibank, N.A.

<u>Agency Fee</u>: To be negotiated by the Closing Agent and Mexico.

Amendments to <u>Debt Agreements</u>: Amendments will be made on the terms specified in Part III below to the following Debt Agreements of Mexican public sector debtors:

- 1983 U.S. $5 Billion Credit Agreement,
- 1984 U.S. $3.8 Billion Credit Agreement,
- 1987 Multi-Facility Agreement,
- 52 Restructure Agreements,
- 35 New Restructure Agreements and
- FICORCA Facility Agreement.

<u>Implementation</u>: The Eligible Debt of all participating Lenders (including Lenders participating only in the New Money Options) will be exchanged for new debt, as specified in Part IV below, in debt-for-debt exchanges under Section 5.11 of the Debt Agreements evidencing such Eligible Debt:

(a) The terms of the Discount and Par Bonds to be received by participants in the Debt and Debt-Service Reduction Options in exchange for their Eligible Debt are specified in Part I below.

(b) The terms of the New Debt Agreements governing the New Debt to be received by participants in the New Money Options in exchange for their Eligible Debt will be comparable to the terms of the Debt Agreements now governing such Eligible Debt, except as specified in Parts III and IV below.

Interbank Liabilities <u>of Mexican Banks</u>: The proposed amendments to the existing Debt Agreements specified in Part III and the New Money agreements and New Debt Agreements to implement Parts II and IV will extend until December 31, 1992 the existing Event of Default clause relating to the aggregate level of liabilities of the foreign agencies and branches of the Mexican Banks to non-Mexican commercial banks. During this period of extension, Mexico intends that the Mexican Banks will continue to work with their bank creditors to develop and implement specific proposals, on a voluntary case-by-case basis, to convert existing short-term placements to longer-term funded or unfunded arrangements, including<u>, but not limited to</u>, acceptances, letters of credit or other standby facilities.

Interim Measures:	In Part V below, Mexico requests the continuation of certain interim measures relating to (a) the interbank liabilities of the foreign agencies and branches of Mexican Banks and (b) the extension to the second calendar quarter of 1990 of principal maturities due through March 31, 1990 under the 1983 U.S. $5 Billion and 1984 U.S. $3.8 Billion Credit Agreements. In addition, Mexico is requesting (c) additional flexibility within specified limits under the existing Debt Agreements to enter into voluntary market-based transactions with its creditors during an interim period ending March 31, 1990, as described in Part V below, and (d) a waiver under the negative pledge covenants in the Debt Agreements in order to permit the collateralization of the Discount and Par Bonds.
Signing:	Simultaneous signing of documentation to implement Parts I, II, III and IV, expected to occur in the fourth quarter of 1989.
Closing:	Simultaneous closing of the transactions contemplated in Parts I, II, III and IV, expected to occur in the first quarter of 1990.
Debt Conversion Program:	In connection with the implementation of the 1989-92 Financing Package, Mexico will institute a voluntary Debt Conversion Program, as described in the accompanying communication from the Mexican Minister of Finance and Public Credit to the international banking community.
Certain Defined Terms:	Capitalized terms not otherwise defined in the Financing Package are used as defined in Mexico's existing Debt Agreements.

PART I. DEBT AND DEBT-SERVICE REDUCTION OPTIONS

Commitment of Eligible Debt to Options: Each Lender may select from the Debt and Debt-Service Reduction Options by committing to exchange any or all of its Eligible Debt for Discount or Par Bonds on the terms described below.

Options:

Option A: Collateralized Floating Rate Discount Bond Exchange -- See Option A term sheet.

Option B: Collateralized Fixed Rate Par Bond Exchange -- See Option B term sheet.

Purchasers: Lenders electing to participate in one or both of the Debt and Debt-Service Reduction Options.

Bond Currencies: Discount and Par Bonds (each of which is referred to herein as a "Type" of Bonds) will each be issuable in a separate Series for each Bond Currency listed below:

Bond Currency	Series
U.S. Dollars	USD Discount Series USD Par Series
Belgian Francs	BFF Discount Series BFF Par Series
Canadian Dollars	CAN Discount Series CAN Par Series
Deutsche Marks	DMK Discount Series DMK Par Series
Dutch Guilders	DGU Discount Series DGU Par Series
French Francs	FFF Discount Series FFF Par Series

Italian Lire	LRA Discount Series LRA Par Series
Japanese Yen	YEN Discount Series YEN Par Series
Pounds Sterling	STG Discount Series STG Par Series
Swiss Francs	SSF Discount Series SSF Par Series

provided that Bonds of any Bond Currency will be issued only if the aggregate principal amount of Eligible Debt denominated in such Bond Currency that is to be exchanged for such Bonds is at least the equivalent of U.S. $50 million. Bonds will not be issued in European Currency Units.

Bond Currency Elections:

In its Commitment Telex, each Lender must indicate its Bond Currency Elections for its Eligible Debt.

Eligible Debt in U.S. Dollars:

Eligible Debt denominated in U.S. Dollars may only be exchanged for Bonds denominated in U.S. Dollars, provided that any Lender (other than a Lender whose Home Country Currency is Japanese Yen) with U.S. Dollar Eligible Debt in an aggregate amount of less than U.S. $10 million may exchange all (but not less than all) of such Eligible Debt into Bonds denominated in such Lender's Home Country Currency so long as such Home Country Currency is a Bond Currency.

Eligible Debt in Currencies other than U.S. Dollars:

Eligible Debt denominated in a Bond Currency other than U.S. Dollars may be exchanged, at the Lender's option, for Bonds in U.S. Dollars or Bonds in the same Bond Currency as such Eligible Debt, provided that

(a) such Bond Currency is the Home Country Currency of such Lender.

(b) Eligible Debt in Japanese Yen held by a Japanese Lender may be exchanged for Bonds in U.S. Dollars or, subject to the limitations described in "Currency of Collateral" below, for Bonds in Japanese Yen.

(c) Eligible Debt denominated in European Currency Units may be exchanged, at the Lender's option, for (i) Bonds in U.S. Dollars or (ii) Bonds in the Home Country Currency of the Lender, so long as such Home Country Currency is a Bond Currency.

<u>Eligible Debt Subject to Currency Conversion</u>:

(a) Each Lender with Eligible Debt in U.S. Dollars subject to currency conversion under Debt Agreements that is to be exchanged for Bonds in U.S. Dollars may enter into conversion agreements to provide that such Eligible Debt remain in U.S. Dollars.

(b) Each Lender with Eligible Debt subject to currency conversion under Debt Agreements that is to be exchanged for Bonds in the Home Country Currency of such Lender may enter into conversion agreements to provide that such Eligible Debt be converted to such Home Country Currency on or before the Exchange Date.

Level and Allocation of <u>Enhancements</u>:

U.S. $7 billion will be made available by Mexico from funds borrowed from the IMF, the World Bank and the Export-Import Bank of Japan (the "<u>Official Sources</u>"), as well as from Mexico's own resources, to collateralize <u>first</u> the principal of, and <u>then</u> interest on, the Discount and Par Bonds, as described below.

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Except as specified in "Currency of Collateral" below, Bonds denominated in any Bond Currency will have collateral in such Bond Currency.

Because the overall amount of funds available for enhancements is a fixed amount, the amount of collateral available for any Discount or Par Bond will depend, among other things, on

(a) the aggregate principal amount of Eligible Debt to be exchanged for Discount Bonds and Par Bonds, and

(b) the cost of purchasing collateral for principal in each Bond Currency.

The U.S. $7 billion available for collateral will be apportioned among the Bonds on the following basis:

All Discount and Par Bonds will be fully collateralized as to principal. U.S. $7 billion <u>less</u> the amount applied to collateralize the principal of all Bonds will be applied to collateralize interest, as follows:

(1) Discount and Par Bonds denominated in U.S. Dollars will be collateralized as to not less than 18 and not more than 24 months of interest. To the extent that the U.S. $7 billion available for enhancements is insufficient for any reason to collateralize a full 24 months of interest on the Discount and Par Bonds denominated in U.S. Dollars consistent with the principles outlined herein, the amount of interest covered will be reduced, as necessary, to a minimum of 18 months.

(2) The amount of collateral applied to secure interest on Bonds denominated in U.S. Dollars will be determined by assuming that all Bonds other than the Bonds denominated in Japanese Yen are to be issued in U.S. Dollars and, using interest rates of 10% and 6.25%, respectively, for the Discount and Par Bonds, allocating U.S. $7 billion <u>less</u>

the amounts necessary to collateralize the principal of all Bonds and interest on the Yen Bonds (as noted in paragraph 3 below) in such a way as to collateralize the same number of months of interest for the U.S. Dollar Discount and Par Bonds.

(3) The limited issue of Discount and Par Bonds denominated in Japanese Yen will be collateralized as to 18 months of interest;

(4) In the case of Discount and Par Bonds denominated in currencies other than the U.S. Dollar or Japanese Yen, the amounts to be applied to interest collateral shall be the equivalent, in each currency, of the total amount applied to collateralize the principal of and interest on Bonds of the same Type denominated in U.S. dollars, less the amount applied to collateralize the principal of such Bonds.

(5) Because of differing costs of purchasing zero-coupon obligations for collateral in the different Bond Currencies, this method of apportionment will necessarily result in different levels of interest rate coverage for Bonds in different Bond Currencies. Although the number of months of interest covered for Bonds of different Bond Currencies will be different, it is intended that (except for the limited amount of Japanese Yen Bonds as referred to above) Discount Bonds in all Bond Currencies will have collateral of substantially equal value as of the Exchange Date, and Par Bonds in all Bond Currencies will have collateral of substantially equal value as of the Exchange Date.

(6) The exact amounts of collateral for principal and interest allocated to each Bond will be determined shortly before the Exchange Date, on the basis of foreign exchange rates and interest rates in the different Bond Currencies then prevailing.

Delivery of Enhancements:

Mexico will obtain from the Official Sources approximately U.S. $5.7 billion of the funds to be used for the purchase of collateral over the period 1989-92. It is expected that at least U.S. $5.8 billion (including U.S. $4.5 billion of funds from the Official Sources and the U.S. $1.3 billion to be provided by Mexico from its own resources) will be made available for the purchase of collateral on or before the Exchange Date, with the balance expected to be made available no later than December 31, 1992. Pending delivery of the remaining funds, the shortfall in funded collateral will be covered by committed amounts under irrevocable standby letters of credit to be issued, for the account of Mexico, by a group of approximately 15 commercial banks in favor of the Collateral Agents for the Discount and Par Bonds (the "Commercial Bank Bridge Facility").

All collateral for principal will be fully funded on the Exchange Date. The Commercial Bank Bridge Facility will be allocated entirely to collateral for interest on the Discount and Par Bonds denominated in U.S. Dollars.

The amounts available to be drawn under the Commercial Bank Bridge Facility will be reduced from time to time as fully funded collateral is made available by the Official Sources or Mexico and delivered to the Collateral Agents. The Commercial Bank Bridge Facility may be drawn by the Collateral Agents (i) to cover any shortfall in funded collateral remaining at December 31, 1992 (after which time the Commercial Bank Bridge Facility will expire) or (ii) at any time before such expiration date to cover any interest arrearages on the U.S. Dollar Discount and Par Bonds remaining after application of all other interest collateral for such Bonds.

Currency of Collateral:

For Bonds in U.S. Dollars:

Bonds denominated in U.S. Dollars will have collateral in U.S. Dollars.

For Bonds in other Bond Currencies:

(a) Bonds denominated in any Bond Currency other than U.S. Dollars will have collateral in such Bond Currency, provided that

(i) zero-coupon obligations in such Bond Currency that fully defease the principal of the Bond in such Bond Currency at maturity can be purchased by Mexico at a cost that does not exceed the purchase price in U.S. Dollars of collateral for principal and interest pledged to secure a Bond of the same amount and Type in U.S. Dollars (determined on the assumption that all Bonds would be issued in U.S. Dollars), and

(ii) the zero-coupon obligations to be used as collateral in such Bond Currency are not subject to withholding or other taxes. Mexico will not be responsible for the payment of any such tax that may later become applicable.

(b) If zero-coupon obligations in any Bond Currency (other than Japanese Yen as described below) that fully defease the principal of the Bonds in such Bond Currency at maturity cannot be purchased (due to the limitations on cost or taxability referred to above or for any other reason), the principal of Bonds in such Bond Currency will be secured at maturity by a pledge of U.S. Dollar zero-coupon obligations in the same face amount as the zero-coupon obligations pledged to secure the principal of an equivalent amount of Bonds in U.S. Dollars. At maturity, Mexico will deliver the U.S. Dollar proceeds of the

U.S. Dollar zero-coupon obligations to the holders of such Bonds in lieu of paying the principal amount of the Bonds then due in their Bond Currency. Accordingly, in any such case, the Lender will bear any foreign exchange loss, and benefit from any foreign exchange gain, realized at maturity of the Bonds upon conversion of the proceeds of the principal collateral in U.S. Dollars to such Bond Currency.

Any such Bonds in a Bond Currency that are secured as to principal by a pledge of U.S. Dollar collateral will nevertheless have interest collateral denominated in the Bond Currency of such Bonds.

(c) If government zero-coupon obligations in any Bond Currency that fully defease the principal of the Bonds in such Bond Currency at maturity are not available for any reason (or, if available, are subject to withholding or other tax), Mexico would consider purchasing zero-coupon obligations issued by a single private issuer in such Bond Currency that fully defease such Bonds at maturity, but only on the following basis:

(1) The cost of such zero-coupon obligations reflects the 30-year market rate available (theoretically or otherwise) to such private issuer (and not to its government);

(2) Recourse of the holder with respect to the principal amount of any Bond secured at maturity by any such zero-coupon obligations shall be limited to such zero-coupon obligations, and Mexico would have no obligation to pay such principal at maturity or for any shortfall of principal resulting from any withholding or other tax or from any other reason;

(3) The cost of issuing any such zero-coupon obligation of a private issuer (other than the purchase price thereof) would be for the account of the Lender;

(4) Lenders eligible to receive Bonds secured by any such zero-coupon obligations would be informed of the identity of the private issuer before October 31, 1989; and

(5) Other provisions applicable to the zero-coupon obligations issued by governmental issuers as specified above would be similarly applicable to collateral issued by private issuers.

<u>For Bonds in Japanese Yen held by Japanese Lenders</u>:

Bonds in Japanese Yen received by Japanese Lenders in exchange for Eligible Debt in Japanese Yen will have:

(a) principal collateral in Japanese Yen sufficient to defease such Bonds fully at maturity, together with

(b) interest collateral in Japanese Yen sufficient to cover 18 months of interest on such Bonds (calculated, in the case of Discount Bonds, at an appropriate assumed rate equivalent to the 10% assumed rate for the U.S. Dollar Discount Bonds); <u>provided</u> that the principal amount of Eligible Debt in Japanese Yen that may be exchanged for such Japanese Yen Bonds is limited to 5% of the Eligible Debt in Japanese Yen held by Japanese Lenders. In the event that these Japanese Yen Bonds are over-subscribed, subscriptions will be ratably reduced, and the remaining Eligible Debt in Japanese Yen will be exchangeable only for Bonds in U.S. Dollars.

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<u>Exit Undertaking</u>: Mexico will covenant that (a) neither the Bonds (nor the Eligible Debt exchanged for such Bonds) will be considered as part of a base amount with respect to any future requests by Mexico for new money and (b) the Bonds will not be subject to any future restructuring requests.

<u>Exchange Date</u>: Eligible Debt will be exchanged for Discount or Par Bonds on the date on which the Conditions to Exchange described below are satisfied.

<u>Conditions to Exchange</u>: Bonds will be issued in exchange for Eligible Debt on the date the following conditions are satisfied (the "<u>Exchange Date</u>"):

(a) Effectiveness of collateral arrangements to secure the Bonds and delivery of collateral to the Collateral Agents.

(b) Purchase by Mexico of all amounts scheduled to become available in 1989 under the IMF Extended Fund Arrangement.

(c) Delivery of a status report on implementation of the Paris Club Agreed Minute.

(d) Signature of documentation to implement Parts I and II by Mexico and Banks with at least 90% of the Eligible Debt, <u>provided</u> that such percentage may be reduced to 80% with the consent of Mexico and Banks with at least 50% of the Eligible Debt committed to Part I.

(e) Signature of amendments of Debt Agreements to implement Part III below by Mexico and Banks with at least 90% of the Eligible Debt, <u>provided</u> that such percentage may be reduced to 80% with the consent of Mexico and Banks with at least 50% of the Eligible Debt committed to Part I.

(f) Satisfaction of Conditions of Availability for first Tranche under the 1989-92 New Money Credit Agreement referred to in the New Money Options described in Part II below.

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(g) Waivers under the Debt Agreements to the extent necessary to permit the collateralization of the Discount and Par Bonds.

(h) Mexican public sector borrowers are current on interest due as of date 15 days before the Exchange Date.

(i) Continuing foreign exchange availability for payment of private sector interest.

(j) Other customary conditions precedent.

The Exchange Date may not occur after March 31, 1990 without the consent of Mexico and Banks with at least 75% of the Eligible Debt committed to Part I.

Implementation:

(a) Accrued but unpaid interest on Eligible Debt that is exchanged for Bonds will be paid (net of the credit referred to under "Interest Adjustments" below) on the first Interest Payment Date under the Debt Agreement for such Eligible Debt occurring after the Exchange Date.

(b) Appropriate arrangements will be made to minimize or eliminate (1) losses for broken funding of Eligible Debt bearing interest at a LIBO Rate or Domestic Rate and (2) foreign exchange losses resulting from the exchange of Eligible Debt in one currency for Bonds in another Bond Currency.

Interest Adjustments:

The Bonds will be subject to an interest adjustment mechanism designed to give Mexico the economic benefits of their issuance with effect from July 1, 1989. This adjustment will be effected as follows:

(a) All Lenders exchanging Eligible Debt for Bonds will continue to receive interest on such Eligible Debt until (but excluding) the Exchange Date at ordinary contractual rates, in accordance with the terms of the Debt Agreements evidencing such Eligible Debt.

(b) Mexico will be entitled to a credit against interest payments on such Eligible Debt and the Bonds in an amount equal to <u>the excess of</u>

(1) the interest accrued during the period from (and after) July 1, 1989 to (but excluding) the Exchange Date on the Eligible Debt that is exchanged for Bonds <u>over</u>

(2) the amount of interest that would have accrued during such period on the Bonds received in exchange for such Eligible Debt if the Bonds had been issued as of July 1, 1989.

The credit will be applied <u>first</u> to reduce the amount of interest otherwise payable on such Eligible Debt on the first Interest Payment Date for such Eligible Debt on or after the Exchange Date and <u>then</u> to reduce the amount of interest otherwise payable on the Bonds until the credit has been used up.

(c) Appropriate arrangements will be made to give comparable treatment to Lenders with Eligible Debt in currencies other than U.S. Dollars.

<u>Value Recovery</u>: From July 1, 1996 to December 31, 2019, additional payments (the "<u>Additional Payments</u>") will be made in respect of the Discount and Par Bonds, payable in U.S. Dollars on each quarterly payment date, in an aggregate amount equal to 30% of an amount determined as follows:

(Current Oil Price <u>minus</u> Reference Oil Price) <u>times</u> Current Export Volume <u>times</u> 91 days <u>times</u> the Participation Percentage,

<u>where</u>

"<u>Current Oil Price</u>" means, for any quarterly payment date, the average price per barrel of oil exported by Mexico (determined by reference to a surrogate price, as described below) during the four calendar quarters ending before such date; and

"<u>Reference Oil Price</u>" means a price of U.S. $14 per barrel of oil, as adjusted as of the end of the second calendar quarter of each year (commencing June 30, 1990) for U.S. inflation during the four calendar quarters ending before such date;

"Current Export Volume" means, for any quarterly payment date, the average daily Mexican oil export volume for the four calendar quarters ending before such date; and

"Participation Percentage" means the percentage of the aggregate principal amount of Eligible Debt on the Exchange Date that is exchanged for Bonds.

Allocation of Payments Among Holders: Each holder's share of each Additional Payment shall be equal to the ratio of the U.S. Dollar equivalent of (i) the Eligible Debt exchanged for the Bonds of such holder to (ii) the aggregate amount of Eligible Debt exchanged for Bonds.

Surrogate Price of Oil: The average price per barrel of oil exported by Mexico during any period shall be deemed equal to an appropriate surrogate price to be determined.

Limitation on Additional Payments: The aggregate amount of Additional Payments made in any quarter shall be subject to the following limitations:

(a) Additional Payments for any quarter may not exceed an amount equal to 30% of an amount determined as follows:

(Mexico's average gross quarterly oil export revenues for the preceding four quarters minus the Base Revenue Amount) times the Participation Percentage,

where

"Base Revenue Amount" means 1.25 million barrels per day times 91 days times Reference Oil Price.

(b) The Additional Payments made in the 12-month period beginning July 1, 1996 and in each 12-month period beginning on July 1 of each succeeding year may not exceed 3% of the U.S. Dollar equivalent of the Eligible Debt exchanged for Bonds (the "Base Amount") (1.5% of the Base Amount for the final 6-month period beginning July 1, 2019 and ending

December 31, 2019). Additional Payments for any quarter may not exceed 0.75% of the Base Amount; and any amount otherwise payable in any quarter (but for such 0.75% quarterly payment limitation) shall be carried forward cumulatively and available for making payments at any time when there would otherwise have been a quarterly payment of less than 0.75% of the Base Amount. Accordingly, the maximum amount available to be carried forward from the 12-month period beginning July 1, 1996 and from each 12-month period beginning on July 1 of each succeeding year will in no event exceed (x) 3% of the Base Amount minus (y) the Additional Payments earned and paid during such period.

Issuance and Transfer Restrictions: The Bonds will not be registered under the U.S. Securities Act of 1933. Bonds will be freely transferable, but their issuance and transfer will be subject to compliance with applicable securities and commodities laws of various countries, including U.S. securities and commodities laws, in accordance with procedures to be confirmed.

Debt Conversion Program: The Bonds will be eligible for voluntary conversion under Mexico's Debt Conversion Program.

Miscellaneous: Commitments under Part I will be subject to no material adverse change occurring in international capital or money market conditions before the signing of the exchange documentation.

Mexico will reimburse the Bank Advisory Committee for all documented and reasonable expenses (including legal fees of the Bank Advisory Committee, printing and out-of-pocket expenses) incurred in connection with the development, preparation and execution of the documentation.

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Same as Par Bonds

OPTION A TERM SHEET: COLLATERALIZED FLOATING RATE DISCOUNT BOND EXCHANGE

1. TERMS OF EXCHANGE

Exchange:	Exchange of Eligible Debt for Collateralized Floating Rate Discount Bonds Due 2019 (the "Discount Bonds") in a principal amount equal to 65% of the principal amount of the Eligible Debt exchanged for such Bonds.
Purchasers:	Each Lender that elects this Option.
Commitment Amount:	Each Purchaser may commit for Discount Bonds in an aggregate principal amount of up to 65% of the aggregate principal amount of its Eligible Debt.
Currency of Commitment:	Each currency in which a Purchaser's Eligible Debt is denominated.

2. TERMS OF COLLATERALIZED FLOATING RATE DISCOUNT BONDS DUE 2019

Issuer:	The United Mexican States.
Interest Rate:	For Discount Bonds in each Bond Currency, 13/16% per annum over the six-month LIBO rate for such Bond Currency (or, if market, tax, regulatory or other legal constraints preclude Lenders from funding Discount Bonds on a LIBO rate basis in any Bond Currency, an appropriate cost of funds floating reference rate in such Bond Currency comparable to the LIBO rate to be agreed). Interest will be payable at the end of each six-month interest period.
Repayment:	To be repaid in a single installment on December 31, 2019.
Form:	Registered.
Denominations:	Minimum denominations of U.S. $250,000 (or comparable amount in other currencies) or, if a Purchaser's commitment in respect of Discount Bonds is less than such amount, in a denomination equal to such lesser amount.

OPTION A TERM SHEET
COLLATERALIZED FLOATING RATE DISCOUNT BOND EXCHANGE

1 TERMS OF EXCHANGE

Exchange	Exchange of Eligible Debt for Collateralized Floating Rate Discount Bonds Due 2019 (the "Discount Bonds") in a principal amount equal to 65% of the principal amount of the Eligible Debt exchanged for such Bonds
Purchasers	Each Lender that elects this Option
Commitment Amount	Each Purchaser may commit for Discount Bonds in an aggregate principal amount of up to 65% of the aggregate principal amount of its Eligible Debt
Currency of Commitment	Each currency in which a Purchaser's Eligible Debt is denominated

2 TERMS OF COLLATERALIZED FLOATING RATE DISCOUNT BONDS DUE 2019

Issuer	The United Mexican States
Interest Rate	For Discount Bonds in each Bond Currency, 13/16% per annum over the six-month LIBO rate for such Bond Currency (or, if market, tax, regulatory or other legal constraints preclude Lenders from funding Discount Bonds on a LIBO rate basis in any Bond Currency, an appropriate cost of funds floating reference rate in such Bond Currency comparable to the LIBO rate to be agreed) Interest will be payable at the end of each six-month interest period
Repayment	To be repaid in a single installment on December 31, 2019
Form	Registered
Denominations	Minimum denominations of U S $250,000 (or comparable amount in other currencies) or, if a Purchaser's commitment in respect of Discount Bonds is less than such amount, in a denomination equal to such lesser amount

Bonds will be held by the Collateral Agent for the benefit of the holders of the Discount Bonds of such Series pursuant to a Collateral Pledge Agreement.

Redemption; <u>Purchases</u>:

(a) Mexico may redeem Discount Bonds of any Series, in whole or in part, on any Interest Payment Date at par, <u>provided</u> that any partial redemption shall be made ratably or in such other manner as the Fiscal Agent shall deem appropriate and fair.

(b) Mexico or any Mexican Governmental Agency may also purchase Discount Bonds of any Series at any time by tender (available to all holders alike) or in the open market at any price, <u>provided</u> that

(1) Neither Mexico nor any Mexican Governmental Agency (other than a Mexican Bank (a) for its trading account in the ordinary course of business or (b) for the account of private sector customers) may purchase Discount or Par Bonds of any Series, directly or indirectly, at any time

(A) when interest payments on the Discount or Par Bonds of any Series are not current, or

(B) before the Fadeaway Date when the interest collateral for the Discount or Par Bonds of any Series is not at its original level.

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(2) Any Discount Bonds purchased by Mexico must be surrendered for cancellation.

