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have been completed and that Mexico may proceed to make the purchases authorized in paragraphs 4(b) and 5(b) above

UNQUOTE

Leo Van Houtven

Secretary

Interfund

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SEC-9000496
JSD:AS

ORIGINAL: SPANISH

United Mexican States
Secretariat of Finance and Public Credit

Mexico, D.F., January 29, 1990

ORIG: WHD

CC: MD
DMD
MRS. FILARDO
ETR
MR. H. SIMPSON

Mr. Michel Camdessus
Managing Director
International Monetary Fund
Washington, D.C.

Dear Mr. Camdessus:

In our letter of January 15, 1990, we described the progress made to date in implementing our medium-term economic strategy, and the broad policy outlines for 1990. We also stated that we would take the additional steps needed to achieve the objectives of Mexico's economic program.

Our preliminary information indicates the existence of some divergences from the Bank of Mexico's international reserve target and the limit on domestic assets for end-1989.

We believe this requires some comment. First of all, we consider that the divergences referred to can be reversed early in 1990. Under various amendments to the Income Tax Law, enterprises, in contradistinction to the years prior to 1989, were able to deduct from their taxable income the full amount of payments made in 1989 for input purchases (including capital goods, unless the plant is located in one of the country's three largest metropolitan areas). This resulted in an extraordinary, unforeseen demand for credit by the private sector toward the end of the year. The financial authorities thus saw themselves obliged to cut back their program for the placement of public securities in November and December. Had they done otherwise, interest rates could have reached unduly high levels, causing alarm in the financial, and particularly foreign exchange, market. The steps taken explain the divergence both as regards the limit on the Bank of Mexico's domestic assets, and the international reserve target. The latter divergence stems from the fact that some of the largest payments made by enterprises to their suppliers were undoubtedly in favor of external entities.

We believe this state of affairs will tend to reverse itself gradually of its own accord. Nevertheless, we are taking steps to foster the recovery of reserves, i.e.:

(a) Revise the timetable for public expenditure during the first months of the year, with a view to compressing such expenditure for said months

(b) Place a larger amount of public securities on the market with a view to soaking up liquidity This is being done despite its impact on interest rates, which have risen, as regards the leading instrument on the market--28-day Treasury Certificates--by somewhat more than 2 percentage points during the first three weeks of 1990, and by 4 percentage points since November 1989

(c) Speed up the sale of parastatal enterprises, especially TELMEX Given the size of this enterprise, its sale may generate considerably more revenue than is provided for in the program

Moreover, the fiscal and monetary effort made during 1989 should be mentioned The original program for 1989 provided that the public sector would receive net external credit of 6 1 billion dollars This was so far from being the case, that there was, in fact, a net debt reduction tentatively estimated at 276 million dollars Higher petroleum prices and lower external interest rates, which combined to produce an alleviation estimated at 1,174 million dollars, offset only a negligible portion of lost external financing Consequently, intense pressure on the domestic financial market pushed up interest rates well beyond expectations Under the circumstances, monetary measures which were even more restrictive than those introduced might have caused a surge in interest rates that would have been incompatible with the stability of the system

Notwithstanding the above statements, please note that we are prepared to take additional measures if, within a reasonable period, recovery in the course of the year of the net reserves lost over and above the adjusted program projections for 1989 seems unlikely To achieve this objective, once the final figures for 1989 are known, we will examine with the IMF such adjustments as may be required in the international reserve targets for 1990

Sincerely yours,

/s/

Pedro Aspe
Secretary of Finance
and Public Credit

/s/

Miguel Mancera
Director-General
Bank of Mexico

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FORMULARIO Nº BNTF 01

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5217267

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4	95 202 623 7499	ENERO 29, 1990

PARA

SR M CAMDESSUS
SR T BEZA
DRA. L FILARDO
FONDO MONETARIO INTERNACIONAL
WASHINGTON, D C

ORIG WHD
CC MD
DMD
MRS FILARDO
ETR
MR H SIMPSON

DE

BANCO DE MEXICO

INSTRUCCIONES ESPECIALES DEL SOLICITANTE

ADJUNTO CARTA CONVENIDA

ATENTAMENTE,

PARA USO EXCLUSIVO DE LA OFICINA DE TELECOMUNICACIONES

OBSERVACIONES DE LA TRANSMISION	RESPONSABLE DE LA TRANSMISION

DEPENDENCIA SOLICITANTE

NOMBRE	TELEFONO/EXTENSION	FIRMA AUTORIZADA
	2240	

JAN 29 '90 08 50 TO IMF WHD WASH DC 003 FROM ORG Y ACS INTERNAC T-172 P 01

G.H 1

SECRETARIA
DE
HACIENDA Y CREDITO PUBLICO

Mexico, D. F , enero 29 de 1990

Sr Michel Camdessus
Director Gerente
Fondo Monetario Internacional
Washington, D. C

Estimado Sr Camdessus·

En nuestra carta del 15 del presente mes, describimos el progreso logrado hasta la fecha en la instrumentación de nuestra estrategia económica a plazo medio, así como los lineamientos de política para 1990 En esa ocasión, indicamos que tomaríamos las medidas adicionales que se requirieran para lograr los objetivos del programa económico de Mexico

Tenemos información preliminar que indica la existencia de algunas desviaciones respecto de la meta de reservas internacionales y del tope de activos internos del Banco de Mexico para el final de 1989

Al respecto, estimamos conveniente hacer algunas consideraciones Por una parte, pensamos que las citadas desviaciones son de caracter reversible en los primeros meses de 1990. En efecto, en virtud de ciertas modificaciones que se hicieron a la Ley del Impuesto sobre la Renta, las empresas pudieron, a diferencia de años anteriores a 1989, deducir de su ingreso gravable el importe íntegro de los pagos que hicieron en el propio 1989 por concepto de adquisicion de insumos (incluso bienes de capital excepto si la planta esta ubicada en alguna de las tres zonas metropolitanas mas grandes del país) Esto determinó una demanda extraordinaria y no prevista de credito por parte del sector privado hacia el final del año Las autoridades financieras se vieron entonces en la necesidad de reducir su programa de colocacion de valores publicos en los meses de noviembre y diciembre De no haberlo hecho así, las tasas de interes hubiesen podido alcanzar niveles inusitadamente altos, mismos que habrian causado alarma en el mercado financiero y particularmente en el cambiario La referida accion explica tanto la desviacion respecto del tope de activos internos del Banco de México, como la desviacion concerniente a la meta de reservas internacionales. Esto ultimo porque parte de los mayores pagos que hicieron las empresas a sus proveedores seguramente fueron en favor de entidades del exterior

Estimamos que el fenomeno descrito por su propia naturaleza tendera a revertirse gradualmente Sin embargo, estamos tomando medidas que contribuyan a la reposicion de reservas, a saber.

a) Revisar el calendario de gasto publico correspondiente a los primeros meses del año, con miras a disminuir dicho gasto en los meses citados

b) Colocar mayor cantidad de valores publicos en el mercado con proposito de restringir la liquidez Esto se esta haciendo no obstante su impacto sobre las tasas de interes, las cuales han aumentado, en lo que toca al papel líder del mercado -los Certificados de Tesoreria de 28 días- en poco mas de 2 puntos porcentuales durante las primeras tres semanas del año y en 4 puntos porcentuales desde noviembre de 1989

c) Acelerar la venta de empresas paraestatales, particularmente de TELMEX Dada la magnitud de esta empresa, su venta puede generar importantes ingresos adicionales a los programados

Por otra parte, es de recordar el esfuerzo fiscal y monetario realizado durante el año 1989 En el programa original para dicho año se habia previsto que el sector publico recibiera crédito externo neto por 6 1 miles de

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DE
HACIENDA Y CREDITO PUBLICO

millones de dólares. Lejos de haber sido este el caso, hubo un desendeudamiento neto que se estima preliminarmente en 276 millones de dolares La mejoría en el precio del petroleo y la disminución de las tasas de interés externas, que en conjunto produjeron un alivio estimado en 1174 millones de dólares, no compensaron sino una fracción muy pequeña de la perdida de financiamiento externo Por consiguiente, se produjo una gran presión sobre el mercado financiero domestico, en el cual las tasas de interés estuvieron a niveles muy superiores a los previstos. En esas condiciones, una acción monetaria todavía más restrictiva que la emprendida hubiese determinado una elevación de las tasas de interes quizá incompatible con la estabilidad del sistema

No obstante lo expuesto en la presente carta, deseamos manifestar a usted nuestra disposición para tomar medidas adicionales en el caso de que, dentro de un tiempo razonable, se vean pocas probabilidades de recuperar en el curso del año las reservas netas perdidas en exceso de lo previsto en el programa ajustado de 1989 Con el propósito de alcanzar este objetivo y cuando se conozcan las cifras definitivas de 1989, se considerarán con el FMI los ajustes que, en su caso, proceda efectuar a las metas de reservas internacionales durante 1990.

Atentamente,

PEDRO ASPE
Secretario de Hacienda
y Credito Publico

MIGUEL MANCERA
Director General del
Banco de México

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FORMULARIO Nº BMTF 01.

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4	95.202.623.7499	ENERO 29, 1990

PARA:

SR. M. CAMDESSUS
SR. T. BEZA
DRA. L. FILARDO
FONDO MONETARIO INTERNACIONAL
WASHINGTON, D. C.

ORIG: WHD
CC: MD
DMD
MRS. FILARDO
ETR
MR. H. SIMPSON

DE:

BANCO DE MEXICO

INTERNATIONAL MONETARY FUND
WESTERN HEMISPHERE DEPT.
1990 JAN 29 PM 12:03

INSTRUCCIONES ESPECIALES DEL SOLICITANTE:

ADJUNTO CARTA CONVENIDA.

ATENTAMENTE,

PARA USO EXCLUSIVO DE LA OFICINA DE TELECOMUNICACIONES

OBSERVACIONES DE LA TRANSMISION.	RESPONSABLE DE LA TRANSMISION.

DEPENDENCIA SOLICITANTE

NOMBRE:	TELEFONO/EXTENSION	FIRMA AUTORIZADA.
	2240	

JAN 29 '90 08:50 TO IMF WHD WASH DC 003 FROM ORG. Y ACS. INTERNAC. T-172 P.01

G.H 1

SECRETARIA
DE
HACIENDA Y CREDITO PUBLICO

Mexico, D F , enero 29 de 1990

Sr Michel Camdessus
Director Gerente
Fondo Monetario Internacional
Washington, D. C.

Estimado Sr. Camdessus:

En nuestra carta del 15 del presente mes, describimos el progreso logrado hasta la fecha en la instrumentación de nuestra estrategia económica a plazo medio, así como los lineamientos de política para 1990 En esa ocasión, indicamos que tomaríamos las medidas adicionales que se requirieran para lograr los objetivos del programa económico de Mexico

Tenemos información preliminar que indica la existencia de algunas desviaciones respecto de la meta de reservas internacionales y del tope de activos internos del Banco de Mexico para el final de 1989.

Al respecto, estimamos conveniente hacer algunas consideraciones Por una parte, pensamos que las citadas desviaciones son de carácter reversible en los primeros meses de 1990 En efecto, en virtud de ciertas modificaciones que se hicieron a la Ley del Impuesto sobre la Renta, las empresas pudieron, a diferencia de años anteriores a 1989, deducir de su ingreso gravable el importe íntegro de los pagos que hicieron en el propio 1989 por concepto de adquisicion de insumos (incluso bienes de capital excepto si la planta esta ubicada en alguna de las tres zonas metropolitanas mas grandes del país) Esto determinó una demanda extraordinaria y no prevista de credito por parte del sector privado hacia el final del año Las autoridades financieras se vieron entonces en la necesidad de reducir su

SECRETARIA
DE
HACIENDA Y CREDITO PUBLICO

programa de colocacion de valores publicos en los meses de noviembre y diciembre De no haberlo hecho así, las tasas de interes hubiesen podido alcanzar niveles inusitadamente altos, mismos que habrían causado alarma en el mercado financiero y particularmente en el cambiario La referida acción explica tanto la desviación respecto del tope de activos internos del Banco de México, como la desviacion concerniente a la meta de reservas internacionales. Esto ultimo porque parte de los mayores pagos que hicieron las empresas a sus proveedores seguramente fueron en favor de entidades del exterior.

Estimamos que el fenomeno descrito por su propia naturaleza tendera a revertirse gradualmente Sin embargo, estamos tomando medidas que contribuyan a la reposicion de reservas, a saber.

a) Revisar el calendario de gasto publico correspondiente a los primeros meses del año, con miras a disminuir dicho gasto en los meses citados

b) Colocar mayor cantidad de valores publicos en el mercado con proposito de restringir la liquidez Esto se esta haciendo no obstante su impacto sobre las tasas de interes, las cuales han aumentado, en lo que toca al papel líder del mercado -los Certificados de Tesorería de 28 días- en poco mas de 2 puntos porcentuales durante las primeras tres semanas del año y en 4 puntos porcentuales desde noviembre de 1989

c) Acelerar la venta de empresas paraestatales, particularmente de TELMEX Dada la magnitud de esta empresa, su venta puede generar importantes ingresos adicionales a los programados.

Por otra parte, es de recordar el esfuerzo fiscal y monetario realizado durante el año 1989 En el programa original para dicho año se había previsto que el sector publico recibiera crédito externo neto por 6 1 miles de

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DE
HACIENDA Y CREDITO PUBLICO

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No obstante lo expuesto en la presente carta, deseamos manifestar a usted nuestra disposición para tomar medidas adicionales en el caso de que, dentro de un tiempo razonable, se vean pocas probabilidades de recuperar en el curso del año las reservas netas perdidas en exceso de lo previsto en el programa ajustado de 1989 Con el propósito de alcanzar este objetivo y cuando se conozcan las cifras definitivas de 1989, se considerarán con el FMI los ajustes que, en su caso, proceda efectuar a las metas de reservas internacionales durante 1990.

Atentamente,

PEDRO ASPE
Secretario de Hacienda
y Credito Publico

MIGUEL MANCERA
Director General del
Banco de México

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INTERNATIONAL MONETARY FUND

January 26, 1990

Mexico

Mr. Caiola
Mr. Hino

For your information.

Robert Franklin

DATE January 24, 1990

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	January 29, 1990
Agenda Item	Mexico Extended Arrangement & Review & Program for the Second Year
Bank Staff Attending	Miguel Martinez Division Chief Latin America & the Caribbean, Country Operations 473-8729

cc

Regional Vice President	- Mr Husain (I-8015)
IMF Secretary's Dept	- Mr Franklin
Director, EAS	- Mr Dubey
Bank Representative	-Mr Martinez (I-8155)

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

Office Memorandum

TO: The Managing Director
The Deputy Managing Director

DATE: January 25, 1990

FROM: S.T. Beza

SUBJECT: Mexico--Supplement to the Staff Report - Review and Program for Second Year Under the Extended Arrangement

The attached supplement to the staff report for Mexico describes the latest economic developments and presents updated information on the commercial bank financing package and its effects on Mexico's balance of payments outlook. The text of the supplement has been based on the assumption that understandings will be reached with the Mexican authorities concerning adjustments to targets for 1990 to compensate for deviations that took place in 1989. The paper would be issued once confirmation on such understandings is achieved with the Mexican authorities.

The draft decision (page 9) seeks approval for the second year program under Mexico's extended arrangement with the Fund, the use of Fund general resources in support of debt operations in the form of an augmentation of the arrangement, the release of accumulated set-asides, and acceleration of disbursements of set-asides to be available in 1990.

The supplement has been reviewed by the following departments:

Exchange and Trade Relations:	Mr. Brau
Fiscal Affairs:	Mr. Nashashibi
Legal:	Mr. Surr
Research:	Mr. Aghevli
Treasurer's:	Mr. Coats
Western Hemisphere:	Messrs. Caiola, Ferran and myself

Attachment

cc: Mr. H. Simpson

JAN 25 '90 14:50 ...

FORMULARIO No BMFF 01

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CONTROL DE SERVICIO TELEFACSIMIL

NUMERO DE DOCUMENTOS (INCLUIR HOJA DE CONTROL)	NUMERO DE TELEFONO FACSIMIL	FECHA
4	95 202 623 7499	Enero 25 de 1990

PARA

SR S T BEZA
SR CLAUDIO LOSER
FONDO MONETARIO INTERNACIONAL
WASHINGTON, D C

DE

LIC ARIEL BUIRA
DIRECCION DE ORGANISMOS Y ACUERDOS
INTERNACIONALES

INSTRUCCIONES ESPECIALES DEL SOLICITANTE

SEGUN CONVERSACION CON EL SR LOSER, ENVIO TEXTO DE CARTA
A SU CONSIDERACION

PARA USO EXCLUSIVO DE LA OFICINA DE TELECOMUNICACIONES

OBSERVACIONES DE LA TRANSMISION	RESPONSABLE DE LA TRANSMISION

DEPENDENCIA SOLICITANTE

NOMBRE	TELEFONO/EXTENSION	FIRMA AUTORIZADA
	2240	[signature]

México, D. F., enero 24 de 1990

Sr. Michel Camdessus
Director Gerente
Fondo Monetario Internacional
Washington, D. C.

Estimado Sr Camdessus.

En nuestra carta del 15 del presente mes, describimos el progreso logrado hasta la fecha en la instrumentación de nuestra estrategia económica a plazo medio, así como los lineamientos de política para 1990. En esa ocasión, indicamos que tomaríamos las medidas adicionales que se requirieran para lograr los objetivos del programa económico de Mexico.

Tenemos informacion preliminar que indica la existencia de algunas desviaciones respecto de la meta de reservas internacionales y del tope de activos internos del Banco de Mexico para el final de 1989.

Al respecto, estimamos conveniente hacer algunas consideraciones. Por una parte, pensamos que las citadas desviaciones son de carácter reversible en los primeros meses de 1990. En efecto, en virtud de ciertas modificaciones que se hicieron a la Ley del Impuesto sobre la Renta, las empresas pudieron, a diferencia de años anteriores a 1989, deducir de su ingreso gravable el importe integro de los pagos que hicieron en el propio 1989 por concepto de adquisición de insumos (incluso bienes de capital excepto si la planta está ubicada en alguna de las tres zonas metropolitanas más grandes del país). Esto determinó una demanda extraordinaria y no prevista de crédito por parte del sector privado hacia el final del año. Las autoridades financieras se vieron entonces en la necesidad de reducir su programa de colocación de valores publicos en los meses de noviembre y diciembre. De no haberlo hecho así, las tasas de interés hubiesen podido alcanzar niveles inusitadamente altos, mismos que habrían causado alarma en el mercado financiero y particularmente en el cambiario. La referida accion explica tanto la desviacion respecto del tope de activos internos del Banco de México, como la desviación concerniente a la meta de reservas internacionales. Esto último porque parte de los mayores pagos que hicieron las empresas a sus proveedores seguramente fueron en favor de entidades del exterior.

Estimamos que el fenómeno descrito por su propia naturaleza tenderá a revertirse gradualmente. Sin embargo, estamos tomando medidas que contribuyan a la reposición de reservas, a saber:

a) Revisar el calendario de gasto público correspondiente a los primeros meses del año, con miras a disminuir dicho gasto en los meses citados.

b) Colocar mayor cantidad de valores publicos en el mercado con propósito de restringir la liquidez Esto se está haciendo no obstante su impacto sobre las tasas de interés, las cuales han aumentado, en lo que toca al papel líder del mercado -los Certificados de Tesorería de 28 días- en poco mas de 2 puntos porcentuales durante las primeras tres semanas del año y en 4 puntos porcentuales desde noviembre de 1989.

c) Acelerar la venta de empresas paraestatales, particularmente de TELMEX. Dada la magnitud de esta empresa, su venta puede generar importantes ingresos adicionales a los programados.