As used herein, "<u>Fadeaway Date</u>" means the <u>later</u> of

(i) January 1, 1995, unless interest on the Discount or Par Bonds of any Series is <u>not</u> then current (in which case, the first date thereafter on which interest is current), and

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(ii) the date on which the Commercial Bank Bridge Facility is cancelled (or drawn and repaid) in full.

(c) Upon cancellation of Discount Bonds redeemed or purchased as provided above, the _pro rata_ amount of the principal and interest collateral for such Discount Bonds will be released to Mexico.

Covenants: Customary covenants, including:

Negative Pledge:
Substantially as contained in the amended Debt Agreements and New Debt Agreements (as specified under "Negative Pledge" in Part III-A below), with the following additional exception:

(1) collateral pledged to secure financings, the proceeds of which are used to make or secure interest payments on the Discount or Par Bonds of any Series;

provided that the negative pledge shall apply only before the Fadeaway Date and then only when either

(A) interest payments on the Discount or Par Bonds of any Series are not current or

(B) the interest collateral for the Discount or Par Bonds of any Series is not at its original level.

Events of Default: Customary Events of Default, including:

(a) Default in the payment of principal when due at maturity; or, upon redemption, default in the payment of principal for at least 15 days.

(b) Default in the payment of interest for at least 30 days.

(c) Pledge of collateral ceases to be valid and perfected first priority security interest.

(d) Breach of any other covenant for at least 90 days.

(e) Default in the payment of principal, or acceleration, of any public issue of external indebtedness of Mexico or any of its Governmental Agencies (including any other Series of Discount and Par Bonds); or any default in the payment of interest on any other Series of Discount or Par Bonds.

(f) Moratorium on payment of principal of, or interest on, any public issue of external indebtedness of Mexico or any of its Governmental Agencies (including any other Series of Discount and Par Bonds).

<u>Acceleration</u>: Upon occurrence of an Event of Default in respect of any Series of Discount Bonds, holders of at least 25% in aggregate principal amount of such Series of Bonds may declare such Series of Bonds due and payable. Holders of at least 50% in aggregate principal amount of such Series of Bonds may rescind the declaration after any such Event of Default is cured.

Recourse to <u>Collateral</u>:

(a) Notwithstanding any Event of Default or acceleration of the Discount Bonds of any Series, holders of such Series of Bonds will not have recourse to the collateral securing principal of such Series of Bonds until December 31, 2019, at which time the proceeds of the collateral will be available to pay the full principal amount of such Series of Bonds.

(b) Upon an Event of Default for nonpayment of interest on the Discount Bonds of any Series, the Collateral Agent shall at the request, or may with the consent, of the holders of

25% in aggregate principal amount of such Series of Bonds apply amounts from the interest collateral for such Series to pay accrued and unpaid interest on such Series of Bonds.

Taxes:	Discount Bonds will be exempt from Mexican withholding taxes. All payments will be made free and clear of any future Mexican taxes, withholdings or other deductions whatsoever.
Fiscal Agent:	To be agreed.
Collateral Agent(s):	To be agreed.
Agency Fees:	To be negotiated by each Agent and the Issuer.
Governing Law; Jurisdiction:	The Discount Bonds will be governed by the laws of the State of New York[(unless otherwise required by local regulatory requirements)]and will provide for the jurisdiction of the State and Federal Courts in New York and the High Court of Justice in London.
Listing:	Application will be made to list the Discount Bonds on the Luxembourg Stock Exchange.
Documentation:	Subject to negotiation, execution and delivery of mutually satisfactory documentation, including: • Exchange Agreement; • Bonds; • Fiscal Agency Agreement; and • Collateral Pledge Agreements.

Same as Discount bonds

OPTION B TERM SHEET:
COLLATERALIZED FIXED RATE PAR BOND EXCHANGE

1. TERMS OF EXCHANGE

Exchange: Exchange of Eligible Debt for Collateralized Fixed Rate Par Bonds Due 2019 (the "Par Bonds") in a principal amount equal to 100% of the principal amount of the Eligible Debt exchanged for such Bonds.

Purchasers: Each Lender that elects this Option.

Commitment Amount: Each Purchaser may commit for Par Bonds in an aggregate principal amount of up to 100% of the aggregate principal amount of its Eligible Debt.

Currency of Commitment: Each currency in which a Purchaser's Eligible Debt is denominated.

2. TERMS OF COLLATERALIZED FIXED RATE PAR BONDS DUE 2019

Issuer: The United Mexican States.

Interest Rate: For Par Bonds in each Bond Currency, the fixed rate per annum specified below for such Bond Currency, payable semi-annually in arrears:

Bond Currency	Fixed Rate
U.S. Dollars	6.25%
Belgian Francs	6.42%
Canadian Dollars	7.29%
Deutsche Marks	-
Dutch Guilders	5.31%
French Francs	6.63%
Italian Lire	[10.31%]
Japanese Yen	3.85%
Pounds Sterling	8.11%
Swiss Francs	3.75%

Repayment: To be repaid in a single installment on December 31, 2019.

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Form: Registered.

Denominations: Minimum denominations of U.S. $250,000 (or comparable amount in other currencies) or, if a Purchaser's commitment in respect of Par Bonds is less than such amount, in a denomination equal to such lesser amount.

Enhancements:

Collateral for Principal: Payment in full of the principal amount of the Par Bonds on Decebar 31, 2019 will be secured by a pledge by Mexico of zero-coupon U.S. Treasury obligations and other zero-coupon obligations expressly backed by the full faith and credit of the United States Government, or other comparable collateral for other currencies, in a face amount equal to the principal amount of the Par Bonds and with a maturity date on or before December 31, 2019. The collateral in U.S. Dollars will be held by the Collateral Agent in a segregated book-entry Treasury securities account of the Collateral Agent for the benefit of the holders at the Federal Reserve Bank of New York pursuant to a Collateral Pledge Agreement. Collateral for principal in other Bond Currencies will be held by the Collateral Agent under appropriate arrangements to be determined for each Bond Currency. In the event that Mexico does not make available to the Fiscal Agent on Decebar 31, 2019 the full principal amount of the Par Bonds of any Series, the Collateral Agent shall cause the proceeds of the collateral to be remitted to the Fiscal Agent to the extent necessary to pay the principal of the Par Bonds of such Series.

Collateral for Interest: Payment of interest on the Par Bonds in U.S. Dollars will be secured by the pledge by Mexico of cash or permitted investments in U.S. Dollars in an amount equal to up to 24 months (but in no event less than 18 months) of interest, as specified in

"Level and Allocation of Enhancements" above. Payment of interest on the Par Bonds in any Bond Currency other than U.S. Dollars will be secured by a pledge of cash or permitted investments in such Bond Currency in an amount to be determined as provided in "Level and Allocation of Enhancement" above. The collateral for each Series of Par Bonds will be held by the Collateral Agent for the benefit of the holders of the Par Bonds of such Series pursuant to a Collateral Pledge Agreement.

Redemption; <u>Purchases</u>:

(a) Mexico may redeem Par Bonds of any Series, in whole or in part, on any Interest Payment Date at par, <u>provided</u> that any partial redemption shall be made ratably or in such other manner as the Fiscal Agent shall deem appropriate and fair.

(b) Mexico or any Mexican Governmental Agency may also purchase Par Bonds of any Series at any time by tender (available to all holders alike) or in the open market at any price, <u>provided</u> that

(1) Neither Mexico nor any Mexican Governmental Agency (other than a Mexican Bank (a) for its trading account in the ordinary course of business or (b) for the account of private sector customers) may purchase Discount or Par Bonds of any Series, directly or indirectly, at any time

(A) when interest payments on the Discount or Par Bonds of any Series are not current, or

(B) before the Fadeaway Date when the interest collateral for the Discount or Par Bonds of any Series is not at its original level.

(2) Any Par Bonds purchased by Mexico must be surrendered for cancellation.

As used herein, "Fadeaway Date" means the later of

(i) January 1, 1995, unless interest on the Discount or Par Bonds of any Series is not then current (in which case, the first date thereafter on which interest is current), and

(ii) the date on which the Commercial Bank Bridge Facility is cancelled (or drawn and repaid) in full.

(c) Upon cancellation of Par Bonds redeemed or purchased as permitted above, the pro rata amount of the principal and interest collateral for such Par Bonds will be released to Mexico.

Covenants: Customary covenants, including:

Negative Pledge:
Substantially as contained in the amended Debt Agreements and New Debt Agreements (as specified under "Negative Pledge" in Part III-A below), with the following additional exception:

(1) collateral pledged to secure financings, the proceeds of which are used to make or secure interest payments on the Discount or Par Bonds of any Series;

provided that the negative pledge shall apply only before the Fadeaway Date and then only when either

(A) interest payments on the Discount or Par Bonds of any Series are not current, or

(B) when the interest collateral for the Discount or Par Bonds of any Series is not at its original level.

Events of Default: Customary Events of Default, including:

(a) Default in the payment of principal when due at maturity; or, upon redemption, default in the payment of principal for at least 15 days.

(b) Default in the payment of interest for at least 30 days.

(c) Pledge of collateral ceases to be valid and perfected first priority security interest.

(d) Breach of any other covenant for at least 90 days.

(e) Default in the payment of principal, or acceleration, of any public issue of external indebtedness of Mexico or any of its Governmental Agencies (including any other Series of Discount and Par Bonds); or any default in the payment of interest on any other Series of Discount or Par Bonds.

(f) Moratorium on payment of principal of, or interest on, any public issue of external indebtedness of Mexico or any of its Governmental Agencies (including any other Series of Discount and Par Bonds).

Acceleration: Upon occurrence of an Event of Default in respect of any Series of Par Bonds, holders of at least 25% in aggregate principal amount of such Series of Bonds may declare such Series of Bonds due and payable. Holders of at least 50% in aggregate principal amount of such Series of Bonds may rescind the declaration after any such Event of Default is cured.

Recourse to <u>Collateral</u>:	(a) Notwithstanding any Event of Default or acceleration of the Par Bonds of any Series, holders of such Series of Bonds will not have recourse to the collateral securing principal of such Series of Bonds until December 31, 2019, at which time the proceeds of the collateral will be available to pay the full principal amount of such Series of Bonds.
	(b) Upon an Event of Default for nonpayment of interest on the Par Bonds of any Series, the Collateral Agent shall at the request, or may with the consent, of the holders of 25% in aggregate principal amount of such Series of Bonds apply amounts from the interest collateral for such Series to pay accrued and unpaid interest on such Series of Bonds.
<u>Taxes</u>:	Par Bonds will be exempt from Mexican withholding taxes. All payments will be made free and clear of any future Mexican taxes, withholdings or other deductions whatsoever.
<u>Fiscal Agent</u>:	To be agreed.
<u>Collateral Agent(s)</u>:	To be agreed.
<u>Agency Fees</u>:	To be negotiated by each Agent and the Issuer.
Governing Law; <u>Jurisdiction</u>:	The Par Bonds will be governed by the laws of the State of New York (unless otherwise required by local regulatory requirements) and will provide for the jurisdiction of the State and Federal Courts in New York and the High Court of Justice in London.
<u>Listing</u>:	Application will be made to list the Par Bonds on the Luxembourg Stock Exchange.

<u>Documentation</u>: Subject to negotiation, execution and delivery of mutually satisfactory documentation, including:

- Exchange Agreement;
- Bonds;
- Fiscal Agency Agreement; and
- Collateral Pledge Agreements.

PART II. NEW MONEY OPTIONS

Allocation of New Money Commitment to Options: Each Lender may select from the four New Money Options by allocating its New Money Commitment among one or more of them, provided that a Lender's right to participate in Option D (New Money Bonds), Option E (Onlending Facility) or Option F (Medium-Term Trade Credit Facility) is, in each case, limited to the percentage of a Lender's total New Money Commitment specified in the term sheet for that Option.

Options:

Option C: 1989-92 New Money Credit Agreement-- See Option C term sheet.

Option D: New Money Bonds-- See Option D term sheet.

Option E: Onlending Facility-- See Option E term sheet.

Option F: Medium-Term Trade Credit Facility-- See Option F term sheet.

Reallocation of New Money Commitments: If any [of Option D (New Money Bonds), Option E (Onlending Facility) or Option F (Medium-Term Trade Credit Facility)] is undersubscribed after the initial allocations, there will be a voluntary reallocation of New Money Commitments for Lenders requesting additional amounts under [any such] Option, as specified by the Lenders in their respective Commitment Telexes (see form of Commitment Telex below). If the New Money Bonds are oversubscribed after the initial allocations, the subscriptions for New Money Bonds based upon Eligible Debt other than Facilities 2 and 3 of the 1987 Multi-Facility Agreement ("Facilities 2 and 3") will be reduced pro rata until the New Money Bonds are no longer oversubscribed, and the excess New Money Commitments initially allocated to New Money Bonds will be reallocated to other New Money Options, as specified by the Lenders in their respective Commitment Telexes.

Lenders: Lenders under the Financing Package who have not committed all of their Eligible Debt to one or both [of the] Debt and Debt-Service Reduction Options.

New Money Commitment: 25% of the Eligible Debt (other than Facilities 2 and 3) not committed by each Lender to one or both of the Debt and Debt-Service Reduction Options, to be available as follows:

7% for 1989
6% for 1990
6% for 1991
6% for 1992

plus

an amount equal to 12.5% of the aggregate amount of its Facilities 2 and 3 advances (after reducing such aggregate amount of advances, if applicable, by an amount equal to twice the amount of such Lender's Facilities 2 and 3 advances allocated to the Debt or Debt-Service Reduction Options).

Each Lender that commits 100% of its Eligible Debt (including Facilities 2 and 3) to the Financing Package may allocate 100% of its New Money Commitment (if any) based on Facilities 2 and 3 as specified above to New Money Bonds (with the terms specified in the term sheet for Option D).

Commitment Period: December 1, 1989 through December 31, 1992.

Funding: Each Lender may fund its commitment under each New Money Option by advancing fresh funds or (except for the New Money Bonds) by recycling interest paid to such Lender in respect of its Eligible Debt as described below, provided that the Interest Recycling feature will not be made available unless it is selected by Lenders with respect to New Money Commitments aggregating at least U.S. $50 million (or its equivalent in other currencies).

Interest Recycling: Under the Interest Recycling feature, a Lender could elect to fund a portion of its obligations under one or more New Money Options (other than New Money Bonds) by recycling interest paid on its Eligible Debt (or any New Debt Agreements that govern New Debt received in exchange for such Eligible Debt, as described in Part IV below) (together, the "Eligible Debt Agreements").

Lenders electing the Interest Recycling feature would instruct the Agents and Servicing Banks under the Eligible Debt Agreements to deposit all or a portion of the interest paid for the account of such Lender with a Recycling Agent. The Recycling Agent would hold and invest the funds until such funds are disbursed to the Borrower subject to normal borrowing conditions under one or more of the New Money Options (other than New Money Bonds) designated by such Lender. Each Lender would be required to make up any shortfalls in the amount of funds necessary to fulfill its New Money Commitment. If the conditions for disbursement are not met, the funds (together with interest earned thereon) would be paid to the applicable Lender by the Recycling Agent.

Conditionality: As described below for each New Money Option.

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.

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

Miscellaneous: New Money Commitments under Part II will be subject to no material adverse change occurring in international capital or money market conditions before the signing of the New Money documentation.

Mexico will reimburse the Bank Advisory Committee for all documented and reasonable expenses (including legal fees of the Bank Advisory Committee, printing and out-of-pocket expenses) incurred in connection with the development, preparation and execution of the documentation.

OPTION C TERM SHEET:
1989-92 NEW MONEY CREDIT AGREEMENT

Mechanism: 1989-92 New Money Credit Agreement.

Borrower: United Mexican States, with Banco de Mexico foreign exchange undertaking.

Commitment Amount Per Lender: Each Lender may elect to participate in this Option for a commitment amount of up to 100% of its New Money Commitment.

Aggregate Commitment Amount: Up to 100% of the aggregate New Money Commitments.

Currency of Commitment: Each Lender's Home Country Currency or, at such Lender's option, U.S. Dollars.

Currencies of Advances: U.S. Dollars or equivalent at each borrowing date in one of the following currencies (if such currency is the Home Country Currency of such Lender): Belgian Francs, Canadian Dollars, Deutsche Marks, Dutch Guilders, European Currency Units, French Francs, Italian Lire, Japanese Yen, Pounds Sterling and Swiss Francs.

Each Lender to make a one-time currency selection at time of signing. Each Advance will be made in the selected currency.

Interest Rates: U.S. Dollar Advances

For Advances denominated in U.S. Dollars, each Lender at time of signing shall make a one-time election of a LIBO, domestic or fixed rate as set forth below:

LIBO Rate

13/16% per annum over the LIBO rate for three-month or six-month U.S. Dollar deposits (at the option of the Borrower), payable at the end of each interest period.

Domestic Rate

13/16% per annum over three-month CD rate (adjusted for reserve requirements and FDIC premiums), payable at the end of each interest period.

Fixed Rate

A fixed rate to provide a yield comparable to floating rate options.

Non-U.S. Dollar Advances

For non-U.S. Dollar Advances, each Lender at time of signing shall make a one-time election of a LIBO or domestic rate (to be comparably priced, with respect to both margins and reference rates, with the LIBO and domestic rates set forth above) or a fixed rate to provide a yield comparable to such floating rate options.

For all Advances

For all LIBO Advances, provision will be made on an exceptional basis to limit LIBO interest periods to three months for specified Eligible Banks.

All interest rate definitions will be comparable to those contained in the Debt Agreements on the date hereof.

Final Maturity; Grace Period: 15 years with 7 years' grace.

Repayment: Advances will be repayable in equal quarterly installments, beginning in 1997 and ending in 2004.

Mandatory Prepayment: Required upon voluntary prepayments of any IMF purchase, World Bank loan or other official credit.

Availability: Amounts under this Option will be available to the Borrower from 1989-1992 in 6 separate Tranches as follows:

Tranche	Percentage of New Money Commitments for this Option	Availability Date
1	40%	December 1, 1989
2	12%	July 1, 1990
3	12%	January 1, 1991
4	12%	July 1, 1991
5	12%	January 1, 1992
6	12%	July 1, 1992
	100%	

Conditions of Availability: Customary conditions, including:

First Tranche
(available from December 1, 1989)

(a) Purchase by Mexico of all amounts scheduled to become available in 1989 under the IMF Extended Fund Arrangement.

(b) Delivery of a status report on implementation of the Paris Club Agreed Minute.

(c) Signature of documentation to implement Parts I and II by Mexico and Banks with at least 90% of the Eligible Debt, provided that such percentage may be reduced to 80% with the consent of Mexico and Banks with at least 50% of the Eligible Debt committed to Part II.

(d) Signature of amendments of Debt Agreements to implement Part III below by Mexico and Banks with at least 90% of the Eligible Debt, <u>provided</u> that such percentage may be reduced to 80% with the consent of Mexico and Banks with at least 50% of the Eligible Debt committed to Part II.

(e) Satisfaction of Conditions to Exchange for the Discount and Par Bonds described in Part I above.

(f) Effectiveness of documentation implementing Part IV below in respect of the Eligible Debt committed by each Lender to the New Money Options.

(g) Satisfaction of Conditions of Purchase for the New Money Bonds and Conditions of Availability for the first Tranche of each of the other New Money Options.

<u>Subsequent Tranches</u>

(a) Purchase by Mexico of all amounts scheduled to become available under the IMF Extended Fund Arrangement as indicated below:

<u>Second Tranche</u>
(available from July 1, 1990)

Purchase scheduled for March 1, 1990

<u>Third Tranche</u>
(available from January 1, 1991)

Purchase scheduled for August 1, 1990

<u>Fourth Tranche</u>
(available from July 1, 1991)

Purchase scheduled for March 1, 1991

<u>Fifth Tranche</u>
(available from January 1, 1992)

Purchase scheduled for August 1, 1991

Sixth Tranche
(available from July 1, 1992)

Purchase scheduled for March 1, 1992

(b) Satisfaction of Conditions of Availability for prior Tranches.

All Tranches

(a) Mexican public sector borrowers are current on interest due as of the date 15 days before the availability date for such Tranche.

(b) Continuing foreign exchange availability for payment of private sector interest.

(c) Other customary conditions of availability.

Covenants: Customary covenants for Mexico.

Negative Pledge:

Substantially as contained in the Debt Agreements (as in effect on the date hereof), with the following additional exceptions to permit [collateralization of (x) the Discount and Par Bonds as described in Part I above and (y) existing public issues of bonds to the extent required to be equally and ratably secured with the Discount and Par Bonds, and also to permit] pledges of:

(1) Cash, cash equivalents, securities and intangible assets other than accounts receivable ("Available Assets"), in an amount (valued at market value at time of pledge and excluding the amount of any Available Assets previously pledged to secure External Indebtedness and later released from such pledge) in any year, together with the cash used for payments as described in "Debt Purchases" below, not to exceed the sum of

(a) U.S. $500 million, plus

(b) 50% of the amount, if any, by which Mexico's International Monetary Assets at the end of the most recent quarterly period ending on the last day of February, May, August and November exceed the sum of U.S. $500 million plus three months of imports and external interest payments (measured on the basis of average monthly imports and interest payments during the preceding six months) (the availability of sufficient International Monetary Assets to be certified by Banco de Mexico).

(2) The proceeds of any New Money loans (other than the proceeds of New Money loans under this Part II and the proceeds of certain loans from official and other sources extended during the 1989-92 period) made within three months after the date of disbursement (it being understood that any portion of such proceeds not pledged or used for buybacks shall not be considered a part of Mexico's International Monetary Assets for purposes of paragraph (1) above until three months after the date of its disbursement).

(3) Accounts receivable (defined to include amounts payable in respect of the sale, lease or other provision of goods, energy, services or the like, whether or not yet earned by performance) and tangible assets (i.e., assets other than Available Assets) other than gold, oil and gas and receivables deriving from the sale of oil and gas.

(4) External Indebtedness of Mexico or of any other Governmental Agency by Mexican Banks (or any of their special purpose financing subsidiaries or affiliates).

(5) Assets by Mexican Banks (or any of their special purpose financing subsidiaries or affiliates)

(a) to secure the repayment of liabilities incurred by them in connection with the refinancing, on a medium or long-term basis, of (i) the liabilities of the foreign agencies and branches of such Mexican Banks to non-Mexican commercial banks or (ii) in the case of any Mexican Bank that does not have a foreign agency or branch, money market lines of credit payable in foreign currencies to non-Mexican commercial banks, and

(b) to secure short-term obligations in the ordinary conduct of commercial banking business.

<u>Debt Conversions</u>: There will be a Section 5.11 debt exchange provision substantially similar to that contained in the existing Debt Agreements, except that the term "<u>Qualified Debt</u>" would include:

(1) in addition to specified indebtedness of any Mexican public or private sector entity, specified indebtedness of any non-Mexican entity owned or controlled by a Mexican person or entity.

(2) instead of the category of indebtedness now specified in clause (a) thereof,

(a) indebtedness (up to U.S. $500 million per transaction, up to an annual limit of U.S. $2.5 billion in the aggregate plus any amounts unused in the prior year and carried forward for up to one year) that has a Duration not less than

(i) the product of (x) the Duration of the outstanding debt for which the new debt is being exchanged, and (y) a fraction the numerator of which is the present value of the aggregate amount of principal and interest payable in respect of the new debt, and the denominator of which is the present value of the aggregate amount of principal and interest payable in respect of the outstanding debt being exchanged, <u>minus</u>

(ii) 1.5 years; and

(b) indebtedness that has a Duration not less than the product of (x) the Duration of the outstanding debt for which the new debt is being exchanged, and (y) a fraction the numerator of which is the present value of the aggregate amount of principal and interest payable in respect of the new debt, and the denominator of which is the present value of the aggregate amount of principal and interest payable in respect of the outstanding debt being exchanged;

where (x) "Duration" of any indebtedness means the present value weighted average life to maturity of the combined principal and interest payments of such indebtedness, and (y) the discount rate used for all present value calculations is the LIBO Rate plus 13/16%.

Debt Purchases: Mexico and its Governmental Agencies will be able to purchase debt under the existing Debt Agreements, New Debt Agreements and other New Money agreements provided that

(a) such purchases are made pursuant to offers made to all Lenders under the Agreement governing the debt to be purchased on a pro rata basis,

(b) in any year, the cash used for such purchases under the Agreement and all other existing Debt Agreements, New Debt Agreements and other New Money agreements in the aggregate, plus the Available Assets pledged under clauses (1) and (2) of "Negative Pledge" above, may not exceed the amount permitted under such clauses, and

(c) any such debt purchased by the Borrower shall be cancelled.

The provisions in (a) and (b) above shall not apply to purchases of debt by Mexican Banks (i) for their trading account in the ordinary course of business, (ii) for their own account or for the account of another Governmental Agency, in each case to the extent the debt purchased is used to make a Section 5.11 Qualified Investment, or (iii) for the account of private sector customers, and the provisions in (a) above shall not apply to purchases of debt by Mexican Banks for their own account or for the account of another Governmental Agency, in each case to the extent that the debt purchased is used to secure External Indebtedness of such Mexican Bank or Governmental Agency (as the case may be).

Events of Default:	Customary Events of Default for Mexico.
Acceleration:	Upon occurrence of an Event of Default, the Majority Banks under the 1989-92 New Money Credit Agreement may declare all Advances due and payable.
Agent:	To be agreed.
Agency Fee:	To be negotiated by the Agent and the Borrower.
Taxes:	Advances will be exempt from Mexican withholding taxes. All payments of principal and interest will be made free and clear of any future Mexican taxes, withholdings or other deductions whatsoever.
Assignments:	Advances will be assignable, in whole or in part, to Lenders and other financial institutions agreeing to be bound by the terms of the 1989-92 New Money Credit Agreement.
Governing Law; Jurisdiction:	The 1989-92 New Money Credit Agreement will be governed by the laws of the State of New York and will provide for the jurisdiction of the State and Federal Courts in New York and the High Court of Justice in London and the courts of each jurisdiction in which the principal office of each Lender is located.
Documentation:	Subject to negotiation, execution and delivery of a mutually satisfactory 1989-92 New Money Credit Agreement.