Por otra parte, es de recordar el esfuerzo fiscal y monetario realizado durante el año 1989. En el programa original para dicho año se había previsto que el sector publico recibiera crédito externo neto por 6 1 miles de millones de dólares. Lejos de haber sido este el caso, hubo un desendeudamiento neto que se estima preliminarmente en 276 millones de dólares. La mejoría en el precio del petróleo y la disminución de las tasas de interés externas, que en conjunto produjeron un alivio estimado en 1174 millones de dólares, no compensaron sino una fracción muy pequeña de la pérdida de financiamiento externo. Por consiguiente, se produjo una gran presión sobre el mercado financiero doméstico, en el cual las tasas de interés estuvieron a niveles muy superiores a los previstos. En esas condiciones, una acción monetaria todavía más restrictiva que la emprendida hubiese determinado una elevación de las tasas de interes quizá incompatible con la estabilidad del sistema.

No obstante lo expuesto en la presente carta, deseamos manifestar a usted nuestra disposición para tomar medidas adicionales en el caso de que, dentro de un tiempo razonable, se vean pocas probabilidades de recuperar en el curso del año las reservas netas perdidas en exceso de lo previsto en el programa ajustado de 1989.

INTERNATIONAL MONETARY FUND

January 24, 1990

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

For your information

Robert Franklin

INTERNATIONAL MONETARY FUND

F

Date: January 24, 1990

MEMORANDUM FOR FILES

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

Date of Meeting:	Tuesday, January 30, 1990
Agenda Item:	Mexico: Interest Support Loan
Fund Staff Attending:	Jorge Bonvicini Division Chief Western Hemisphere Department Tel: 623-8482 Claudio M. Loser Senior Advisor Western Hemisphere Department Tel: 623-8373

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

Robert Franklin

Office Memorandum

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January 23, 1990

MEMORANDUM FOR FILES

Subject: Schedule of Meetings - Waiver of Circulation Period

At EBM/90/6, (1/17/90), Mrs. Filardo asked for a shortening of the circulation period for the discussion of the staff paper on the review of the program under the extended arrangement with Mexico (EBS/90/10, 1/17/90). The paper would be circulated on January 17, 1990 and she requested that it be placed on the agenda for January 29, 1990.

The Executive Directors accepted the proposal.

Marina Primorac

Marina Primorac
Executive Board Proceedings Division

cc: The Secretary
Treasurer
General Counsel
Director, Western Hemisphere Department
Director, Exchange and Trade Relations Department
Director, Fiscal Affairs Department
Director, Research Department
Mr. H. Simpson
Miss Jacob
Mrs. Moses

TELEFAX / FACSIMILE

MINISTRY OF FINANCE AND PUBLIC CREDIT
UNDERSECRETARY FOR INTERNATIONAL FINANCIAL AFFAIRS
M E X I C O

107 STB CL JB IO

DATE: JANUARY 23, 1990.

ORIG: WHD

CC: MD
DMD
MR. H. SIMPSON

NUMBER OF PAGES
(including cover sheet):

TO:

NAME OF ADDRESSEE:

MR. MICHEL CAMDESSUS
MANAGING DIRECTOR
INTERNATIONAL MONETARY FUND

862281

TELEFAX/FACSIMILE NUMBER: 95 (202) 623-4661

INTERNATIONAL MONETARY FUND
WESTERN HEMISPHERE DEPT.
1990 JAN 25 PM 2:59

FROM:

NAME OF SENDER:

DR. PEDRO ASPE,
MINISTER OF FINANCE AND
PUBLIC CREDIT
MEXICO

1990 JAN 25 PM 1:49
RECEIVED
IMF CABLE ROOM

TELEFAX/FACSIMILE NUMBER: 011-525-542-4581

WE WOULD MUCH APPRECIATE THAT A REPLY TO THE ATTACHED BE SENT TO:

MS. SAMIA AVALOS Z.
ASSISTANT TO MR. JOSE ANGEL GURRIA
TEL. 542-1300 AND 542-9839
FAX. 542-4581
MEXICO, CITY.

AT YOUR EARLIEST CONVENIENCE, THANK YOU.

IF THERE IS ANY PROBLEM WITH THE TRANSMISSION, PLEASE CALL: (011 525) 542-1300, 522-5622, 542-3904 OR 542-9839

Pedro Aspe Armella

SECRETARIO DE HACIENDA Y CREDITO PUBLICO

México, D F a 25 de enero de 1990.

Sr. Michel Camdessus,
Director Gerente,
FONDO MONETARIO INTERNACIONAL
Washington, D. C

Estimado Michel

A nombre del Presidente Salinas me permito confirmarte nuestra más cordial invitación para que nos acompañes a la ceremonia de firma del Paquete Financiero, el 4 de febrero próximo.

La ceremonia se iniciará a las 11 00 de la mañana, en el Palacio Nacional, y será seguida por un almuerzo en la Residencia Presidencial de los Pinos, a las 13.30 horas En ambos casos contaremos con la presencia del Presidente de la República, quien me hizo especial énfasis en la importancia de poder contar con tu presencia

Tanto en lo personal, como en tu capacidad de Director Cerente del Fondo Monetario Internacional, tu invariable apoyo y orientación al esfuerzo mexicano por reducir el peso de la deuda externa de nuestro país son ampliamente reconocidos y agradecidos El Presidente Salinas quisiera aprovechar la oportunidad para expresarte personalmente dicho reconocimiento

En otro orden de cosas, tu presencia, junto con la de los principales banqueros del mundo y los más importantes funcionarios de otras organizaciones internacionales y del Tesoro y la Reserva Federal de los Estados Unidos, constituirán un fuerte mensaje al resto del mundo de que el problema de la deuda de los países en desarrollo puede resolverse mediante esfuerzos comunes La ocasión puede servir también de oportunidad para reanudar el diálogo entre los diferentes participantes en la estrategia de la deuda, pues noto con preocupación que el proceso se ha polarizado

En lo personal, nada nos daría más gusto que poderte ver otra vez y darte un cariñoso abrazo en tan importante ocasión para México

Cordialmente,

Pedro Aspe

Office Memorandum

STB
CL
JB

January 19, 1990
12:00 noon

To: Treasurer
Internal Auditor
General Counsel
Director, Administration Department
Director, Exchange and Trade Relations Department
Director, Western Hemisphere Department

for

From: The Secretary

Subject: Mexico - Request for Technical Services

This is to advise you that within the time specified no Executive Director has expressed an objection to the matter set out in EBD/90/19 (1/12/90).

Accordingly, the Executive Board's approval is assumed and will be so recorded.

INTERNATIONAL MONETARY FUND
WASHINGTON, D. C. 20431

FACSIMILE NUMBERS
(202) 623-4661 STB
(202) 623-4662 IO
(202) 623-7491 JB

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(202) 623-6775 F

Facsimile Service Cover Sheet
(TYPE)

MSG. NO. (For Cable Room use only)	DATE January 17, 1990	PAGE 1 OF 2

TO

NAME Lic. Angel Gurría
AGENCY Subsecretario de Asuntos Financieros Internacionales
Palacio Nacional
10 Patio Mariano
Oficina 4037
CITY/COUNTRY Mexico D.F., Mexico

FACSIMILE TELEPHONE NO. 525 (Country Code) (City Code) 542.4581 (Number)

TEXT

INTERNAL DISTRIBUTION

FROM

NAME Claudio Loser

DEPT./DIV. Western Hemisphere Department

ROOM NO. 10-100	EXTENSION 8373	ACCOUNT CODE
AUTHORIZED BY (TYPE) Claudio Loser	SIGNATURE Claudio M. Loser	

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

IMO/MEX
lt9mex01 (1/16/90)

January --, 1990

Dear Mr. Camdessus

In our letter of January 15, 1990 we described the progress made to date in the implementation of our medium-term economic strategy as well as the policy guidelines for the year 1990. On that occasion we indicated that we would take any additional measures needed to achieve the objectives of Mexico's economic program.

We have preliminary information which indicates that there have been some deviations with regard to the target for net international reserves and the ceiling for net domestic assets of the Bank of Mexico for end-1989 We consider these deviations to be the result of temporary factors, but we have tightened monetary policy and are reducing the pace of public sector expenditures to strengthen performance under the program being supported by the extended arrangement from the Fund

We will continue to review developments closely If the final information on performance criteria for end-1989 confirms these deviations, we would propose compensating modifications of performance criteria for 1990, consistent with a reconstitution in 1990 of the shortfall in net international reserves experienced by end-1989 Moreover, we would take any additional action needed for the preservation of the program, which we consider essential for the achievement of sustained economic growth with financial stability

Yours truly,

Pedro Aspe Armella
Secretary of Finance and
Public Credit of Mexico

Miguel Mancera Aguayo
Director General
Bank of Mexico

JAN 17 '90 10:26 TO FROM BANCO DE MEXICO 4 T-331 P.01

Formulario No. B'IIF01

BANCO DE MEXICO

AV. 5 DE MAYO NO. 2
MEXICO, D.F.
CODIGO POSTAL 06059

INTERNATIONAL MONETARY FUND WESTERN HEMISPHERE DEPT 1990 JAN 17 PM 2:56

FOLIO 1246

NUMERO TELEFACSIMIL
GRUPO 2/3 5129990

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CONTROL DE SERVICIO TELEFACSIMIL

NUMERO DE DOCUMENTOS (INCLUIR HOJA DE CONTROL)	NUMERO DE TELEFONO FACSIMIL	FECHA
TRECE HOJAS	95 (202) 623 4661, 4662	17 enero 1990

PARA :

MR. MICHEL CAMDESSUS
MANAGING DIRECTOR
INTERNACIONAL MONETARY FUND
WASHINGTON, D.C.

ORIG: WHD

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

861932

DE :

LIC. JESUS A. CERVANTES GONZALEZ
GERENTE DE INVESTIGACION
ECONOMICA INTERNACIONAL
BANCO DE MEXICO
MEXICO, D. F.

1990 JAN 17 AM 11:53

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INSTRUCCIONES ESPECIALES DEL SOLICITANTE

PARA USO EXCLUSIVO DE LA OFICINA DE TELECOMUNICACIONES

OBSERVACIONES DE LA TRANSMISION	RESPONSABLE DE LA TRANSMISION

DEPENDENCIA SOLICITANTE

NOMBRE	TELEFONO/EXTENSION	FIRMA AUTORIZADA
LIC. JESUS A. CERVANTES GONZALEZ GERENTE DE INVESTIGACION ECONOMICA INTERNACIONAL.- D-20	518 31 12	[signature]

SECRETARIA
DE
HACIENDA Y CREDITO PUBLICO

Mexico City, January 15, 1990

Mr Michel Camdessus,
Manager Director,
International Monetary Fund,
Washington, D C

As you are aware, Mexico is about to finalize its financing package with its commercial banks creditors as a result of which this country will receive a substantial amount of debt relief As I understand the Fund has scheduled the consideration of Mexico's program for 1990 and the Mexican request of the release of the set aside and approval for an augmentation of resources available under the arrangement, for the 7th of February

As you recall these resources will be used to purchase zero coupon bonds from the US Treasury to guarantee the re-payment of the principal of the debt to commercial banks and some 18 months of interest Since the cost of the enhancement to be provided by Mexico rises by $11 million dollars with every basis point that interest rates decline, (i e by $550 million for half a percentage point) and the current perception is that interest rates are likely to fall in the coming weeks, we would like to ask for your assistance in order to bring forward the consideration of Mexico's request by the Executive Board to a date in late January, say the 29th

By that date the legal documentation of the package will have been completed and sent to the banks

We shall greatly appreciate your support in this matter which may will may signify a very considerable saving for us

Sincerely yours,

PEDRO ASPE
Secretary of Finance and
Public Credit of Mexico

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SECRETARIA
DE
HACIENDA Y CREDITO PUBLICO

Mexico City, MEXICO
January 15 , 1990

MR. MICHEL CAMDESSUS
Managing Director
International Monetary Fund
Washington, D C 20431

Dear Mr Camdessus

In a separate letter we have stated the objectives, policies, and measures that we intend to pursue for the second year of Mexico's extended arrangement from the Fund In accordance with the terms of that arrangement and of the Decision by which it was approved, we are requesting in this letter the Fund's appropriate approval for the disbursement of the amounts set aside for collateralization of interest and principal in connection with our debt reduction operations accumulated in 1989 and the full amount scheduled to be available in 1990 We also are requesting approval of augmentation of the extended arrangement from the Fund in order to provide an additional amount for interest support in connection with our debt and debt-service reduction operations All amounts would be made available upon completion of the current review under the extended arrangement The equivalent of these amounts will be used as part of the total of at least US$7 billion of collateral required for operations in connection with the commercial bank financing package recently completed on the basis of the previously agreed term sheet.

1 Amounts set aside Mexico hereby represents that it has a need to purchase an amount equivalent to SDR 209 79 million set aside in 1989 and an amount equivalent to SDR 279 22 million scheduled to be set aside in 1990, because of impending payments for purchase of collateral under debt reduction transactions Amounts equivalent to the requested purchases will be used within 90 days of the date of completion of the current review of the extended arrangement, for the purchase of principal collateral associated with new discount bonds issued to commercial banks (at a 35 percent discount), and for the deposit with a collateral agent of funds to secure interest payment of these bonds

681

ESTADOS UNIDOS MEXICANOS

SECRETARIA
DE
HACIENDA Y CREDITO PUBLICO

2 Additional amounts Mexico hereby requests augmentation of its extended arrangement from the Fund by the equivalent of SDR 466.20 million in accordance with the Decision in which the Fund expressed its preparedness at the time the extended arrangement was approved to consider such augmentation. Mexico also represents that it has a need to purchase the full amount by which the amount of the extended arrangement would be augmented. An amount equivalent to this purchase will be used within 90 days of the date of the completion of the current review of the extended arrangement for interest support in connection with Mexico's debt and debt-service reduction operations For this purpose, amounts equivalent to the requested purchase will be deposited as collateral for interest payments on par bonds carrying interest at a fixed interest rate (which, for those denominated in U S dollars, will be 6 25 percent a year) and on the discount bonds referred in paragraph 1 above.

Yours Truly,

Pedro Aspe Armella
Secretary of Finance and
Public Credit of Mexico

p.o.

Miguel Mancera Aguayo
Director General
Banco de Mexico

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SECRETARIA
DE
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Mexico City, Mexico
January 15, 1990

MR MICHEL CAMDESSUS
Managing Director
International Monetary Fund
Washington, D C 20431

Dear Mr Camdessus

1 At the time of its inauguration, the Government of Mexico announced a medium-term economic strategy for sustained economic growth and price stability covering the period 1989-94, supported by a three-year extended arrangement from the Fund As stated in our letter of April 11, 1989, the economic strategy for the medium-term encompasses demand management measures, efforts to increase domestic savings both in the public and private sectors, and structural policies necessary to foster economic efficiency The economic program was developed on the basis of a significant reduction in the net external resource transfer abroad, a decrease in the debt service burden, and the availability of new external resources within a multiyear horizon In the following paragraphs we describe the progress made to date in the implementation of the medium-term strategy, as well as the policy guidelines for the year 1990.

2 Performance in 1989 was satisfactory Economic activity recovered markedly, with industrial production up by about 6 percent and real GDP up by some 3 percent The momentum of private sector activity, in the context of a liberalized trade system, was also reflected in an increase in imports, the bulk of which constituted intermediate and capital goods, as well as temporary imports which in time will be reflected in exports, financed mainly by greater private capital inflows Hence, despite a large external current account deficit, the net international reserve position was stronger than anticipated, after taking account

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of substantially lower commercial bank financing The inflation rate, measured by consumer prices, declined from 52 percent during 1988 to less than 20 percent during 1989; when measured by producer prices, it declined from 37 percent to 15 percent

3. Underlying these results was a significant strengthening of the public sector finances The primary surplus of the nonfinancial public sector increased from almost 6 percent of GDP in 1988 to about 8 percent of GDP in 1989. This outcome was due to high yields from the income tax reform and a curtailment of noninterest expenditures, as well as more favorable oil prices Domestic interest rates declined sharply in late July from about 4 1/2 percent a month and remained at somewhat over 3 percent in subsequent months following the announcement of the signing of the financing package for 1989-92 with Mexico's commercial bank creditors On average, interest rates were higher than projected for the year as a whole, but their effect on the fiscal balance was more than offset by the strong primary outcome As a result, the public sector borrowing requirement declined from about 13 percent of GDP in 1988 to about 6 percent of GDP in 1989 and the operational deficit dropped from 4 1/2 percent of GDP to less than 2 percent of GDP

4 The public sector received very limited financing from abroad in 1989 and the financial fiscal deficit was covered primarily through the issuance of government securities placed with the public, facilitated by a strong rise in private sector financial savings, which grew at an annual rate of over 20 percent in real terms This reflected to a large extent the effect of financial liberalization and the improvement in confidence by the public, and permitted commercial bank credit to the private sector to rise markedly, without putting pressures on reserves

5 The Government of Mexico continued to implement significant structural reform policies in 1989--an effort which it intends to reinforce over the medium term The measures, which have already resulted in increased productivity, included a major overhaul of the tax system, regulatory changes to encourage increased foreign direct investment, and transfer of technology, an intensified process of public enterprise reform and divestiture, the

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intensification of the trade liberalization effort, and reforms to raise the efficiency of the financial system, free interest rates, and encourage financial intermediation Furthermore, major efforts have been made to deregulate domestic economic activity, particularly in the areas of transportation, communication, petrochemicals and fisheries Furthermore, the Mexican Government has iniciated a program of liberalization of automotive industry and promotion of in-bond industry

6. Adequate external financing and a reduction of the net resource transfer are indispensable for the success of the economic program In this regard, the Government's domestic adjustment efforts have been supported, in addition to Fund resources, by a rescheduling of official debt service obligations to Paris Club creditors, World Bank assistance in the form of sectoral and project loans, and financing facilities from several official creditors

7 An additional important element in Mexico's financing program is the package with commercial banks Last July the Government of Mexico reached agreement in principle with the commercial banks' steering committee on a term sheet incorporating a new money option and two debt and debt-service reduction options Banks have responded favorably to the agreement and signing of the package is scheduled for the first week of february. The package will result in debt reduction of some US$7 billion, with an additional US$22 5 billion benefiting from a low fixed contractual interest rate. Gross interest relief arising from these operations could amount to some US$2 2 billion in 1990, and US$1 5 billion a year subsequently, and new money disbursements would total some US$1.5 billion in the period 1990-92 Thus, after taking account of the restructuring of amortization obligations, the financial package would provide an average annual assistance of some US$3 8 billion for the period through 1994, net of the cost of enhancements To finance collaterals for these operations, Mexico expects to draw resources from the Fund, the World Bank, as well as use its own resources, including those freed on account of the funding provided by the Japan Export-Import Bank, these resources are estimated to total some US$7 billion

8 The choices made by commercial banks within the package will result in a larger than foreseen reduction

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in debt service obligations over the medium-term However the Government considers that it is crucial to sustain its adjustment efforts in order to achieve the objectives of the multiyear program The objetives and the key aspects, of the general economic strategy of the Government of Mexico are reflected in the National Development Plan for 1989-94, which has been designed to help provide an adequate framework of action for the Government and the Mexican society in general, and which in turn will help achieve an improvement in the quality of life of all Mexicans. In order to attain the required economic recovery, the Government of Mexico will base its policies on the continued stabilization of the economy, increased availability of resources for investment, and a process of economic modernization. These objectives are to be achieved through a consistent and strict management of fiscal, monetary, and exchange rate policies, together with the needed structural reforms in the financial and tax systems, in the context of agreements reached within the Pact for Economic Solidarity (PECE)

9 Within the framework of its medium-term program, the Government is seeking to raise the rate of growth of real GDP to 6 percent a year by 1994 The rate of inflation would gradually come down to that of its trading partners National savings would increase by 7 percentage points of GDP from 1989 to 1994, with private savings accounting for 3 percentage points and public sector savings for 4 percentage points. Gross domestic investment would increase by some 4 percentage points of GDP, equally accounted for by the public and private sectors.

10 In the context of the general strategy described above, the economic policy for 1990 will be based on four general principles: the consolidation of the progress made so far in stabilizing prices, the increase in the availability of resources for investment, the gradual recovery of sustained economic growth, and the improvement of the general well-being of the Mexican people, particularly for the poorer segments of the population Because of existing trends and the need to improve the structure of costs and prices, the reduction of inflation will be gradual Thus, within the context of firm macroeconomic policies, the rate of inflation is expected to decline to 15 percent in 1990. Real GDP would increase by some 3 5 percent in 1990, in line with a sustained improvement in economic performance.

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11. The macroeconomic targets would be consistent with an increase in national savings of some 2 percentage points of GDP, mainly reflecting the performance of the public sector and the impact of the debt relief obtained by Mexico. Domestic investment would increase by 1 percentage point of GDP after the strong performance shown in 1989. The external current account deficit would decline by some 1 percentage point of GDP, even as the net resource transfer is reduced If the use of reserves needed to cover the costs of enhancements for debt reduction operations were excluded net international reserves would rise reflecting the strengthening of the Mexican economy

12. In December 1989, the Mexican Government and the various sectors of society agreed to extend the PECE through July 1990. Within this framework, the peso continues to be depreciated daily according to a preannounced schedule, of Mex$1 per U S dollar a day, minimum wages were increased by 10 percent, and public sector prices and tariffs have been adjusted--most recently by an average 5 percent The extension of the PECE provides the needed framework in which the public sector policy stance will result in a continued decline in the rate of inflation.

13. In 1990, the Mexican Government will be seeking a further strenthening of the public finances while improving the availability of resources for capital and high priority current expenditures. On the basis of a petroleum price of US$15 a barrel, the primary fiscal balance would register a surplus amounting to some 7 percent of GDP (6.5 percent in the budget approved by Congress on the basis of a price of US$13 a barrel). The fiscal effort as reflected in primary surplus would be consistent with a reduction in the PSBR and the operational deficit by about 1.0 percentage point of GDP to 5 1 percent and 1 0 percent of GDP, respectively, excluding the capital gains from debt reduction operations The improvement in the public finances would be achieved in circumstances in which interest payments of the public sector are expected to decline by more than 3 0 percentage points of GDP because of the interest relief from the financing package with the commercial banks as well as the favorable effects on interest rates of lower inflation and greater private sector confidence

14 The budget for 1990 contains a series of measures to improve further the efficiency of the tax system and to

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strengthen tax administration The marginal tax rates on corporate and personal income were reduced to bring them in line with those prevailing abroad while the tax base will be broadened significantly by eliminating the special tax treatment accorded to certain sectors of the economy. Tax administration will be strengthened by simplifying payment procedures and strengthening incentives for tax collection. These measures are expected to yield an additional increase in tax revenue equivalent to some 1/2 percentage point of GDP. However, total public revenues are expected to decline by 0.9 percent of GDP as some nonrecurrent revenues and oil export volumes decline

15 Consistent with its general formulation of policy, the Government of Mexico has made significant adjustments to public sector prices and tariffs helping correct relative prices and strengthening the public finances The Government of Mexico will continue to monitor developments in this area, and will take actions as needed in light of the objectives of the program in the context of the PECE

16. Total expenditures, excluding interest payments, are budgeted to rise by some 1/2 percentage point of GDP in 1990, following several years of decline . The increase will be allocated in part to public sector investment in economic infrastructure such as transportation, energy, and communication. In addition, the authorities intend to increase outlays on high priority social sectors such as education, health and the environment and to improve the working conditions of the civil service so as to enhance productivity.

17. The Mexican authorities will continue to implement vigorously its policy of reform and divestiture of the public enterprises. In 1989, the number of enterprises in the public sector has declined to 390. Several large enterprises were privatized, including AeroMexico and Mexicana--the two major domestic airlines--and DINA--a truck manufacturing company For 1990, the Mexican Government has announced its intention to initiate the process of privatization of TELMEX, the telecommunications company, and to streamline and reduce the scope of the operations of CONASUPO The privatization program will enable the Government to concentrate its resources in areas of high priority

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18 Monetary policy will continue to help consolidate the recent gains in reducing inflation, while supporting the macroeconomic objectives of the program, including the attainment of a sustainable balance of payments In order to achieve the monetary targets, the Government will continue to rely mainly on open market operations, helping increase the efficiency of the financial intermediation process and enhance the prospects for sustained growth in financial savings Furthermore, the deepening of financial markets can be expected to take place as confidence is strengthened, reflecting the completion of the external financing package and continued progress in attaining the objectives of the Mexican economic strategy, which should foster a decline in real interest rates.

19 The structural reform of the financial system constitutes a major factor in helping strengthen the savings performance of the economy and in improving the allocation of loanable funds for investment Following a major liberalization of the banking system, financial instruments have been made more flexible and reserve requirements have been eliminated and only a liquidity ratio is required Additional actions will be taken during the year in order to enhance the efficiency and profitability of commercial banks by increasing their autonomy while strengthening the supervisory role of the National Banking Commission In addition Congress has recently approved several reforms to financial legislation which will promote the deepening of financial markets and the lengthening of maturities of financial instruments Outstanding among these are the reforms related to the operations of insurance, bonding, and leasing companies and other credit related institutions Actions are also being taken to permit greater participation of foreign investors in Mexican enterprises, while enhancing the role of the stock market in allocating savings The operations of development banks will be streamlined to help improve resource allocation and further rationalize existing subsidies.

20. The maintenance of the country's competitive position vis-a-vis its major trading partners is a key element of Mexico's economic strategy To this end, and as announced in the revision of the PECE for the period through July 31, 1990, the value of the peso will be adjusted daily by Mex$1 against the U S dollar--equivalent to a monthly

depreciation of more than one percent As a general principle, the exchange rate policy will continue to be one of small daily adjustments, consistent with the macroeconomic objectives of the program and taking into account developments in key components of the balance of payments (including non-crude oil exports, imports, transfers from abroad, travel related operations, and the behavior of international reserves), as well as forward-looking indicators such as the real effective exchange rate The authorities intend to maintain the policy of permitting free access to the foreign exchange markets and expect that the differential between the exchange rates in the official and free exchange markets will remain low

21 The policies described above, along with anticipated financial assistance from abroad--including in the form of the already agreed rescheduling of official credits under the auspicies of the Paris Club and the financing package with commercial banks--are expected to lead to a strengthening of Mexico's underlying balance of payments position In 1990 US$1 3 billion of gross international reserves will be used for debt reduction operations An additional US$1 2 billion will be provided by the Fund for those operations The program provides for a strengthening in the gross international reserve position, as well as the purchasing of debt enhancements which may be viewed as effectively constituting prepayments of an important portion of Mexico's external debt and debt service obligations

22 In order to attain the overall balance of payments objective, the current account position is programmed to improve by some US$0.4 billion, before taking account of interest relief of US$2.2 billion provided by the debt reduction exercises, and despite a projected drop in exports of crude oil. This improvement is to be achieved in the context of a further enhancement in the efficiency of the trade system which has already been subject to substantial liberalization The external debt position is projected to strengthen substantially, reflecting both the reduction of claims and contractual interest rates under the financing package with commercial banks, the reduced level of private sector external debt, and the reduced pace of new debt creation

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ESTADOS UNIDOS MEXICANOS

SECRETARIA
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23 The Mexican authorities believe that the policies and measures for 1990 described in this letter and the results of Mexico's financing package with its commercial bank creditors are adequate to achieve the objectives of the economic strategy, but will take additional measures that may become appropriate for this purpose On this basis, the Government of Mexico seeks continued Fund support in the form of approval of the second year of the extended arrangement The authorities of Mexico and the Fund will consult periodically, in accordance with the policies on such consultations, as specified in our letter of April 11, 1989 A review with the Fund of the implementation of the economic program for 1990 will be completed before August 31, 1990, and the review for reaching policy understandings for 1991 will be completed before February 28, 1991.

Yours truly,

PEDRO ASPE ARMELLA
Secretary of Finance and
Public Credit of Mexico

P.

MIGUEL MANCERA AGUAYO
Director General
Banco de Mexico

Formulario No. BMTF01

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JB
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BANCO DE MEXICO
AV. 5 DE MAYO NO. 2
MEXICO, D.F.
CODIGO POSTAL 06059

INTERNATIONAL MONETARY FUND
WESTERN HEMISPHERE DEPT.
1990 JAN 17 PM 2:55

FOLIO 1262

NUMERO TELEFACSIMIL
GRUPO 2/3 5129990

CONTROL DE SERVICIO TELEFACSIMIL

NUMERO DE DOCUMENTOS (INCLUIR HOJA DE CONTROL)	NUMERO DE TELEFONO FACSIMIL	FECHA
OCHO	95 (202) 623 4662, 4661	17 enero 1990

PARA :

MR. MICHEL CAMDESSUS
MANAGING DIRECTOR
INTERNATIONAL MONETARY FUND
WASHINGTON, D.C.

ORIG: WHD
CC: MD
DMD
MRS. FILARDO
ETR
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MR. H. SIMPSON

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1990 JAN 17 PM 6 10
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DE :

LIC. JESUS A. CERVANTES GONZALEZ
GERENTE DE INVESTIGACION
ECONOMICA INTERNACIONAL
BANCO DE MEXICO
MEXICO, D.F.

INSTRUCCIONES ESPECIALES DEL SOLICITANTE

SE ENVIA EL MEMORANDUM TECNICO ANEXO A LA CARTA DE INTENCION DE MEXICO QUE INADVERTIDAMENTE NO SE ADJUNTO EN EL FAX ANTERIOR.

PARA USO EXCLUSIVO DE LA OFICINA DE TELECOMUNICACIONES

OBSERVACIONES DE LA TRANSMISION	RESPONSABLE DE LA TRANSMISION

DEPENDENCIA SOLICITANTE

NOMBRE	TELEFONO/EXTENSION	FIRMA AUTORIZADA
LIC. JESUS A. CERVANTES GONZALEZ GERENTE DE IVNESTIGACION ECONOMICA INTERNACIONAL.- D-20	518 31 12	Jesus Cervantes González

Technical Memorandum of Understanding 1990

1. In accordance with the economic strategy described in the letters dated April 11, 1989, and January 15, 1990, the following performance criteria have been established for 1990 Establishment of performance criteria for 1991 and their phasing will be determined on the occasion of the reviews described in paragraph 28 of the letter dated April 11, 1989, and paragraph 23 of the letter dated January 15, 1990.

2. Adjustments to performance criteria will be made as described below in the event of deviations from the projected evolution of the price of oil. To the extent that the structure and timing of the financial package with commercial banks differ from those assumed in the formulation of the performance criteria contained in this memorandum, the performance criteria for March 1990 also will be adjusted for changes in the external financial flows associated with the bank package, including those flows related to the purchase of debt enhancements.

I. Foreign Financing

3 The public sector's net use of foreign credit (excluding foreign trade lending operations by the Banco de Comercio Exterior) is estimated at US$1,294 billion in 1989. The public sector's net use of foreign credit will not exceed US$6,580 million for the period January-March 1990, US$7,040 million for the period January-June 1990, and US$7,190 million for the period January-September 1990. An

indicative ceiling of US$7,370 million has been established for the period January-December 1990; the ceiling for end-1990 will be specified at the time of the forthcoming review of the arrangement. Notwithstanding the use of foreign credit specified above, the stock of public sector debt is not expected to increase because of the favorable effect of debt-reduction operations Within the ceilings on use of foreign credit, the authorities intend to limit the net use of foreign credit with maturities of less than one year to US$450 million for the period January-December 1990.

II Public Finance

4. The overall public sector borrowing requirement, "PSBR" (i.e., the economic deficit of the nonfinancial public sector on a cash basis plus the financial intermediation conducted by the national development banks and official trust funds, excluding FICORCA), is estimated at Mex$30,500 billion in 1989. The PSBR will not exceed Mex$6,500 billion in the period January-March 1990, Mex$14,200 billion in the period January-June 1989, Mex$21,350 billion in the period January-September 1990, and Mex$31,050 billion in the period January-December 1990. These limits will be adjusted in accordance with the provisions described in paragraphs 11 through 13

5. The operational deficit of the nonfinancial public sector is estimated at Mex$8,900 billion in 1989. The operational balance will register a surplus of no less than Mex$1,000 billion in the period January-March 1990. It will register a deficit of no more than Mex$1,490 billion in the period January-June 1990, Mex$2,850 billion in the period

January-September 1990, and Mex$6,150 billion in the period January-December 1990. These limits will be adjusted in accordance with the provisions described in paragraphs 11 through 13.

6. The primary surplus of the nonfinancial public sector is estimated at Mex$41,000 billion in 1989. The primary balance will register a surplus of at least Mex$12,550 billion in the period January-March 1990, Mex$23,050 billion in the period January-June 1990, Mex$33,500 billion in the period January-September 1990, and Mex$41,900 billion in the period January-December 1990. These targets will be adjusted in accordance with the provisions described in paragraphs 11 through 13.

7. Should macroeconomic objectives of the program (defined for this purpose as: (a) the inflation rate as measured by the CPI, and (b) the external current account net of crude oil exports) not be achieved in spite of the observance of the fiscal targets stated above, the Mexican authorities, in consultation with the Fund staff, will strengthen their fiscal stance with additional policy measures. These policy measures, which will be of a permanent nature, will aim at increasing the fiscal primary surplus to a level that would assure achievement of the macroeconomic objectives of the program.

III. Banco de Mexico Operations

8. The net international reserves of the Banco de Mexico are estimated at US$1,090 million on December 31, 1989. The net international reserves of the monetary authorities will not decline by more than US$1,130 million in the period January-March 1990, by more

than US$1,090 million in the period January-June 1990, by more than US$920 million in the period January-September 1990, and by more than US$650 million in the period January-December 1990. These targets will be adjusted in accordance with the provisions of paragraphs 11 through 13.

9. The net domestic assets of the Banco de Mexico are estimated at Mex$13,980 billion on December 31, 1989. The net domestic assets of the Banco de Mexico will increase by no more than Mex$2,730 billion in the period January-March 1990, by no more than Mex$3,110 billion in the period January-June 1990, by no more than Mex$2,920 billion in the period January-September 1990, and by no more than Mex$5,540 billion in the period January-December 1990. These limits will be adjusted in accordance with the provisions of paragraphs 11 through 13.

10. The Banco de Mexico's net claims on the public sector are estimated at Mex$31,880 billion on December 31, 1989. The Banco de Mexico's net claims on the public sector will not exceed Mex$32,370 billion during the period January-March 1990, Mex$33,040 billion during the period January-June 1990, Mex$33,510 billion during the period January-September 1990, and Mex$34,250 billion during the period January-December 1990. These limits will be adjusted in accordance with the provisions of paragraphs 11 through 13.

IV. Oil Price Adjustments

11. Performance criteria will be adjusted for deviations in the price of oil, as specified below. The adjustment, based on the cumulative effect of the movements in this variable, will be made on all

performance criteria with the exception of the public sector's net use of foreign credit, which will not be subject to this adjustment. The oil price adjustment to quantitative performance criteria in any calendar quarter beginning January 1, 1990 will be calculated as the value that results from multiplying the reference volume of crude oil exports 1/ by the difference between the mean price of Mexican oil exports in the respective quarter 2/ and US$15 a barrel.

12. Upper-end adjustment. If in any calendar quarter beginning January 1, 1990 the cumulative effect of higher than projected oil prices (as defined in paragraph 11), exceeds a threshold value of US$675 million on an annual basis 3/ the target for the Banco de Mexico's net international reserves for the same quarter will be adjusted upward by the value of the excess over the threshold for that quarter. In addition, the corresponding limits on the net domestic assets of the Banco de Mexico, on the net credit from the Banco de Mexico to the public sector, on the PSBR, on the operational deficit of the nonfinancial public sector will be lowered, and the target for the

---

1/ The reference volume of crude oil exports is defined to be 1.23 million barrels a day.

2/ For purposes of this adjustment, the mean price of oil in any calendar quarter is defined as the average price of Mexican exports of Maya, Isthmus, and Olmeca prices in that quarter, weighted by their respective shares in exports, as reported by PEMEX.

3/ For the March 31, 1990, June 30, 1990, and September 30, 1990 testing dates, the relevant threshold value will be limited to 25 percent, 50 percent, and 75 percent, respectively, of US$675 million.

primary surplus of the nonfinancial public sector will be raised, by the Mexican peso equivalent 1/ of the adjustment to the net international reserve target.

13. Lower-end adjustment. If in any calendar quarter beginning January 1, 1990, there is a cumulative effect of lower than projected oil prices (as defined in paragraph 11), the target for the Banco de Mexico's net international reserves for the same quarter will be adjusted downward by that value. In addition, the corresponding limits on the net domestic assets of the Banco de Mexico, on the net credit from the Banco de Mexico to the public sector, on the PSBR, and on the operational deficit of the nonfinancial public sector will be raised, and the target for the primary surplus of the nonfinancial public sector will be lowered, by the Mexican peso equivalent of the adjustment to the net international reserve target. For purposes of adjusting Banco de Mexico's net international reserve target and net domestic assets limit, the lower-end adjustment will be limited to US$675 million (or its Mexican peso equivalent) on an annual basis 2/. For purposes of adjusting the limit on the net credit from the Banco de Mexico to the public sector, on the PSBR, on the operational deficit of the nonfinancial public sector, and the target for the primary surplus of

---

1/ For purposes of the oil price adjustment, the Mexican peso equivalent will be calculated on the basis of the average exchange rate for the corresponding period.

2/ For the March 31, 1990, June 30, 1990, and September 30, 1990 testing dates, the relevant limit will be 25 percent, 50 percent, and 75 percent, respectively, or US$675 billion (or its Mexican peso equivalent).

.. ie nonfinancial public sector, the lower-end adjustment will be limited to the Mexican peso equivalent of US$900 million on an annual basis. 1/

V. Orher

14. Exchange rate developments will be kept under careful monitoring in accordance with the macroeconomic objectives of the program, on the basis of the principles contained in paragraph 20 of the letter dated January 15 1990. This issue will be examined with the Fund staff in the context of discussions under the arrangement

1/ For the March 31, 1990, June 30, 1990, and September 30, 1990 testing dates, the relevanc limit will be 25 percent, 50 percent, and 75 percent, respectively of th. Mexican peso equivalent of US$900 million

Formulario No. B'T F01

STB
cc JB

BANCO DE MEXICO
AV. 5 DE MAYO No. 2
MEXICO, D.F.
CODIGO POSTAL 06059

FOLIO

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GRUPO 2/3 5129990

1990 JAN 18 AM 8:44

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DOS HOJAS	95 (202) 623 4661, 4662.	17 ENERO DE 1990

PARA :

SR. CLAUDIO LOSER
INTERFUND
WASHINGTON, D.C.