OPTION D TERM SHEET: NEW MONEY BONDS

1. TERMS OF SUBSCRIPTION

Mechanism:	New Money Bonds.
Purchasers; Aggregate Commitment Amount Per Purchaser:	Each Lender (a "Purchaser") may elect to participate in this Option for a commitment amount of up to the sum of (a) 50% of such Lender's New Money Commitment for 1989 based upon its Eligible Debt (other than Facilities 2 and 3) and (b) [for any Purchaser that has committed 100% of its Eligible Debt (including Facilities 2 and 3) to the Financing Package,] the full amount of its New Money Commitment based upon Facilities 2 and 3, subject to possible reallocation as described under "Aggregate Commitment Amount for All Lenders" below and "Allocation of New Money Commitment Among Options" above and in each Lender's Commitment Telex.
Aggregate Commitment Amount for All Purchasers:	Up to the sum of (a) the lesser of U.S. $500 million and 50% of aggregate New Money Commitments for 1989 based upon Eligible Debt (other than Facilities 2 and 3) and (b) the full amount of the aggregate New Money Commitments based upon Facilities 2 and 3. If, in the aggregate, Purchasers allocate to the New Money Bonds more than U.S. $500 million of their New Money Commitments based upon their Eligible Debt other than Facilities 2 and 3, each such allocation will be reduced pro rata until such New Money Commitments initially allocated to New Money Bonds in excess of U.S. $500 million are reallocated to other New Money Options, as specified by each Purchaser in its Commitment Telex.
Currency of Commitment:	U.S. Dollars.

<u>Purchases</u>: Purchasers will purchase New Money Bonds, subject to satisfaction of the Conditions of Purchase, at par in a single purchase.

Conditions <u>of Purchase</u>: Customary conditions of availability and satisfaction of Conditions of Availability for the first Tranche of the 1989-92 New Money Credit Agreement.

2. <u>TERMS OF NEW MONEY BONDS</u>

<u>Issuer</u>: The United Mexican States.

<u>Purchase Date</u>: The borrowing date for the first Tranche of the 1989-92 New Money Credit Agreement.

<u>Currency</u>: U.S. Dollars.

<u>Form</u>: Registered.

<u>Denominations</u>: Minimum denominations of U.S. $250,000 or, if a Purchaser's final commitment in respect of New Money Bonds is less than U.S. $250,000, in a denomination equal to such lesser amount.

<u>Interest Rate</u>: 13/16% per annum over the LIBO Rate for six-month U.S. Dollar deposits, payable at the end of each six-month interest period.

Final Maturity; <u>Grace Period</u>: 15 years with 7 years' grace.

<u>Repayment</u>: Principal will be repayable in equal semi-annual installments, beginning in 1997 and ending in 2004.

Mandatory <u>Prepayment</u>: Required upon voluntary prepayments of any IMF purchase, World Bank loan or other official credit.

Events of <u>Default</u>: Customary Events of Default, including:

(a) Default in the payment of principal.

(b) Default in the payment of interest for at least 30 days.

(c) Breach of any other covenant for at least 90 days.

(d) Default in the payment of principal or acceleration of any public issue of External Indebtedness of Mexico or any of its Governmental Agencies.

(e) Moratorium on payment of principal of, or interest on, any public issue of External Indebtedness of Mexico or any of its Governmental Agencies.

<u>Acceleration</u>:	Upon occurrence of a payment Event of Default under the New Money Bonds, holders of at least 25% in aggregate principal amount of the New Money Bonds may declare such Bonds due and payable. Upon occurrence of any other Event of Default under the New Money Bonds, holders of more than 50% in aggregate principal amount of the New Money Bonds may declare such Bonds due and payable.
<u>Fiscal Agent</u>:	To be agreed.
<u>Agency Fee</u>:	To be negotiated by the Fiscal Agent and the Issuer.
<u>Taxes</u>:	New Money Bonds will be exempt from Mexican withholding taxes. All payments will be made free and clear of any future Mexican taxes, withholdings or other deductions whatsoever.
Issuance and Transfer <u>Restrictions</u>:	The New Money Bonds will not be registered under the U.S. Securities Act of 1933. New Money Bonds will be freely transferable, but their issuance and transfer will be subject to compliance with applicable securities laws of various countries, including the U.S. securities laws, in accordance with procedures to be confirmed.
<u>Listing</u>:	Application will be made to list the New Money Bonds on the Luxembourg Stock Exchange.

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Governing Law; <u>Jurisdiction</u>:	Same as Par and Discount Bonds.
<u>Documentation</u>:	Subject to negotiation, execution and delivery of mutually satisfactory documentation, including: • New Money Bond Subscription Agreement; • Bonds; and • Fiscal Agency Agreement.

OPTION E TERM SHEET: ONLENDING FACILITY

<u>Mechanism</u>: Lenders will make advances (the "<u>Advances</u>") to the Obligor pursuant to an Onlending Facility. Advances will be available for onlending to Mexican public sector borrowers, as described below.

Aggregate Commitment Amount <u>Per Lender</u>: Each Lender may elect to participate in this Option for a commitment amount of up to 20% of its New Money Commitment (or up to 40% for any Lender with a New Money Commitment of less than U.S. $10 million that does not participate in Option F (Medium-Term Trade Credit Facility)), subject to possible voluntary reallocation as described under "Allocation of New Money Commitment to Options" above and in each Lender's Commitment Telex.

Minimum Commitment Amount <u>Per Lender</u>: U.S. $2 million (or equivalent).

1. <u>TERMS OF ADVANCES</u>

<u>Obligor</u>: A trust established by Mexico with Banco de Mexico as Trustee, and Banco de Mexico foreign exchange undertaking.

<u>Guarantor</u>: United Mexican States.

Currency of <u>Commitment</u>: Each Lender's Home Country Currency or, at such Lender's option, U.S. Dollars.

Currencies <u>of Advances</u>: U.S. Dollars or equivalent at each borrowing date in one of the following currencies (if such currency is the Home Country Currency of such Lender): Belgian Francs, Canadian Dollars, Deutsche Marks, Dutch Guilders, European Currency Units, French Francs, Italian Lire, Japanese Yen, Pounds Sterling and Swiss Francs.

Each Lender to make a one-time currency selection at time of signing. Each Advance made by a Lender will be made in such Lender's selected currency.

<u>Purpose</u>: To provide Mexican public sector borrowers with new financing.

<u>Interest Rates</u>: <u>U.S. Dollar Advances</u>

For Advances denominated in U.S. Dollars, each Lender at time of signing shall make a one-time election of a LIBO or domestic rate as set forth below:

<u>LIBO Rate</u>

13/16% per annum over the LIBO rate for three-month U.S. Dollar deposits, payable at the end of each interest period.

<u>Domestic Rate</u>

13/16% per annum over three-month CD rate (adjusted for reserve requirements and FDIC premiums), payable at the end of each interest period.

<u>Non-U.S. Dollar Advances</u>

For non-U.S. Dollar Advances, each Lender at time of signing shall make a one-time election of a LIBO or domestic rate (to be comparably priced, with respect to both margins and reference rates, with the LIBO and domestic rates set forth above).

<u>For all Advances</u>

All interest rate definitions will be comparable to those contained in the Debt Agreements on the date hereof.

Final Maturity of Advances; <u>Grace Period</u>: 15 years with 7 years' grace.

Repayment of Advances:	Advances will be repayable in equal quarterly installments, beginning in 1997 and ending in 2004.
Mandatory Prepayment:	Required upon voluntary prepayments of any IMF purchase, World Bank loan or other official credit.
Availability:	Advances under this Option (other than Readvances under "Readvance Obligation" below) will be made to the Obligor in successive tranches, on a basis consistent with the schedule of availability of Tranches under the 1989-92 New Money Credit Agreement.
Conditions of Availability:	Customary conditions, including: (a) Satisfaction of Conditions of Availability for the corresponding Tranche of the 1989-92 New Money Credit Agreement. (b) Satisfaction of Conditions of Availability for prior Tranches.
Covenants:	Same as 1989-92 New Money Credit Agreement.
Debt Conversions:	Same as 1989-92 New Money Credit Agreement.
Debt Purchases:	Same as 1989-92 New Money Credit Agreement.
Events of Default:	Same as 1989-92 New Money Credit Agreement.
Acceleration:	Upon occurrence of an Event of Default, the Majority Banks under the Onlending Facility may declare all Advances due and payable.
Agent:	To be agreed.
Agency Fee:	To be negotiated by the Agent and the Obligor.
Taxes:	Advances will be exempt from Mexican withholding taxes. All payments of principal and interest with respect to Advances will be made free and clear of any future Mexican taxes, withholdings or other deductions whatsoever.

Assignments:	Advances may be assigned, in whole or in part, to Lenders and other financial institutions agreeing to be bound by the Onlending Facility.
Governing Law; Jurisdiction:	Same as 1989-92 New Money Credit Agreement.
Documentation:	Subject to negotiation, execution and delivery of a mutually satisfactory agreement.

2. TERMS OF ONLENDING

Availability of Advances for Onlending:	Advances will be available for funding Onloans to Mexican public sector borrowers on the terms described below, and on such other terms (including pricing, tenor and security) as are negotiated in each Onlending transaction.
Onlending Procedures:	Advances under the Facility will be prepayable in the inverse order of their maturity, at the request of the Lender, on any interest payment date to fund a permitted Onloan. Each Onloan must be in a minimum amount of U.S. $500,000 (or, if less, the full amount of a Lender's Advances) and must comply with all regulations generally applicable to external borrowing.
Permitted Borrowers:	Mexican public sector entities.
Currencies of Onlending:	Currency of the Advances or, with the approval of Mexico, other currencies, as agreed between the Lender and its borrower.
Interest Rates:	As negotiated between the prospective borrower and the Lender, but not to exceed the interest rate on Advances.

<u>Tenor</u>: As negotiated between the prospective borrower and the Lender, with a minimum tenor of the lesser of (x) three years and (y) the remaining term of the Onlending Facility. Subject to the agreement of the relevant borrowers, Onloans may be made with tenors longer than the remaining term of the Onlending Facility.

<u>Repayment of Onloans</u>: As negotiated between the prospective borrower and the Lender, subject to "Readvance Obligation" below; <u>provided</u> that repayment of Onloans shall be made outside of Mexico, at the New York agency of a Mexican bank acting as servicing agent for Onloans, in the currency of the Onloans.

<u>Readvance Obligation</u>: Each Lender must readvance to the Obligor any amounts repaid with respect to an Onloan (in the currency of the Advance prepaid to fund such Onloan) to the extent that such amounts are repaid faster than they would have been repaid had they remained as Advances with the Obligor and, subject to "Onlending Procedures" above, they will again become available for Onlending.

<u>Taxes</u>: Onloans will be subject to or exempt from Mexican withholding tax in accordance with applicable law. Allocation of burden of taxes, if any, will be subject to negotiation between the Lender and each prospective borrower.

<u>Assignments of Onloans</u>: Onloans may be assigned, in whole or in part, to Lenders and other financial institutions agreeing to be bound by the Onlending Facility.

<u>Guaranty</u>: Whether a particular Onloan will be entitled to benefit from a direct guaranty of Mexico will be subject to negotiation among the Lender, the prospective borrower and Mexico.

<u>Documentation</u>: Customary foreign currency loan documentation negotiated with the prospective borrower.

OPTION F TERM SHEET: MEDIUM-TERM TRADE CREDIT FACILITY

Mechanism:	Lenders will make advances (the "Advances") to the Obligor pursuant to a Medium-Term Trade Credit Facility. Advances will be available for financing Eligible Trade Credits, as described below.
Aggregate Commitment Amount Per Lender:	Each Lender may elect to participate in this Option for a commitment amount of up to 20% of its New Money Commitment (or up to 40% for any Lender with a New Money Commitment of less than U.S. $10 million that does not participate in Option E (Onlending Facility)), subject to possible voluntary reallocation as described under "Allocation of New Money Commitment to Options" above and in each Lender's Commitment Telex.
Minimum Commitment Amount Per Lender:	U.S. $2 million (or equivalent).

1. TERMS OF ADVANCES

Obligor:	A trust established by Mexico, with Banco de Mexico as Trustee, and Banco de Mexico foreign exchange undertaking.
Guarantor:	United Mexican States.
Currency of Commitment:	Each Lender's Home Country Currency or, at such Lender's option, U.S. Dollars.

Currencies of Advances:

U.S. Dollars or equivalent at each borrowing date in one of the following currencies (if such currency is the Home Country Currency of such Lender): Belgian Francs, Canadian Dollars, Deutsche Marks, Dutch Guilders, European Currency Units, French Francs, Italian Lire, Japanese Yen, Pounds Sterling and Swiss Francs.

Each Lender to make a one-time currency selection at time of signing. Each Advance made by a Lender will be made in such Lender's selected currency.

Purpose:

To provide Mexican public and private sector entities with medium-term credits to finance import and export transactions.

Interest Rates:

U.S. Dollar Advances

For Advances denominated in U.S. Dollars, each Lender at time of signing shall make a one-time election of a LIBO or domestic rate as set forth below:

LIBO Rate

13/16% per annum over the LIBO rate for three-month U.S. Dollar deposits, payable at the end of each interest period.

Domestic Rate

13/16% per annum over a three-month CD rate (adjusted for reserve requirements and FDIC premiums), payable at the end of each interest period.

Non-U.S. Dollar Advances

For non-U.S. Dollar Advances, each Lender at time of signing shall make a one-time election of a LIBO or domestic rate (to be comparably priced, with respect to both margins and reference rates, with the LIBO and domestic rates set forth above).

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	<u>For all Advances</u>
	In each case, Lenders may elect up to two successive one-month interest periods in any twelve-month period to facilitate the funding of Eligible Trade Credits.
	All interest rate definitions will be comparable to those contained in the Debt Agreements on the date hereof.
Final Maturity of Advances; <u>Grace Period</u>:	15 years with 7 years' grace.
Repayment <u>of Advances</u>:	Advances will be repayable in equal quarterly installments, beginning in 1997 and ending in 2004.
Mandatory <u>Prepayment</u>:	Required upon voluntary prepayments of any IMF purchase, World Bank loan or other official credit.
<u>Availability</u>:	Advances under this Option (other than readvances under "Readvance Obligation" below) will be made to the Obligor in successive tranches, on a basis consistent with the schedule of availability of Tranches under the 1989-92 New Money Credit Agreement.
Conditions of <u>Availability</u>:	Customary conditions, including: (a) Satisfaction of Conditions of Availability for the corresponding Tranche of the 1989-92 New Money Credit Agreement. (b) Satisfaction of Conditions of Availability for prior Tranches.
<u>Covenants</u>:	Same as 1989-92 New Money Credit Agreement.
<u>Debt Conversions</u>:	Same as 1989-92 New Money Credit Agreement.
<u>Debt Purchases</u>:	Same as 1989-92 New Money Credit Agreement.
Events of <u>Default</u>:	Same as 1989-92 New Money Credit Agreement.

<u>Acceleration</u>:	Upon occurrence of an Event of Default, the Majority Banks under the Medium-Term Trade Credit Facility may declare all Advances due and payable.
<u>Agent</u>:	To be agreed.
<u>Agency Fee</u>:	To be negotiated by the Agent and the Obligor.
<u>Taxes</u>:	Advances will be exempt from Mexican withholding taxes. All payments of principal and interest with respect to Advances will be made free and clear of any future Mexican taxes, withholdings or other deductions whatsoever.
<u>Assignments</u>:	Advances may be assigned, in whole or in part, to Lenders and other financial institutions agreeing to be bound by the Medium-Term Trade Credit Facility.
Governing Law; <u>Jurisdiction</u>:	Same as 1989-92 New Money Credit Agreement.
<u>Documentation</u>:	Subject to negotiation, execution and delivery of a mutually satisfactory agreement.

2. <u>TERMS OF ELIGIBLE TRADE CREDITS</u>

Availability of Advances for Eligible <u>Trade Credits</u>:	Advances will be available for funding Eligible Trade Credits on the terms described below, and on such other terms (including pricing, tenor and security) as are negotiated in each trade credit transaction.
Trade Financing <u>Procedures</u>:	Advances under the Facility will be prepayable in the inverse order of their maturity, at the request of the Lender, on any interest payment date to fund Eligible Trade Credits.

Each Eligible Trade Credit must be in a minimum amount of U.S. $250,000 (or, if less, the full amount of a Lender's Advances) and must comply with all regulations generally applicable to external borrowing.

Permitted Borrowers: Mexican public and private sector entities; provided, however, that no more than 50% of each Lender's Advances may be used to fund Eligible Trade Credits to Mexican private sector borrowers.

Currencies of Eligible Trade Credits: Currency of the Advances or, with the approval of Mexico, other currencies, as agreed between the Lender and its borrower.

Interest Rates: As negotiated between the prospective borrower and the Lender, but interest rates on Eligible Trade Credits to public sector entities not to exceed the interest rate on Advances.

Eligible Trade Credits: Either (i) unguaranteed portions of bilateral trade credits to Mexican public sector borrowers or (ii) trade credits to Mexican private sector borrowers for transactions approved by Mexico, in each case, to finance exports or imports of capital and intermediate goods from or into Mexico of the kind ordinarily financed for a term of at least three years, as well as the refinancing of such credits within three months after the initial extension of credit.

Tenor: As negotiated between the prospective borrower and the Lender, with a minimum tenor of the lesser of (x) three years and (y) the remaining term of the Medium-Term Trade Credit Facility.

Repayment of Eligible Trade Credits:

As negotiated between the prospective borrower and the Lender, subject to "Readvance Obligation" below; provided that repayment of Eligible Trade Credits shall be made outside of Mexico, at the New York agency of a Mexican bank acting as servicing agent for Eligible Trade Credits, in the currency of the Eligible Trade Credits.

Readvance Obligation:

Each Lender must readvance to the Obligor any amounts repaid with respect to an Eligible Trade Credit (in the currency of the Advance prepaid to fund such Eligible Trade Credit) to the extent that such amounts are repaid faster than they would have been repaid had they remained as Advances with the Obligor and, subject to the "Trade Financing Procedures" above, they will again become available for financing Eligible Trade Credits.

Exchange Risk Coverage:

Eligible Trade Credits to the private sector will enjoy comparable access to (i) any short-term U.S. Dollar futures market and (ii) any long-term foreign exchange risk coverage program from time to time in effect.

Taxes:

Eligible Trade Credits will be subject to or exempt from Mexican withholding tax in accordance with applicable law. Allocation of burden of taxes, if any, will be subject to negotiation between the Lender and each prospective borrower.

Assignments of Eligible Trade Credits:

Eligible Trade Credits may be assigned, in whole or in part, to Lenders and other financial institutions agreeing to be bound by the Medium-Term Trade Credit Facility.

Option F, p. 7

Guaranty: Whether a particular Eligible Trade Credit to a public sector borrower will be entitled to benefit from a direct guaranty of Mexico will be subject to negotiation among the Lender, the prospective borrower and Mexico.

Documentation: Customary trade financing documentation negotiated with the prospective borrower.

PART III. AMENDMENT OF DEBT AGREEMENTS

The United Mexican States requests that the Debt Agreements be amended on the terms summarized below:

A. Amendment of
<u>1983 U.S. $5 Billion Credit Agreement and
1984 U.S. $3.8 Billion Credit Agreement</u>

1. <u>Amendment to Maturity Schedule</u>

Amend amortization schedules of each Agreement to provide that the principal installments falling due in years 1989 through 1994 be repaid in equal quarterly installments beginning in 1997 and ending in 2004.

2. <u>Negative Pledge</u>

Amend the negative pledge covenant in each Agreement to permit the collateralization of [(x)] the Discount and Par Bonds as described in Part I above and [(y) existing public issues of bonds to the extent required to be equally and ratably secured with the Discount and Par Bonds, and also] to permit additional pledges of:

(1) Cash, cash equivalents, securities and intangible assets other than accounts receivable ("<u>Available Assets</u>"), in an amount (valued at market value at time of pledge and excluding the amount of any Available Assets previously pledged to secure External Indebtedness and later released from such pledge) in any year, together with the cash used for payments as described in "Debt Purchases" below, not to exceed the sum of

(a) U.S. $500 million, <u>plus</u>

(b) 50% of the amount, if any, by which Mexico's International Monetary Assets at the end of the most recent quarterly period ending on the last day of February, May, August and November exceed the sum of U.S. $500 million <u>plus</u> three months of imports and external interest payments (measured on the basis of average monthly imports and interest payments during the preceding six months) (the availability of sufficient International Monetary Assets to be certified by Banco de Mexico).

(2) The proceeds of any new money loans (other than the proceeds of new money loans under Part II above and the proceeds of certain loans from official and other sources extended during the 1989-92 period) made within three months after the date of disbursement (it being understood that any portion of such proceeds not pledged or used for buybacks shall not be considered a part of Mexico's International Monetary Assets for purposes of paragraph (1) above until three months after the date of its disbursement).

(3) Accounts receivable (defined to include amounts payable in respect of the sale, lease or other provision of goods, energy, services or the like, whether or not yet earned by performance) and tangible assets (i.e., assets other than Available Assets) other than gold, oil and gas and receivables deriving from the sale of oil and gas.

(4) External Indebtedness of Mexico or of any other Governmental Agency by Mexican Banks (or any of their special purpose financing subsidiaries or affiliates).

(5) Assets by Mexican Banks (or any of their special purpose financing subsidiaries or affiliates)

(a) to secure the repayment of liabilities incurred by them in connection with the refinancing, on a medium or long-term basis, of the liabilities of (i) the foreign agencies and branches of such Mexican Banks to non-Mexican commercial banks or (ii) in the case of any Mexican Bank that does not have a foreign agency or branch, money market lines of credit payable in foreign currencies to non-Mexican commercial banks and

(b) to secure short-term obligations in the ordinary conduct of commercial banking business.

3. IMF Purchases

Revise covenant to make purchases from the IMF in Section 8.01(e) of each Agreement to apply to all purchases scheduled under the new IMF Extended Fund Arrangement.

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4. Interbank Placements

Extend to December 31, 1992 the date in the Event of Default provisions of each Agreement for the minimum level (U.S. $5.2 billion) of liabilities of the foreign agencies and branches of Mexican Banks to non-Mexican commercial banks.

5. Cross Default

[To be revised to exclude Events of Default under the existing Debt Agreements.]

6. Debt Conversions

Amend Section 5.11 of each Agreement so that the term "Qualified Debt" would include:

(1) in addition to specified indebtedness of any Mexican public or private sector entity, specified indebtedness of any non-Mexican entity owned or controlled by a Mexican person or entity.

(2) instead of the category of indebtedness now specified in clause (a) thereof,

(a) indebtedness (up to U.S. $500 million per transaction, up to an annual limit of U.S. $2.5 billion in the aggregate plus any amounts unused in the prior year and carried forward for up to one year) that has a Duration not less than

(i) the product of (x) the Duration of the outstanding debt for which the new debt is being exchanged, and (y) a fraction the numerator of which is the present value of the aggregate amount of principal and interest payable in respect of the new debt, and the denominator of which is the present value of the aggregate amount of principal and interest payable in respect of the outstanding debt being exchanged, minus

(ii) 1.5 years; and

(b) indebtedness that has a Duration not less than the product of (x) the Duration of the outstanding debt for which the new debt is being exchanged, and (y) a fraction the account or for the account of another Governmental Agency, in each case to the extent that the debt purchased is used to secure External Indebtedness of such Mexican Bank or Governmental Agency (as the case may be).

8. <u>Reporting Requirements</u>

Conform reporting requirements.

9. <u>Future Amendments or Waivers</u>

Amend each Agreement to allow (a) any amendment or waiver currently requiring approval by 100% of the Banks to instead require approval by Banks having at least 95% of the unpaid principal amount of Advances under such Agreement and (b) any amendment or waiver adversely affecting any Bank to be made by each Bank so affected, in each case with the approval of Mexico and the applicable Agent.

10. <u>Conditions Precedent</u>

a. <u>Changes to Maturity Schedule</u>

Signing of Amendment by all Banks party to the 1983 U.S. $5 Billion Credit Agreement and the 1984 U.S. $3.8 Billion Credit Agreement.

b. <u>Other Changes</u>

Signing of Amendment by Majority Banks under each of the 1983 U.S. $5 Billion Credit Agreement and the 1984 U.S. $3.8 Billion Credit Agreement.

c. <u>All Changes</u>

Other customary conditions precedent.

11. <u>Agency Fees</u>

Agency fees subject to change, if any, after review with the Agent.

12. <u>General</u>

All subject to satisfactory documentation.

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B. Amendment of
<u>1987 Multi-Facility Agreement</u>

1. <u>Amendment to Maturity Schedule</u>

a. Amend amortization schedule of Advances under Facility 1 (Parallel New Money) to provide that all principal installments be repaid in equal quarterly installments beginning in 1997 and ending in 2004.

b. Amortization schedule of Advances under Facility 2 (Cofinancing New Money) and Facility 3 (Growth Cofinancing) to remain unchanged.

2. <u>Negative Pledge</u>

Amend the negative pledge covenant in Section 8.02(a) to permit the collateralization of the Discount and Par Bonds as described in Part I above and to permit additional pledges as described under "Negative Pledge" in Part III-A above.

3. <u>IMF Purchases</u>

Revise covenant to make purchases from the IMF in Section 8.01(e) to apply to all purchases scheduled under the new IMF Extended Fund Arrangement.

4. <u>Interbank Placements</u>

Extend to December 31, 1992 the date in the Event of Default provisions of the Agreement for the minimum level (U.S. $5.2 billion) of liabilities of the foreign agencies and branches of Mexican Banks to non-Mexican commercial banks.

5. <u>Cross Default</u>

[To be revised to exclude Events of Default under the existing Debt Agreements.]

6. <u>Debt Conversions</u>

Amend Section 5.11 to the extent described under "Debt Conversions" in Part III-A above.

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7. Debt Purchases

Amend the Agreement to the extent described under "Debt Purchases" in Part III-A above.

[8. Reporting Requirements

Conform reporting requirements.]

9. Future Amendments or Waivers

Amend the Agreement to allow (a) any amendment or waiver currently requiring 100% of the Banks with respect to any Facility to instead require approval by Banks having at least 95% of the unpaid principal amount of Advances under such Facility and (b) any amendment or waiver adversely affecting any Bank to be made by each Bank so affected, in each case with the approval of Mexico, The World Bank and the Agent.

10. Conditions Precedent

a. Changes to Maturity Schedule

Signing of Amendment by all Banks party to the Agreement.

b. Other Changes

Signing of Amendment by Majority Banks under the Agreement.

c. All Changes

Consent of the World Bank to Amendment, and other customary conditions precedent.

11. Agency Fees

Agency fees subject to change, if any, after review with the Agent.

12. General

All subject to satisfactory documentation.