DE :

LIC. JESUS CERVANTES
GERENTE DE INVESTIGACION
ECONOMICA INTERNACIONAL
BANCO DE MEXICO

RECEIVED
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1990 JAN 17 PM 5:02

INSTRUCCIONES ESPECIALES DEL SOLICITANTE

TE ENVIO CORRECCION A LA PAGINA 1 DE LA PETICION DEL GOBIERNO DE MEXICO, DE DESEMBOLSOS DE LOS "SET ASIDE"

PARA USO EXCLUSIVO DE LA OFICINA DE TELECOMUNICACIONES

OBSERVACIONES DE LA TRANSMISION	RESPONSABLE DE LA TRANSMISION

DEPENDENCIA SOLICITANTE

NOMBRE	TELEFONO/EXTENSION	FIRMA AUTORIZADA
LIC. JESUS A. CERVANTES GONZALEZ GERENCIA DE INVESTIGACION ECONOMICA INTERNACIONAL	518 31 12	J. Cervantes G.

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ESTADOS UNIDOS MEXICANOS

SECRETARIA
DE
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Mexico City, MEXICO
January 15, 1990

MR MICHEL CAMDESSUS
Managing Director
International Monetary Fund
Washington, D C 20431

Dear Mr Camdessus

In a separate letter we have stated the objectives, policies, and measures that we intend to pursue for the second year of Mexico's extended arrangement from the Fund In accordance with the terms of that arrangement and of the Decision by which it was approved, we are requesting in this letter the Fund's appropriate approval for the disbursement of the amounts set aside for collateralization of interest and principal in connection with our debt reduction operations accumulated in 1989 and the full amount scheduled to be available in 1990 We also are requesting approval of augmentation of the extended arrangement from the Fund in order to provide an additional amount for interest support in connection with our debt and debt-service reduction operations All amounts would be made available upon completion of the current review under the extended arrangement. The equivalent of these amounts will be used as part of the total of at least US$7 billion of collateral required for operations in connection with the commercial bank financing package recently completed on the basis of the previously agreed term sheet

1 <u>Amounts set aside</u> Mexico hereby represents that it has a need to purchase an amount equivalent to SDR 209 79 million set aside in 1989 and an amount equivalent to SDR 279 72 million scheduled to be set aside in 1990, because of impending payments for purchase of collateral under debt reduction transactions Amounts equivalent to the requested purchases will be used within 90 days of the date of completion of the current review of the extended arrangement, for the purchase of principal collateral associated with new discount bonds issued to commercial banks (at a 35 percent discount), and for the deposit with a collateral agent of funds to secure interest payment of these bonds

F

Office Memorandum

Mexico

TO: The Managing Director

DATE: January 17, 1990

FROM: S. T. Beza

SUBJECT: Mexico--Communication to Commercial Banks

Attached for your review and signature is a proposed communication to commercial banks to be attached to the documentation now being prepared for the 1989-92 Financial Package for Mexico. The communication presents information on the amounts already made available under the Extended Arrangement; the phasing for the remainder of the period of the arrangement; and the amounts of set asides and proposed augmentation of the arrangement for use in debt operations.

Messrs. Brau (ETR) and Liuksila (LEG) agree with the content of the communication.

Attachment

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

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SHEARMAN AND STERLING
NEW YORK, N.Y.
ATTN MR. MARK WALKER

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M D
DMD (o/r)
Mrs Filardo
ETR
LEG
WHD
Mr H Simpson

START TEXT HERE

TO THE INTERNATIONAL BANKING COMMUNITY

FROM M. CAMDESSUS, MANAGING DIRECTOR,
INTERNATIONAL MONETARY FUND

DATE JANUARY 17, 1990

1 I REFER TO MY COMMUNICATION DATED SEPTEMBER 15, 1989 TO THE INTERNATIONAL BANKING COMMUNITY

2. ON MAY 26, 1989, THE EXECUTIVE BOARD OF THE FUND APPROVED AN EXTENDED ARRANGEMENT FOR MEXICO PROVIDING FOR PURCHASES FROM THE FUND DURING THE PERIOD UNTIL MAY 25, 1992, OF UP TO SDR 2,797.2 MILLION, SUBJECT TO THE FOLLOWING

A. PURCHASES UNDER THE EXTENDED ARRANGEMENT SHALL NOT, WITHOUT THE CONSENT OF THE FUND, EXCEED SDR 233.1 MILLION UNTIL AUGUST 31, 1989, SDR 466 2 MILLION UNTIL NOVEMBER 30, 1989, SDR 699 3 MILLION UNTIL FEBRUARY 28, 1990, AND SDR 932 4 MILLION UNTIL MAY 31, 1990.

B. UNTIL MAY 25, 1991 PURCHASES UNDER THE

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EXTENDED ARRANGEMENT SHALL NOT, WITHOUT THE CONSENT OF THE FUND, EXCEED THE EQUIVALENT OF SDR 1,864.8 MILLION

C. THE RIGHT OF MEXICO TO MAKE PURCHASES DURING THE SECOND AND THIRD YEARS OF THE EXTENDED ARRANGEMENT SHALL BE SUBJECT TO SUCH PHASING AS SHALL BE DETERMINED

3 EXCLUDING THE AMOUNT EQUIVALENT TO 30 PERCENT OF EACH PURCHASE TO BE SET ASIDE FOR USE IN CONNECTION WITH DEBT REDUCTION OPERATIONS TO BE SPECIFIED BY THE FUND, THE RIGHT OF MEXICO TO MAKE PURCHASES IS SUBJECT TO THE FOLLOWING PHASING

DATE	CUMULATIVE AMOUNT
AUGUST 31, 1989	SDR 163.17 MILLION
NOVEMBER 30, 1989	SDR 326 34 MILLION
FEBRUARY 28, 1990	SDR 489 51 MILLION
MAY 31, 1990	SDR 652.68 MILLION
MAY 25, 1991	SDR 1,305.36 MILLION
MAY 25, 1992	SDR 1,958.04 MILLION

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4. IN ACCORDANCE WITH THE EXTENDED ARRANGEMENT, AS OF TODAY'S DATE, MEXICO HAS MADE PURCHASES FROM THE FUND IN AN AMOUNT EQUIVALENT TO SDR 489.51 MILLION, AND AN AMOUNT EQUIVALENT TO SDR 209 79 MILLION THAT MEXICO OTHERWISE COULD HAVE PURCHASED HAS BEEN SET ASIDE FOR USE IN CONNECTION WITH DEBT REDUCTION OPERATIONS TO BE SPECIFIED BY THE FUND.

5 I AM RECOMMENDING TO THE EXECUTIVE BOARD OF THE FUND A DECISION THAT, AMONG OTHER THINGS, THE PHASING OF CUMULATIVE PURCHASES BY MEXICO AFTER MAY 31, 1990 AND UNTIL MAY 25, 1991 (EXCLUSIVE OF AMOUNTS THAT MAY BE SET ASIDE FOR DEBT REDUCTION AS AFORESAID) BE AS FOLLOWS UP TO SDR 815 85 MILLION UNTIL AUGUST 31, 1990, SDR 979 02 MILLION UNTIL NOVEMBER 30, 1990 AND SDR 1,142 19 MILLION UNTIL FEBRUARY 28, 1991

6. AS SOON AS THE EXECUTIVE BOARD OF THE IMF DETERMINES THE PHASING OF PURCHASES TO BE MADE BY MEXICO AFTER MAY 25, 1991, THE FUND WILL SO ADVISE MEXICO.

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7. I SHOULD LIKE TO TAKE THIS OPPORTUNITY TO STATE THAT ALL FUTURE PURCHASES REFERRED TO ABOVE ARE CONDITIONAL, INTER ALIA, ON THE SATISFACTION BY MEXICO OF ECONOMIC AND FINANCIAL PERFORMANCE CLAUSES OF THE EXTENDED ARRANGEMENT FOR MEXICO.

REGARDS,

M. CAMDESSUS,
MANAGING DIRECTOR
INTERNATIONAL MONETARY FUND
INTERFUND

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Office Memorandum

January 16, 1990

MEMORANDUM FOR FILES

SUBJECT: Mexico: Oil Contingency

We received last week a copy of a letter from Bank of America and Citibank to the Mexican authorities stating that the banks intend to proceed with the US$500 million oil contingency loan once the financing package is signed (Attachment). The letter and accompanying documentation also contain a reference to a parallel facility from the Fund for an equivalent amount. This reference contradicts the message conveyed to the authorities in earlier telephone conversations in which Mr. Beza indicated to Mr. Gurria that the decision governing the CCFF currently does not allow for an ECM to be approved in mid-arrangement and that, even so, it would be difficult to have an oil-based ECM ready before the expected Board consideration of possible access to resources for collaterals. Futhermore, during the September Board meeting, management and several Directors had expressed serious reservations as to the advisability of introducing an ECM because of the Fund's high exposure to Mexico and the banks continued attempts to shift the financing burden toward the official sector. At that occasion, it was noted that any resources provided under the ECM should be considerably lower than those available from commercial banks.

In further contacts with representatives of Mexico, we were informed that our position was reported to both the Advisory Committee and the World Bank. The letter, which is needed to satisfy a condition of the World Bank's interest support loan, was thus written in awareness of our position. We have not received any indications that the authorities intend to proceed with an ECM request at this stage.

Claudio M. Loser

Claudio M. Loser
Senior Advisor
Western Hemisphere Department

Attachment

cc: Mr. Beza
Mr. Brau
Mr. Bonvicini

Mexico

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

Mexico City, January 15, 1990.

Mr. Michel Camdessus,
Manager Director,
International Monetary Fund,
Washington, D. C.

As you are aware, Mexico is about to finalize its financing package with its commercial banks creditors as a result of which this country will receive a substantial amount of debt relief. As I understand the Fund has scheduled the consideration of Mexico's program for 1990 and the Mexican request of the release of the set aside and approval for an augmentation of resources available under the arrangement, for the 7th. of February.

As you recall these resources will be used to purchase zero coupon bonds from the US Treasury to guarantee the re-payment of the principal of the debt to commercial banks and some 18 months of interest. Since the cost of the enhancement to be provided by Mexico rises by $11 million dollars with every basis point that interest rates decline, (i.e. by $550 million for half a percentage point) and the current perception is that interest rates are likely to fall in the coming weeks, we would like to ask for your assistance in order to bring forward the consideration of Mexico's request by the Executive Board to a date in late January, say the 29th.

By that date the legal documentation of the package will have been completed and sent to the banks.

We shall greatly appreciate your support in this matter which may will may signify a very considerable saving for us.

Sincerely yours,

Pedro

PEDRO ASPE.
Secretary of Finance and
Public Credit of Mexico.

T.I.E.V.-MEX.

G.H.1

SECRETARIA
DE
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Mexico City, MEXICO
January 15 , 1990.

MR. MICHEL CAMDESSUS
Managing Director
International Monetary Fund
Washington, D. C. 20431

Dear Mr. Camdessus:

In a separate letter we have stated the objectives, policies, and measures that we intend to pursue for the second year of Mexico's extended arrangement from the Fund. In accordance with the terms of that arrangement and of the Decision by which it was approved, we are requesting in this letter the Fund's appropriate approval for the disbursement of the amounts set aside for collateralization of interest and principal in connection with our debt reduction operations accumulated in 1989 and the full amount scheduled to be available in 1990. We also are requesting approval of augmentation of the extended arrangement from the Fund in order to provide an additional amount for interest support in connection with our debt and debt-service reduction operations. All amounts would be made available upon completion of the current review under the extended arrangement. The equivalent of these amounts will be used as part of the total of at least US$7 billion of collateral required for operations in connection with the commercial bank financing package recently completed on the basis of the previously agreed term sheet.

1. Amounts set aside. Mexico hereby represents that it has a need to purchase an amount equivalent to SDR 209.79 million set aside in 1989 and an amount equivalent to SDR 279.22 million scheduled to be set aside in 1990, because of impending payments for purchase of collateral under debt reduction transactions. Amounts equivalent to the requested purchases will be used within 90 days of the date of completion of the current review of the extended arrangement, for the purchase of principal collateral associated with new discount bonds issued to commercial banks (at a 35 percent discount), and for the deposit with a collateral agent of funds to secure interest payment of these bonds.

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2. Additional amounts. Mexico hereby requests augmentation of its extended arrangement from the Fund by the equivalent of SDR 466.20 million in accordance with the Decision in which the Fund expressed its preparedness at the time the extended arrangement was approved to consider such augmentation. Mexico also represents that it has a need to purchase the full amount by which the amount of the extended arrangement would be augmented. An amount equivalent to this purchase will be used within 90 days of the date of the completion of the current review of the extended arrangement for interest support in connection with Mexico's debt and debt-service reduction operations. For this purpose, amounts equivalent to the requested purchase will be deposited as collateral for interest payments on par bonds carrying interest at a fixed interest rate (which, for those denominated in U.S. dollars, will be 6.25 percent a year) and on the discount bonds referred in paragraph 1 above.

Yours Truly,

p.o.

Pedro Aspe Armella
Secretary of Finance and
Public Credit of Mexico

Miguel Mancera Aguayo
Director General
Banco de Mexico

G.H.1

ESTADOS UNIDOS MEXICANOS

SECRETARIA
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Mexico City, Mexico
January 15, 1990.

MR. MICHEL CAMDESSUS
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Mr. Camdessus:

1. At the time of its inauguration, the Government of Mexico announced a medium-term economic strategy for sustained economic growth and price stability covering the period 1989-94, supported by a three-year extended arrangement from the Fund. As stated in our letter of April 11, 1989, the economic strategy for the medium-term encompasses demand management measures, efforts to increase domestic savings both in the public and private sectors, and structural policies necessary to foster economic efficiency. The economic program was developed on the basis of a significant reduction in the net external resource transfer abroad, a decrease in the debt service burden, and the availability of new external resources within a multiyear horizon. In the following paragraphs we describe the progress made to date in the implementation of the medium-term strategy, as well as the policy guidelines for the year 1990.

2. Performance in 1989 was satisfactory. Economic activity recovered markedly, with industrial production up by about 6 percent and real GDP up by some 3 percent. The momentum of private sector activity, in the context of a liberalized trade system, was also reflected in an increase in imports, the bulk of which constituted intermediate and capital goods, as well as temporary imports which in time will be reflected in exports, financed mainly by greater private capital inflows. Hence, despite a large external current account deficit, the net international reserve position was stronger than anticipated, after taking account

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of substantially lower commercial bank financing. The inflation rate, measured by consumer prices, declined from 52 percent during 1988 to less than 20 percent during 1989; when measured by producer prices, it declined from 37 percent to 15 percent.

3. Underlying these results was a significant strengthening of the public sector finances. The primary surplus of the nonfinancial public sector increased from almost 6 percent of GDP in 1988 to about 8 percent of GDP in 1989. This outcome was due to high yields from the income tax reform and a curtailment of noninterest expenditures, as well as more favorable oil prices. Domestic interest rates declined sharply in late July from about 4 1/2 percent a month and remained at somewhat over 3 percent in subsequent months following the announcement of the signing of the financing package for 1989-92 with Mexico's commercial bank creditors. On average, interest rates were higher than projected for the year as a whole, but their effect on the fiscal balance was more than offset by the strong primary outcome. As a result, the public sector borrowing requirement declined from about 13 percent of GDP in 1988 to about 6 percent of GDP in 1989 and the operational deficit dropped from 4 1/2 percent of GDP to less than 2 percent of GDP.

4. The public sector received very limited financing from abroad in 1989 and the financial fiscal deficit was covered primarily through the issuance of government securities placed with the public, facilitated by a strong rise in private sector financial savings, which grew at an annual rate of over 20 percent in real terms. This reflected to a large extent the effect of financial liberalization and the improvement in confidence by the public, and permitted commercial bank credit to the private sector to rise markedly, without putting pressures on reserves.

5. The Government of Mexico continued to implement significant structural reform policies in 1989--an effort which it intends to reinforce over the medium term. The measures, which have already resulted in increased productivity, included a major overhaul of the tax system, regulatory changes to encourage increased foreign direct investment, and transfer of technology, an intensified process of public enterprise reform and divestiture, the

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intensification of the trade liberalization effort, and reforms to raise the efficiency of the financial system, free interest rates, and encourage financial intermediation. Furthermore, major efforts have been made to deregulate domestic economic activity, particularly in the areas of transportation, communication, petrochemicals and fisheries. Furthermore, the Mexican Government has iniciated a program of liberalization of automotive industry and promotion of in-bond industry.

6. Adequate external financing and a reduction of the net resource transfer are indispensable for the success of the economic program. In this regard, the Government's domestic adjustment efforts have been supported, in addition to Fund resources, by a rescheduling of official debt service obligations to Paris Club creditors, World Bank assistance in the form of sectoral and project loans, and financing facilities from several official creditors.

7. An additional important element in Mexico's financing program is the package with commercial banks. Last July the Government of Mexico reached agreement in principle with the commercial banks' steering committee on a term sheet incorporating a new money option and two debt and debt-service reduction options. Banks have responded favorably to the agreement and signing of the package is scheduled for the first week of february. The package will result in debt reduction of some US$7 billion, with an additional US$22.5 billion benefiting from a low fixed contractual interest rate. Gross interest relief arising from these operations could amount to some US$2.2 billion in 1990, and US$1.5 billion a year subsequently, and new money disbursements would total some US$1.5 billion in the period 1990-92. Thus, after taking account of the restructuring of amortization obligations, the financial package would provide an average annual assistance of some US$3.8 billion for the period through 1994, net of the cost of enhancements.. To finance collaterals for these operations, Mexico expects to draw resources from the Fund, the World Bank, as well as use its own resources, including those freed on account of the funding provided by the Japan Export-Import Bank; these resources are estimated to total some US$7 billion.

8. The choices made by commercial banks within the package will result in a larger than foreseen reduction

in debt service obligations over the medium-term. However the Government considers that it is crucial to sustain its adjustment efforts in order to achieve the objectives of the multiyear program. The objetives and the key aspects, of the general economic strategy of the Government of Mexico are reflected in the National Development Plan for 1989-94, which has been designed to help provide an adequate framework of action for the Government and the Mexican society in general, and which in turn will help achieve an improvement in the quality of life of all Mexicans. In order to attain the required economic recovery, the Government of Mexico will base its policies on the continued stabilization of the economy, increased availability of resources for investment, and a process of economic modernization. These objectives are to be achieved through a consistent and strict management of fiscal, monetary, and exchange rate policies, together with the needed structural reforms in the financial and tax systems, in the context of agreements reached within the Pact for Economic Solidarity (PECE)

9. Within the framework of its medium-term program, the Government is seeking to raise the rate of growth of real GDP to 6 percent a year by 1994. The rate of inflation would gradually come down to that of its trading partners. National savings would increase by 7 percentage points of GDP from 1989 to 1994, with private savings accounting for 3 percentage points and public sector savings for 4 percentage points. Gross domestic investment would increase by some 4 percentage points of GDP, equally accounted for by the public and private sectors.

10. In the context of the general strategy described above, the economic policy for 1990 will be based on four general principles: the consolidation of the progress made so far in stabilizing prices; the increase in the availability of resources for investment; the gradual recovery of sustained economic growth; and the improvement of the general well-being of the Mexican people, particularly for the poorer segments of the population. Because of existing trends and the need to improve the structure of costs and prices, the reduction of inflation will be gradual. Thus, within the context of firm macroeconomic policies, the rate of inflation is expected to decline to 15 percent in 1990. Real GDP would increase by some 3.5 percent in 1990, in line with a sustained improvement in economic performance.

11. The macroeconomic targets would be consistent with an increase in national savings of some 2 percentage points of GDP, mainly reflecting the performance of the public sector and the impact of the debt relief obtained by Mexico. Domestic investment would increase by 1 percentage point of GDP after the strong performance shown in 1989. The external current account deficit would decline by some 1 percentage point of GDP, even as the net resource transfer is reduced. If the use of reserves needed to cover the costs of enhancements for debt reduction operations were excluded net international reserves would rise reflecting the strengthening of the Mexican economy.

12. In December 1989, the Mexican Government and the various sectors of society agreed to extend the PECE through July 1990. Within this framework, the peso continues to be depreciated daily according to a preannounced schedule, of Mex$1 per U.S. dollar a day, minimum wages were increased by 10 percent, and public sector prices and tariffs have been adjusted--most recently by an average 5 percent. The extension of the PECE provides the needed framework in which the public sector policy stance will result in a continued decline in the rate of inflation.

13. In 1990, the Mexican Government will be seeking a further strenthening of the public finances while improving the availability of resources for capital and high priority current expenditures. On the basis of a petroleum price of US$15 a barrel, the primary fiscal balance would register a surplus amounting to some 7 percent of GDP (6.5 percent in the budget approved by Congress on the basis of a price of US$13 a barrel). The fiscal effort as reflected in primary surplus would be consistent with a reduction in the PSBR and the operational deficit by about 1.0 percentage point of GDP to 5.1 percent and 1.0 percent of GDP, respectively, excluding the capital gains from debt reduction operations. The improvement in the public finances would be achieved in circumstances in which interest payments of the public sector are expected to decline by more than 3.0 percentage points of GDP because of the interest relief from the financing package with the commercial banks as well as the favorable effects on interest rates of lower inflation and greater private sector confidence.

14. The budget for 1990 contains a series of measures to improve further the efficiency of the tax system and to

strengthen tax administration. The marginal tax rates on corporate and personal income were reduced to bring them in line with those prevailing abroad while the tax base will be broadened significantly by eliminating the special tax treatment accorded to certain sectors of the economy. Tax administration will be strengthened by simplifying payment procedures and strengthening incentives for tax collection. These measures are expected to yield an additional increase in tax revenue equivalent to some 1/2 percentage point of GDP. However, total public revenues are expected to decline by 0.9 percent of GDP as some nonrecurrent revenues and oil export volumes decline.

15. Consistent with its general formulation of policy, the Government of Mexico has made significant adjustments to public sector prices and tariffs helping correct relative prices and strengthening the public finances. The Government of Mexico will continue to monitor developments in this area, and will take actions as needed in light of the objectives of the program in the context of the PECE.

16. Total expenditures, excluding interest payments, are budgeted to rise by some 1/2 percentage point of GDP in 1990, following several years of decline. The increase will be allocated in part to public sector investment in economic infrastructure such as transportation, energy, and communication. In addition, the authorities intend to increase outlays on high priority social sectors such as education, health and the environment and to improve the working conditions of the civil service so as to enhance productivity.

17. The Mexican authorities will continue to implement vigorously its policy of reform and divestiture of the public enterprises. In 1989, the number of enterprises in the public sector has declined to 390. Several large enterprises were privatized, including AeroMexico and Mexicana--the two major domestic airlines--and DINA--a truck manufacturing company. For 1990, the Mexican Government has announced its intention to initiate the process of privatization of TELMEX, the telecommunications company, and to streamline and reduce the scope of the operations of CONASUPO. The privatization program will enable the Government to concentrate its resources in areas of high priority.

18. Monetary policy will continue to help consolidate the recent gains in reducing inflation, while supporting the macroeconomic objectives of the program, including the attainment of a sustainable balance of payments. In order to achieve the monetary targets, the Government will continue to rely mainly on open market operations, helping increase the efficiency of the financial intermediation process and enhance the prospects for sustained growth in financial savings. Furthermore, the deepening of financial markets can be expected to take place as confidence is strengthened, reflecting the completion of the external financing package and continued progress in attaining the objectives of the Mexican economic strategy, which should foster a decline in real interest rates.

19. The structural reform of the financial system constitutes a major factor in helping strengthen the savings performance of the economy and in improving the allocation of loanable funds for investment. Following a major liberalization of the banking system, financial instruments have been made more flexible and reserve requirements have been eliminated and only a liquidity ratio is required. Additional actions will be taken during the year in order to enhance the efficiency and profitability of commercial banks by increasing their autonomy while strengthening the supervisory role of the National Banking Commission. In addition Congress has recently approved several reforms to financial legislation which will promote the deepening of financial markets and the lengthening of maturities of financial instruments. Outstanding among these are the reforms related to the operations of insurance, bonding, and leasing companies and other credit related institutions. Actions are also being taken to permit greater participation of foreign investors in Mexican enterprises, while enhancing the role of the stock market in allocating savings. The operations of development banks will be streamlined to help improve resource allocation and further rationalize existing subsidies.

20. The maintenance of the country's competitive position vis-a-vis its major trading partners is a key element of Mexico's economic strategy. To this end, and as announced in the revision of the PECE for the period through July 31, 1990, the value of the peso will be adjusted daily by Mex$1 against the U.S. dollar--equivalent to a monthly

depreciation of more than one percent. As a general principle, the exchange rate policy will continue to be one of small daily adjustments, consistent with the macroeconomic objectives of the program and taking into account developments in key components of the balance of payments (including non-crude oil exports, imports, transfers from abroad, travel related operations, and the behavior of international reserves), as well as forward-looking indicators such as the real effective exchange rate. The authorities intend to maintain the policy of permitting free access to the foreign exchange markets and expect that the differential between the exchange rates in the official and free exchange markets will remain low.

21. The policies described above, along with anticipated financial assistance from abroad--including in the form of the already agreed rescheduling of official credits under the auspicies of the Paris Club and the financing package with commercial banks--are expected to lead to a strengthening of Mexico's underlying balance of payments position. In 1990 US$1.3 billion of gross international reserves will be used for debt reduction operations. An additional US$1.2 billion will be provided by the Fund for those operations. The program provides for a strengthening in the gross international reserve position, as well as the purchasing of debt enhancements which may be viewed as effectively constituting prepayments of an important portion of Mexico's external debt and debt service obligations.

22. In order to attain the overall balance of payments objective, the current account position is programmed to improve by some US$0.4 billion, before taking account of interest relief of US$2.2 billion provided by the debt reduction exercises, and despite a projected drop in exports of crude oil. This improvement is to be achieved in the context of a further enhancement in the efficiency of the trade system which has already been subject to substantial liberalization. The external debt position is projected to strengthen substantially, reflecting both the reduction of claims and contractual interest rates under the financing package with commercial banks, the reduced level of private sector external debt, and the reduced pace of new debt creation.

G.H.1

ESTADOS UNIDOS MEXICANOS

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DE
HACIENDA Y CREDITO PUBLICO

23. The Mexican authorities believe that the policies and measures for 1990 described in this letter and the results of Mexico's financing package with its commercial bank creditors are adequate to achieve the objectives of the economic strategy, but will take additional measures that may become appropriate for this purpose. On this basis, the Government of Mexico seeks continued Fund support in the form of approval of the second year of the extended arrangement. The authorities of Mexico and the Fund will consult periodically, in accordance with the policies on such consultations, as specified in our letter of April 11, 1989. A review with the Fund of the implementation of the economic program for 1990 will be completed before August 31, 1990, and the review for reaching policy understandings for 1991 will be completed before February 28, 1991.

Yours truly,

p.o.

PEDRO ASPE ARMELLA
Secretary of Finance and
Public Credit of Mexico

MIGUEL MANCERA AGUAYO
Director General
Banco de Mexico

Technical Memorandum of Understanding 1990

1. In accordance with the economic strategy described in the letters dated April 11, 1989, and January 15, 1990, the following performance criteria have been established for 1990. Establishment of performance criteria for 1991 and their phasing will be determined on the occasion of the reviews described in paragraph 28 of the letter dated April 11, 1989, and paragraph 23 of the letter dated January 15, 1990.

2. Adjustments to performance criteria will be made as described below in the event of deviations from the projected evolution of the price of oil. To the extent that the structure and timing of the financial package with commercial banks differ from those assumed in the formulation of the performance criteria contained in this memorandum, the performance criteria for March 1990 also will be adjusted for changes in the external financial flows associated with the bank package, including those flows related to the purchase of debt enhancements.

I. Foreign Financing

3. The public sector's net use of foreign credit (excluding foreign trade lending operations by the Banco de Comercio Exterior) is estimated at US$1,294 billion in 1989. The public sector's net use of foreign credit will not exceed US$6,580 million for the period January-March 1990, US$7,040 million for the period January-June 1990, and US$7,190 million for the period January-September 1990. An

indicative ceiling of US$7,370 million has been established for the period January-December 1990; the ceiling for end-1990 will be specified at the time of the forthcoming review of the arrangement. Notwithstanding the use of foreign credit specified above, the stock of public sector debt is not expected to increase because of the favorable effect of debt-reduction operations. Within the ceilings on use of foreign credit, the authorities intend to limit the net use of foreign credit with maturities of less than one year to US$450 million for the period January-December 1990.

II. Public Finance

4. The overall public sector borrowing requirement, "PSBR" (i.e., the economic deficit of the nonfinancial public sector on a cash basis plus the financial intermediation conducted by the national development banks and official trust funds, excluding FICORCA), is estimated at Mex$30,500 billion in 1989. The PSBR will not exceed Mex$6,500 billion in the period January-March 1990, Mex$14,200 billion in the period January-June 1989, Mex$21,350 billion in the period January-September 1990, and Mex$31,050 billion in the period January-December 1990. These limits will be adjusted in accordance with the provisions described in paragraphs 11 through 13.

5. The operational deficit of the nonfinancial public sector is estimated at Mex$8,900 billion in 1989. The operational balance will register a surplus of no less than Mex$1,000 billion in the period January-March 1990. It will register a deficit of no more than Mex$1,490 billion in the period January-June 1990, Mex$2,850 billion in the period

January-September 1990, and Mex$6,150 billion in the period January-December 1990. These limits will be adjusted in accordance with the provisions described in paragraphs 11 through 13.

6. The primary surplus of the nonfinancial public sector is estimated at Mex$41,000 billion in 1989. The primary balance will register a surplus of at least Mex$12,550 billion in the period January-March 1990, Mex$23,050 billion in the period January-June 1990, Mex$33,500 billion in the period January-September 1990, and Mex$41,900 billion in the period January-December 1990. These targets will be adjusted in accordance with the provisions described in paragraphs 11 through 13.

7. Should macroeconomic objectives of the program (defined for this purpose as: (a) the inflation rate as measured by the CPI, and (b) the external current account net of crude oil exports) not be achieved in spite of the observance of the fiscal targets stated above, the Mexican authorities, in consultation with the Fund staff, will strengthen their fiscal stance with additional policy measures. These policy measures, which will be of a permanent nature, will aim at increasing the fiscal primary surplus to a level that would assure achievement of the macroeconomic objectives of the program.

III. Banco de Mexico Operations

8. The net international reserves of the Banco de Mexico are estimated at US$1,090 million on December 31, 1989. The net international reserves of the monetary authorities will not decline by more than US$1,130 million in the period January-March 1990, by more

than US$1,090 million in the period January-June 1990, by more than US$920 million in the period January-September 1990, and by more than US$650 million in the period January-December 1990. These targets will be adjusted in accordance with the provisions of paragraphs 11 through 13.

9. The net domestic assets of the Banco de Mexico are estimated at Mex$13,980 billion on December 31, 1989. The net domestic assets of the Banco de Mexico will increase by no more than Mex$2,730 billion in the period January-March 1990, by no more than Mex$3,110 billion in the period January-June 1990, by no more than Mex$2,920 billion in the period January-September 1990, and by no more than Mex$5,540 billion in the period January-December 1990. These limits will be adjusted in accordance with the provisions of paragraphs 11 through 13.

10. The Banco de Mexico's net claims on the public sector are estimated at Mex$31,880 billion on December 31, 1989. The Banco de Mexico's net claims on the public sector will not exceed Mex$32,370 billion during the period January-March 1990, Mex$33,040 billion during the period January-June 1990, Mex$33,510 billion during the period January-September 1990, and Mex$34,250 billion during the period January-December 1990. These limits will be adjusted in accordance with the provisions of paragraphs 11 through 13.

IV. Oil Price Adjustments

11. Performance criteria will be adjusted for deviations in the price of oil, as specified below. The adjustment, based on the cumulative effect of the movements in this variable, will be made on all

performance criteria with the exception of the public sector's net use of foreign credit, which will not be subject to this adjustment. The oil price adjustment to quantitative performance criteria in any calendar quarter beginning January 1, 1990 will be calculated as the value that results from multiplying the reference volume of crude oil exports 1/ by the difference between the mean price of Mexican oil exports in the respective quarter 2/ and US$15 a barrel.

12. Upper-end adjustment. If in any calendar quarter beginning January 1, 1990 the cumulative effect of higher than projected oil prices (as defined in paragraph 11), exceeds a threshold value of US$675 million on an annual basis 3/ the target for the Banco de Mexico's net international reserves for the same quarter will be adjusted upward by the value of the excess over the threshold for that quarter. In addition, the corresponding limits on the net domestic assets of the Banco de Mexico, on the net credit from the Banco de Mexico to the public sector, on the PSBR, on the operational deficit of the nonfinancial public sector will be lowered, and the target for the

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1/ The reference volume of crude oil exports is defined to be 1.23 million barrels a day.

2/ For purposes of this adjustment, the mean price of oil in any calendar quarter is defined as the average price of Mexican exports of Maya, Isthmus, and Olmeca crudes in that quarter, weighted by their respective shares in exports, as reported by PEMEX.

3/ For the March 31, 1990, June 30, 1990, and September 30, 1990 testing dates, the relevant threshold value will be limited to 25 percent, 50 percent, and 75 percent, respectively, of US$675 million.

primary surplus of the nonfinancial public sector will be raised, by the Mexican peso equivalent 1/ of the adjustment to the net international reserve target.

13. Lower-end adjustment. If in any calendar quarter beginning January 1, 1990, there is a cumulative effect of lower than projected oil prices (as defined in paragraph 11), the target for the Banco de Mexico's net international reserves for the same quarter will be adjusted downward by that value. In addition, the corresponding limits on the net domestic assets of the Banco de Mexico, on the net credit from the Banco de Mexico to the public sector, on the PSBR, and on the operational deficit of the nonfinancial public sector will be raised, and the target for the primary surplus of the nonfinancial public sector will be lowered, by the Mexican peso equivalent of the adjustment to the net international reserve target. For purposes of adjusting Banco de Mexico's net international reserve target and net domestic assets limit, the lower-end adjustment will be limited to US$675 million (or its Mexican peso equivalent) on an annual basis 2/. For purposes of adjusting the limit on the net credit from the Banco de Mexico to the public sector, on the PSBR, on the operational deficit of the nonfinancial public sector, and the target for the primary surplus of

1/ For purposes of the oil price adjustment, the Mexican peso equivalent will be calculated on the basis of the average exchange rate for the corresponding period.

2/ For the March 31, 1990, June 30, 1990, and September 30, 1990 testing dates, the relevant limit will be 25 percent, 50 percent, and 75 percent, respectively, of US$675 billion (or its Mexican peso equivalent).

the nonfinancial public sector, the lower-end adjustment will be limited to the Mexican peso equivalent of US$900 million on an annual basis. 1/

V. Other

14. Exchange rate developments will be kept under careful monitoring in accordance with the macroeconomic objectives of the program, on the basis of the principles contained in paragraph 20 of the letter dated January 15, 1990. This issue will be examined with the Fund staff in the context of discussions under the arrangement.

1/ For the March 31, 1990, June 30, 1990, and September 30, 1990 testing dates, the relevant limit will be 25 percent, 50 percent, and 75 percent, respectively, of the Mexican peso equivalent of US$900 million.

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Office Memorandum

TO: The Managing Director OK
The Deputy Managing Director

DATE: January 12, 1990

FROM: S. T. Beza

SUBJECT: Mexico--Letter in Support of Bank Bridge Financing

The Japanese banks participating in bridge financing of the enhancements for debt reduction operations have requested that the Mexican authorities obtain a letter from the management of the Fund supporting the bridge financing and the economic program for 1990. The attached letter is designed to meet this request.

Mr. Brau (ETR) and Mr. Liuksila (LEG) agree with the content of the letter.

Attachment

cc: Mr. Brau
Mr. Liuksila
Mr. H. Simpson

F

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Attachment

cc Mr Brau
Mr. Liuksila
Mr H. Simpson

INTERNATIONAL MONETARY FUND
WASHINGTON, D C 20431

MANAGING DIRECTOR

CABLE ADDRESS
INTERFUND

Dear Sirs

I refer to the bridge facility for up to US$1 2 billion to provide letter of credit support for payment of interest under the discount and par bonds to be issued by Mexico under its 1989-92 financing package. We appreciate that a selected group of commercial banks has organized this facility to enable Mexico to make available the amount of collateral to be provided by Mexico under the package

In this connection, I would like to state that Mexico has made all purchases available to date under the extended arrangement from the Fund, for the equivalent of SDR 489.5 million. In addition, I am prepared to recommend that the Executive Board of the Fund, based on your Government's policies and objectives for 1990 as outlined in your letter of January 15, reach understandings on economic and financial policies for 1990 under the extended arrangement supporting México's medium-term economic program through 1992, which was approved by the Executive Board of the Fund on May 26, 1989.

Yours sincerely,

Michel Camdessus

Mr Pedro Aspe Armella
Secretary of Finance and
Public Credit of Mexico

Mr Miguel Mancera Aguayo
Director General
Bank of Mexico

Office Memorandum

OK

TO: The Managing Director DATE: January 12, 1990

FROM: S. T. Beza

SUBJECT: Mexico - Review and Program for Second Year Under the Extended Arrangement

Attached is the staff report for the review and program for the second year under the extended arrangement for Mexico.

In addition to the report you will find attached a letter of intent that incorporates some changes proposed by the Mexican authorities after you had approved the letter. We had expected some modifications to the letter by the Mexican authorities, but they took somewhat longer than we had thought. The changes, which aim at reducing political risks when the letter is published in Mexico, are not of a substantive nature. A reference to the programmed loss of foreign reserves in 1990, because of the use of enhancements, is being dropped from the letter but remains in the technical memorandum of understanding.

A supplement to the staff report incorporating a description of the final version of the financing package with commercial banks and its implications for the program targets will be issued before the Board meeting. The supplement will incorporate a proposed decision and would deal with the deviations in the net international reserves and net domestic assets of the Bank of Mexico that occurred in late 1989 as well as the policy implications of these deviations. We are expecting to receive material from Mexico in the coming days on the deviations and the policy actions the authorities are taking to cope with this problem.

The staff report has been reviewed by the following departments:

Exchange and Trade Relations	Mr. Brau
Fiscal Affairs	Messrs. Mahler and Ouanes
Legal	Mr. Surr
Research	Mr. Aghevli
Treasurer's	Mr. Coats
Western Hemisphere	Messrs. Ferrán, Quirk, and myself

A summary of the staff report is attached.

OK

Tell me soon your analysis of the deviation, and of the appropriateness of the policy response. Thank you

Attachments

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

Tell me soon your analysis of the deviation and of the appropriateness of the policy response.

Thank you.