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C. Amendment of
52 Restructure Agreements and
35 New Restructure Agreements

1. Negative Pledge

Amend the negative pledge covenant in each Agreement to permit the collateralization of the Discount and Par Bonds as described in Part I above and to permit additional pledges as described under "Negative Pledge" in Part III-A above.

2. Interbank Placements

Extend to December 31, 1992 the date in the Event of Default provisions of all Agreements for the minimum level (U.S. $5.2 billion) of liabilities of the foreign agencies and branches of Mexican Banks to non-Mexican commercial banks.

3. Cross Default

[To be revised to exclude Events of Default under the existing Debt Agreements.]

4. Debt Conversions

Amend Section 5.11 of each Agreement to the extent described under "Debt Conversions" in Part III-A above.

5. Debt Purchases

Amend each Agreement to the extent described under "Debt Purchases" in Part III-A above.

[6. Reporting Requirments

Conform reporting requirements.]

7. Future Amendments or Waivers

Amend each Agreement to allow (a) any amendment or waiver currently requiring approval by 100% of the Banks to instead require approval by Banks having at least 95% of the unpaid principal amount of Credits under such Agreement and (b) any amendment or waiver adversely affecting any Bank to be made by each Bank so affected, in each case with the approval of Mexico, the applicable Obligor and the applicable Servicing Bank.

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8. Conditions Precedent to the Amendment

a. Signing of Amendment by Majority Banks under each Restructure Agreement and each New Restructure Agreement.

b. Other customary conditions precedent.

9. Servicing Bank Fees

Servicing Bank fees subject to change, if any, after review with each Servicing Bank.

10. General

All subject to satisfactory documentation.

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D. Amendment of
FICORCA Facility Agreement

1. Negative Pledge

Amend the negative pledge covenant in Section 8.04(a) to permit the collateralization of the Discount and Par Bonds as described in Part I above and to permit additional pledges as described under "Negative Pledge" in Part III-A above.

2. Interbank Placements

Extend to December 31, 1992 the date in the Event of Default provisions under the Agreement for the minimum level (U.S. $5.2 billion) of liabilities of the foreign agencies and branches of Mexican Banks to non-Mexican commercial banks.

3. Cross-Default Provisions

To be revised to exclude Events of Default under the existing Debt Agreements.

4. Debt Conversions

Amend Section 5.11 to the extent described under "Debt Conversions" in Part III-A above.

5. Debt Purchases

Amend the Agreement to the extent described under "Debt Purchases" in Part III-A above.

6. Reporting Requirements.

Conform reporting requirements.

7. Future Amendments or Waivers

Amend the Agreement to allow (a) any amendment or waiver currently requiring approval by 100% of the Banks to instead require approval by Banks having at least 95% of the unpaid principal amount of Loans and Outstanding Reloan Amounts under the Agreement and (b) any amendment or waiver adversely affecting any Bank to be made by each Bank so affected, in each case with the approval of Mexico, FICORCA, the Servicing Bank and the Agent.

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8. Conditions Precedent to the Amendment

a. Signing of Amendment by Majority Banks under the Agreement.

b. Other customary conditions precedent.

9. Agency Fees

Agency fees subject to change, if any, after review with the Agent.

10. General:

All subject to satisfactory documentation.

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PART IV. IMPLEMENTATION OF THE FINANCING PACKAGE

The Financing Package will be implemented through debt-for-debt exchanges by all participating Lenders (including Lenders participating only in the New Money Options) of their Eligible Debt for new debt under Section 5.11 of the Debt Agreements evidencing such Eligible Debt. The exchanges will be made on the terms summarized below:

A. Participants in Debt and Debt-Service Reduction Options

Each Lender that has allocated Eligible Debt to the Debt or Debt-Service Reduction Options will exchange such Eligible Debt for Discount or Par Bonds as described in Part I above.

B. Participants in New Money Options

Each Lender participating in one or more New Money Options will exchange the Eligible Debt on which its New Money Commitment is based for new debt ("New Debt") under new agreements ("New Debt Agreements") as described below.

1. Implementation

Accrued but unpaid interest on such Eligible Debt will be paid on the first interest payment date under the Debt Agreement for such Eligible Debt occurring after the Exchange Date, which will also be the first interest payment date under the New Debt Agreement for the New Debt exchanged for such Eligible Debt. Existing interest rates and periods under the Debt Agreements will be carried over into the New Debt Agreements.

2. Exchange Date

Eligible Debt will be exchanged for New Debt on the Exchange Date under Part I above.

3. Obligor or Borrower; Guarantor

Except in the case of a limited number of New Debt Agreements that will be consolidated, the Obligor or Borrower and Guarantor (if any) under each New Debt Agreement will be the same as the Debt Agreement governing the Eligible Debt exchanged for such New Debt. Banks party to the agreements that will be subject to consolidation will be advised of such consolidation before October 31, 1989.

4. Agent or Servicing Bank

Except to the extent described in paragraph 3 above the agent or servicing bank under each New Debt Agreement will be the same as the Agent or Servicing Bank under the Debt Agreement governing the Eligible Debt exchanged for such New Debt.

5. Terms of the New Debt Agreements

The New Debt Agreements will have payment and other terms (including tax status) substantially similar to the terms of the Debt Agreements governing such Eligible Debt after giving effect to the amendments to the Debt Agreements described in Part III above, except to the extent described below:

a. Cross-Default Provisions

To be revised to exclude Events of Default under the existing Debt Agreements.

b. Mandatory Prepayment

The New Debt Agreements corresponding to the 1983 U.S. $5 Billion Credit Agreement, the 1984 U.S. $3.8 Billion Credit Agreement or Facility 1 of the 1987 Multi-Facility Agreement will provide for mandatory ratable prepayment of the New Debt if Eligible Debt under the corresponding existing Debt Agreement is paid earlier than as provided for in the amendments to maturity schedule described in Parts III-A and III-B above.

c. Conditions Precedent to New Debt Agreements

(1) Signing of each New Debt Agreement by each Bank with Eligible Debt under the corresponding Debt Agreement committed to one or more of the New Money Options described in Part II above.

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(2) Satisfaction of Conditions of Availability for first Tranche under the 1989-92 New Money Credit Agreement referred to in the New Money Options described in Part II above.

(3) Other customary conditions precedent.

C. <u>Facilities 2 and 3 of 1987 Multi-Facility Agreement</u>

Advances under Facilities 2 and 3 of the 1987 Multi-Facility Agreement (50% of which is guaranteed at final maturity by the World Bank) are eligible to participate in the Financing Package following their exchange (under Section 5.11 of the 1987 Multi-Facility Agreement) for new advances under two New Debt Agreements. Each Facility 2 advance and each Facility 3 advance will be exchanged for two new advances (a Tranche A Advance and a Tranche B Advance for Facility 2 and a Tranche A Advance and a Tranche B Advance for Facility 3) in an aggregate amount equal to the amount of the original advance exchanged therefor.

The Tranche A Advances will be in the same principal amount, and have the same maturity schedule, as the first U.S. $500 million of installments under Facility 2 and the first U.S. $250 million of installments under Facility 3. The Tranche A Advances (which will correspond to the unguaranteed portion of Facilities 2 and 3) will not be guaranteed by the World Bank.

The Tranche B Advances will be in the same principal amount, and have the same maturity schedule, as the remaining U.S. $500 million of installments under Facility 2 and the remaining U.S. $250 million of installments under Facility 3. The principal amount of the Tranche B Advances (which will correspond to the World Bank-guaranteed portion of Facilities 2 and 3) will be fully guaranteed at final maturity by the World Bank.

PART V. INTERIM MEASURES

A. Extension Request

In its communication to the international banking community of April 21, 1989, Mexico requested certain interim measures. Mexico requests the continuation of these measures pending the effectiveness of documentation to implement the Financing Package (expected to occur in the first quarter of 1990), as follows:

(1) The June 30, 1989 expiration date for the Event of Default relating to minimum aggregate liabilities of the foreign agencies and branches of Mexican banks to non-Mexican commercial banks (as it appears in each of Mexico's public sector Restructure and New Money Agreements) be extended for nine months to March 31, 1990; and

(2) Each of the principal maturities falling due from July 1, 1989 through March 31, 1990 under Mexico's U.S. $5 Billion Credit Agreement dated as of March 3, 1983 and U.S. $3.8 Billion Credit Agreement dated as of April 27, 1984 be extended for successive three-month periods to new maturity dates in the second calendar quarter of 1990, and that during the interim extension period interest on the deferred principal amounts continue to accrue at the normal rates set forth in Sections 3.05, 3.06 and 3.07 of the Credit Agreements, payable at the end of each such three-month period, and not at the rate for overdue payments provided for in Section 3.09(a) of the Credit Agreements.

B. Additional Flexibility

In addition, Mexico requests additional flexibility to enter into voluntary market-based transactions with its creditors subject to limitations consistent with those that will apply under the New Debt Agreements. Specifically, Mexico requests that Lenders waive the provisions of the existing Debt Agreements to permit, until the earlier of March 31, 1990 and the date on which the Bond Exchange Agreements contemplated under Part I above become effective, transactions permitted under paragraphs (2), (3), (4) and (5) under the heading "Negative Pledge" in Part III-A above and transactions permitted by paragraphs (1), (2)(a) and (2)(b) under the heading "Debt Conversions" in Part III-A above;

provided that, in the case of paragraphs (2) and (3) under the heading "Negative Pledge", any transactions involving debt reduction

(i) would be required to meet the requirements of paragraph (2)(a) or (2)(b) under the heading "Debt Conversions", and

(ii) would involve the issuance of new debt in a principal amount of not more than U.S. $250 million per transaction and not more than U.S. $1 billion for all such transactions.

C. Waiver of Negative Pledge

In addition, Mexico requests that Lenders waive Section 8.02(a) of the Restructure and New Restructure Agreement for the United Mexican States, as Obligor, Section 9.04(a) of each Restructure and New Restructure Agreement for Mexican public sector obligors other than the United Mexican States, Section 8.04(a) of the FICORCA Facility Agreement and Section 8.02(a) of the 1983 U.S. $5 Billion Credit Agreement, the 1984 U.S. $3.8 Billion Credit Agreement and the 1987 Multi-Facility Agreement to permit, until the earlier of March 31, 1990 and the date on which the Bond Exchange Agreements contemplated under Part I above become effective, the collateralization of the Discount and Par Bonds as described in Part I above and the collateralization of the existing public issues of bonds to the extent required to be equally and ratably secured with the Discount and Par Bonds.

Specifically, Mexico requests that each Lender (a) consent to the pledge of collateral by Mexico to secure the repayment of interest and principal on the Discount and Par Bonds to the extent described in Part I above and to secure the repayment of interest on the existing public issues of bonds to the extent required to be equally and ratably secured with the Discount and Par Bonds and (b) waive the negative pledge covenant identified above in each existing Debt Agreement to which it is a party to the extent that such covenant may be inconsistent with the exchange of Eligible Debt for Bonds as described in Part I above.

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BANCO DE MEXICO

DIRECCION DE OPERACIONES INTERNACIONALES
AV. 5 DE MAYO NO 2, COL. CENTRO
MEXICO D.F., C.P. 06059 MEXICO

INTERNATIONAL MONETARY FUND
WESTERN HEMISPHERE DEPT.
1989 SEP 15 PM 5:18
856095

ORIG: TRE
CC: MD
DMD
MRS. FILARDO
WHD
ETR
FAD
LEG
RES
SEC
MR. H. SIMPSON

DATE: SEPTEMBER 15, 1989

FROM: DR. JOSE QUIJANO

TO: MR. KLAUS BOESE
TREASURER DEPARTMENT
INTERNATIONAL MONETARY FUND

REMARKS:

BANCO DE MEXICO

SEPTEMBER 15, 1989.

MR. KLAUS ROESL,
TREASURER DEPARTMENT,
INTERNATIONAL MONETARY FUND,
WASHINGTON, D C

WE MAKE REFERENCE TO OUR TELEX DATED SEPTEMBER 8, 1989 AND
[redacted]

WE HEREBY REQUEST TO AMEND PARAGRAPH NUMBER 5 OF THE REFERENCED TELEX

THE AMENDED PARAGRAPH SHOULD READ AS FOLLOWS:

QUOTE

5 PLEASE PLACE OTHER CURRENCIES AT OUR DISPOSAL AT RESPECTIVE DEPOSITORIES AND REQUEST THOSE INSTITUTIONS TO ARRANGE EXCHANGE OF CURRENCIES INTO U S DOLLARS AND PAYMENT OF PROCEEDS TO OUR REGULAR ACCOUNT WITH FEDERAL RESERVE BANK OF NEW YORK, NEW YORK ON VALUE DATE OF PURCHASE

UNQUOTE

REGARDS,

BANCO DE MEXICO
DR. JOSE QUIJANO

357

IMF OFFICIAL MESSAGE

WASHINGTON, D. C. 20431

DO NOT SOFT ROLL EXCEPT WHEN ALIGNING INTO LINE 23

START ADDRESS IN THE BOX

Mr. Miguel Mancera, Director General
Banco de Mexico
Apartado Postal 98 Bis
5 de Mayo, No. 2
06059 Mexico 1, D.F., Mexico

INTERNATIONAL MONETARY FUND
WESTERN HEMISPHERE DEPT.
1989 SEP 18 AM 11: 03

1989 SEP 14 PM 10:11

MARK XX FOR CODE

( ) CODE

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DISTRIBUTION

CC: SEC
MD
DMD
MRS. FILARDO
WHD
ETR
FAD
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TRE
MR. H. SIMPSON

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Executive took following decision September 14, 1989:

QUOTE

1. Mexico has consulted with the Fund in accordance with paragraph 4 of the extended arrangement for Mexico (EBS/89/91, Sup. 2) and paragraph 28 of the letter dated April 11, 1989 from the Secretary of Finance and Public Credit of Mexico and the Director General of the Banco de Mexico, in order to review the implementation of the economic program described in that letter and attached Technical Memorandum of Understanding 1989 ("the Memorandum"), and to reach understandings regarding the circumstances in which purchases by Mexico may be resumed.

2. Tables 7 and 8 in EBS/89/178, which incorporate understandings of the Fund with the Mexican authorities, shall be annexed to the extended arrangement for Mexico, and the letter and attached Memorandum dated April 11, 1989 shall be read as modified and supplemented by Tables 7 and 8 in EBS/89/178.

IF REQUIRED INITIAL BELOW

SPECIAL INSTRUCTIONS — TEXT MUST END HERE

TELEX NO.:

DRAFTED BY NAME (TYPE): bjo:syeager:jac — EXT.: 6706 — DEPT/DIV: sec — DATE 9/14/89

AUTHORIZED BY NAME (TYPE): Leo Van Houtven

AUTHORIZED BY NAME (TYPE):

( )

TYPE ** ON LAST OR ONLY PAGE OF MESSAGE

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EC. 48 (a) REV. 3 11-21-88 CONTINUOUS

SIGNATURE (PLEASE KEEP SIGNATURE IN SPACE ALLOWED) SIGNATURE

IMF OFFICIAL MESSAGE

WASHINGTON D C 20431

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MEXICO

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3. Mexico will not make purchases under the extended arrangement that would increase the Fund's holdings of Mexico's currency in the credit tranches beyond 25 percent of quota or increase the Fund's holdings of that currency resulting from purchases of supplementary financing or borrowed resources beyond 12 5 percent of quota during any period in which the data at the end of the preceding period indicate that any of the limits described in paragraphs 2, 3, 8, 9, or 10 of the Memorandum attached to the letter of April 11, 1989 and adjusted as shown in Tables 7 and 8 in EBS/89/178 are not observed.

4. The Fund finds that the review contemplated in paragraph 4(b) of the extended arrangement has been completed, and that Mexico may proceed to make purchases under the extended arrangement.

UNQUOTE

Leo Van Houtven

Secretary

IF REQUIRED INITIAL BELOW

SPECIAL INSTRUCTIONS — TEXT MUST END HERE

A

B

C TELEX NO

D DRAFTED BY NAME (TYPE) ______ EXT DEPT/DIV DATE

E AUTHORIZED BY NAME (TYPE) AUTHORIZED BY NAME (TYPE) (**)

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SIGNATURE (PLEASE KEEP SIGNATURE IN SPACE ALLOWED) SIGNATURE

F

Office Memorandum

TO	The Managing Director The Deputy Managing Director	DATE	September 15, 1989
FROM	S T Beza		
SUBJECT	Mexico Communication for Official Bridge Financing		

Attached find a revised draft letter to be attached to the bridge financing documentation for Mexico now being finalized The revised draft incorporates information on the recently completed review and Mexico's ability to make the second purchase under the extended arrangement.

The draft has been reviewed by Mr Brau (ETR) and Messrs. Elizalde and Liuksila (LEG)

Attachment

cc Mr Brau
Mr Elizalde/Mr Liuksila
Mr H Simpson

mm9mexc104 (WHD1) 9/15/89

DRAFT
September --, 1989

SCHEDULE D
LETTER FROM THE MANAGING DIRECTOR OF THE FUND

Banco de España
Bank for International Settlement
Board of Governors of the Federal Reserve System
U S Department of the Treasury

Dear Sirs

I wish to inform you that on the basis of the information available to the Fund staff the Mexican economic program is proceeding satisfactorily On September 14, 1989, and on the basis of the performance criteria for June 30, 1989, the Fund's Executive Board completed the first scheduled review contemplated under the extended arrangement for Mexico Mexico is now in a position to make its second purchase under the arrangement

Very truly yours,

Michel Camdessus

INTERNATIONAL MONETARY FUND

September 14, 1989

Mr Caiola
Mr Hino/Ms Puckahtikom
Mr Choi, IBRD
Mr Loser

For your information

Robert Franklin

INTERNATIONAL MONETARY FUND

Mexico

Date September 14, 1989

MEMORANDUM FOR FILES

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

Date of Meeting	Thursday, September 14, 1989
Agenda Item	Mexico--Executive Session
Fund Staff Attending	Mr 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

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DOCUMENT OF INTERNATIONAL MONETARY FUND AND NOT FOR PUBLIC USE

September 13, 1989 - 89/171

Statement by Mrs. Filardo on Mexico
Executive Board Meeting
September 14, 1989

The Mexican authorities wish to express their recognition to the staff for the high quality of the review paper, the lively and constructive discussions held in Mexico City during the first review of the program, and their appreciation for the support during the difficult process of negotiations with commercial banks. Since the Mexican authorities are in full agreement with the staff appraisal and all performance criteria for end-June have been observed, I will only highlight some aspects of the recent developments in the Mexican economy.

1. Background

The first review of Mexico's program comes less than four months after the Fund approved an EFF and a CCFF for Mexico. At that time, Executive Directors supported Mexico's growth oriented adjustment program based on its strong record of adjustment and on the recent actions taken to further strengthen the fiscal accounts, the successful reduction of inflation, the major trade liberalization, and other structural reforms such as the liberalization of the financial system, the opening up to foreign investment and the privatization of several important public sector enterprises. It was widely acknowledged that the success of the program hinged on reducing the heavy debt service burden that had adversely affected investment and the prospects for private sector capital reflows as well as on consolidating the gains from the reduction in inflation and, in general, from the stabilization and structural adjustment efforts.

The uncertainties prevailing then were, on the external front, those related to the amounts of debt and debt service reduction that would result from the negotiations with commercial banks, the availability of commercial bank financing, the evolution in the price of oil and that of international interest rates. On the internal front, there was uncertainty about the behavior of domestic interest rates--whether they would fall sufficiently--as well as on the wage settlements following the end of the Pacto para la Estabilidad y el Crecimiento Económico (PECE) in July and, consequently, on the anti-inflation objectives of the program.

During the last four months, some of the above mentioned uncertainties have been dispelled by the debt agreement reached with commercial banks, the renewal of PECE, the favorable evolution of petroleum prices and international interest rates, and the strict adherence to a tight fiscal policy and a prudent monetary policy. All these events have helped improve market participants expectations about the viability of the program and the sustainability of the current policy stance. Consequences of improved expectations have been the important inflow of private capital during the last three months of the year, the sharp decline in domestic interest rates and the strength of private investment. In what follows I will comment on credit policy and interest rates, the balance of payments and the debt agreement with commercial banks.

2. Recent economic developments

Credit policy and interest rates. Developments along this front during the first half of 1989 have reflected on the one hand, the absence of external financing from private sources, and on the other hand, the uncertainty surrounding the ongoing external debt negotiations. Even though financial savings rose by 9 percent in real terms in the first half of 1989, a considerable increase by historical standards, the response is meager when assessed against the high real interest rates that have prevailed on peso-denominated financial assets since the beginning of the year. This outcome reflects the private sector unfavorable expectations regarding the sustainability of the stabilization efforts given the uncertainty prevailing around exchange rate policy prior to the renewal of the PECE and the debt agreement with external creditors. Once the inflationary and devaluatory fears were dissipated, interest rates on one-month Treasury Bills which reached a peak of 57 percent in June 1989 have fallen by more than 20 percentage points. The simultaneous reduction of inflationary/devaluatory expectations and of nominal interest rates have presumably left the expected yield on peso-denominated assets unaltered at its previous equilibrium level. Therefore, financial savings should continue growing at a healthy rate reflecting the coalescence of expectations towards the program's targets and the recent liberalization of the financial system.

If domestic interest rates remain around their current level, and given that domestic debt represents approximately 20 percent of GDP, the public sector would save close to 4 percentage points of GDP on interest outlays on an annual basis. This, along with the savings on external debt service payments emanating from the accord with commercial banks, would certainly contribute to reach the substantial increase in public sector savings that is contemplated in the medium term under the current economic program.

Balance of payments and exchange rate policy. Interest rates have been the instrument used to equilibrate the demand and supply of loanable funds and have contributed to promote a considerable inflow of private capital. Given the lack of external financing, private capital inflows have contributed to finance expenditures on imports of capital goods, debt buybacks by the private sector and public sector debt amortization, as well as allowed an increase in international reserves during June and July.

With regard to exchange rate policy, the current nominal depreciation of the peso of around 1.2 percent per month under the guidelines of the renewed PECE, together with the decline in the monthly rate of inflation from 2.4 percent in January 1989 to 1 percent in July, has helped to maintain the competitiveness of Mexico's exports. Thus, manufactured exports continue growing at a strong pace. The higher than projected imports reflect mainly the strength of private investment and still, to some extent, the once and for all increase in imports produced by the trade liberalization.

External debt negotiations. Mexico reached preliminary agreement on July 23 with the steering committee of its commercial bank creditors on a debt restructuring package. The term sheet for the agreement is expected to be finalized shortly, with the financing package becoming effective around the end of 1989 or early 1990. Some specific features of the package are still being discussed. Therefore, the precise impact on Mexico's debt and cash flow position will be known once these discussions are settled and when the distribution of choices by foreign banks among the three options is determined. The illustrative calculations made by the staff in EBS/89/171 show the orders of magnitude and the sensitivity to the different parameters involved in the calculations.

Mexico considers that the debt agreement has been an important step in reducing the debt overhang. The agreement will allow Mexico to reduce its net resource transfer to the rest of the world from an average of 6.2 percent of GDP during the last five years to 2.7 percent of GDP in 1989 and to around 2 percent of GDP in 1992. The reduction in the net resource transfer will free resources with which to effect the required investment in plant and equipment and infrastructure, items that have been highly neglected over the past seven years.

When considering the benefits of the debt agreement one has to go beyond the merely direct financial effects. An aspect that is often overlooked is the automatic stabilizers built into the accord and the effects--some of which are already apparent--in restoring confidence. In so far as banks choose the par exchange involving 30-year bonds at a reduced fixed interest rate of 6.25 percent, Mexico's vulnerability to increases in international interest rates will be greatly reduced. In similar fashion, should oil prices fall beyond 10 dollars, additional financing would be available. Thus, even though the balance of payments might appear more vulnerable compared with the original baseline scenario, many elements of the agreement will act as automatic stabilizers.

Another very important effect of the debt agreement will be the impact on public finances. The improved public finances will reduce public sector pressure on financial markets contributing to further reductions in real interest rates and promoting private investment. This virtuous circle will undoubtedly generate an atmosphere of confidence that will induce private capital repatriation and direct foreign investment. These autonomous capital inflows will contribute to finance private sector investment and related expenditures.

3. Conclusions

The developments during the last four months attest to the versatility incorporated into the design of Mexico's growth oriented program and to the commitment by the Mexican authorities to take the necessary policy actions in the light of changing circumstances. A close monitoring of the financial and foreign exchange markets have permitted a rapid reaction by the authorities to changing market conditions. The Government has had to pay a high price in order to regain credibility. The response by the authorities to persistent adverse expectations has been to tighten further the fiscal stance, continue with thorough structural reforms, and maintain monetary discipline. The fruits of maintaining domestic policies on a steady course for several years are finally being reaped as manifested by improved business confidence, greater private investment, lower interest rates and a rebound of economic activity.

The unexpected vigor that economic activity has shown recently, which is the product of robust private investment, has exerted some pressure on the balance of payments. However, private investment has been financed mainly by private capital inflows that, according to some estimates, exceeded US$2 billion during the first seven months of the year. These developments are being closely monitored by the Mexican authorities in order to promptly adjust monetary and fiscal policy should the external or internal balance be threatened.

The forthcoming review of the program, that will take place before the end of the year, will permit a reevaluation of the medium term scenarios in the light of the final outcome of the debt agreement.

mexico

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Contact: Richard Howe Phone: (212) 559-2722

New York, Sept. 13 -- The Government of Mexico and the Bank Advisory Committee for Mexico today reached agreement on a detailed term sheet for a commercial-bank financing package covering the four-year period 1989-92, Angel Gurria, Under-Secretary of the Ministry of Finance of Mexico, and William R. Rhodes, co-chairman of the 15-member committee, announced.

The term sheet will be sent to Mexico's creditor banks by courier shortly.

An agreement in principle on the main points of the package was announced July 24.

Mr. Gurria said that the financing package, together with support from creditor governments and the multilateral institutions, "offers Mexico both meaningful debt reduction and the new money it needs to support its program of economic adjustment and growth."

Mr. Rhodes said, "This package is the most complex and innovative ever assembled in the international markets, providing substantial voluntary debt reduction along with new money."

Mr. Rhodes estimated that the package offers Mexico net financial benefits, from debt-principal reduction, debt-service reduction and new money, of approximately U.S. $2 billion to $3 billion a year.

The package covers approximately U.S. $52.7 billion of Mexico's medium- and long-term external debt.

As previously announced, under the package, each creditor bank may choose one or more of three basic options for its medium- and long-term debt. The options are debt-principal reduction, debt-service reduction and new money (including interest recycling).