MEXICO

Extended Arrangement - Review and Program for Second Year

Summary

1 Recent developments

Real GDP rose by an estimated 2 1/2 percent in 1989 and the 12-month increase in consumer prices declined from 52 percent in December 1988 to 20 percent in December 1989 Notwithstanding favorable developments in oil prices and interest rates, the external current account deficit was higher than projected because of rapid rise in imports, financed by higher than projected net private capital inflows A strong fiscal performance at the level of the primary balance and the decline in nominal interest rates after July were important factors behind the reduction in the PSBR from almost 13 percent of GDP in 1988 to about 6 percent in 1989, the operational deficit declined from 4 1/2 percent of GDP in 1988 to 2 percent in 1989 All quantitative performance criteria under the arrangement through September 30, 1989 were met Preliminary indications are that most performance criteria for end-1989 were observed, but it appears that there may have been deviations from the target for net international reserves and the limit on the net domestic assets of the Bank of Mexico. Further information concerning performance under the program and on measures to deal with the aforementioned deviations will be presented in a supplement to this paper

2 The program for 1990

The key objectives of the 1990 program are the consolidation of the process of reducing inflation, increasing the availability of resources for investment, and achieving a sustained recovery of economic growth in the context of a viable balance of payments The PSBR and the operational fiscal deficit are projected to decline by about one percentage point of GDP in 1990 Interest rates are expected to decline further in 1990, and on this basis the primary surplus would be permitted to decline somewhat, reflecting increased investment and priority current expenditure Policies are being directed to a decline in annual inflation to 15 percent and to a reduction in the external current account deficit in 1990. Real GDP is projected to rise by 3 1/2 percent this year

The negotiations with commercial banks on a financing package, which includes debt and debt-service reduction operations, are virtually complete, and Mexico is requesting Board approval for augmentation of resources under the arrangement (by 40 percent of quota), release of accumulated set-asides, and accelerated disbursement of the set-asides scheduled to become available during 1990

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Office Memorandum

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FROM	S. T. Beza		
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Attachments

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

MEXICO

Extended Arrangement - Review and Program for Second Year

Summary

1. Recent developments

Real GDP rose by an estimated 2 1/2 percent in 1989 and the 12-month increase in consumer prices declined from 52 percent in December 1988 to 20 percent in December 1989. Notwithstanding favorable developments in oil prices and interest rates, the external current account deficit was higher than projected because of rapid rise in imports, financed by higher than projected net private capital inflows. A strong fiscal performance at the level of the primary balance and the decline in nominal interest rates after July were important factors behind the reduction in the PSBR from almost 13 percent of GDP in 1988 to about 6 percent in 1989, the operational deficit declined from 4 1/2 percent of GDP in 1988 to 2 percent in 1989. All quantitative performance criteria under the arrangement through September 30, 1989 were met. Preliminary indications are that most performance criteria for end-1989 were observed, but it appears that there may have been deviations from the target for net international reserves and the limit on the net domestic assets of the Bank of Mexico. Further information concerning performance under the program and on measures to deal with the aforementioned deviations will be presented in a supplement to this paper.

2. The program for 1990

The key objectives of the 1990 program are the consolidation of the process of reducing inflation, increasing the availability of resources for investment, and achieving a sustained recovery of economic growth in the context of a viable balance of payments. The PSBR and the operational fiscal deficit are projected to decline by about one percentage point of GDP in 1990. Interest rates are expected to decline further in 1990, and on this basis the primary surplus would be permitted to decline somewhat, reflecting increased investment and priority current expenditure. Policies are being directed to a decline in annual inflation to 15 percent and to a reduction in the external current account deficit in 1990. Real GDP is projected to rise by 3 1/2 percent this year.

The negotiations with commercial banks on a financing package, which includes debt and debt-service reduction operations, are virtually complete, and Mexico is requesting Board approval for augmentation of resources under the arrangement (by 40 percent of quota), release of accumulated set-asides, and accelerated disbursement of the set-asides scheduled to become available during 1990.

INTERNATIONAL MONETARY FUND

STB
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January 10, 1990

Mexico

Mr. Camdessus:

Attached is the material Dr. Mulford promised.

Thomas C. Dawson II

FACT SHEET ON MEXICAN ZERO-COUPON BONDS

- The pricing of the U.S. Treasury issue of zero-coupon bonds to Mexico is based on sound market principles. The price will be determined by the average of the prevailing market rates on U.S. Treasury 30-year securities for the three day period ending January 5, 1990 less one-eighth of one percent. This works out to 7.925 percent.

- Treasury based its decision on the actual 30-year borrowing costs of the U.S. Treasury, the same approach of pricing off the market yields of U.S. Treasury coupon securities used in the 1988 zero coupon transaction between Mexico and the U.S. Treasury.

- Treasury charged the same fee as State and local governments and REFCORP were charged.

- The pricing does not subsidize the Mexican agreement. In fact, it does not eliminate the shortfall in resources available to back this agreement. We understand that this shortfall is approximately $300 million and will have to be addressed by Mexico and the banks.

TALKING POINTS ON PRICING MEXICAN ZEROS

- The pricing decision was based on sound market principles and not with the aim of closing the shortfall in resources to back the Mexican commercial bank agreement.

  -- We understand that a shortfall of about $300 million existed before we made our pricing decision and continues to exist now. It is up to the Mexicans and the commercial banks to fill this shortfall.

- The decision to use Treasury's actual borrowing costs is consistent with the precedent established by the U.S Treasury in its 1988 zero-coupon agreement with Mexico

  -- It is priced off of the 3-day average of 30-year Treasury securities.

- The U.S. taxpayer is in no way subsidizing the Mexican agreement.

- We charged a fee for providing the zeros identical to that charged state and local municipalities and for other special Treasury issues.

JTB
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Office Memorandum

CONFIDENTIAL

January 8, 1990

MEMORANDUM FOR FILES

SUBJECT: Mexico Commercial Bank Financing Package

As reported in today's Wall Street Journal and confirmed informally with the US Treasury, there are indications that Mexico will be able to purchase 30-year zero coupon US Treasury bonds with yields equivalent to those on ordinary 30-year bonds. This would reduce by some US$250 million the immediate cost for Mexico of collaterals under the commercial bank package. Accordingly, total requirements for enhancements would amount to around US$7 3 billion, given the current configuration of bank choices among the three options in the package

In their meeting with the banks' Advisory Committee last week, the Mexican authorities proposed two schemes to reduce further the immediate resource requirement The proposals, which are presented in the attachment, may be summarized as follows

1. Reducing the Cash Value of the Interest Collateralization Account

The Mexican authorities are proposing that the interest collateralization account (to guarantee 18 months of interest payments on the post-exchange bonds) be constituted on the basis of the present value of guaranteed interest obligations rather than the cash value If accepted by the banks, this would save Mexico about US$0 3 billion upfront. The saving would be offset during the year as the interest earned on the collateral account effectively accrues to the account rather than be disbursed to Mexico.

To render the proposal attractive to banks, Mexico is also proposing effectively to extend the coverage of the interest collateralization account This would be achieved by earmarking exclusively funding from the retroactive interest rate adjustment to interest payments due on the post-exchange bonds This, as well as the earlier element of the proposal, would alter the time profile of net relief from commercial banks, thereby affecting the quarterly distribution of the balance of payments in 1990 Quantification of these changes will be made once additional information is received on the detailed features of the proposal.

2 Macro Debt-Equity Conversion

The original term sheet includes a debt equity conversion program to be implemented over 3 1/2 years The program allows for the exchange of US$3 5 billion of eligible debt (face value) for equity in infrastructure projects approved by the Government and for up to 50 percent participation in the purchase of companies being privatized. In order to reduce debt requiring enhancements, the authorities are proposing that the entire amount of debt-equity rights be auctioned before the exchange of the debt instruments (scheduled for March 1990). Under this proposal, banks would tender their eligible claims for swap instruments which would be converted into equity during the next 3 1/2 years In the meantime, holders would receive interest payments on these instruments equivalent to those accruing on the post-exchange bonds After a period of 3 1/2 years, the banks would have the possibility of converting back the swap instruments under one or more of the three options specified in the term sheet (i.e , new money, enhanced discount bonds, and enhanced par bonds with below-market interest rates)

Mr Gurria indicated that, in their initial reactions, the banks appeared receptive to constituting the interest collateralization account on the basis of the present value of obligations There was less support for the macro debt-equity proposal Further discussions are to be held in the coming days on both proposals

Mohamed A El-Erian MAE
Exchange and Trade Relations Department

Attachment

cc Mr Brau
~~Mr.~~ Loser
Mr Allen
Mr Bonvicini
Mr Watson
Mr Kalter

TRANSMITTAL SHEET FOR CONFERENCE CENTER

SHEARMAN & STERLING
CONFERENCE CENTER
599 LEXINGTON AVENUE
2ND FLOOR
NEW YORK, NEW YORK 10022

OUR MACHINE AND NUMBER IS RICOH FAX60, Autoanswer (212) 848-8496

DATE Jan 4 TOTAL PAGES (Including Cover Sheet) 8

NAME Mr Mohammed El-Erian

FIRM IMF

LOCATION.

TELECOPIER NUMBER 1-202-623-4661

COMMENTS As requested, proposals on enhancements and debt-equity for the Mexican Package

FROM Mr. Angel Gurría

Please note the total number of pages to be transmitted If you do not receive the amount indicated, please call us as soon as possible at (212) 848-8899

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12/19/89

1990 JAN -4 PM 1 24

IMF

December 28, 1989

Proposal to Cover a Portion of Enhancement Shortfall via Delivery of Interest Coverage in Present Value Terms

I As of this date, Mexico and the Bank Advisory Committee jointly face a problem of an enhancements shortfall on the order of $400-$600 million dollars, depending on the final mix of options chosen by the banks, the level of the 30-year U S Treasury zero coupon rate the pricing of the zeros purchased for use as collateral and the total base at the Closing

II This proposal is intended as a contribution by Mexico towards solving the enhancement shortfall, to the extent and only to the extent that it is complemented by a timely and successful implementation of additional measures aimed at solving the shortfall problem -- the macroswap program, satisfactory pricing of principal collateral and the extension of the final maturity of the Bonds to a date 31 years from issuance

III The Financing Package envisages that the Par and Discount Bond options are backed by zero coupon bonds to defease the principal payments plus an up-front cash-equivalent pool to cover a minimum of 18 months of interest This proposal entails replacing the up-front cash-equivalent pool that covers 18 months of interest payments with its <u>present</u> <u>value</u> equivalent that is, since the first interest payments occur in months 6, 12 and 18, we can invest funds now - in discount paper or strips to cover the interest payments in months 6, 12 and 18 For example, to cover $100 of payments falling due in month 6 we would have to invest $95 now if the annual interest rate were 10%

IV As an illustrative example, suppose that 30-year U S Treasury zero coupon rates are at 7 75% and that short-term instruments are also at the same level on a bond-equivalent basis If the total base eligible for enhancements is $45 3 bln and the split is 49% Par Bonds and 42% Discount Bonds, we would have the following situation at the moment

Eligible Debt Choosing
- Par Bonds $22 197
- Discount Bonds 19 026

Enhancements per $1 of Eligible Debt
Assuming 18 mos Up-front Cash Interest Coverage
- Par Bonds 19 392 ¢
- Discount Bonds 16 391 ¢

In dollar terms this becomes
- Par Bonds $4,348 8 MM
- Discount Bonds 3 118 6
7,467 4 MM

As can be seen, the enhancement shortfall is $467 4 MM, if the interest collateral is placed on an up-front cash basis

Suppose instead that at the outset, the interest payments occurring in months 6 12 and 18 were covered by 6-month, 12-month and 18-month discount bills and strips maturing on the necessary dates In that case we would have the following situation

Cost of Covering Principal

Par Bonds	$22 197 @ 10 217¢	=	$2 267 9
Discount Bonds	$19,026 @ 6 641¢	=	1 263 6
Total			$3,531 5 MM

Each semi-annual payment to be collateralized on the Bonds will be in the following aggregate amount

Par Bonds	$ 693 7 MM
Discount Bonds	618 3 MM
Total	$1,312 0 MM

If the semi-annual interest rate applicable to discount paper and strips were 3 875 (7 75/2), then to have the sums indicated above at each of months 6, 12 and 18 we would need to invest on the Exchange Date in discounted instruments

For maturity in 6 mos $\dfrac{693\ 7 + 618\ 3}{1\ 03875} = \$1,263\ 1$

For maturity in 12 mos	$\frac{1\ 312}{(1\ 03875)^2}$	=	\$1,215 9
For maturity in 18 mos	$\frac{1\ 312}{(1\ 03875)^3}$	=	\$1 170 6
	Total		3,649 6
	+ Principal Cost		3,531 5
	TOTAL		\$7 181 1

In this case the total enhancement shortfall is only \$181MM at the outset versus \$467 4 MM

V Based on the foregoing, Mexico makes the following specific proposal

1 The retroactive interest rate adjustment will be applied solely against interest payments due on the Bonds and not against interest payable on Eligible Debt in order to obtain the maximum reduction in interest payments initially requiring enhancement

2 Mexico will invest the interest collateral in discount instruments maturing on the first interest payment dates after the Exchange Date, with the amounts invested at each maturity to reflect the reduced interest payable by virtue of the retroactive interest rate adjustment Accordingly, the initial maturity profile of the interest collateral will extend 24 or 30 months after the Exchange Date

3 In light of the additional collateral to be furnished by Mexico through this arrangement maturing investments of interest collateral would be reinvested on a present value basis going forward with the face amount of investments held by the Collateral Agent at any time not to exceed 18 months of interest (determined as per the Financing Package) Amounts collected by the Collateral Agent in respect of maturing investments in excess of amounts required to be reinvested would be for the account of and immediately distributable to, Mexico

VI Mexico believes this proposal to be consistent with the spirit of the terms and conditions agreed with the banks as well as a real economic contribution since at the end of 18 months, Mexico will have contributed upwards of $300 MM (depending on actual interest rates) beyond the $1 3 billion stipulated in the Term Sheet For this reason Mexico will only offer this option if it is accompanied by the other measures mentioned in Section II above

December 28, 1989

Macroswap: Implementation of the Debt-Equity Conversion Program

In order to facilitate an early implementation of the Debt-Equity Conversion Program and decrease the likelihood that the $7 billion available for enhancements will not provide the minimum collateral required by the Financing Package, Mexico will conduct an auction of debt-equity conversion rights before the exchange of Eligible Debt for Bonds contemplated by the Financing Package. Recipients of conversion rights will exchange their Eligible Debt for special instruments (the "Swap Instruments") described below. To the extent banks receive Swap Instruments in exchange for their Eligible Debt, they will be relieved of their obligation to exchange that Eligible Debt for Bonds or to lend Mexico new money with respect to that Eligible Debt.

All banks that have committed 100% of their Eligible Debt to the Financing Package may participate in the auction. Up to $3.5 billion of Eligible Debt will be accepted for exchange. Mexico will accept tenders of Eligible Debt in descending order of the discount offered, provided that the minimum level of discount will be 35%.

The Swap Instruments awarded in the auction will be the only debt accepted for conversion under Mexico's Debt-Equity Conversion Program.

Swap Instruments will have the following characteristics:

<u>Principal Amount</u>. The principal amount of the Swap Instruments will equal (i) if issued in exchange for Eligible Debt committed to Par Bonds or New Money, the principal amount of the Eligible Debt in exchange for which they are issued and (ii) if issued in exchange for Eligible Debt committed to Discount Bonds, 65% of the principal amount of the Eligible Debt in exchange for which they are issued.

<u>Interest</u>. Interest on Swap Instruments will be payable quarterly and calculated on the basis of a notional principal amount equal to the principal amount of the Eligible Debt in exchange for which they are issued, at a rate equal to (i) if issued in exchange for Eligible Debt committed to Discount Bonds or New Money, 65% of the sum of LIBOR and 13/16% and (ii) if issued in exchange for Eligible Debt committed to Par Bonds, the fixed rate for Par Bonds denominated in the same currency.

Denomination U S Dollars and other Bond Currencies

Form Loans (with a thirty-year bullet maturity) to the United Mexican States, transferable to financial institutions registered with the Ministry of Finance and Public Credit

Redemption Redeemable in Pesos in an amount equivalent, at the controlled exchange rate, to a percentage of the principal amount of the Eligible Debt in exchange for which they are issued equal to 100% less the discount at which such Eligible Debt is tendered in the auction, and solely to fund the domestic content of infrastructure projects approved by the Government and up to 50% of the purchase price of stock of companies being privatized in accordance with applicable rules and procedures.

Value Recovery Rights None

Collateral. None.

Exchange. If, after three and one-half years from issuance, any Swap Instrument has not been redeemed, the holder will have the option, exercisable ratably over a period to be determined, to tender the Swap Instrument to Mexico in exchange for one of the following:

1. In the case of Swap Instruments originally issued in exchange for Eligible Debt committed to Discount Bonds, a bond denominated in U S Dollars in a principal amount equivalent to the principal amount of the Swap Instrument and having the same interest rate provisions (including value recovery rights) and maturity date as, and collateral comparable to, the U S Dollar Discount Bonds (comparable collateral as to principal to be defined to include government agency and similar securities and to take account of market availability of stripped securities).

2. In the case of Swap Instruments originally issued in exchange for Eligible Debt committed to Par Bonds, a bond denominated in U.S Dollars in a principal amount equivalent to the principal amount of the Swap Instrument and having the same interest rate provisions (including value recovery rights) and maturity date as, and collateral comparable to, the U.S Dollar Par Bonds (comparable collateral as to principal to be defined to include government agency and similar securities and to take account of market availability of stripped securities)

3 In the case of Swap Instruments originally issued in exchange for Eligible Debt committed to New Money, a loan in a principal amount equal to the principal amount of the Swap Instrument and having the same terms (interest rate, amortization, etc) as the Eligible Debt (as proposed to be amended in Part III of the Financing Package) in exchange for which they are issued; <u>provided</u> that at the time of the exchange the holder of the Swap Instrument will make a new loan to Mexico. The new loan will be in a principal amount equal to 25% of the principal amount of such Swap Instrument (12 5% of such principal amount in the case of Swap Instruments issued in exchange for Eligible Debt under Facility 2 or 3 of the Multi-Facility Agreement), or such lesser percentage of the commitments of the banks that are drawn by Mexico under the 1989-92 Credit Agreement, <u>less</u> (y) the excess of the interest that would have accrued on the Eligible Debt in exchange for which such Swap Instruments are issued over the interest that in fact accrued on Swap Instruments during the period in which they are outstanding The new loan will have the same terms (currency, interest rate, amortization, etc.) as those governing Advances under the 1989-92 Credit Agreement.

STB
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mexico

January 8, 1990

Lic. Angel Gurria
Undersecretary of Finance
The United Mexican States
Palacio Nacional
Mexico, D.F. 06066

Commercial Bank Oil Facility

Dear Sir:

We refer to our conversations last summer regarding the Commercial Bank Revolving Contingent Oil Facility (the "Commercial Bank Oil Facility") proposed in the context of the 1989-92 Financing Package for Mexico. We intend to proceed with this transaction after the signing of the documentation implementing the 1989-92 Financing Package.

As we discussed in July and August, the Commercial Bank Oil Facility could be structured as a revolving credit and term loan agreement to provide Mexico with balance of payments support when Mexican oil prices fall below a specified level. (See draft term sheet dated 8/29/89 attached.) Payment of the principal amount of the advances at scheduled maturity would be guaranteed by the International Bank for Reconstruction and Development ("IBRD"). It is our understanding that this facility will be arranged in conjunction with a parallel U.S. $500 million oil contingency facility to be extended by the International Monetary Fund.

We have not yet agreed upon specific terms for the Commercial Bank Oil Facility (including, among other things, pricing and the level of oil prices that will trigger advances and prepayments under the facility), nor have we discussed specific documentation with you or the IBRD. However, we will be proceeding with this transaction as soon as possible after the documentation for the 1989-92 Financing Package for Mexico (including the Commercial Bank Bridge Facility) is signed.

After the 1989-92 Financing Package has been successfully implemented, we together expect to commit U.S. $150 million to the Commercial Bank Oil Facility and to syndicate the other U.S. $350 million to a group of 10 to 15 major international banks.

We look forward to working with you towards the successful completion of this transaction.

BANK OF AMERICA
NATIONAL TRUST AND
SAVINGS ASSOCIATION

By Richard Bloom
Richard Bloom
Senior Vice President

CITIBANK, N.A.

By
William R. Rhodes
Group Executive

S&S DRAFT
08/29/89

COMMERCIAL BANK REVOLVING
CONTINGENT OIL FACILITY

Borrower	The United Mexican States, with Banco de Mexico Foreign Exchange Undertaking
Guarantor	The International Bank for Reconstruction and Development ("The World Bank")
Lenders	A group of 10 to 15 major international banks (the "Lenders")
Purpose	To provide Mexico with balance of payments support in the event that the average export price for Mexican oil for any calendar quarter falls below U S $10 per barrel For the purposes of this Facility, the average export price of Mexican oil for each calendar quarter shall be [method of determination to be discussed]
Commitment	U S $500,000,000 The Facility will be a revolving credit and term loan Before the Termination Date, the Borrower may borrow, prepay and reborrow, provided that all borrowings and reborrowings shall be made at the times and in the amounts specified in "Advances" below, provided, further, that the maximum aggregate amount of all Advances outstanding at any time shall not exceed the Commitment.
Currency of Commitment	U S Dollars
Availability Period	______________, 1990 through the Termination Date
Termination Date	December 31, 1992 Any amounts undrawn on the Termination Date will be cancelled
Advances	Subject to the Commitment, Advances for any calendar quarter shall be made within __ days after the end of such quarter and shall be in an aggregate amount not to exceed the following

If the average export price for Mexican oil for such calendar quarter is U S $9 or less, U S $125,000,000

If the average export price for Mexican oil for such calendar quarter is greater than U S $9 but less than U S $10, an amount equal to the product of (x) U S $125 000,000 and (y) U S $10 minus the average export price for Mexican oil for such calendar quarter.

Currency of Advances — U S Dollars

Commitment Fee — ____% per annum, payable quarterly from __________ 19 ___ through the Termination Date, on the undrawn amount of the Facility

Interest Rate — LIBO rate for [three-month] [six-month] U S Dollar deposits plus the Applicable Margin payable at the end of each interest period

The Applicable Margin shall be the rate per annum indicated below for each of the following periods

Through Dec 31, 1992	___%
Jan 1, 1993 - Dec 31, 1993	___%
Jan 1, 1994 - Dec 31, 1994	___%
Jan 1, 1995 - Dec 31, 1995	___%
Jan 1, 1996 - Dec 31, 1996	___%
Jan 1, 1997 - Dec 31 1997	___%
Jan 1, 1998 - Dec 31 1998	___%
Jan 1, 1999 - Dec 31, 1999	___%

Optional Prepayments — Before the Termination Date, the Borrower may prepay the Advances in amounts of not less than U S $__________

Mandatory Prepayments — (1) Before the Termination Date, if the average export price of Mexican oil exceeds U S $14 per barrel for any calendar quarter, the Borrower will be required to prepay the Advances in an aggregate amount equal to the following

If the average export price of Mexican oil for such calendar quarter is equal to or greater than U S $15, an amount equal to the lesser of (i) U S $125,000,000 and (ii) the aggregate amount of Advances outstanding

If the average export price of Mexican oil for such calendar quarter is less than U S $15, but greater than U S $14, an amount equal to the lesser of (i) the aggregate amount of Advances outstanding and (ii) the product of (x) U.S $125,000,000 and (y) the average export price for Mexican oil for such quarter minus U S $14

(2) In addition prepayments will be required if at any time any official credit (or any indebtedness under the 1989-92 Financing Package) is voluntarily prepaid

Final Maturity, Grace Period	7 years with 4 years' grace from the Termination Date
Repayment	The aggregate principal amount of all Advances outstanding on the Termination Date shall be repaid in 7 equal semi-annual installments, starting January 1, 1997 and ending December 31, 1999
Conditions of Availability	For each Advance, the customary conditions of availability and the following

(a) The average export price of Mexican oil for the immediately preceding calendar quarter shall have been less than U S $10 and the Lenders shall have received a certificate of ________ to such effect, setting forth such average export price.

(b) Purchase by Mexico of all amounts scheduled to become available under the 1989 IMF Extended Fund Arrangement before and during the calendar quarter immediately preceding the calendar quarter in which such Advance is to be made [(c) Delivery of a certificate of ________, certifying that, as of the date of such Advance, the Borrower has drawn [all available] amounts under the 1990 IMF Oil Contingency Mechanism in respect of the calendar quarter for which such Advance is to be made]

(d) Mexican public sector borrowers are current on interest due as of the date 15 days before the date of such Advance

[(e) Continuing foreign exchange availability for payment of private sector interest]

(f) Effectiveness of the 1989-92 Financing Package

<u>The World Bank Guaranty Provisions</u>

<u>Scope</u>. The World Bank guaranty will cover timely payment when due of the principal installments of the Advances at their scheduled maturity Payments of interest will not be guaranteed.

<u>Acceleration</u>. The Advances may be accelerated at any time without affecting the guaranty, <u>provided</u> that The World Bank guaranty may only be called at the time of the scheduled maturity of the Advances, as indicated under "<u>Scope</u>" above

<u>Subrogation</u> Upon payment by The World Bank under the guaranty, The World Bank will immediately become entitled to recover from the Borrower the amount so paid and will have the immediate right of subrogation against the Borrower in respect of such amounts regardless of whether the Lenders have been fully repaid by the Borrower in respect of other amounts due the Lenders under the agreement.

<u>Requisite Authorizations</u> All requisite authorizations and approvals required to make the guaranty effective to have been obtained and to be in full force and effect

<u>Guaranty Fee</u> ____________

Assignment The guaranty is not a separate obligation of The World Bank independent from the underlying Advances of a Lender, and the benefit of the guaranty may be assigned only with a simultaneous assignment by a Lender of the underlying Advances No such assignment may be made without the consent of The World Bank except to another Lender

Option to Release Provisions expressly enabling each Lender to release the guaranty will be included

Amendment Any amendment to the terms of the agreement which affects the guaranty will require the consent of The World Bank

Indemnity by Borrower: The Borrower will enter into an indemnity agreement with The World Bank in respect of its guaranty Under such indemnity, the Borrower will undertake an obligation to reimburse The World Bank, on demand, or as The World Bank may otherwise determine, for any payments made by The World Bank under the guaranty

Governing Law and Jurisdiction The agreement will be governed by the laws of the State of New York and will provide for non-exclusive jurisdiction against the Borrower, Banco de Mexico [and each Lender] 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. The agreement will also provide for non-exclusive jurisdiction against The World Bank of the State and Federal courts in New York and the High Court of Justice in London The Indemnity Agreement will follow the legal regime, and include dispute settlement provisions, which are customary in agreements between member countries and The World Bank

Taxes and Other Deductions	Advances to be exempt from Mexican taxes All payments to be made under the agreement would be free and clear of any future Mexican taxes, withholdings or other deductions whatsoever.
Pari Passu	Advances to be at least *pari passu* in priority of payment with all other Mexican public sector external indebtedness
Agent	______________________
Agency Fee	To be negotiated by Agent and Borrower
Assignability	Lenders to be able to assign Advances to other financial institutions, *provided, however*, that the benefit of The World Bank guaranty may be assigned only as set forth above
Covenants	Same as the 1989-92 New Money Credit Agreement (including, but not limited to, maintenance of government approvals, membership in IMF, negative pledge and reporting requirements) Mexico undertakes that the Advances will not be considered as part of a base amount with respect to any future requests by Mexico for new money, and will not be subject to any future restructuring requests
Events of Default	Same as the 1989-92 New Money Credit Agreement (including, but not limited to, failure to pay principal or interest, misrepresentation, breach of covenant and cross-default) and other customary events of default related to The World Bank guaranty
Acceleration	Upon the occurrence of an Event of Default, the Lenders having more than 50% of the Advances outstanding may declare all Advances due and payable
Miscellaneous	Commitment subject to no adverse change occurring in international capital or money market conditions before the signing of the agreement

The Borrower agrees to reimburse the Lenders for all documented expenses (including legal fees of the Lenders, printing and out-of-pocket expenses) incurred in connection with the development, preparation and execution of the agreement.

Documentation — Subject to negotiation, execution and delivery of mutually satisfactory documentation

F

MESSAGE CONFIRMATION

JAN-04-'90 THU 19:26

TERM ID: IME-WHD WASH DC 003 P-0000
TEL NO: 202-623-7499

ATE	ST.TIME	TOTAL TIME	ID	DEPT CODE	OK	NG
-04	19:25	00°01'14	12128488496		02	00

INTERNATIONAL MONETARY FUND
WASHINGTON, D. C. 20431

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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 1.4.90	PAGE 1 OF 2

TO

NAME Mr. Mark Walker
Cleary Gottlieb, Steel & Hamilton

Mexico

AGENCY

CITY/COUNTRY (212) 848-8496

FACSIMILE TELEPHONE NO.
(Country Code) (City Code) (Number)

TEXT

Attached please find a draft letter incorporating the comments by the staff, for the purpose of fulfilling the request by the Japanese banks. I am sending it to you before showing it to Management for their approval, for your reactions.

Best regards,

Claudio Loser

INTERNAL DISTRIBUTION

FROM

NAME

DEPT./DIV.

ROOM NO. 10-100	EXTENSION 8373	ACCOUNT CODE 0043

(TYPE)
AUTHORIZED BY C. Loser

SIGNATURE Claudio M. Loser

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

WHD1/dez -- 1t09mex8--(1/4/90)
DRAFT

January --, 1990

Dear Sirs,

I refer to the bridge facility for up to US$1 2 billion to provide letter of credit support for payment of interest under the discount and par bonds to be issued by Mexico under its 1989-92 financing package We appreciate that a selected group of commercial banks has organized this facility to enable Mexico to make available the amount of collateral to be provided by Mexico under the package

In this connection, I would like to state that Mexico has made all purchases available to date under the extended arrangement from the Fund, for the equivalent of SDR 489 5 million In addition, I am prepared to recommend that the Executive Board of the Fund, based on your Government's policies and objectives for 1990 as outlined in your letter of January ---, reach understandings on economic and financial policies for 1990 under the extended arrangement supporting Mexico's medium-term economic program through 1992, which was approved by the Executive Board of the Fund on May 26, 1989

Yours sincerely,

Michel Camdessus

Mr Pedro Aspe Armella
Secretary of Finance and
Public Credit of Mexico

Mr Miguel Mancera Aguayo
Director General
Bank or Mexico

10-1W

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INTERNATIONAL MONETARY FUND
WESTERN HEMISPHERE DEPT.
RECEIVED
1990 JAN -2 PM 3:04

FACSIMILE MESSAGE

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

1990 JAN -2 PM 1:43

Fax Number(s): (202) 623-4661 or 4662
Name: Claudio Loser
Company: International Monetary Fund
City: Washington
State/Country:
Tel. No.: (202) 623-8373

Mexico

From: Mark A. Walker
Date: January 2, 1990
No./Pgs. (incl. cover): 2
Our File Number: 24636-080

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

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

Dear Claudio:

As we discussed, I enclose a proposed form of letter from the IMF to Mexico. As I mentioned this morning, The Bank of Tokyo has advised us that a letter of this sort is necessary in order to secure participation by Japanese banks in Mexico's commercial bank bridge (letter of credit) facility.

I am anxious to provide a draft to the Japanese banks as soon as possible; accordingly I would appreciate your thoughts at your earliest convenience.

Best regards,

Mark A. Walker

2 JAN 90 11:28

Draft: January 2, 1989

[Proposed letter from IMF to Mexico]

The International Monetary Fund understands that Mexico and a selected group of commercial banks have organized a bridge facility to provide letter of credit support for payment of interest under the Discount and Par Bonds to be issued by Mexico as part of its 1989-92 Financing Package. We appreciate the essential contribution represented by this facility to Mexico's efforts to make available at the closing the full amount of enhancements to be provided under the Package.

The Fund intends to continue to work in close cooperation with Mexico and the other parties involved (including the commercial banks). In this regard, I note with satisfaction that Mexico is in full compliance with targets under its existing program and that Mexico and the Fund have reached agreement on Mexico's economic program for 1990. The Fund will be providing continuing support for Mexico's medium-term economic program through 1992 in accordance with the extended arrangement approved by the Executive Board of the Fund on May 26, 1989.

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Mexico

INTERNATIONAL MONETARY FUND

January 2, 1990

Mr. Frenkel
Mr. Laske

Re: Mexico - Request for
Technical Services

The attached draft Executive Board paper, which has been cleared by management as of today, may be of interest to you. You will note that the paper will be issued upon receipt of the request of Mexico.

WEH

Attachment

cc: Mr. Gianviti (o/r)
Mr. Whittome (w/o attachment)
Mr. Beza (w/o attachment)
Mr. Liuksila (w/o attachment)

William E. Holder

10-1
STB
CL
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IO
File

CLEARY, GOTTLIEB, STEEN & HAMILTON

RUE DE LA LOI 23, BTE 5
1040 BRUSSELS, BELGIUM

56TH FLOOR, BANK OF CHINA TOWER
ONE GARDEN ROAD
HONG KONG

WINCHESTER HOUSE
77 LONDON WALL
LONDON EC2N 1DA, ENGLAND

ONE STATE STREET PLAZA
NEW YORK, N.Y. 10004
(212) 344-0600
FACSIMILE
(212) 269-4978
TELEX
WUI 62985

41, AVENUE DE FRIEDLAND
75008 PARIS, FRANCE

SHIN KASUMIGASEKI BUILDING
3-2 KASUMIGASEKI 3-CHOME
CHIYODA-KU,
TOKYO 100, JAPAN

1752 N STREET, N.W.
WASHINGTON, D.C. 20036

Mexico

January 2, 1990

ORIG: MD
CC: DMD
MR. BEZA
MR. LASKE
MR. WHITTOME
MR. GIANVITI
MR. HOLDER
MR. H. SIMPSON

00994

VIA FEDERAL EXPRESS

Aarno O. Luksila
International Monetary Fund
700 19th Street, N.W.
Washington, D.C. 20431

Dear Aarno:

As we discussed, I enclose the original executed letter from Mexico to the Fund requesting that the Fund assist Mexico in calculating the value recovery payments in respect of the Discount and Par Bonds.

Best regards,

Sincerely,

Wanda

Wanda J. Olson

GHI

SECRETARIA
DE
HACIENDA Y CREDITO PUBLICO

January 2, 1990

Mr Michel Camdessus
Managing Director
International Monetary Fund
700 19th Street, N W.
Washington, D C 20431

Dear Michel

I am writing on behalf of the United Mexican States to request the assistance of the International Monetary Fund in the implementation of the 1989-92 Financing Package for Mexico

As you know, one of the elements of the debt reduction and debt-service reduction options set forth in the Financing Package is the right of the holders exchanging existing debt for Discount and Par Bonds to receive, in respect of the period from July 1, 1996 to December 31, 2019, additional payments in the event that Mexico's oil revenues increase due to an increase in the real price of the Mexican oil mix above $14 per barrel The details regarding the computation of the amount of these additional payments are set forth in pages I-12 to I-14 of the Financing Package and in the draft form of Value Recovery Rights forwarded to you previously

Mexico hereby requests that, as a technical service to Mexico pursuant to Article V, Section 2(b) of the Fund's Articles of Agreement, the Fund act as Mexico's agent in reference to the calculation of these additional payments

Very truly yours,

Jose Angel Gurria Trevino
Subsecretario de Asuntos
Financieros Internacionales

TIEV MEX

INTERNATIONAL MONETARY FUND
WASHINGTON, D. C. 20431

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Facsimile Service Cover Sheet
(TYPE)

MSG. NO. 4 (For Cable Room use only)	DATE January 2, 1990	PAGE 1 OF 3

DISPATCHED IMF 1990 JAN -2 P 3:21

TO

NAME Lic. Ariel Buira

AGENCY Director de Organismos y Acuerdos Internacionales
Banco de Mexico

CITY/COUNTRY Mexico D.F., Mexico

FACSIMILE TELEPHONE NO. (525) (Country Code) (City Code) 512.9990 (Number)

TEXT

INTERNAL DISTRIBUTION

Ariel,

Tal como lo conversáramos telefónicamente, adjunto te envío copia del borrador de carta solicitando los recursos para garantía de las operaciones de reducción de deuda y servicio de la deuda. Nuestros abogados todavía podrían sugerir algunos cambios.

FROM

NAME Claudio Loser

DEPT./DIV. Departamento del Hemisferio Occidental

ROOM NO. 10-100 (TYPE)	EXTENSION 8373	ACCOUNT CODE 0043
AUTHORIZED BY Claudio Loser	SIGNATURE	

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

PREPARATION OF FACSIMILE MESSAGE

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

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

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

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

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

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

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

Messages delivered to the Cable Room should be accompanied by a complete duplicate set of the message using the yellow copy as cover. This does not apply to offices of Executive Directors.

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

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

Dear Mr Camdessus,

In a separate letter we have stated the objectives, policies, and measures that we intend to pursue for the second year of Mexico's extended arrangement In accordance with the terms of that arrangement and of the Decision by which it was approved, we are requesting in this letter the Fund's appropriate approval for the disbursement of the 1989 and 1990 amounts set aside for collateralization of interest and principal in connection with our debt reduction operations, and of the additional amount for interest support in connection with our debt and debt-service reduction operations, both amounts to be made available upon completion of the current review under the extended arrangement The equivalent of these amounts will be used as part of the total of US$7 billion of collateral required for operations in connection with the commercial bank financing package now nearing completion on the basis of the previously agreed term sheet

1 Amounts set aside Mexico hereby represents that it has a need to purchase the amounts set aside in 1989 and scheduled to be set aside in 1990 because of impending payments for purchase of collateral under debt reduction transactions Amounts equivalent to the requested purchases will be used within 90 days of the date of completion of the current review of the extended arrangement for the purchase of principal collateral associated with new discount bonds issued to commercial banks (at a 35 percent discount), and for the deposit with a collateral agent of funds to secure interest payment of these bonds

2 Additional amounts Mexico hereby represents that it has a need to purchase the full amount by which the amount of the extended arrangement would be augmented in accordance with the Decision in which the Fund expressed its preparedness to consider such augmentation at the time the extended arrangement was approved An amount equivalent to this purchase will be used within 90 days of the date of the completion of the current review of the extended arrangement for interest support in connection with Mexico's debt and debt-service reduction operations For this purpose, amounts equivalent to the requested purchase will be deposited as collateral for interest payments on par bonds carrying interest at a fixed interest rate (which, for those denominated in U S dollars, will be 6 25 percent a year) and on the discount bonds referred in paragraph 1 above

Yours truly,

Pedro Aspe Armella
Secretary of Finance and
Public Credit of Mexico

Miguel Mancera Aguayo
Director General
Banco de Mexico

STB

Office Memorandum

File Mexico

TO: The Managing Director
The Deputy Managing Director

DATE: February 21, 1990

FROM: S. T. Beza

SUBJECT: Mexico - Communication to the U.S. authorities

The attached draft incorporates our comments to the proposed communication in support of the Mexican request for bridge financing from the U.S. authorities.