The principal-reduction bonds will be issued in exchange for existing loans at a discount of 35 percent, with a floating interest rate of 13/16ths of a percentage point over the London Interbank Offered Rate (LIBOR). The debt-service reduction bonds, which will be issued in exchange for existing loans at par, will bear interest at a fixed rate of 6 1/4 percent for U.S.-dollar-denominated instruments. Debt-service reduction bonds denominated in other currencies will carry comparable fixed rates in those currencies.

Mr. Rhodes said that the debt-service reduction bonds "provide Mexico with a 30-year shield against rising interest rates, which were a major cause of the debt crisis."

Under the principal-reduction and debt-service reduction options, creditor banks will exchange their medium- and long-term loans for 30-year bonds to be issued by the Government of Mexico in up to ten currencies. All principal and a portion of the interest payments on both types of bonds will be supported by U.S. $7 billion of collateral to be provided by Mexico from its own resources together with resources made available to it by the International Monetary Fund, the World Bank and support from the Export-Import Bank of Japan.

Principal will be collateralized fully at maturity by a pledge of U.S. Treasury zero-coupon obligations or comparable collateral. Interest payments on the bonds denominated in U.S. Dollars will be backed by a pledge of cash collateral covering a minimum of 18 months and a maximum of 24 months of interest. Collateral of comparable value will be provided for bonds in all currencies.

Under a value-recovery provision, creditor banks selecting either bond option will have the opportunity to share in certain incremental revenues that Mexico may receive from oil exports, starting in July, 1996. Such payments would be limited to 30 percent of the incremental revenues resulting from increases in the real price of Mexican oil over 1989 oil export revenues and could provide a maximum additional yield of 3 percent a year.

Creditor banks that provide new money will be asked to commit over a four-year period an amount equal to 25 percent of their existing medium- and long-term loans that are not exchanged for principal-reduction or debt-service-reduction bonds. Forty percent of the new money will be made available to Mexico in the first drawdown, and 12 percent in each of the following five drawdowns, the last of which is expected in 1992. The new loans will be repayable in 15 years, with seven years of grace, and will bear interest at 13/16ths of a percentage point over LIBOR or comparable cost of funds rates.

Each bank that selects new money will have the choice of funding its commitment either by advancing fresh funds or, in certain cases, by recycling interest payments received on loans previously extended to Mexico. New-money options include new-money bonds and facilities for on-lending and trade finance.

Banks opting for new money may designate up to 50 percent of their 1989 commitment (up to 20 percent of their overall new-money commitment) for the new-money bonds, which will be issued for approximately $500 million. The financial terms of the new money bonds will be the same as for other new money.

Banks opting for new money may also designate up to 20 percent of their new-money commitment for on-lending to public-sector borrowers in Mexico and up to 20 percent to finance medium-term trade transactions with public- and private-sector borrowers in Mexico. The financial terms for these facilities will also be the same as for other new money.

Drawdowns under the new-money facilities will be linked to purchases under Mexico's Extended Fund Facility with the International Monetary Fund.

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

Each creditor bank will be asked to participate in the debt-principal reduction, debt-service reduction and/or new-money portions of the package with the principal amount of all its current medium- and long-term debt outstandings.

Creditor banks also will be asked to amend certain clauses in current debt agreements to allow Mexico additional flexibility within specified limits to enter into voluntary market-based transactions with its creditors.

Creditor banks also will be asked to amend the maturity schedules that would cover any debt remaining under prior new money agreements after the current package is completed. Under the new maturity schedules for these prior new money agreements, principal would be repaid beginning in 1997 and ending 2004.

Mexico has also requested that the existing clauses in its debt agreements relating to the interbank liabilities of Mexican banks be extended until December 31, 1992. During this time, Mexican banks will continue to work with their bank creditors, on a voluntary case-by-case basis, to develop proposals for converting short-term placements into longer-term arrangements.

Banks committing fully to the financing package on or before October 31, 1989 will receive an early-participation fee of 1/8th of a percentage point of the amount (if any) that they commit to new money.

The Government of Mexico, with the support of representatives of the Bank Advisory Committee, will make a series of presentations on the financing package during the next few weeks. Meetings will be scheduled in Europe, Japan, Canada, the United States and the Middle East.

Mr. Gurria and Mr. Rhodes said that the debt-principal and debt-service reduction bonds are expected to be issued during the first weeks of 1990, though the financial benefits accruing to Mexico from the exchanges will be retroactive to July 1, 1989. The first drawdown on the new-money facilities, including the issuance of all new-money bonds, is also expected during the first quarter of 1990.

Mr. Gurria said: "The agreement on the term sheet concludes the second stage of the process. As expected, it has taken several weeks since we reached agreement in principle in July, but the issues we confronted were new, extremely complex and economically of great importance, both for Mexico and the banks. The work that we have now accomplished will save substantial time in the documentation stage and will expedite the responses from Mexico's creditors, as all of the business issues are explained in great detail. After a period for review, we will visit financial centers around the world to explain the package and answer the banks' questions."

The Mexican Ministry of Finance has confirmed that Mexico is now in a position to draw the official bridge loan for up to $2 billion from the U.S. monetary authorities, the BIS, the central banks of the G-10 countries and Spain. Documentation is being completed and the drawing is expected next week.

The members of the Bank Advisory Committee are: Bank of America N.T. and S.A., Citibank, N.A., and Swiss Bank Corporation, co-chair; Bank of Montreal, The Bank of Tokyo, Ltd., Bankers Trust Company, The Chase Manhattan Bank, N.A., Chemical Bank, Deutsche Bank AG, Lloyds Bank Plc, Manufacturers Hanover Trust Company, Midland Bank Plc, Morgan Guaranty Trust Company of New York, Societe Generale and The Sumitomo Bank, Limited.

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Mexico

Facsimile Service Cover Sheet
(TYPE)

MSG. NO. (For Cable Room use only) | DATE September 13, 1989 | PAGE 1 OF 6

TO

NAME Mr. William Rhodes
Chairman

AGENCY Bank Advisory Committee for Mexico

CITY/COUNTRY New York, New York

FACSIMILE TELEPHONE NO. (212) 559-5138
(Country Code) (City Code) (Number)

TEXT

Attached please find the proposed communication by The Managing Director that would accompany the term sheet for the financial package of Mexico.

INTERNAL DISTRIBUTION

MD
DMD
MRS. FILARDO
ETR
LEG
RES
WHD
MR. H. SIMPSON

FROM

NAME S. T. Beza

DEPT./DIV. WHD/Immediate Office

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AUTHORIZED BY *(TYPE)* S. T. Beza

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

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MEX\CAC nt9mex04 (9/13/89)

To The Bank Advisory Group for Mexico and the International Banking Community

I would like to inform you about developments under the economic program of Mexico which is being supported by a three-year extended arrangement for an amount of SDR 2,797 2 million that the Fund approved in May 1989, and to discuss the external financing for this purpose

In December 1987 the Mexican authorities introduced a comprehensive economic program based on a pact with labor and business, which was aimed at restoring economic growth, consolidating earlier gains in the balance of payments, and in bringing down the rate of inflation In the event, the rate of inflation fell sharply in 1988 but economic activity remained depressed and the balance of payments weakened

The program formulated by the authorities for 1989-92 is designed to continue the recent gains made in respect of inflation, to strengthen the balance of payments, and to provide the basis for sustained economic growth. The strategy has obtained the support of official multilateral and bilateral creditors, and deserves the endorsement of the international financial community at large

A central element of the program is the planned increase in the primary fiscal surplus and in public sector savings. This is being achieved through improvements in the tax system and in the operational efficiency of the public enterprise sector, including the divestiture of some public entities and the streamlining of the operations of those kept in the public sector Monetary policy is directed to ensuring that private sector financial savings are promoted and allocated in an effective manner The process of financial intermediation has been improved by the recent reforms of the financial system, particularly the liberalization of interest rates, the development of new financial instruments, and the simplification of reserve requirements

Structural policies seek to ensure the outward orientation of the economy, together with an increase in foreign investment and private capital reflows The improvement in external competitiveness and the major liberalization of the trade system and tariff regime since mid-1985 have contributed to a rapid expansion in external trade, with significant benefits in terms of improved efficiency of domestic producers and a dampening of inflationary pressures Furthermore, the authorities recently announced important changes in foreign investment regulations which, combined with the reforms of the tax system, are expected to lead to a major expansion of the role of foreign direct investment in promoting the growth of employment and the modernization of plant and equipment

Economic performance this year has been favorable The monthly rate of inflation declined from 2 4 percent in January 1989 to under 1 percent in August, and the 12-month rate of price increase declined from 52 percent in December 1988 to less than 17 percent in August 1989 Furthermore, economic activity is recovering, mainly as a result of increased private sector investment, with industrial production 6 percent higher in the first half of 1989 than in the same period a year earlier Real GDP is expected to increase by at least 2 percent in 1989

The public finances have strengthen markedly in the first half of 1989 The primary balance of the nonfinancial public sector registered a sizable surplus that more than offset the impact of high real interest rates on domestic debt prevailing during the period and, as a consequence, the public sector borrowing requirement declined sharply

Domestic private financial savings rose markedly in real terms in the first half of 1989 During this period real domestic interest rates remained high because of the shortfall in foreign financing and uncertainties concerning the settlement of the financial package with Mexico's external private creditors However, as domestic policies were maintained on a steady course and expectations about the agreement on a debt-reduction package with commercial banks improved, interest rates declined sharply in late July and have remained at lower levels since then Meanwhile, Mexico's competitiveness has benefited from the policy of daily adjustments of the peso in relation to the U S dollar

In late May 1989 Mexico reached agreement with its official bilateral creditors on the rescheduling of debt-service obligations falling due over the period from June 1, 1989 to May 31, 1992 The Paris Club agreement covers all principal payments falling due on account of most nonrestructured loans contracted before December 31, 1985, and a gradually declining portion of interest obligations Payments were rescheduled over a period of 10 years including six years of grace Total debt relief associated with the Paris Club amounts to about US$2 2 billion, of which some US$0 5 billion became available in 1989

With a continuation of strong policies and in the absence of unfavorable external events, Mexico's balance of payments can be expected to strengthen during the period of the program The trade balance should show an improvement, and there should be a decline in scheduled interest obligations because of the effect of debt and debt-service reduction operations. Based on current projections for oil prices and interest rates, the current account deficit is projected to fall from US$5 billion in 1989 to some US$2 3 billion in 1992 Based on the oil price and interest rate assumptions made at the time when the economic program was developed, the current account deficit would have fallen from US$7 4 billion in 1989 to US$4 4 billion in 1992

To supplement domestic resources in the effort to attain sound economic growth and strengthen the balance of payments and reserves, the program envisages net inflows from official sources (including the Fund) of around US$13 billion during 1989-92, part of which is to finance the collateralization of prospective debt and debt-service reduction operations In addition to purchases from the Fund, net disbursements of US$6 billion are expected from multilateral sources and net disbursements of a similar amount are expected from bilateral sources and supplier credits aided by open export cover of Mexico's official creditors. Furthermore, official creditors are expected to provide bridge financing of about US$1 9 billion in 1989

While the contribution of commercial banks to the various components of the Mexican package cannot be determined precisely at this stage, the cash flow relief resulting from the combination of new money and interest savings may be expected to be around US$8 billion over the period 1989-92, which would be tantamount to only a moderate increase in exposure over the period The additional resources needed to cover the current account and a limited accumulation of reserves would come from private capital inflows that are expected to continue to react favorably to the financing package, including debt reduction, and the more liberal regulations now governing foreign direct investment Such positive reactions would be strengthened by an early completion of the financing package Overall, Mexico's external financial position does not allow any room for slippages in the external financing and of course it will depend on continued favorable developments in oil prices and interest rates

To conclude, the Mexican authorities are pursuing the macroeconomic and structural policies required to restore sustained economic growth in the context of reduced financial imbalances, and it is essential that this effort be backed by adequate financial support Mexico's proposed financing package with commercial banks contains new elements that reflect the adaptation of the debt strategy to current circumstances Voluntary debt and debt-service reduction is a key component of the new strategy, and therefore I urge the early support for the Mexican program

Michel Camdessus
Managing Director
Interfund

Office Memorandum

TO: Managing Director
Deputy Managing Director

DATE: September 12, 1989

FROM: S. T. Beza

SUBJECT: Mexico--Communication to Banking Community

Attached is a draft communication to the international banking community describing the economic program of Mexico and its financing. This communication would accompany the term sheet for the financial package of Mexico which is expected to be completed soon.

The draft has been reviewed by Mr. Brau (ETR) and Mr. Elizalde (LEG).

Attachment

cc: Mr. H. Simpson

1989 SEP 12 PM 7:01
OFFICE OF THE
DEPUTY MANAGING DIRECTOR

MEX CAC nt9mex04 (9/12/89)

To The Bank Advisory Group for Mexico and the International Banking Community

I would like to inform you about developments under the economic program of Mexico which is being supported by a three-year extended arrangement for an amount of SDR 2,797 2 million that the Fund approved in May 1989, and to discuss the external financing for this purpose

In December 1987 the Mexican authorities introduced a comprehensive economic program based on a pact with labor and business, which was aimed at restoring economic growth, consolidating earlier gains in the balance of payments, and in bringing down the rate of inflation. In the event, the rate of inflation fell sharply in 1988 but economic activity remained depressed and the balance of payments weakened.

The program formulated by the authorities for 1989-92 is designed to continue the recent gains made in respect of inflation, to strengthen the balance of payments, and to provide the basis for sustained economic growth The strategy has obtained the support of official multilateral and bilateral creditors, and deserves the endorsement of the international financial community at large

A central element of the program is ~~a further tightening of fiscal policy as reflected in~~ the planned increase in the primary fiscal surplus and in public sector savings This is being achieved through improvements in the tax system and in the operational efficiency of the public enterprise sector, including the divestiture of some public entities and the streamlining of the operations of those kept in the public sector Monetary policy is directed to ensuring that private sector financial savings are promoted and allocated in an effective manner The process of financial intermediation has been improved by the recent reforms of the financial system, particularly the liberalization of interest rates, the development of new financial instruments, and the simplification of reserve requirements

Structural policies seek to ensure the outward orientation of the economy, together with an increase in foreign investment and private capital reflows The improvement in external competitiveness and the major liberalization of the trade system and tariff regime since mid-1985 have contributed to a rapid expansion in external trade, with significant benefits in terms of improved efficiency of domestic producers and a dampening of inflationary pressures Furthermore, the authorities recently announced important changes in foreign investment regulations which, combined with the reforms of the tax system, are expected to lead to a major expansion of the role of foreign direct investment in promoting the growth of employment and the modernization of plant and equipment

Economic performance this year has been favorable The monthly rate of inflation declined from 2 4 percent in January 1989 to under 1 percent in August, and the 12-month rate of price increase declined from 52 percent in December 1988 to less than 17 percent in August 1989 Furthermore, economic activity is recovering, mainly as a result of increased private sector investment, with industrial production 6 percent higher in the first half of 1989 than in the same period a year earlier Real GDP is expected to increase by at least 2 percent in 1989

The public finances have strengthen markedly in the first half of

1989 The primary balance of the nonfinancial public sector registered a sizable surplus that more than offset the impact of high real interest rates on domestic debt prevailing during the period and, as a consequence, the public sector borrowing requirement declined sharply

Domestic private financial savings rose markedly in real terms in the first half of 1989 During this period real domestic interest rates remained high because of the shortfall in foreign financing and uncertainties concerning the settlement of the financial package with Mexico's external private creditors However, as domestic policies were maintained on a steady course and expectations about the agreement on a debt-reduction package with commercial banks improved, interest rates declined sharply in late July and have remained at lower levels since then Meanwhile, Mexico's competitiveness has benefited from the policy of daily adjustments of the peso in relation to the U S dollar

In late May 1989 Mexico reached agreement with its official bilateral creditors on the rescheduling of debt-service obligations falling due over the period from June 1, 1989 to May 31, 1992 The Paris Club agreement covers all principal payments falling due on account of most nonrestructured loans contracted before December 31, 1985, and a gradually declining portion of interest obligations Payments were rescheduled over a period of 10 years including six years of grace Total debt relief associated with the Paris Club amounts to about US$2 2 billion, of which some US$0 5 billion became available in 1989

With a continuation of strong policies and in the absence of unfavorable external events, Mexico's balance of payments can be

Based on oil prices and interest rates at the time the economic program was developed, the current account deficit was projected to fall from -- to -- in 1992.

Based on oil prices and interest rates at the time the economic program was developed, the current account deficit was projected to fall from — to — in 1992

expected to strengthen during the period of the program. The trade balance should show an improvement, and there should be a decline in scheduled interest obligations because of the effect of debt and debt-service reduction operations. Based on current oil prices and interest rates The current account deficit is projected to fall from US$5 billion in 1989 to some US$2.3 billion in 1992.

Based on current oil prices and interest rates.

To supplement domestic resources in the effort to attain sound economic growth and strengthen the balance of payments and reserves, the program envisages net inflows from official sources (including the Fund) of around US$13 billion during 1989-92, part of which is to finance the collateralization of prospective debt and debt-service reduction operations. In addition to purchases from the Fund, net disbursements of US$6 billion are expected from multilateral sources and net disbursements of a similar amount are expected from bilateral sources and supplier credits aided by open export cover of Mexico's official creditors. Furthermore, official creditors are expected to provide bridge financing of about US$1.9 billion in 1989.

While the contribution of commercial banks to the Mexican package cannot be determined precisely at this stage, the cash flow relief resulting from the combination of new money and interest savings may be expected to be around US$8 billion over the period 1989-92, which would be tantamount to only a moderate increase in exposure over the period. The additional resources needed to cover the current account and a limited accumulation of reserves would come from private capital inflows that are expected to continue to react favorably to the financing package, including debt reduction, and the more liberal regulations now governing foreign direct investment. Such positive reactions would be

Overall, Mexico's external financial position doesn't allow any room for slippages in the external financing and of course will depend on continued favorable developments in oil price and interest rates

strengthened by an early completion of the financing package

To conclude, the Mexican authorities are pursuing the macroeconomic and structural policies required to restore sustained economic growth in the context of reduced financial imbalances, and it is essential that this effort be backed by adequate financial support Mexico's proposed financing package with commercial banks contains new elements that reflect the adaptation of the debt strategy to current circumstances Voluntary debt and debt-service reduction is a key component of the new strategy, and therefore I urge the early support for the Mexican program

Overall, Mexico's external financial position does not allow any room for slippages in the external financing and of course will depend on continued favorable developments in oil prices and interest rates

Michel Camdessus
Managing Director
Interfund

THE WORLD BANK INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE September 11, 1989

TO Files S. H. Choi

FROM S. H. Choi, Adviser, SLC

EXTENSION 76441

SUBJECT Proposed Attendance of Bank Staff at IMF Board Meeting

Place of Meeting	IMF-12-120 (Fund Board Room)
Date of Meeting	Thursday, September 14, 1989
Agenda Item	Mexico - Review of Program
Bank Staff Attending	Mr John Johnson Economist for Mexico LAC Country Department II Tel No 473-8732

cc	Regional Vice President	- Mr Husain
	IMF Secretary's Dept	- Mr Franklin
	Director, EAS	- Mr Dubey
	Bank Representative	- Mr Johnson (Rm I-8-167)

NOTE For details in timing of this item, please contact Mrs Janet Billenstein (Ext 56679), IMF Secretary's Dept

Office Memorandum

CONFIDENTIAL

TO Mr Loser

DATE September 8, 1989

FROM Eliot Kalter EK

SUBJECT Mexico--Official Bridge Financing

Finalization of the term sheet for the Mexican financial package is expected soon Remaining issues include Mexico's request for a waiver to allow the purchase of the newly issued bonds in the secondary market, the currency denomination of the bonds and associated enhancements, and the size of the commercial bank bridge to eventual official funding of the enhancements

The bridge loans, one from multilateral sources and another from the U S., are expected to be disbursed upon finalization of the term sheet. The size of total official bridge loans would be US$1,875 million if disbursed before Mexico's next purchase from the Fund, or US$1,669 million if disbursed after Mexico's next purchase from the Fund, of this amount, US$1/2 billion would be placed in a "locked account" at the U S Federal Reserve

The size of the bridge loan from multilateral sources initially was set at US$1 billion (with US$250 million from the U.S Treasury and the Federal Reserve and US$750 million from other G-7 countries) It has been reduced to US$875 million reflecting a drawdown of US$450 million by Mexico from IBRD policy based loans, the bridge loan had been formulated on the basis of an amount of US$325 million from the IBRD by end-September The first repayment obligation is to be met in mid-September after the next purchase from the Fund As noted, the amount of the bridge loan would be reduced by the amount of the Fund purchase (about US$206 million) if disbursed after the purchase The remaining outstanding balance of the bridge loan would be paid as follows US$206 million after the Fund purchase scheduled in December, US$356 million after the second tranche disbursement of the IBRD loans approved in June (excluding loans for technical assistance and set asides), and US$107 million on the basis of disbursements associated with previously approved policy based IBRD loans The bridge loan from multilateral sources would be totally amortized by January 1990 The interest rate on the bridge loan would be between 0 25 to 0 50 percentage point above the Treasury funding rate

The size of the U S bridge loan is US$1 billion made by the U S. Treasury and the Federal Reserve, of the total amount, US$500 million would be placed in a "locked account" at the Federal Reserve Bank of New York The remaining US$500 million would be repaid with US$20 million from IBRD policy loans, US$300 million from IBRD project loans, and US$180 million from Mexico's own resources The U S bridge financing would be amortized totally by February 15, 1990 The interest rate on the bilateral bridge also would be between 0 25 to 0 50 percentage point above the Treasury funding rate

As noted, there are three remaining issues to be resolved before the finalization of the term sheet for the financial package with Mexico The first is Mexico's request for a waiver to allow the purchase of newly issued bonds in the secondary market Commercial banks reportedly have indicated their acceptance of this request but only if all funds earmarked for interest support remain unused, this requirement would be waived after June 1996 The second unresolved issue involves the treatment of non-U S. dollar claims, and at present neither party is willing to accept the currency exchange risk, e g. the Mexican authorities have argued that enhancements be exclusively in U S dollars to minimize their exchange risk Finally, the size of the commercial bank bridge required to raise enhancements available at the onset to US$7 billion may be an issue Resources available at the outset for enhancements may amount to US$5 8 billion, and banks have indicated that they are unwilling to finance a bridge greater than US$1 billion. The resolution of this issue may be facilitated by the possible willingness of the Japanese authorities to bridge their own resources

cc Mr Beza
Mr. Brau

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Cable Room ID: MC1A0065 Page: 1	Distribution
Processed: September 08, 1989 15:33 Sender: Banco de Mexico Mexico (Mexico)	

INTERNATIONAL MONETARY FUND
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1989 SEP 11 AM 9:12

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DMD
MRS. FILARDO
ETR
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SEC
MR. H. SIMPSON
WHD

INCOMING MESSAGE

1772049 BMCOME
OIXPOXIO QECQYCWE

T 19948 MEXICO D.F. 8 SEP 1989 OGM LFCP
TREASURER
INTERNATIONAL MONETARY FUND
WASHINGTON, D.C.

NO.- 60

1. AS FISCAL AGENCY FOR THE GOVERNMENT OF MEXICO WE DESIRE TO PURCHASE FROM THE INTERNATIONAL MONETARY FUND SDR 60,670,000 AND THE EQUIVALENTS OF SDR 5,000,000 IN DANISH KRONER, SDR 2,000,000 IN FINNISH MARKKAA, SDR 2,500,000 IN GREEK DRACHMAS, SDR 4,000,000 IN MALAYSIA RINGGIT, SDR 4,000,000 IN NEW ZEALAND DOLLARS, SDR 8,000,000 IN SAUDI ARABIAN RIYALS, SDR 2,000,000 IN U.A.E. DIRHAMS AND SDR 75,000,000 IN U.S. DOLLARS TOTALING THE EQUIVALENT OF SDR 163,170,000 IN ACCORDANCE WITH TERMS OF ARTICLE V, SECTIONS 3 AND 4 AND WITH EXTENDED ARRANGEMENT EFFECTIVE MAY 26, 1989, AS AMENDED.

2. WE DO HEREBY REPRESENT THAT THIS PURCHASE IS NEEDED IN ACCORDANCE WITH THE PROVISIONS OF FUND AGREEMENT.

3. PLEASE CREDIT MEXICO'S SDR ACCOUNT WITH SDR 60,670,000 ON VALUE DATE OF PURCHASE.

4. PLEASE ARRANGE PAYMENT OF U.S. DOLLARS TO OUR ACCOUNT WITH FEDERAL RESERVE BANK OF NEW YORK, NEW YORK ON VALUE DATE OF PURCHASE.

5. PLEASE PLACE OTHER CURRENCIES AT OUR DISPOSAL AT RESPECTIVE DEPOSITORIES AND REQUEST THOSE INSTITUTIONS TO ARRANGE EXCHANGE OF CURRENCIES INTO U.S. DOLLARS AND PAYMENT OF PROCEEDS TO OUR SPECIAL FUNDS ACCOUNT WITH FEDERAL RESERVE BANK OF NEW YORK, NEW YORK ON VALUE DATE OF PURCHASE.

6. THE EQUIVALENT OF DESIRED PURCHASE, NAMELY MEXICAN PESOS 506,756,441,990 WILL BE CREDITED TO FUND'S NO. 1 ACCOUNT WITH OURSELVES ON THE VALUE DATE OF PURCHASE.

7 REGARDING SERVICE CHARGE, PLEASE DEBIT MEXICO'S SDR ACCOUNT WITH SDR 815,850 ON VALUE DATE OF PURCHASE

BANCO DE MEXICO

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Note
*** Test Accepted ***

INTERNATIONAL MONETARY FUND

INCOMING MESSAGE

INTERNATIONAL MONETARY FUND

STB
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(w/att.) JB
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Sept. 8

Mr. Beza:

For info. - This group may weigh in on quota debate in U.S. Congress next year.

RR

Robert W. Russell

Mexico

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MEXICO-UNITED STATES MUSI INSTITUTE

EXTERNAL RELATIONS DEPT.
89 SEP -8 AM 10: 11

INTERNATIONAL MONETARY FUND
WESTERN HEMISPHERE DEPT.
1989 SEP 11 AM 10: 16

September 7, 1989

<u>FOR IMMEDIATE RELEASE</u> <u>Contact</u>: Daniel James

ONCE SELF-SUFFICIENT, MEXICO IMPORTS MILK, CORN TO SURVIVE

Mexico has become the world's largest importer of milk in the world, according to the latest issue of the <u>Mexico-United States Report</u>, based on official Mexican sources. The country where corn originated 10,000 years ago must also buy abroad huge quantities of the grain in order to feed its people. Mexico spends upward of $3 billion a year on food imports -- about equal to the amount expected from the recently negotiated debt-relief agreement -- due to an agricultural crisis that is under-reported, <u>MUSR</u> calculates.

The media have kept Americans well-informed about the turmoil in Poland that has led to the unprecedented Solidarity-dominated noncommunist government, but what about a like situation in Mexico? The nation of 85 million just south of the border is going through a similar crisis. The Mexicans not only lack food, but suffer from political violence in two states where the ruling Institutional Revolutionary Party (PRI) recently committed electoral fraud. Meanwhile, high-placed Mexicans are newly implicated in drug trafficking.

- 30 -

All this could lead to grave problems just next door to America A Los Angeles Times poll quoted in this issue of Mexico-United States Report shows that nearly half of the Mexican people think that an armed revolution is "likely" within five years Yet the crisis in Mexico, except for dry financial accounts about its foreign debt, has been seriously neglected by the U S media

The current issue of Mexico-United States Report leads with a factual account of the milk and grain shortages brought on by state mismanagement of agriculture, and of the seizure by leftists of 65 town halls in one state and their blockade of roads in a second resulting from the PRI's electoral fraud These acts left 110 people injured MUSR continues with a report on intra-labor strife among in-bond plants along the border, and the trip to Mexico by Secretary of State James Baker and four other Cabinet-level officials to glad-hand the new Mexican President, Carlos Salinas de Gortari, for his still-unproven reforms

MUSR also publishes an analysis by the noted Mexican economist Luis Pazos, which warns that President Salinas may squander the popularity the Los Angeles Times poll found he enjoys, if he does not make profound political and economic structural changes He predicts that the unhappy fate of Argentina's once-popular former President, Raul Alfonsin, who left his country in bankruptcy, will befall Salinas "if he does not make profound changes "

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SID
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Office Memorandum

TO: The Deputy Managing Director DATE: September 6, 1989

FROM: S. T. Beza

SUBJECT: Mexico--Contingency Financing

You will recall that recently the issue of possible access to contingency financing was raised by Mexican officials.

Current CCFF guidelines allow for Board approval of a contingency mechanism only at the time that the underlying arrangement is approved. Changes aiming at greater flexibility for multi-year arrangements are proposed in the paper being drafted for the forthcoming Board review of the CCFF; if approved, a contingency mechanism could be attached to an existing EFF at the time of the first program review following the change in CCFF rules. This review would not take place before early March.

A contingency arrangement could be used to protect the Mexican program from substantial declines in the price of oil, as well as adverse changes in other important exogenous variables. Allowance could continue to be made for absorbing within the program the impact of certain deviations from the baseline oil price, with the contingency mechanism being triggered only for large deviations (say, below US$12.50 a barrel, rather than the US$10 a barrel suggested by the banks, against a new baseline of US$15). This would amount to increasing the level of the mechanism's activation threshold to well above 10 percent of quota, which is permissible.

The Fund's high current and potential exposure to Mexico would suggest that contingency funding from the Fund be kept well below the maximum access of 65 percent--say, around 33 percent of quota or US$0.5 billion. In addition, there is concern about unduly shifting the burden of financing toward official creditors, and it therefore would be important to ensure that commercial banks bear an appropriate portion of any possible financing, particularly in view of the limited size of the proposed bank package. Accordingly, commercial bank contingency financing of some US$1 billion would appear appropriate to accompany US$0.5 billion from the Fund. The World Bank may choose to issue principal guarantees for such credits--as is currently being asked by the banks--and this would imply some additional transfer of risk to the official sector.

This note has been discussed with Messrs. Brau and Kaibni.

cc: The Managing Director (o/r)
Mr. Frenkel/Mr. Kaibni
Mr. Brau
Mr. H. Simpson

Office Memorandum

TO The Managing Director

FROM S T Beza

SUBJECT ~~Mexico~~--Staff Report on the First Review Under the Extended Arrangement

DATE August 30, 1989

Attached is the draft report for the first review under the extended arrangement for Mexico We would like to issue this to Executive Directors no later than Friday, September 1, given that the Board meeting is scheduled for September 14

Performance under the arrangement has been good but, as was indicated in the back-to-office report, issues arise with regard to the quantitative performance criteria for 1989 because of developments in external financing. The extended arrangement contemplated the possibility of revisions to certain performance criteria for changes in the timing of external financing. On this basis, it is proposed that technical adjustments be made to the net international reserves and related targets because of changes in the financing provided by commercial banks for 1989 The adjustments for end-June involve a technical waiver as it relates to performance, while those for the remainder of the year (affecting the September and December test dates) involve a modification to the program

Adjustments are being proposed for the end-June performance criteria (as discussed in Section II-4 and Tables 7 and 8) for net international reserves and related domestic targets for the full amount of the financing shortfall from commercial banks for the first half of the year with respect to the original program

The modifications for the second half of the year are for possible delays in disbursements in 1989 with respect to the currently expected flows for the year on the basis of the agreement with commercial banks in place since July

The proposed decision (pages 28 and 29) provides for the technical waiver and modification

The paper has been reviewed by the following departments

Exchange and Trade Relations	Mr Leddy
Fiscal Affairs	Ms Ter-Minassian and Mr Katz
Legal	Messrs Luiksila and Surr
Research	Mr Dooley
Treasurer's	Mr Coats
Western Hemisphere	Messrs Ferrán, Stephens, Quirk, and myself

Attachment

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

Mexico--Summary of the Staff Report on the First Review Under the Extended Arrangement

I. Recent developments

Economic activity is recovering at a faster pace than envisaged in the program, with real GDP expected to grow by at least 2 percent during 1989 The 12-month rate of price increase has declined in July to less than 17 percent but, with planned adjustments in public sector prices and tariffs, is projected at 20 percent for end-year The external current account deficit is wider than programmed, notwithstanding favorable oil price and interest rate developments. This has occurred mainly because investment (particularly in the private sector) is rising at a faster rate than national savings, as compared with the program The larger current account deficit was financed mainly by higher private capital inflows, which offset a shortfall in official borrowing from commercial banks. Net international reserves declined by US$0 9 billion in the first half of 1989, some US$0 1 billion less than in the original program For the year as a whole, reserves are now projected to remain broadly unchanged

II Policy issues

The economy has performed well so far, but the program supported by the extended arrangement has become more vulnerable to adverse external developments because of the shortfall of financing from commercial banks relative to the original program, and notwithstanding the improved structure of indebtedness The authorities seek to maintain a tight fiscal and monetary stance in order to consolidate the gains under the program

III Adjustments to the arrangement

The paper proposes technical adjustments to the net international reserves and related targets on the basis of the observed and projected changes in the financing by commercial banks for 1989 The adjustments for end-June involve a technical waiver, while those proposed for the remainder of the year involve a modification of the program

Full adjustment for shortfalls in financing from commercial banks for the first half of the year, amounting to US$1,449 million, is proposed because the program counted on equivalent financing from the banks for the period January-June (US$4 3 billion for the year), and domestic policy was formulated on that assumption The modifications for the second half of the year involve an adjustment only for the delays in disbursements with respect to currently expected flows for the year because the agreement with commercial banks has been in place since July

Mr. Beza

STB
JB
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Office Memorandum

INTERNATIONAL MONETARY FUND
WESTERN HEMISPHERE DEPT.
1989 AUG 29 PM 3:17

TO: Mr. C. Loser

DATE: August 28, 1989

FROM: J. V. Surr JVS

SUBJECT: Mexico: Review Under Extended Arrangement

Attached is a draft decision on the first review under the extended arrangement for Mexico.

The Legal Department's main comment is that a letter is needed to request the specific adjustments being made in Table 7 to the performance criteria because of delays in external financing. Although the adjustments relating to oil prices and interest rates were automatic and need not be reflected in the letter and decision, the Technical Memorandum of Understanding 1989 provided in paragraph 2 that "The precise modalities of these [timing of gross external financing] adjustments will be examined at the time of the first review of the program." To establish these modalities, the Mexican authorities should send you a letter requesting the adjustments that you describe and propose on pages 11-13 of the draft, and the draft decision should specify the adjustments accordingly.

This approach would constitute a technical waiver of the previously established performance criteria. In this regard we have noted that the adjustment was not meant to be automatic, as it was intended to be made not only to neutralize the effects of delays, but also in the light of "other objectives". Moreover, paragraph 2 of the Technical Memorandum of Understanding 1989 is not referred to in paragraph 4 of the extended arrangement. The justification for the waiver would be the same as the reasons for the adjustment.

Our other comments have been given to Mr. Kalter over the telephone.

Attachment

cc: Mr. Beza
Mr. Leddy
Mr. Laske
Mr. Liuksila
Mr. Kalter

Office Memorandum

TO The Managing Director OK /JS DATE August 30, 1989

FROM S T. Beza JB

SUBJECT Mexico--Staff Report on the First Review Under the Extended Arrangement

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Performance under the arrangement has been good but, as was indicated in the back-to-office report, issues arise with regard to the quantitative performance criteria for 1989 because of developments in external financing. The extended arrangement contemplated the possibility of revisions to certain performance criteria for changes in the timing of external financing. On this basis, it is proposed that technical adjustments be made to the net international reserves and related targets because of changes in the financing provided by commercial banks for 1989 The adjustments for end-June involve a technical waiver as it relates to performance, while those for the remainder of the year (affecting the September and December test dates) involve a modification to the program

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cc The Deputy Managing Director (o/r)
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MSG NO (For Cable Room use only)	DATE August 22, 1989	PAGE 1 OF 8

TO

NAME Dr Luis Tellez Kuenzler
Director General de Planeación Hacendaria

AGENCY Secretaría de Hacienda y Crédito Público
Palacio Nacional
Mexico City, Mexico

CITY/COUNTRY

FACSIMILE TELEPHONE NO 525 510 3796
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TEXT

As discussed, attached is the comment on Pedro Aspe's paper for the Yale conference

INTERNAL DISTRIBUTION

FROM

NAME S T Beza

DEPT /DIV Western Hemisphere Dept , Immediate Office

ROOM NO 10-100	EXTENSION 8631	ACCOUNT CODE 0043

AUTHORIZED BY *(TYPE)* S T Beza	SIGNATURE

SEC 56 REV 2
2 18 88

Comment by S T. Beza on Mexico Foreign Debt and Growth,
a paper presented by Pedro Aspe

I am pleased to have been asked to comment on the paper presented by Secretary Aspe I have known Secretary Aspe for many years, and I admire his many accomplishments in improving his country's economic performance

Because I agree with so much of what Secretary Aspe has written on Mexico's policies and their results, however, my task as a commentator is not any easy one Because his presentation is so comprehensive, I have had to look into a few corners to find things to say that might usefully complement his paper

First of all, I should note that I agree with Secretary Aspe's characterization of the adjustment made and reforms undertaken by Mexico These were far reaching as exemplified by the very large movement into a primary fiscal surplus, the major opening of the economy, the removal of domestic price distortions, the restructuring of the public enterprises, and the liberalization of the financial system The blot on recent developments has been the behavior of domestic output, which on average has experienced very little growth since 1981 Indeed, adjusted for the terms of trade, there has been a decline in the country's income over the period just mentioned

Why has economic growth fared so poorly, given the achievements in respect of adjustment and reform? I gave part of the answer when I referred to the terms of trade Since 1981 Mexico's terms of trade have deteriorated by some 45 percent, equivalent to a loss of output of more than 8 percent over this period The other part of the answer is that the curtailment of Mexico's access to international capital markets on a voluntary basis after 1981, together with the rise in real interest rates on foreign credits, left a very large hole. Domestic investment as a fraction of GDP (or in absolute terms) has not recovered to the level prevailing before 1982, although the reforms made in the intervening period undoubtedly are having the effect of making investment more efficient than it was some years ago

The following tabulation illustrates the problem faced by Mexico in the post-1982 period through a comparison of the five years just before the crisis with the last five years

	1977-81	1984-88
	(In percent of GDP in real terms)	
Domestic expenditure	101 0	90 9
Consumption	75 9	74 1
Investment	25 1	16 8
Domestic saving	24 1	25 9
National saving	20 6	22 9
External saving	4 5	-6 1
Net exports (resource gap)	-1 0	9 1
Net factor payments plus transfers	-3 5	-3 0
	(In percent)	
Interest rates on foreign credits (in US$ terms)	9 2	9 3
Real interest rates (based on U S inflation)	-0 6	5 6
	(Average annual percentage changes)	
Real GDP	7 5	1 0
Exports (in US$)	40 3	1 5
Non-oil exports (in US$)	13 6	19 1
Terms of trade	1 9	-6 1

The effects of the deterioration in the terms of trade, of the curtailment of external credits, and of the increase in the real cost of servicing such credits showed up in the need to adjust "net exports" by more than 10 percentage points of GDP from 1977-81 to 1984-88 Domestic savings at constant prices improved by close to 2 percentage points of GDP, but this still left about 8 percentage points of GDP to be absorbed by domestic investment

What is the way back to strong and sustained growth (Secretary Aspe mentioned the aim of achieving substantial growth in per capita income by 1992)? In part, it calls for Mexico doing some more of the same that it has been doing in recent years--strengthening domestic savings, improving efficiency, and assuring an adequate degree of external competitiveness In addition, the Mexican authorities believe (and we on the Fund staff agree) that the availability of external saving needs to be increased to permit a faster growth of domestic investment To the extent that these added resources can take the form of debt or debt service reduction, the flow of capital to Mexico would be encouraged as financial investors and direct investors would see a reduced risk as a result of the alleviation of the debt burden, and a favorable effect on real domestic interest rates also could be expected

The other topic I wish to touch on briefly concerns the nature of the latest financial arrangement of Mexico with the International Monetary Fund Secretary Aspe says that the latest arrangement differs from almost every past arrangement because it does not consider a recessionary adjustment to Mexico's economy, takes account of the scope and importance of the structural adjustment already carried out by

Mexico, derives the external resources needed from the projected growth rate of the economy, and recognizes that debt reduction is necessary to adjust the debt to the country's capacity to pay in such a way as to make external debt service payments compatible with economic growth

Change in the way problems are approached can be desirable, but perhaps I see more continuity and constancy in the Fund's relations with Mexico

First, in the arrangements developed between Mexico and the IMF in 1983-85 and in 1986-87, considerable emphasis was placed on attracting external financing in support of the economic program on a scale that would limit the pressures on domestic resources as adjustment was being made to the cutback in voluntary credits to Mexico, particularly from the foreign banking community Thus, the intent was to contain recessionary forces To be sure, the gap to be filled after 1981 was a very large one, and in 1986 a new shock came as oil prices fell sharply

Second, the willingness of the Fund to accept Mexico's latest economic program as presented reflects, of course, the major adjustments and reforms already carried out by Mexico in the past seven years and attests to the quality of the program developed by the Mexican authorities It goes without saying that an economic program is unlikely to be unsuccessful if it is not the creation of the country itself But it also has to be recognized that the Fund's support of a program depends on whether it is one that offers the prospect of clear progress toward durable economic growth in the context of domestic price stability and external balance Mexico's current program does that

Third, economic programs supported by the Fund seek to blend domestic and external saving in the effort to achieve growth objectives, and in that sense the external resources needed are derived in part from the growth rate desired for the economy This is not open ended, however, in that it cannot be <u>any</u> growth rate or <u>any</u> volume of external resources The contribution to growth made by domestic resources (saving) and domestic conditions (the efficiency with which resources are used) is crucial--indeed, for all practical purposes the domestic policy component is the decisively important one The contribution to growth made by external resources, particularly those that involve the creation of external debt, has to take account of the cost of those resources, repayment terms, and other factors that can affect a country's external vulnerability when it relies on external saving to promote its development In the specific case of Mexico, the flow of external saving called for under the program fell within a range that seemed entirely reasonable

Fourth, there is the question of the evolution of thinking on the role of debt reduction in dealing with the debt problem When the debt crisis erupted in the middle of 1982 it was far from clear how long it would take to re-establish voluntary capital flows, although it was fully clear that such flows could not (ought not) regain the importance they had prior to 1982 and that therefore substantial domestic adjustment was needed Indeed, in the wake of the balance of payments successes of major debtor countries in 1983 and 1984, the conclusion drawn by the authorities of a number of debtor countries was that the debt problem was amenable to treatment through the negotiation of multiyear restructuring agreements with lengthy grace periods for the repayment of external debt

These agreements alone were not sufficient, however, because international interest rates continued to be high in real terms, because of further external shocks (e g , the drop in oil prices in 1986), and because in a number of instances events demonstrated that the weight of the external debt was high in relation to the adjustments the debtor countries were able to perform (In the case of Mexico, if oil prices were as high in relation to prices in general as they were in 1981, oil export earnings would be some US$15 billion, around 7-8 percent of GDP, higher than at present) These factors together with the growing reluctance of foreign commercial banks to provide external financing, owing in part to their evaluation that many countries had external debts that were so high as to be difficult to service, have brought us to the stage where debt reduction is to be tried as an option in dealing with the debt problem

The agreement reached recently between Mexico and representatives of its commercial bank creditors, offering choices to banks among debt reduction, debt service reduction, and new money will provide important information on how banks view the options and on the role to be played by debt reduction As Secretary Aspe has pointed out, however, a positive result in this area is not the sole condition for Mexico to attain its growth objectives A favorable outcome would relieve the balance of payments to the equivalent of around 1 percent of GDP, which would be a welcome result and could bring in its wake voluntary capital inflows from Mexican residents as well as foreigners, but it still leaves much to be done by domestic policies

Secretary Aspe appropriately stressed the need for the maintenance of strict fiscal and monetary discipline and for the pursuit of trade and exchange rate policies that assure an adequate degree of external competitiveness as Mexico continues to integrate itself with the world economy These are wise words, and I agree with them whole heartedly

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MSG NO (For Cable Room use only)	DATE August 22, 1989	PAGE 1 OF 8

TO

NAME Mr Dwight S Brothers

AGENCY 215 Fairhaven Hill
Concord, Mass 01742

CITY/COUNTRY

FACSIMILE TELEPHONE NO 9-1-508-369-8796
(Country Code) (City Code) (Number)

TEXT
Attached are my comments on Pedro's paper

INTERNAL DISTRIBUTION

FROM

NAME S T Beza

DEPT /DIV Western Hemisphere, Immediate Office

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AUTHORIZED BY S T Beza

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2 18 88

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I am pleased to have been asked to comment on the paper presented by Secretary Aspe I have known Secretary Aspe for many years, and I admire his many accomplishments in improving his country's economic performance

Because I agree with so much of what Secretary Aspe has written on Mexico's policies and their results, however, my task as a commentator is not any easy one Because his presentation is so comprehensive, I have had to look into a few corners to find things to say that might usefully complement his paper

First of all, I should note that I agree with Secretary Aspe's characterization of the adjustment made and reforms undertaken by Mexico These were far reaching as exemplified by the very large movement into a primary fiscal surplus, the major opening of the economy, the removal of domestic price distortions, the restructuring of the public enterprises, and the liberalization of the financial system The blot on recent developments has been the behavior of domestic output, which on average has experienced very little growth since 1981 Indeed, adjusted for the terms of trade, there has been a decline in the country's income over the period just mentioned.

Why has economic growth fared so poorly, given the achievements in respect of adjustment and reform? I gave part of the answer when I referred to the terms of trade Since 1981 Mexico's terms of trade have deteriorated by some 45 percent, equivalent to a loss of output of more than 8 percent over this period The other part of the answer is that the curtailment of Mexico's access to international capital markets on a voluntary basis after 1981, together with the rise in real interest rates on foreign credits, left a very large hole Domestic investment as a fraction of GDP (or in absolute terms) has not recovered to the level prevailing before 1982, although the reforms made in the intervening period undoubtedly are having the effect of making investment more efficient than it was some years ago

The following tabulation illustrates the problem faced by Mexico in the post-1982 period through a comparison of the five years just before the crisis with the last five years

	1977-81	1984-88
	(In percent of GDP in real terms)	
Domestic expenditure	101 0	90.9
Consumption	75 9	74 1
Investment	25 1	16 8
Domestic saving	24 1	25 9
National saving	20 6	22 9
External saving	4 5	-6 1
Net exports (resource gap)	-1 0	9 1
Net factor payments plus transfers	-3 5	-3 0
	(In percent)	
Interest rates on foreign credits (in US$ terms)	9 2	9 3
Real interest rates (based on U S inflation)	-0 6	5 6
	(Average annual percentage changes)	
Real GDP	7 5	1 0
Exports (in US$)	40 3	1 5
Non-oil exports (in US$)	13 6	19 1
Terms of trade	1 9	-6.1

The effects of the deterioration in the terms of trade, of the curtailment of external credits, and of the increase in the real cost of servicing such credits showed up in the need to adjust "net exports" by more than 10 percentage points of GDP from 1977-81 to 1984-88 Domestic savings at constant prices improved by close to 2 percentage points of GDP, but this still left about 8 percentage points of GDP to be absorbed by domestic investment

What is the way back to strong and sustained growth (Secretary Aspe mentioned the aim of achieving substantial growth in per capita income by 1992)? In part, it calls for Mexico doing some more of the same that it has been doing in recent years--strengthening domestic savings, improving efficiency, and assuring an adequate degree of external competitiveness In addition, the Mexican authorities believe (and we on the Fund staff agree) that the availability of external saving needs to be increased to permit a faster growth of domestic investment To the extent that these added resources can take the form of debt or debt service reduction, the flow of capital to Mexico would be encouraged as financial investors and direct investors would see a reduced risk as a result of the alleviation of the debt burden, and a favorable effect on real domestic interest rates also could be expected

The other topic I wish to touch on briefly concerns the nature of the latest financial arrangement of Mexico with the International Monetary Fund Secretary Aspe says that the latest arrangement differs from almost every past arrangement because it does not consider a recessionary adjustment to Mexico's economy, takes account of the scope and importance of the structural adjustment already carried out by

Mexico, derives the external resources needed from the projected growth rate of the economy, and recognizes that debt reduction is necessary to adjust the debt to the country's capacity to pay in such a way as to make external debt service payments compatible with economic growth

Change in the way problems are approached can be desirable, but perhaps I see more continuity and constancy in the Fund's relations with Mexico.

First, in the arrangements developed between Mexico and the IMF in 1983-85 and in 1986-87, considerable emphasis was placed on attracting external financing in support of the economic program on a scale that would limit the pressures on domestic resources as adjustment was being made to the cutback in voluntary credits to Mexico, particularly from the foreign banking community Thus, the intent was to contain recessionary forces To be sure, the gap to be filled after 1981 was a very large one, and in 1986 a new shock came as oil prices fell sharply

Second, the willingness of the Fund to accept Mexico's latest economic program as presented reflects, of course, the major adjustments and reforms already carried out by Mexico in the past seven years and attests to the quality of the program developed by the Mexican authorities It goes without saying that an economic program is unlikely to be unsuccessful if it is not the creation of the country itself But it also has to be recognized that the Fund's support of a program depends on whether it is one that offers the prospect of clear progress toward durable economic growth in the context of domestic price stability and external balance Mexico's current program does that

Third, economic programs supported by the Fund seek to blend domestic and external saving in the effort to achieve growth objectives, and in that sense the external resources needed are derived in part from the growth rate desired for the economy This is not open ended, however, in that it cannot be any growth rate or any volume of external resources. The contribution to growth made by domestic resources (saving) and domestic conditions (the efficiency with which resources are used) is crucial--indeed, for all practical purposes the domestic policy component is the decisively important one The contribution to growth made by external resources, particularly those that involve the creation of external debt, has to take account of the cost of those resources, repayment terms, and other factors that can affect a country's external vulnerability when it relies on external saving to promote its development In the specific case of Mexico, the flow of external saving called for under the program fell within a range that seemed entirely reasonable

Fourth, there is the question of the evolution of thinking on the role of debt reduction in dealing with the debt problem When the debt crisis erupted in the middle of 1982 it was far from clear how long it would take to re-establish voluntary capital flows, although it was fully clear that such flows could not (ought not) regain the importance they had prior to 1982 and that therefore substantial domestic adjustment was needed Indeed, in the wake of the balance of payments successes of major debtor countries in 1983 and 1984, the conclusion drawn by the authorities of a number of debtor countries was that the debt problem was amenable to treatment through the negotiation of multiyear restructuring agreements with lengthy grace periods for the repayment of external debt

These agreements alone were not sufficient, however, because international interest rates continued to be high in real terms, because of further external shocks (e g , the drop in oil prices in 1986), and because in a number of instances events demonstrated that the weight of the external debt was high in relation to the adjustments the debtor countries were able to perform (In the case of Mexico, if oil prices were as high in relation to prices in general as they were in 1981, oil export earnings would be some US$15 billion, around 7-8 percent of GDP, higher than at present) These factors together with the growing reluctance of foreign commercial banks to provide external financing, owing in part to their evaluation that many countries had external debts that were so high as to be difficult to service, have brought us to the stage where debt reduction is to be tried as an option in dealing with the debt problem

The agreement reached recently between Mexico and representatives of its commercial bank creditors, offering choices to banks among debt reduction, debt service reduction, and new money will provide important information on how banks view the options and on the role to be played by debt reduction As Secretary Aspe has pointed out, however, a positive result in this area is not the sole condition for Mexico to attain its growth objectives A favorable outcome would relieve the balance of payments to the equivalent of around 1 percent of GDP, which would be a welcome result and could bring in its wake voluntary capital inflows from Mexican residents as well as foreigners, but it still leaves much to be done by domestic policies

Secretary Aspe appropriately stressed the need for the maintenance of strict fiscal and monetary discipline and for the pursuit of trade and exchange rate policies that assure an adequate degree of external competitiveness as Mexico continues to integrate itself with the world economy These are wise words, and I agree with them whole heartedly

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FORMULARIO No SNTF 01.

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MEXICO, D. F.
CODIGO POSTAL 06059

INTERNATIONAL MONETARY FUND
WESTERN HEMISPHERE DEPT.
1989 SEP -5 AM 9: 03

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GRUPO 2/3 5129990

CONTROL DE SERVICIO TELEFACSIMIL

NUMERO DE DOCUMENTOS (INCLUIR HOJA DE CONTROL):	NUMERO DE TELEFONO FACSIMIL	FECHA:
1	95-202-6230748	Sept. lo., 1989

PARA:

SR. CLAUIDO LOSER
FONDO MONETARIO INTERNACIONAL
WASHINGTON, D. C.

TELECOMUNICACIONES INTERNACIONALES
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DE:

ARIEL BUIRA
DIRECTOR

INSTRUCCIONES ESPECIALES DEL SOLICITANTE:

"IN THE CONTEXT OF THE DISCUSSIONS FOR THE FIRST REVIEW OF THE PROGRAM SUPPORTED BY THE EFF APROVED BY THE FUND ON MAY 26, 1989, PROPOSALS WERE AGREED TO CONCERNING ADJUSTMENTS TO PERFORMANCE CRITERIA ON NET INTERNATIONAL RESERVES AND OTHER RELATED CEILINGS. THESE ADJUSTMENTS REFLECT SHORTFALLS IN FINANCING BY COMMERCIAL BANKS. WE CONFIRM THAT THE ATTACHED TABLES REPRESENT THE AGREED PROPOSALS."

ATENTAMENTE,

PARA USO EXCLUSIVO DE LA OFICINA DE TELECOMUNICACIONES

OBSERVACIONES DE LA TRANSMISION.	RESPONSABLE DE LA TRANSMISION.

DEPENDENCIA SOLICITANTE

NOMBRE:	TELEFONO/EXTENSION	FIRMA AUTORIZADA.
DIRECCION DE ORGANISMOS Y ACUERDOS INTERNACIONALES	2240	[signature]

STB
cc
10

Office Memorandum

INTERNATIONAL MONETARY FUND
WESTERN HEMISPHERE DEPT.

1989 AUG 28 PM 3:12

To: Mr. Kalter

August 28, 1989

From: Warren L. Coats, Jr. (pp.)

Subject: Mexico -- Staff Report

We have no comments on the body of this well written report. In appendix II the projected "Financial Obligations due to the Fund" correctly reflect the amounts we think you should report but the basis for those projections is incorrectly reported in the footnote on page 2. The amounts reported in fact reflect "transactions through end July, 1989 and the assumption that all currently programed purchases (as shown in Table 1) are made as scheduled."

cc: Mr. Laske
Mr. Beza
Mr. Frenkel
Mr. Gianviti
Mr. Tanzi
Mr. Leddy

Office Memorandum

TO The Managing Director

DATE August 21, 1989

FROM S T Beza

SUBJECT Mexico--Back-to-Office Report

Attached is the back-to-office report of the mission that conducted the first review under the extended arrangement

On the basis of preliminary data, all performance criteria for end-June were met with margins, after adjustment for shortfalls in foreign financing (as described below) Developments and the current policy stance suggest that the quantitative performance criteria also would be met for the rest of the year, after adjustments that would take account of the financing arrangement emerging from Mexico's negotiations with commercial bank creditors

Economic activity has recovered in 1989, with real GDP expected to increase by 2 percent for the year The 12-month rate of inflation has declined to 17 percent, with the monthly rate declining to 1 percent in July The external current account deficit has widened, however, notwithstanding oil prices higher and interest rates lower than contemplated in the program This has occurred mainly because of higher private imports associated with a marked rise in private investment financed from higher than expected private capital inflows, but other factors also are present It might be noted that the authorities plan public sector price and tariff adjustments in the coming months, which should help to strengthen fiscal performance, particularly in 1990

The mission agreed, ad referendum, with the authorities on adjustments to the net international reserve targets and related quantitative performance criteria that were designed to reflect developments in external financing The reserve targets for June would be adjusted fully for the shortfall in financing with respect to the original program for the first half of 1989 Adjustments in the second half of the year would be related to delays in financing under the package that is emerging from the negotiations with the banks As has been apparent, this package will be providing less financing than envisaged under the original program, and the international reserve position also will be weakened by the contributions of Mexico to the enhancements

The end-1989 target for net international reserves is consistent with the projected balance of payments outcome, but the authorities are concerned about possible reversals in private capital movements after the strong showing so far this year Therefore, they have requested that modification of the reserve target and related credit ceilings be considered for year-end if the basic policy stance remains strong but other developments suggest that the target would not be met Such possible modifications would be discussed at the time of the review in October/November 1989 that is to be introduced to determine whether the set-asides can be accelerated and the augmentation permitted

The staff is striving to issue the staff report on September 1 (or at the latest on September 5) so that the review can be completed before the Annual Meetings

Attachment

cc The Deputy Managing Director (o/r)
Mr Simpson

Office Memorandum

TO The Managing Director

DATE August 21, 1989

FROM Claudio M Loser

SUBJECT Mexico--Back-to-office Report (July 26-August 16, 1989)

The mission that just returned from Mexico conducted discussions for the first review under the extended arrangement Completion of the review and observance of the quantitative performance criteria for end-June are the conditions for the next scheduled purchase under the arrangement, for a total of SDR 233 million (SDR 163 million after excluding the 30 percent set-aside for debt-reduction operations)

The mission met with the Secretaries of Finance and Public Credit, and of Budgeting and Planning, as well as the Director General of the Bank of Mexico Discussions focused on economic developments under the program for the first half of the year, as well as on some technical aspects of the arrangement, as described below The mission also discussed some aspects of the commercial bank debt operations However, Mr Gurria, the main debt negotiator, was outside Mexico for most of the period, and this affected the scope of the discussion on this subject

Economic performance under the program has been satisfactory In particular, the authorities have pursued fiscal and monetary policy vigorously and, in response, all performance criteria for end-June have been met with ample margins, when adjusted for shortfalls in foreign financing, as discussed below Furthermore, on the basis of the existing policy stance, quantitative performance criteria would be met for the rest of the year

1 Economic developments and prospects

Economic activity recovered in the first half of the year, reflecting increased private sector investment, with GDP expected to grow by at least 2 percent in 1989 (compared with 1 5 percent under the program--Table 1) The rate of inflation has declined rapidly, with the monthly rate of consumer price increase amounting to one percent in July, and the 12-month rate to some 17 percent--compared with 52 percent at the end of 1988 The producer price index has increased by only around 10 percent over the last 12 months

The external current account deficit has been higher than expected, notwithstanding the favorable impact of higher oil prices and lower international interest rates The widening of the deficit was accounted for by larger imports, reflecting an increase in private sector investment (by some 3 percentage points of GDP) financed by private sector capital flows However, there were also higher tourist-related expenditures, and slightly lower non-oil exports Overall, and accounting for the shortfall in official capital inflows, the decline in net international reserves for the first half of the year was smaller than programmed

Fiscal policy has been strong during the first half of the year In particular, tax revenue performance was better than programmed, moreover, expenditure was restrained, and enterprise revenues were higher than expected, notwithstanding lags in adjusting public sector prices and tariffs As a consequence, the primary surplus reached over 11 percent of GDP (8 6 percent under the program) in the first six months of 1989 (Table 2) The larger primary surplus was sufficient to offset the effect of high domestic interest rates Consequently, the operational deficit amounted to less than 1 percent of GDP, and the PSBR was 4 8 percent (the ceilings under the program were 2 4 percent and 6 7 percent, respectively)

In the monetary area, the Bank of Mexico's net domestic assets were well within the program targets Interest rate policy became more flexible during the year, helping to strengthen financial savings in the banking system, which also reflected high private capital inflows (Table 3) Furthermore, when it became apparent that an agreement on a debt reduction package with commercial banks would materialize and domestic policies maintained a steady course, interest rates fell markedly in late July Credit to the private sector has risen sharply, reflecting in part increased activity and financial reintermediation

2 Policy issues

The trends in the first half of the year suggest that the program objectives for 1989 are achievable However, the lower level of financing from commercial banks compared to the original program will result in less flexibility in managing the economy and a weaker than expected overall balance of payments

The mission reviewed the public finance prospects for the rest of the year and noted the need for a continued strong effort at the primary level to offset the effect of prevailing interest rates, even though they have declined The authorities indicated that, in order to strengthen their effort, they intend to introduce a package of pricing measures, equivalent to about 0 3 percentage point of GDP for the rest of the year (and over 1 percentage point in 1990) Price corrections would cover fertilizers, electricity for home consumption, and gasoline However, gasoline prices would be increased only in the major metropolitan areas, with part of the revenues being used for ecological improvement The package of measures could result in a 12-month rate of price increase of about 20 percent by year-end, relative to the program target of 18 percent On the basis of the existing trends and the package of prices and tariffs just described, the primary surplus could amount to about 9 percent of GDP (7 1/2 percent in the program, when adjusted for oil prices), the operational deficit would be below

2 percent (2 percent in the program, when adjusted for oil prices and interest rates), and the PSBR about 6 percent (6 1/2 percent in the adjusted program)

A further improvement in the public finances would occur in 1990 reflecting a continued reduction in real interest rates Even assuming some increase in public sector investment (and therefore a decline in the primary surplus), the operational balance could be reduced by some 1 3/4 percentage points of GDP In turn, the PSBR could decline by some 2 percentage points of GDP with respect to 1989

The authorities consider that the sizeable increase in credit to the private sector has been feasible because of a higher level of financial savings, but they have indicated that they stand ready to adjust their policies if there are signs of too rapid an increase in domestic demand The mission indicated its concern about the implications for monetary management of the issuance of indexed bonds (ajustabonos) The authorities made the point that real interest rates on indexed bonds were lower than for nonindexed bonds and that the issuance of these instruments had been limited

The authorities consider that the recent stability in the real effective exchange rate of the peso would help strengthen the balance of payments Furthermore, the guidelines under the PECE (which involve a depreciation at an annual rate of 15 percent a year against the U S dollar through March 1990) have helped stabilize expectations and have been a major component of the anti-inflationary efforts of the authorities The authorities consider that developments in the current account reflect specific sectoral problems which could not be solved effectively through exchange rate corrections They noted that exports continued to grow at a satisfactory rate, particularly in the case of manufactures, and that no exchange rate change was needed at this point

For 1989 as a whole, the balance of payments outlook is weaker than originally programmed, mainly because of the reduced availability of bank financing The external current account is expected to amount to some US$5 billion, compared with US$4 8 billion under the program (Table 4) The more favorable oil price and interest rate conditions are contributing an additional US$2 billion, but this will be more than offset by other components of the current account Capital flows to the public sector (including the impact of debt restructuring) are projected to be US$1 4 billion, compared with some US$6 billion under the program However, private sector flows can be expected to be more than US$3 billion higher than projected On this basis, net international reserves would be broadly unchanged compared with a programmed accumulation of US$1 3 billion, including adjustments for oil prices and interest rates, and delays in resources to be disbursed in 1990 on account of 1989 financing, but excluding shortfalls in financing

With regard to balance of payments prospects for 1990, it appears that the current account deficit would decline from US$5 billion to around US$4 1/2 billion, not including the impact on interest payments of debt reduction operations, the net interest savings resulting from these transactions can be estimated at US$1 3 billion in 1990 Based on a reasonable flow of private sector capital, and excluding borrowings related to debt-reduction operations, the overall balance could be expected to be broadly in equilibrium for 1990 However, if debt enhancement-related operations are taken into account, net reserves could decline by some US$2 billion, financed by a drawdown of resources made available by the Fund and Mexico's own contribution to the enhancements

3 Technical adjustments to the program targets

A major issue in the discussions was the technical adjustment to the net international reserve target, net domestic assets, net Bank of Mexico credit to the public sector, and foreign borrowing limits, because of shortfall and delays in commercial bank financing The Mexican authorities considered that adjustments should be allowed to the full extent of the shortfall of foreign financing, relative to the original program They noted that their effort continues as programmed, and that they should not be penalized for shortfalls in financing, relative to the amounts expected at the outset of the program, particularly for the period in which the features of the financing package with commercial banks were still under negotiation However, the authorities concurred with the mission's concern that there was a need to protect as much as possible the balance of payments, in light of the financing requirements early next year in connection with the commercial bank package

After considerable discussion, the authorities and the staff agreed to a compromise solution whereby for end-June 1989 the target for net international reserves (and related quantitative performance criteria) would be adjusted fully for the shortfall in financing, with respect to the original program, while in subsequent quarters the adjustments to reserves only would be for delays in the disbursements accruing in 1989 under the bank package as it is expected to take place now Accordingly, the program now would involve a maximum reserve loss of some US$0 2 billion for 1989, broadly in line with the revised balance of payments projection

While the authorities accepted this approach, they remain concerned about the uncertainties surrounding the completion of the package with commercial banks Therefore, they have accepted the approach with the understanding that external financing developments in the fourth quarter may warrant a modification of the reserve target for December 1989 Such modifications would be discussed, if necessary, at the time of the November review, and only to the extent that possible deviations are not related to a weakening of the authorities' policy stance The authorities requested that this understanding be made explicit in the papers to the Board The mission agreed to this course of action but noted that in 1990 the program would have to be adjusted to the expected availability of financing, with an abandonment of the band mechanism related to interest rates and oil prices

The authorities agreed on a review to be concluded by the end of 1989, in order to obtain the release of set asides and a possible augmentation of the arrangement The authorities suggested that discussions could be held on the prospects for 1990 in late October, with final discussions by the second half of November (the authorities would not be available in the first half of November, when they will be preparing the budget for 1990) Furthermore, the detailed discussion on the program for 1990 and on the quarterly performance criteria for the year, could be conducted in late January or in February, and would coincide with the Article IV consultation

Attachments

cc The Deputy Managing Director (o/r)
Mr Frenkel
Mr Gianviti
Mr Laske
Mr Tanzi
Mr Van Houtven
Mr Whittome
Mr H Simpson

Table 1 Mexico A Medium-Term Scenario

	1988	Prog 1989	Projection 1989	1990	1991	1992	1993	1994
			(Annual percentage change)					
Real GDP	1 1	1 5	2 0	3 5	4 5	5 5	6 0	6 0
Consumer prices (average)	114 2	20 3	20 6	17 6	11 4	6 4	6 0	6 0
Consumer prices (end of year)	51 7	18 0	20 0	15 0	8 0	6 0	6 0	6 0
			(In billions of U S dollars)					
External sector								
Current account (deficit -)	-2 9	-4 8	-5 0	-4 4	-2 2	-2 1	-2 0	-1 9
Of which								
exports (fob)	23 0	25 0	25 7	27 4	30 4	33 3	36 7	40 4
imports (fob)	-18 9	-20 8	-22 0	-23 4	-25 7	-28 6	-31 9	-35 5
interest payments 1/	-8 9	-10 6	-9 8	-10 1	-8 5	-8 6	-8 7	-8 9
Official capital (net)	0 4	6 1	1 4	1 2	1 1	0 6	2 5	1 7
Private capital (net)	-4 4	0 2	3 4	1 1	1 3	1 9	2 1	2 2
Net reserve movement (increase -)	6 9	-1 5	0 1	2 1	-0 2	-0 4	-2 5	-2 0
			(In percent of GDP)					
Nonfinancial public sector								
Primary balance	5 9	7 3	8 9	6 7	5 5	5 2	4 9	4 4
Operational balance	-4 4	-2 5	-1 8	-0 2	-0 3	0 3	0 4	0 3
Public sector borrowing requirement	12 9	7 0	6 1	4 0	2 8	1 9	1 5	1 5
Savings and investment								
Gross domestic investment	20 4	21 3	23 3	24 8	25 1	26 5	27 7	28 0
Public sector	5 0	4 8	4 8	5 8	5 9	6 1	6 6	6 9
Private sector	15 4	16 4	18 4	19 1	19 2	20 4	21 1	21 1
Gross national savings	18 8	18 9	20 8	23 6	24 1	25 7	27 0	27 3
Public sector 2/	0 7	2 6	3 2	5 8	6 2	6 8	7 3	7 5
Private sector	18 0	16 3	17 5	17 7	17 9	18 9	19 7	19 8
External savings 3/	1 6	2 4	2 5	1 3	1 0	0 8	0 7	0 6

Sources Mexican authorities, and Fund staff estimates

1/ Figures starting 1991 reflect debt reduction and debt service reduction operations
2/ Adjusted for the inflation component of interest payments on domestic debt
3/ External savings in 1990 is adjusted for debt reduction operations

Table 2 Mexico Summary of Public Sector Operations

(In percent of GDP)

	1988	1989						1990
		Prog			Proj			
	Dec	June	Sept	Dec	June	Sept	Dec	Proj
Public sector borrowing requirement	12 9	6 7	7 1	7 0	4 9	6 3	6 1	4 0
Adjusted ceiling					6 2	6 7	6 5	
Financial intermediation	1 6	0 7	1 2	1 2	—	0 2	0 3	1 0
Overall economic balance	-11 3	-6 1	-5 9	-5 8	-4 9	-6 1	-5 8	-3 0
Statistical discrepancy		—	—	—	-1 5	-1 0	-0 7	—
Interest payments	17 2	14 7	13 8	13 1	15 2	15 0	14 0	9 6
Primary balance (total)	5 9	8 6	7 9	7 3	11 8	9 9	8 9	6 7
Adjusted target					9 0	8 2	7 6	
Primary balance (extrabudgetary)	-1 3 1/	--	-0 1	-0 3	0 4	0 4	0 3	0 3
Primary balance (budgetary)	7 2	8 6	7 9	7 6	11 4	9 5	8 6	6 4
Receipts under budgetary control	28 5	29 1	28 2	27 3	29 9	29 4	28 6	28 6
Petroleum	9 9	8 9	8 7	8 4	10 3	9 8	9 4	
Nonpetroleum	18 6	20 2	19 5	18 8	19 5	19 5	19 2	
Outlays within primary balance	21 4	20 5	20 3	19 7	18 5	19 9	20 0	22 2
Programmable outlays	18 1	16 7	16 7	16 2	15 8	16 9	17 2	
Nonprogrammable primary outlays	3 3	3 8	3 6	3 5	3 6	3 6	3 3	
Unclassified					-0 9	-0 6	-0 4	
Inflation component of interest payments	6 9	3 7	3 4	3 3	3 9	4 1	4 1	2 8
Operational balance	-4 4	-2 4	-2 5	-2 5	-1 0	-2 0	-1 8	-0 2
Adjusted ceiling					-1 9	-2 0	-2 0	

Sources Mexican authorities, and Fund staff estimates

1/ Includes statistical discrepancies

Table 3 Mexico Financial Flows

(In trillions of Mexican pesos, unless otherwise indicated)

	1986	1987	1988	Prog 1989	Rev 1989	Proj 1990
Total sources of funds	15 1	53 0	52 7	46 6	49 5	40 3
Growth of M-4	17 0	51 9	52 3	31 0	42 0	32 3
(percentage real annual growth)	(1 6)	(--)	(6 7)	(2 2)	(8 9)	(4 5)
Foreign borrowing by public sector	0 1	6 7	1 4	15 6	7 5	8 0
(billions of U S dollars)	(--)	(4 9)	(0 6)	(6 3)	(2 9)	(2 9) 1/
Other deposits	-1 9	-5 6	-1 0	--	--	--
Total use of funds	15 1	53 0	52 7	46 6	49 5	40 3
International reserve accumulation	-0 7	9 0	-15 6	3 7	0 3	1 4
(billions of U S dollars)	(-1 1)	(6 6)	(-6 9)	(1 5)	(-0 1)	(0 5) 1/
Public sector borrowing requirement	12 4	30 6	51 2	33 9	29 7	23 3
(percent of GDP)	(15 6)	(15 9)	(12 9)	(7 0)	(6 1)	(4 0)
Commercial bank credit to private sector	3 4	13 4	17 0	9 0	20 1	15 7
(percent real annual growth)	(-18 9)	(-0 6)	(17 2)	(1 9)	(25 0)	(11 5)
Memorandum items						
Exchange rate (pesos per dollar)						
End of period	923 0	2,199 0	2,259 0	2,469 0	2,623 0	2,863 0
Period average	611 0	1,367 0	2,250 0	2,398 0	2,442 0	2,762 0
GDP	79 4	195 6	408 9	484 2	484 3	582 0

Sources Mexican authorities, and Fund staff estimates

1/ Excludes transactions related to debt reduction operations

Table 4 Mexico Summary Balance of Payments

(In billions of U S dollars)

	1987	1988 Est	1989 Prog	1989 Proj	1990 Proj.
Current account	3 9	-2 9	-4 8	-5 0	-4 4
Merchandise trade, f o b	10 0	4 1	4 3	3 7	4 0
Exports	22 3	23 0	25 0	25 7	27 4
Petroleum and derivatives	8 6	6 7	6 5	7 7	7 5
Other	13 6	16 3	18 5	18 0	19 9
Imports	-12 2	-18 9	-20 8	-22 0	-23 4
Public sector	-2 8	-3 6	-3 8	-3 9	-4 1
Private sector	-9 4	-15 4	-16 9	-18 2	-19 4
Factor income	-7 3	-7 6	-9 4	-8 7	-8 8
Interest on public debt	-6 3	-7 0	-8 9	-8 0	-8 7
Other interest payments	-2 1	-1 9	-1 7	-1 8	-1 4
Other	1 0	1 3	1 2	1 2	1 3
Other services and transfers	1 1	0 6	0 3	--	0 4
Travel	1 5	1 4	1 6	1 3	1 4
Border transactions	-0 4	-0 6	-0 6	-0 8	-0 7
Other	--	-0 2	-0 6	-0 5	-0 3
Capital account	1 4	-4 1	4 7	3 4	-3 6
Official capital	2 5	0 3	4 6	-0 1	-4 7
Commercial banks	4 4	-1 5	3 5	-0 5	-1 3
Multilaterals	0 4	0 8	1 4	0 8	2 7
Bilaterals and suppliers	0 3	0 8	0 5	1 1	2 1
Other (including short term)	-2 6	0 2	-0 8	-1 5	-8 2
Private capital	-1 1	-4 4	0 2	3 4	1 1
Interest earnings abroad	-1 2	-1 5	-1 5	-1 7	-1 6
Direct investment	3 2	2 6	2 1	2 7	2 5
Net external credits	-2 2	-1 9	-0 9	-1 3	-1 0
Other payments and errors and omissions	-0 9	-3 8	0 5	3 7	1 2
Paris Club	1 4	0 2	0 7	0 5	0 9
Commercial banks (1989-92)					
Rescheduling	--	--	0 9	0 9	1 8
Debt/debt service reduction	--	--	--	--	2 5
Debt bridging operations	--	--	--	--	0 7
Net international reserves (increase -)	-6 6	6 9	-1 5	0 1	2 1

Sources Bank of Mexico, and Fund staff estimates

Mr. Beza

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US Mexico

Office Memorandum

INTERNATIONAL MONETARY FUND
WESTERN HEMISPHERE DEPT.

1989 AUG 16 AM 8:47

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

August 15, 1989

FROM: L.A. Whittome

SUBJECT: U.S. Treasury Meeting on Mexico

I attach a minute on last Friday's meeting in the U.S. Treasury on Mexico that Mr. Erb attended.

The U.S. officials pushed for a final decision by August 18 on the amount of money Japan would provide in January 1990 for credit enhancements. The Japanese have since requested a further few days to consider the issue.

Attachment

cc: Mr. Frenkel
Mr. Beza
Mr. Laske
Mr. H. Simpson

Office Memorandum

August 15, 1989

MEMORANDUM FOR FILES

SUBJECT Meeting in U S Treasury on Mexican Financing Package, August 11, 1989

A meeting was held in the U S Treasury to discuss the resolution of outstanding issues in the Mexican financing package 1/ There was agreement that the financing package should be completed by end-August and the syndication process underway in September to enable final agreement by January 1990 Mr Corrigan suggested further meetings of the present group as necessary and a meeting of the principals on about August 30

The following key points arose (described in detail in the attached)

--Mexico plans to request contingency financing from the Fund, in addition to $500 million being requested from commercial banks, to be triggered if oil prices fall below $12 a barrel

--Japan is offering to disburse only $850 million parallel financing and cofinancing in January 1990, rather than the $1 7 billion assumed by Mexico and the U S The U S officials pressed hard for more Japanese funding, and called for a final decision by August 18

--The World Bank will now provide $2 billion for debt reduction in early 1990, $1 9 billion of this in January This represents an increase in interest support from $950 million to $1 25 billion, all of which is made available in January 1990

--Likely IMF disbursements for debt reduction in early 1990 would be equivalent to $1,215 million, conditional on a November program review

--Mexico is to provide $1 3 billion for credit enhancements from its own resources

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1/ Those present included officials from the U S Treasury (Messrs Mulford and Dallara and Ms Chavez), the Federal Reserve Board (Mr Truman), the New York Fed (Messrs Corrigan and Checki), the World Bank (Messrs Husain and Shilling), IMF (Mr Erb), the Japanese Finance Ministry (Mr Yonezawa) and JEXIM bank, as well as Mr Gurria and the lawyer for the Mexicans, and a number of bankers, led by Mr Rhodes at Citibank

--A commercial bank bridge loan to the remaining credit enhancements is under discussion but amount uncertain, the oil facility may be linked to this Both loans are planned as club deals Mexican officials and bankers raised the issue of a Japanese guarantee (from JEXIM) on part of the bridge loan, as a way of encouraging Japanese bank participation and, possibly, of raising the size of the bridge if the Japanese enhancements in January fall short of $1 7 billion

--The official bridge loan, part multilateral and part U S , is proceeding

--Final agreement on a term sheet is targeted for end-August, outstanding issues, apart from financing of credit enhancements, include waivers on the new bonds, which Mexico wishes to be able to buy back, inclusion of IBRD guaranteed debt in the base, currency options, and treatment of interbank lines

Caroline Atkinson

Caroline Atkinson
Senior Economist
Debt Issues Unit
Exchange and Trade Relations Department

cc The Deputy Managing Director (o/r)
Mr Frenkel
Mr Whittome
Mr Beza
Mr Laske

Attachment

Discussions on Mexican Package at U S Treasury, August 11, 1989

1. Contingent financing for oil

Mr Gurria said that the Mexican program was now very vulnerable to unfavorable developments (he noted that the current account was on track with the original program, reserves stood at $6 billion, and imports were performing "with dynamism") Mexico is thus seeking a contingent loan of $500 million from banks, to cover a reduction in oil prices below $12 a barrel The loan would be a revolving fund during 1990-92--with amounts repaid if the oil price rises above $14 a barrel Outstanding drawings on this fund at the end of 1992 would be converted into a medium-term loan, with a principal guarantee by the World Bank The bankers noted that they had agreed earlier to a trigger price of $10 a barrel

Mr Gurria said that Mexico would request a twin loan for contingency financing from the IMF Mr Erb said that this could cause difficulty in the Executive Board, as there was already concern about Mexico's high level of access He noted that the program vulnerability resulted from lower bank financing and a re-estimate in the context of the bank financing package, of the baseline oil price from that underlying the Fund-supported program

2 Enhancements for debt reduction instruments

The U S made the point strongly that $7 billion of enhancements will need to be in place by January 1990, including a Japanese contribution of $1 7 billion Mr Yonezawa said that this amount would be impossible and offered $0 8 million ($450 million linked to the World Bank and a possible $350 parallel financing with Fund set-asides) He noted in particular that legal difficulties would prevent parallel financing alongside IMF resources for interest support, Mr Erb explained that these resources would be part of the extended arrangement, would involve conditionality (with the November review) and would be disbursed for general balance of payments support

The possibility was also raised by the U S and Mexican officials of switching some cofinancing to loans already approved and now identified by the World Bank as vehicles for debt reduction This was also rejected by the JEXIM representatives

The U S officials pressed hard for more flexibility from Japan They also suggested the possibility of bridge financing from other parts of the government Mr Gurria raised the issue of JEXIM guarantees for Japanese bank bridge financing (see below) The Japanese officials queried whether $7 billion was needed for credit ennancements

Mr Corrigan said that this amount may be too little, but certainly not too much It was left that this issue must by resolved by Friday, August 18

Mr Husain reported that the World Bank could now make $2 billion available in early 1990 for debt reduction ($1 9 billion in January and $100 million from new loans now expected to be approved in March/April) Mr Erb said that IMF resources equivalent to $1,215 million were expected ($592 million interest support, $267 million set-aside from 1990 and $356 million set-aside accelerated from 1990)

The U S officials also noted--despite opposition from Mr Gurria--that there should be an additional Mexican contribution of $250-300 million, essentially financed in 1990 through the acceleration of agreed World Bank loan disbursements There would not be an overall increase in World Bank disbursements during 1990-92 to cover this amount, Mr Husain said

Mexico is discussing a loan from a limited group of commercial banks to bridge to later disbursements of official finance for credit enhancements The size of the bridge will depend on the amount of enhancements yet to come Mr. Dallara mentioned $700-1,200 million, U S banks have discussed a figure of $800 million, Swiss banks may consider joining in the bridge if other non-U S banks participate, the issue was raised of Japanese participation Mr Gurria repeated to the Japanese a suggestion from the Mexican Finance Minister of a JEXIM guarantee that would cover future credit enhancements from JEXIM and encourage Japanese bank participation in the bridge This could raise the possible bridge loan to $1 4-1 5 billion The Japanese officials did not reply directly, but said that Japan would not oppose Japanese bank participation in an international bridging operation, but would see difficulties with a special bridge from Japanese banks alone

Mexico is considering linking the bridge loan to the oil facility, by making participation in the latter conditional on participation in the bridge, banks may oppose this Mr Gurria said that the bridge is designed in the form of a letter of credit, which would be payable on the due dates when future official financing for credit enhancement should be disbursed

3 Term sheet

Agreement by August 31 was necessary The following outstanding issues were discussed

a Waivers on the new bonds

Mexico wants flexibility to buy back the new bonds in the future Mr Gurria said that Mexico intends to service the bonds fully, but the exchange ratio of 35 percent with old debt, and corresponding interest rate reduction on the par bonds, do not reflect this intention (in essence, Mexican risk on the new bonds continues to be valued below par), full servicing of the total amount of new bonds to be issued would be very difficult The capacity to buy the bonds back would enable Mexico to carry out a necessary second round of tackling its debt overhang

The commercial bank position was that for reasons both of moral hazard and business practice, Mexico's ability to buy back the bonds should be limited by requiring a negative pledge on the bonds and waivers for any buybacks unless (i) Mexico is current in interest payments on the bonds, and (ii) the collateral accounts for interest payments are at least equal to the amount pledged at the time of the bond issuance The banks offered flexibility in the majorities required for the waivers

The Mexican officials agreed to the first condition and the U S officials supported them in opposing the second The issue would be referred back to the New York negotiations.

b <u>Exclusion of IBRD guaranteed amounts from base debt</u>

The commercial banks argued that $1 5 billion of medium-term loans from the 1986 and 1987 new money packages that have partial World Bank guarantees should be excluded from the base of eligible debt, further reducing it from the present $52 7 billion (which excludes private sector FICORCA debt) Messrs Mulford, Dallara and Corrigan argued strongly against this, as did Mr Husain, noting that such an exclusion would have a chilling effect on future official support for World Bank guarantees The banks said that it could be left in the base in the term sheet, but that in practice many banks holding this debt would take exit instruments on the rest of their exposure and attempt to free ride on this part

c. <u>Currency options</u>

Some non-U.S banks have argued for the ability to hold collateral in non-U S dollars to match their non-U S. dollar claims on Mexico (there are at present 11 currency options for the medium-term debt) Failing that, they argue for Mexico to take the exchange risk Mexico has offered to allow all banks to convert back into U S dollars if necessary to match the collateral, it will not take the exchange risk for banks that continue to hold unmatched non-U S dollar claims

There was concern that this question could cause considerable delays while other governments consider whether to issue 30-year zero coupon bonds in their currencies During the meeting, Mr Trichet confirmed by telephone that the French would issue such bonds Mr Gurria said to the Japanese representatives that a swift negative response from the MOF to their banks would be very helpful, rather than further delay

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INTERNATIONAL MONETARY FUND
WESTERN HEMISPHERE
1989 AUG 15 PM 12 07

Office Memorandum

August 15, 1989

MEMORANDUM FOR FILES

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Caroline Atkinson

Caroline Atkinson
Senior Economist
Debt Issues Unit
Exchange and Trade Relations Department

cc The Deputy Managing Director (o/r)
Mr Frenkel
Mr Whittome
Mr Beza
Mr Laske

Attachment

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There was concern that this question could cause considerable delays while other governments consider whether to issue 30-year zero coupon bonds in their currencies. During the meeting, Mr. Trichet confirmed by telephone that the French would issue such bonds Mr Gurria said to the Japanese representatives that a swift negative response from the MOF to their banks would be very helpful, rather than further delay

He noted that even if such long-term bonds were available in yen, the problem would arise, as with other low-interest rate currencies, that the enhancement finance was too little to cover even principal collateral fully, it was important for Mexico politically that future principal be fully released

d <u>Interbank lines</u>

Mexican officials and banks expressed concern that the $6-7 billion of outstanding interbank lines, which have never been consolidated into a facility, were very vulnerable to legal suit Any attempt to backstop the lines or buy out reluctant banks that have already got rid of their medium-term exposure could also cause a run It was agreed that the past policy of mandatory roll-over should continue, while every effort is made over the next couple of years to convert the lines into longer-term securities

e <u>Form of interest support</u>

In response to comments from Mr Gurria, the World Bank and IMF representatives made clear that their funds for debt reduction would be disbursed as part of normal Bank lending operations, or Fund arrangements In particular, the World Bank would not provide guarantees for interest support The Mexican and bank officials stated that the technical details of collateral accounts could be worked out quickly between them

4 <u>Fungibility of official resources for debt reduction</u>

It was agreed that this issue could become relevant, but there was no discussion U S officials later raised with Mr Erb whether use of set-aside funds to collateralize interest on the proposed discount bonds (which would be needed for the deal to proceed as presently structured) could run into opposition in the Fund Executive Board It was noted that even if this point is agreed, a limited take up of such bonds (below 20 percent) would mean that the set-aside amounts could not be fully used under the present guidelines

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[handwritten initials]

Office Memorandum

TO The Managing Director
The Deputy Managing Director

DATE August 10, 1989

FROM S T Beza [signature]

SUBJECT Meetings with Messrs Preston and Butcher

I start from the points made by Mr Whittome in looking at issues for cases after Mexico

1 Mexican officials are telling other debtor country authorities that they were rushed into a package that risks being inadequate in financing the program All parties involved, including the banks, will need to show more concern over the adequacy of the financing of programs in future cases of debt reduction

2 In Mexico's case, the Fund tried to strike a reasonable balance between domestic adjustment and external financing, but its judgment was questioned Now there is an admission that the Fund probably was right We should avoid a repetition of this experience In this connection, banks and industrial country authorities should not seek to take advantage of every favorable development (e g , oil price increases), leaving programs vulnerable

3 If banks and industrial country authorities seek to deal with other cases along the lines of Mexico, they may find some unpleasant surprises Other debtor countries are not as fearful of arrears as Mexico (some currently are in arrears and others have been in the recent past) Also, and this applies to Mexico too, a very tight financial program may put exit instruments in jeopardy (i e , unfavorable developments or the nonfulfillment of optimistic assumptions may result in exit instruments not being serviced)

4 It is possible (perhaps probable, in the light of the enhancements available) that programs can be financed adequately only by new money from banks with debt reduction operations on the side In such circumstances, banks will need to be ready to provide waivers and may find it convenient to capitalize interest payments in the Paris Club form

5 Banks are unlikely to be happy about financing packages as outlined above but they have to compare them with the alternative of arrears As Mr Whittome emphasized, they should not think that there will be more official financing Indeed, in the wake of Mexico, the banks should expect the Fund and the World Bank to look more closely into their exposures relative to other creditors

6 On Venezuela, which is of particular relevance for Mr Butcher, I will have more later today after discussions with the authorities

cc Mr Frenkel
Mr Whittome
Mr H Simpson

Mr. Beza
10-100

Mexico

Office Memorandum

INTERNATIONAL MONETARY FUND
WESTERN HEMISPHERE DEPT.

1989 AUG 10 PM 1:51

TO: The Managing Director
The Deputy Managing Director

DATE: August 10, 1989

FROM: Jacob A. Frenkel J.F.

SUBJECT: Meeting with Messrs. Preston and Butcher

- With regard to Mr. Whittome's note on meetings with Messrs. Preston and Butcher, we would introduce a somewhat more positive tone and would emphasize the success of the agreement in achieving debt reduction roughly on market terms and de-emphasize the so-called erosion of the new money base.

- After all, there is considerable doubt that there would have been an adequate amount of new money lending. The basis for a new approach was that this "base" was evaporating and that debtors were likely to go into arrears.

- We do not believe that the willingness of banks to supply "new money" will be materially altered should the debt reduction program succeed. The same banks will hold the new bonds and will be no more or less willing to finance partial payments if things turn out badly for Mexico. The point is that things are now less likely to turn out badly.

Attachments

cc: Mr. Beza
Mr. Whittome
Mr. H. Simpson

Office Memorandum

89 AUG 10 AM 9 27
RESEARCH DEPARTMENT

TO The Managing Director
The Deputy Managing Director

DATE August 10, 1989

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cc Mr Frenkel
Mr Whittome
Mr H Simpson

Office Memorandum

89 AUG -9 PM 5 59

TO The Managing Director
The Deputy Managing Director

August 9, 1989

RESEARCH DEPARTMENT

FROM L A Whittome

SUBJECT Meetings with Messrs Preston and Butcher

You may wish to talk round the following points

-- Despite banks' public statements that Mexico is a special case, that agreement will be a basis of comparison for others What is their assessment of Mexico? Ours is broadly that the deal should be supported but that (a) the enhancements were not adequate to provide the debt reduction that might be needed (b) the new money base is likely to be sharply eroded and (c) the program is unjustifiably tight

-- Important that Mexican deal not be held up Is the January target realistic?

-- Some bankers have warned that other cases will not be priced near the market Difficult to defend this, if too far off the market, difficult to support Contact with Fund during negotiations

-- Urgent bank action is required on other active cases where officials have already moved--the Philippines, Venezuela and Costa Rica Banks' perspectives on these cases? Ecuador also now beginning discussion with banks

-- Does the Philippines' approach--focus first on new money, restructuring, and waivers for debt reduction in a second stage--offer an alternative, perhaps more flexible, framework?

-- Banks, as well as officials, will have to be ready to provide adequate cash relief in future cases to avoid threat of unraveling programs and financing packages Debt reduction operations are not a substitute for cash relief, neither can banks look to more official resources to fill gap

cc Mr Beza
Mr Frenkel
Mr H Simpson

Office Memorandum

Mr. Beza

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TO: The Deputy Managing Director DATE: August 9, 1989

FROM: A. Liuksila

SUBJECT: Mexico - Possible Use of Fund Resources for Debt Reduction/Debt Service Reduction Operations

Mr. Beza has asked me to look into the possible uses of "set asides" and "additional resources" under the EFF for Mexico to collateralize principal and interest under Mexico's debt and debt service reduction schemes. I have investigated the matter on the basis of the projected Mexican financing package (as described in the "Mexican Term Sheet", July 23, 1989 sent to Mr. Gianviti by Mr. Loser on July 25, 1989). I understand that the final term sheet will only be available later this month.

Messrs. Beza and Leddy concur in the approach which is explained and described in the attachment.

Attachment

cc: Mr. Beza
Mr. Leddy

INTERNATIONAL MONETARY FUND
WESTERN HEMISPHERE DEPT.
1989 AUG 10 AM 9: 05

Debt Reduction and Debt Service Reduction Operations
Use of the Fund's General Resources

I The guidelines (see Summing up by the Chairman, Fund Involvement in the Debt Strategy, Executive Board Meeting 89/61 May 23 1989)

1 "Set aside amounts" may be used " to support operations involving principal reduction "

2 "Additional resources" ("augmentation") may be made available for " interest support in connection with debt reduction or debt service reduction operations "

II Application to the specific case of Mexico

Mexico, Possible Availability of Resources under the EFF

	Interest Support (Guarantees)		Principal Enhancement (Zero coupon bonds as collateral)	
	From "Set Aside"	From "Additional Resources"	From "Set Aside"	From "Additional Resources"
Debt Reduction Through exchange of debt at a discount of 35% into new instruments ("discount bonds") carrying interest at LIBOR + 13/16%	**YES** - Reason Interest support within an operation involving principal reduction	**YES** - Reason Interest support in connection with a debt reduction operation	**YES** - Reason Enhancement of principal within an operation involving principal reduction	**NO** - Reason There is no interest support
Debt Service Reduction Through exchange of debt at par into new instruments carrying interest at 6 25%	**NO** - Reason Interest support within an operation not involving principal reduction	**YES** - Reason Interest support in connection with a debt service reduction operation	**NO** - Reason Enhancement of principal within an operation <u>not</u> involving principal reduction	**NO** - Reason There is no interest support

Office Memorandum

Mr. Beza
I prefer the short version
since the language is more direct
RDE
7/2/89

TO: The Acting Managing Director DATE: August 2, 1989

FROM: S. T. Beza MB

SUBJECT: Mexico

Attached are two versions of the suggested draft letter by the Managing Director concerning the bridge loan to Mexico, which would modify an earlier draft proposed by the U.S. Treasury Department (also attached). The difference between the two versions centers on the first sentence of the draft letter (see the portion that is underscored in each case). The shorter version (Attachment I) is favored by ETR, TRE, and WHD. The longer version (Attachment II) is favored by LEG and contains language used previously in a communication from the Managing Director to commercial banks regarding Brazil.

Mr. Beza:

Attachments

I prefer the short version
since the language is more direct

RDE 7/2/85

cc: Mr. Holder
Mr. Leddy
Mr. Coats
Mr. H. Simpson

1989 AUG -2 PM 3:00
OFFICE OF THE
DEPUTY MANAGING DIRECTOR

mm9mex39a, 2.8.89

ATTACHMENT I
DRAFT
August --, 1989

SCHEDULE D
LETTER FROM THE MANAGING DIRECTOR OF THE FUND

Banco de Espana
Bank for International Settlement
Board of Governors of the Federal Reserve System
U.S. Department of the Treasury

Dear Sirs:

I wish to inform you that, on the basis of the latest information available to the Fund staff, the Mexican economic program is proceeding satisfactorily. Preliminary estimates based on partial data indicate that Mexico has met the performance criteria for June 30, 1989 under the extended arrangement with the Fund, taking into account adjustments contemplated under the program for changes in the timing of gross external financing. Compliance with these performance criteria and completion of a scheduled review by the Fund's Executive Board would enable Mexico to make its next purchase.

Very truly yours,

Michel Camdessus

mm9mex39, 2.8.89

ATTACHMENT II
DRAFT
August --, 1989

SCHEDULE D
LETTER FROM THE MANAGING DIRECTOR OF THE FUND

Banco de Espana
Bank for International Settlement
Board of Governors of the Federal Reserve System
U.S. Department of the Treasury

Dear Sirs:

I wish to inform you that, on the basis of the latest information available to the Fund staff, Mexico is proceeding with its economic program supported by the Fund and is making progress toward achieving the goals established in its program. Preliminary estimates based on partial data indicate that Mexico has met the performance criteria for June 30, 1989 under the extended arrangement with the Fund, taking into account adjustments contemplated under the program for changes in the timing of gross external financing. Compliance with these performance criteria and completion of a scheduled review by the Fund's Executive Board would enable Mexico to make its next purchase.

Very truly yours,

Michel Camdessus

ATTACHMEMT III
DRAFT
July 31, 1989

SCHEDULE D
LETTER FROM THE MANAGING DIRECTOR OF THE FUND

Banco de Espana
Bank for International Settlements
Board of Governors of the Federal
  Reserve System
U S Department of the Treasury

Dear Sirs

I wish to inform you that the Mexican economic program is proceeding satisfactorily To the best of my knowledge, Mexico continues to meet the performance criteria under its Extended Fund Facility, compliance with which would enable Mexico to make its next purchase

Very truly yours,

Michel Camdessus

Mexico

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Office Memorandum

INTERNATIONAL MONETARY FUND
WESTERN HEMISPHERE DEPT.
1989 AUG -2 PM 4:29

TO: The Managing Director
The Deputy Managing Director

DATE: August 2, 1989

FROM: L.A. Whittome LAW

SUBJECT: The Mexican Debt Reduction Package

A quick look at the draft term sheet of the Mexico package confirms the view that the debt reduction that would be achieved from the proposed exchanges is broadly in line with the effect of a simple buyback at the secondary market price. We have tried to set this out in a brief but understandable form.

With current interest rates, the par exchange of old debt for reduced interest bonds reduces the present value of Mexico's contractual obligations by $35 for every $100 of old debt exchanged, while the discount bond exchange gives a reduction of $38 for every $100 of old debt exchanged. At the same time Mexico borrows $7 billion for the escrow account, increasing both its obligations and resources by this amount. If banks choose to exchange $30 billion in the par exchange and $10 billion in the discount exchange, the present contractual value of Mexican bank debt would be reduced by $14 billion. However, the recapture clause could reduce this figure by up to $4 billion if oil prices rise sufficiently to trigger the recapture in full. If the $7 billion were instead applied to a buyback at the current secondary market price of 45 cents per dollar, Mexico would achieve a net reduction in the present value of its obligations of $10 billion.

From the banks' viewpoint, the critical issue is how much the new instruments are worth relative to old debt. If we assume the banks expect Mexico to pay its creditors the same stream of payments as before and to receive the entire amount of the guarantee fund, the par bond could be worth about 45 cents on the dollar, and the discount bond a few cents less. If they expect that the stream of Mexican payments to them will be reduced by calls on the guarantee fund, the par bond could be worth as little as 40 cents. The recapture clause could add about 3 cents on the dollar in value if creditors expect to receive about one quarter of the maximum possible, while the debt-equity and other provisions could also add to value. So the likely market worth of the bonds would seem to be close to the current secondary market price of old debt.

There are a further two points worth noting. Firstly, if the bonds' value is so close to the secondary market price, the package may prove difficult to sell to the wider banking community. Secondly, the debt exchanges would reduce the base for future new money packages by about $40 billion, while the buyback would reduce it by only $15.5 billion, so the package may make the raising of new money from banks in the future much more difficult.

cc: Mr. Beza ✓
Mr. Frenkel
Mr. H. Simpson

Mr. Beza

10-100

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Office Memorandum

INTERNATIONAL MONETARY FUND
WESTERN HEMISPHERE DEPT.

1989 AUG -1 PM 4:52

TO: Mr. Jorge Bonvicini DATE: August 1, 1989

FROM: Hector Elizalde

SUBJECT: Mexico - Schedules D and I to the Short Term Credit Facility by the BIS, U.S. Monetary Authorities and Banco de España

We have the following comments on the above-mentioned draft Schedules:

1. Schedule D. The proposed draft provides for an assessment by the Managing Director that Mexico's program is proceeding satisfactorily, and that to the best of his knowledge, Mexico continues to meet the performance criteria under the Fund's extended arrangement for Mexico, compliance with which would enable Mexico to make its next purchase.

The draft is not acceptable in its present form. As in previous cases, we recommend that a communication of this nature be limited to a description of facts within the Fund's knowledge.

We would propose that you suggest the redrafting of Schedule D as follows:

> "I wish to inform you that the three-year extended arrangement approved for Mexico on May 26, 1989 continues in effect. Mexico has purchased all the amounts that it has been entitled to purchase on or prior to this date, and will have the right to make purchases from the Fund up to the total amount approved under the extended arrangement in accordance with the terms of the arrangement, subject to the satisfaction of its terms and conditions."

2. Schedule I. As you are aware, we have received a copy of this Schedule from Ms.Tigert of the Federal Reserve, and have informed her that the Fund does not accept instructions that are irrevocable for the disposition of proceeds of purchases, and that, consequently, the Mexican authorities will need to confirm their instructions at the time of each request for a purchase under the arrangement.

cc. Mr. Holder
Mr. Beza
Mr. Coats

INTERNATIONAL MONETARY FUND

August 1, 1989

Mr Beza

Concerning Mexico, you will be interested in our reply to an inquiry of Ms Ricki Tigert of the Federal Reserve (both attached)

WEH

Attachments

cc Mr Laske

William E Holder

Mexico

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File

INTERNATIONAL MONETARY FUND
WASHINGTON, D. C. 20431

FACSIMILE NUMBERS
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(202) 623-4662
(202) 623-7491

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(202) 623-6775

Facsimile Service Cover Sheet
(TYPE)

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

TO

NAME Ms. Ricki Tigert

AGENCY Board of Governors of the Federal Reserve System

CITY/COUNTRY Washington, D.C.

FACSIMILE TELEPHONE NO. 202 (Country Code) 452-3101 (City Code) (Number)

TEXT

See attached letter.

INTERNAL DISTRIBUTION

INTERNATIONAL MONETARY FUND
WESTERN HEMISPHERE DEPT.
1989 AUG -1 PM 4: 22

FROM

NAME William E. Holder

DEPT./DIV. Legal

ROOM NO. 8-304	EXTENSION 7792	ACCOUNT CODE

AUTHORIZED BY (TYPE) William E. Holder, Acting General Counsel	SIGNATURE William E. Holder

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

INTERNATIONAL MONETARY FUND
WASHINGTON D C 20431

CABLE ADDRESS
INTERFUND

August 1 1989

Dear Ms Tigert

I refer to your request of July 31 1989 for comments on a draft of "Schedule I - Irrevocable Instructions to the International Monetary Fund" concerning "all purchases made by Mexico under the Extended Fund Facility or any other purchase from the IMF by Mexico "

In accordance with its law and practice, the Fund acts on the basis of the latest duly authenticated instructions from the fiscal agency of the member requesting a purchase from the Fund The Fund does not therefore recognize instructions as irrevocable

It follows that, for the Fund to act upon instructions such as those contained in the draft, those instructions would have to be confirmed in the formal request for a purchase which is to be received by the Fund prior to the actual purchase

Sincerely yours,

William E Holder

William E Holder
Acting General Counsel

Ms Ricki Tigert
Associate General Counsel for
International Banking
Board of Governors of the Fede ıl
Reserve System
20th and C St , N W
Washington, D C 20551

LEGAL DIVISION

Fax No. 202-452-3101

FACSIMILE TRANSMISSION COVER SHEET

To: Ernesto Aguirre
IMF

Date: July 31, 1989

1989 JUL 31 AM 10:45
IMF CABLE

13 JUL 31 PM 1:04

852786

From: Ricki Tigert
Associate General Counsel for International Banking

Extension: (202) 452-3428

Message or Special Instructions:
PLEASE DELIVER IMMEDIATELY
I would appreciate your comments as soon as possible

Number of pages including this cover sheet 3

If this message is incomplete or you need retransmission please contact Board of Governors of the Federal Reserve System Washington D C Telegraph (202) 452 3293

DRAFT
7/29/89

SCHEDULE I

IRREVOCABLE INSTRUCTIONS TO THE INTERNATIONAL MONETARY FUND

[Date]

The Treasurer's Department
International Monetary Fund
Washington, D.C. 20431

Re. Extended Fund Facility and Other Sources of IMF Financing for Mexico

Dear Sirs

The United Mexican States ("Mexico") hereby irrevocably authorizes and instructs the International Monetary Fund (the "IMF") to arrange on Mexico's behalf that the proceeds of all purchases made by Mexico under an Extended Fund Facility (the "EFF") or any other purchases from the IMF by Mexico, be either provided in, or converted into, U.S. dollars, and deposited into the Special Funds Account (the "Special Funds Account") of the Banco de Mexico (the "Central Bank") with the Federal Reserve Bank of New York (the "FRBNY") (the "Special Funds Account"). Such irrevocable authorization and instruction shall not, however, apply to purchases for interest support or amounts set aside in connection with debt and debt service reduction.

The Central Bank acknowledges that your action on this request and authorization will be taken in conformity with the relevant provisions of the EFF or any other IMF facility or arrangement made available to Mexico, and confirms that such action shall not be construed in any way as a waiver of any right which the IMF may have under the EFF or under any other IMF facility or arrangement made available to Mexico.

For your information, the Central Bank has separately instructed the FRBNY that all or part of the funds deposited in the Special Funds Account will be used to repay drawings made by the Central Bank under a short-term credit facility (the "Facility") that the Bank for International Settlements acting for certain member central banks, the United States Monetary Authorities, and the Banco de Espana (the "Cooperating Monetary Institutions") have agreed to establish for the purpose of providing near-term support for the international reserves of Mexico. The aggregate amount of drawings by the Central Bank under the Facility may amount to as much as U.S. dollars two billion. Moreover, the Central Bank has agreed with the Cooperating Monetary Institutions that the foregoing instructions shall not be revoked or modified by the Central Bank, Mexico, or any other Mexican institution until the IMF receives from the Central Bank a copy of the notification made by the FRBNY to the Central Bank that the Facility has been repaid in full, including accrued and unpaid interest.

The Central Bank is providing a copy of the executed original of this letter to the FRBNY.

Sincerely yours,

For the United Mexican States

By ____________________

For the Central Bank of Mexico

By ____________________