We suggest mainly editorial changes to the first two paragraphs of the draft prepared by the Mexicans. However, we propose significant changes to the final paragraph because of the importance of corrective policy actions to protect the program; we also delete reference to the program being on track for 1990. Furthermore, we add that a mission will visit Mexico to reach understandings on performance criteria and that the results of the negotiations will be submitted for Executive Board consideration.

The draft note has been reviewed by Mr. Brau (ETR), Ms. Ter-Minassian (FAD), Messrs. Liuksila and Surr (LEG), Mr. Aghevli (RES), and Mr. Coats (TRE).

* * * * *

A more important point is that Ms. Dawson and Mr. Truman have informed me that the U.S. authorities do not wish to receive this kind of letter (Fund support of a bridge) at this time. They told me that they had emphasized more than once to the Mexican authorities that there could be no bridge until after the forthcoming IMF mission has completed its work in Mexico.

Attachment

cc: Mr. H. Simpson

DIRECTOR GENERAL
DEL
BANCO DE MEXICO

México, D F , a 19 de febrero de 1990

SR. MICHEL CAMDESSUS
Director Gerente
Fondo Monetario Internacional
Washington, D C

Estimado Michel

De acuerdo con nuestra conversación del jueves último, te envío con la presente un proyecto de la carta que podría ser dirigida por tí a los señores Nicholas Brady y Alan Greenspan

Aprovecho la ocasión para enviarte un saludo cordial

Con un abrazo

Miguel

MR. NICHOLAS BRADY
Secretary of the Treasury

MR. ALAN GREENSPAN
Chairman
Federal Reserve System
Washington, D.C.

Dear Secretary Brady

As you are aware, the completion of Mexico's financing package, while constituting an important step forward in dealing with that country's financial difficulties, has ~~given rise to~~ been associated with a concentration of net interest payments in the first quarter of 1990, followed by ~~much~~ lower than ~~lighter~~ previously projected payments the following two quarters In fact, ~~as a~~ in the ~~result~~ context of the ~~final~~ agreement ~~between Mexico and~~ with its creditor banks, ~~that country~~ Mexico will have to make interest payments in the first quarter of 1990 greater than previously envisaged, whereas it will receive later in the year the bulk of the interest refund ~~accorded~~ being provided ~~with the~~ by commercial banks under the agreement The shortfall in the first* ~~As all this~~, which totals over 2 billion dollars, ~~is happening in the same quarter when the~~ coincides with the repayment of the bridge loan for $1,271 million and the ~~payment~~ use of $1,300 million for enhancements As a result ~~fall due~~, the country's international reserves will decline to ~~dangerously~~ low levels

* quarter of the year

In view of the above, ~~I consider~~ the Mexican authorities' intention to draw on existing swap lines with the U.S financial authorities, in my opinion, would help ~~as most appropriate~~ to forestall disorderly conditions in the exchange market, thereby ~~since~~ strengthening Mexico's ~~the latter could jeopardize their~~ stabilization efforts.

INSERT

The Fund has recently reviewed Mexico's economic performance in 1989 and approved their economic program for 1990 Although some deviations emerged with regard to the end of year targets, there is no question that performance in 1989 was generally satisfactory despite an extremely large short fall of external finance It is also our view that the program on the whole is on track and that the differences that emerged can be corrected in 1990 Moreover, I am encouraged by the prompt policy response of the authorities in this regard

Yours sincerely,

INSERT

The Fund recently reviewed Mexico's economic performance in 1989 and the economic program for 1990 under the extended arrangement Certain deviations emerged with respect to some end-1989 performance criteria, but the Executive Board found performance in 1989 to have been generally satisfactory Moreover, I have received assurances from the Mexican authorities that the policy stance in 1990 will correct fully the above-mentioned deviations The authorities have responded promptly by taking additional policy measures, and they have indicated their readiness to take further measures if these should be needed In this regard, a staff mission will visit Mexico soon to ascertain the progress being made in achieving the program objectives for 1990 and to reach understandings on the modifications to performance criteria needed to assure the success of the 1990 economic program The results of the mission would be presented to the Executive Board of the Fund for its consideration shortly after the return of the mission

STB

Office Memorandum

TO: The Managing Director
The Deputy Managing Director

DATE: February 21, 1990

FROM: S.T. Beza STB

SUBJECT: Mexico--Staff Visit

You will recall that shortly before the recent Executive Board review of the extended arrangement for Mexico (EBM/90/12, 01/29/90), the Mexican authorities informed us that there appeared to be deviations with respect to the net international reserve target and the ceiling on the Bank of Mexico's net domestic assets for end-1989. Mexico's next purchase under the extended arrangement is dependent on observance of quantitative performance criteria for end-1989.

The authorities were of the view that the deviations were mainly the result of transitory factors which would be self-reversing. They added, however, that they would take compensatory fiscal and monetary measures to ensure that the shortfall in net international reserves experienced in 1989 would be made up in 1990, and thus they agreed to consider modifications to quantitative performance criteria for the 1990 program approved recently by the Executive Board.

Accordingly, a mission consisting of Messrs. Loser (Head), Kalter, Khor (all WHD), and El-Erian (ETR) will visit Mexico City for about two weeks beginning March 6, 1990 to ascertain the extent and nature of the deviations with respect to the quantitative performance criteria for end-1989 and review recent economic trends. In this light the mission will discuss the adequacy of the policy measures being adopted by the authorities and seek agreement on the modifications needed in the performance criteria for 1990.

The mission also will discuss adjustments to performance criteria that will be called for because commercial bank flows in 1990 differ from those assumed in the program as a result of last minute changes to certain features of the financing package. These changes include: a) the payment in the first quarter of the year of interest accruing through end-March 1990 and originally programmed to be paid in the period April-August; and b) the postponement to the fourth quarter of the year of disbursements of the 1989 interest relief which had been expected to take place in March. These changes would give rise to a shortfall in the accumulation of reserves (by some US$2 billion) in the first quarter of 1990, which would be fully offset in the fourth quarter. Therefore, a modification of quarterly performance criteria would be required, possibly including those in the fiscal area because of the acceleration of interest payments abroad during the year.

Following a 3 4 percent increase in December 1989, the consumer price index is reported to have risen by 4 8 percent in January 1990. This increase is much higher than that assumed in the program for 1990, and is attributed in part to some delays in the implementation of public sector price adjustments during December, including a 200 percent increase in public transportation fares it may also have reflected increases in prices by the private sector in excess of the wage-price guidelines The authorities have acknowledged the difficulty of achieving their 15 percent inflation target for 1990 but have reiterated their intention to implement policies consistent with this objective

The acceleration of inflation and the tightening of credit policy resulted in a rise in domestic interest rates in recent weeks. Annual interest rates on one-month treasury bills rose by 5 percentage points to about 45 percent a year Although interest rates are still in line with those assumed in the program for the first quarter of 1990, further increases would jeopardize the attainment of the fiscal targets during the year unless the primary fiscal surplus is larger than programmed The authorities are slowing the pace of expenditure relative to the program, but the mission will examine whether additional measures are needed to raise the primary surplus, including adjustments in public sector prices.

The mission will seek a modification of the target for the official international reserves in 1990 that would offset fully the shortfall experienced in 1989, emphasizing the fragility of the reserve position in light of the debt reduction operations and the importance of preserving the integrity of the program in an area in which there have been some problems. The mission also will seek that the replenishment of reserves take place as early as possible during the year The modification to the reserve targets will be accompanied by corresponding adjustments to the net domestic asset limits Although the authorities agreed to modify the reserve targets along the lines just described, discussions on these issues may turn out to be difficult. In this connection, the mission will stress that the authorities' willingness to modify the targets for 1990 to make up the 1989 shortfall was taken by Executive Directors as an important indication of the determination of the Government's commitment to the program

An area where additional problems may arise is that of the Bank of Mexico's net credit to the nonfinancial public sector While the overall fiscal targets for end-1989 appear to have been achieved, the composition of the public sector financing differed from that envisaged previously, with greater reliance on credit from the Bank of Mexico As a consequence, the end-1989 stock of Bank of Mexico net credit to the nonfinancial public sector is likely to have exceeded projections made in early December by MexS6-7 trillion (about 1 1/4 percent of GDP), although it was still well within the 1989 program ceiling

Because the quarterly ceilings on the outstanding stock of net credit for 1990 (the only ceiling in the program defined in terms of stocks) are based on the early December projection, the authorities may seek a full adjustment of the ceilings for credit to the public sector in 1990 to reflect the actual end-1989 stock of credit. The authorities may argue that maintaining the program ceiling for credit to the public sector recently agreed for 1990 would constrain them unnecessarily in the conduct of monetary policy. In the view of the staff, however, to the extent that the divergence between the actual outcome and the previous estimate for end-1989 was the result of transitory and reversible factors (such as the four-day end-year weekend) there may be no need to adjust the stock of credit to the public sector for 1990 The mission will emphasize the importance of a tight monetary policy in light of the underperformance on international reserves and recent price developments Hence, the ceilings would be modified only if achievement of the program objectives were not at risk.

After understandings on the above points are reached and a letter incorporating them is approved by management, the staff will issue a paper to the Board requesting, as needed, waivers for nonobservance of the end-1989 performance criteria and modifications of performance criteria for 1990 consistent with the reconstitution of foreign reserves and the final features of the financing package with commercial banks.

This note has been reviewed by Messrs Ferrán and van Beek (WHD), Mr Brau (ETR), Ms. Ter-Minassian (FAD), Mr Surr (LFG), Mr Aghevli (RES), and Mr. Coats (TRE)

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

ORIGINAL + 8 COPIES GIVEN
TO MR. BEZA AT
HIS REQUEST
2/20/90

MEXICO

INTERNATIONAL MONETARY FUND

Mr Beza

The MD asks whether the enclosed draft letter would be acceptable to the Fund

HS

cc The DMD

Hugh G.O. Simpson

DIRECTOR GENERAL
DEL
BANCO DE MEXICO

México, D F , a 19 de febrero de 1990

SR. MICHEL CAMDESSUS
Director Gerente
Fondo Monetario Internacional
Washington, D C

Estimado Michel

De acuerdo con nuestra conversación del jueves último, te envío con la presente un proyecto de la carta que podría ser dirigida por tí a los señores Nicholas Brady y Alan Greenspan

Aprovecho la ocasión para enviarte un saludo cordial

Con un abrazo

Miguel

MR NICHOLAS BRADY
Secretary of the Treasury

MR. ALAN GREENSPAN
Chairman
Federal Reserve System
Washington, D.C.

Dear Secretary Brady:

As you are aware, the completion of Mexico's financing package, while constituting an important step forward in dealing with that country's financial difficulties, has given rise to a concentration of interest payments in the first quarter of 1990, followed by much lighter payments the following two quarters. In fact, as a result of the final agreement between Mexico and its creditor banks, that country will have to make interest payments in the first quarter of 1990 greater than envisaged whereas it will receive later the bulk of the interest refund accorded with the commercial banks As all this, which totals over 2 billion dollars, is happening in the same quarter when the repayment of the bridge loan for $1,271 million and the payment of $1,300 million for enhancements fall due, the country's international reserves will decline to dangerously low levels

In view of the above, I consider the Mexican authorities' intention to draw on existing swap lines with the U.S financial authorities as most appropriate to forestall disorderly conditions in the exchange market, since the latter could jeopardize their stabilization efforts.

The Fund has recently reviewed Mexico's economic performance in 1989 and approved their economic program for 1990 Although some deviations emerged with regard to the end of year targets, there is no question that performance in 1989 was generally satisfactory despite an extremely large short fall of external finance. It is also our view that the program on the whole is on track and that the differences that emerged can be corrected in 1990. Moreover, I am encouraged by the prompt policy response of the authorities in this regard.

Yours sincerely,

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

104 W
STB
CU
JB
10
F

ORIG: TRE
CC: MRS. FILARDO
WHD

DATE: FEBRUARY 16 1990

FROM: BANCO DE MEXICO

863348

TO: THE TREASURER'S DEPARTMENT
INTERNATIONAL MONETARY FUND

REMARKS: " U R G E N T "

NUMBER OF PAGES INCLUDING THIS COVER: 3

FAX NO (LONG DISTANCE CODE)-(MEXICO D.F. CODE)- 512-8027

BANCO DE MEXICO

February 15, 1990

The Treasurer's Department
International Monetary Fund
Washington, D C. 20431

Re. Extended Fund Facility and Other Sources of IMF Financing for Mexico.

We refer to.

- The Memorandum of Understanding dated August 31, 1989 (the "Memorandum of Understanding"), among the Banco de México; the United States Monetary Authorities; the Bank for International Settlements, acting for certain participating member central banks (the "BIS"); and the Banco de España ("The Cooperating Monetary Institutions) and the Separate Agreements (the "Separate Agreements") under which the Cooperating Monetary Institutions agreed to provide near-term support for the international reserves of the United Mexican States ("UMS") in the aggregate amount of U.S. $2,000 million, and

- The Communication sent to your attention by The United Mexican States and the Central Bank of Mexico, dated September 13, 1989, Reference: Extended Fund Facility and Other Sources of IMF Financing for Mexico (the "Communication").

We are attaching to this letter a copy of the notification that we received from the FRBNY on behalf of the Cooperating Monetary Institutions, certifying that the facility has been repaid in full, including interest. Therefore, as provided in Section 10 (i) of the Memorandum of Understanding and in the "Communication", we would like you to leave without effect the irrevocability of the instruction given to you on said "Communication".

Terms used in this letter have the same meaning as those used in the Memorandum of Understanding

Sincerely yours,

Banco de México

CABLE BANXICO APARTADO NUM 98 BIS
COL CENTRO,DELEG.CUAUHTEMOC,06059 MEXICO,D F

V 3

FEDERAL RESERVE BANK OF NEW YORK

NEW YORK, N Y 10045

AREA CODE 212 720-6391

GEORGE W RYAN
VICE PRESIDENT

February 15, 1990

Sr. Miguel Mancera-Aguayo
Director General
Banco de Mexico, S.A.
Avenida 5 de Mayo No. 2
06059 Mexico D.F., Mexico

Dear Sir:

This is to inform you that, as of this date, the drawings under the multilateral and bilateral arrangements pursuant to the memorandum of understanding dated August 31, 1989 have been repaid in full to the cooperating monetary institutions.

Very truly yours,

George W. Ryan

INTERNATIONAL MONETARY FUND
SPECIAL DELIVERY
CABLE

File
Mexico

FORMULARIO Nº BNTF 01.

[BANCO DE M]EXICO
AV. 5 DE MAYO Nº 2
MEXICO, D.F.
CODIGO POSTAL 06059

FOLIO:

NUMERO TELEFACSIMIL
GRUPO 2/3 5129990

CONTROL DE SERVICIO TELEFACSIMIL

FAX 510 26 67

NUMERO DE DOCUMENTOS (INCLUIR HOJA DE CONTROL).	NUMERO DE TELEFONO FACSIMIL	FECHA:
DOS	95.202.623.4661	FEBRERO 13, 1990

PARA:
SR. CLAUDIO LOSER
FONDO MONETARIO INTERNACIONAL
WESTERN HEMISPHERE DEPARTMENT
WASHINGTON, D.C.

DE:
LIC. ARIEL BUIRA
DIRECTOR DE ORGANISMOS Y ACUERDOS INTERNACIONALES
BANCO DE MEXICO.

INSTRUCCIONES ESPECIALES DEL SOLICITANTE:

ENVIO CUADRO SOBRE INTERESES DE LA DEUDA EXTERNA DEL SECTOR PUBLICO. COMO PODRA OBSERVAR, EL NUEVO CALENDARIO DE PAGOS DA LUGARA UN MENOR ALIVIO DE INTERESES EN EL PRIMER TRIMESTRE POR 2,084 MILLONES Y UN MENOR ALIVIO DE PRINCIPAL POR 210 MILLONES.

PARA USO EXCLUSIVO DE LA OFICINA DE TELECOMUNICACIONES

OBSERVACIONES DE LA TRANSMISION.	RESPONSABLE DE LA TRANSMISION.

1990 FEB 13 PM 1:34

DEPENDENCIA SOLICITANTE

NOMBRE:	TELEFONO/EXTENSION	FIRMA AUTORIZADA.
IMF CABLE ROOM RECEIVED	083134	[signature]

INTERESES DE LA DEUDA EXTERNA DEL SECTOR PUBLICO, COSTO DE LAS GARANTIAS Y PAGOS DE INTERESES DEL BANCO DE MEXICO AL FMI ENE-DIC 1990

(millones de dólares)

Cifras Preliminares

CONCEPTO	ENE 5/	FEB	MAR	ABR	MAY	JUN	JUL	AGO	SEP	OCT	NOV	DIC	TOTAL
Intereses Deuda con Banca Comercial 1/	812 8	782 4	487 2	--	--	--	--	--	531 3	192 0	303 3	20 1	3129 1
Intereses Deuda No Reestructurada 2/	318 0	250 6	264 7	148 3	148 3	148 3	148 3	148 3	148 3	148 3	148 3	148 3	2168 0
Costo de Garantías 3/	--	--	--	--	--	96 6	--	--	96 7	--	--	96 7	290 0
Intereses FMI 4/	91 2	70 0	--	--	74 1	--	124 9	72 6	--	--	68 8	--	501 6
T O T A L	1222 0	1103 0	751 9	148 3	222 4	244 9	273 2	220 9	776 3	340 3	520 4	265 1	6088 7

1/ Los intereses del primer trimestre del año se ven afectados por los pagos mensuales adoptados a partir del 20 de diciembre de 1989, mismos que tienen por objeto evitar la acumulación de intereses devengados no pagados en el momento del canje de la deuda Se supone una retroactividad de intereses de 1,056 407 millones de dólares generada del 1o de julio de 1989 al 31 de marzo de 1990

2/ Supone una reestructuración por 201 millones de dólares en los intereses del Club de Paris II Estimado con información de la SHCP

3/ Información de la SHCP

4/ Información del Banco de México

5/ Flujos observados en el mercado controlado

09/02/90

Office Memorandum

Mexico

STB
CL
JB
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Files

TO: The Deputy Managing Director — February 8, 1990

FROM: A. F. Mohammed

SUBJECT: Congressional Testimony on Mexican Debt Agreement

You may be interested in a report on the testimony presented yesterday before the House Banking Committee by Secretary Mulford and two other witnesses, together with a summary of the questioning of witnesses by Committee members. I am attaching the Mulford statement; copies of the statements by Professor Nora Lustig, a Visiting Fellow at Brookings (on leave from El Colegio de Mexico) and Mr. Shafiqul-Islam, Senior Fellow at the Council on Foreign Relations can be obtained from the Public Affairs Division (x 7311).

cc: Mr. Beza
Mr. Gianviti
Mr. Whittome
Mr. H. Simpson

Office Memorandum

TO Mr Mohammed February 7, 1990

FROM B J Mauprivez

SUBJECT Hearing on the Mexican Debt Agreement

This morning the Subcommittee on International Development, Finance, Trade and Monetary Policy of the House Banking Committee held a hearing on the recently-ratified Mexican debt agreement Members heard the testimony of Mr David Mulford, Ms Nora Lustig, Visiting Fellow, Brookings Institution, and Mr Shafiqul Islam, Council on Foreign Relations, the last two witnesses testifying as a panel The hearing attracted a small audience of about forty, and only a handful of Members Delegate Fauntroy (D-DC), Chairman, Congressmen Leach (R-IO), Ranking Minority Member, Flake (D-NY), Hoagland (D-NE), Kennedy (D-MA), LaFalce (D-NY), and McMillen (D-MD)

In his introductory remarks Chairman Fauntroy deplored the absence of representatives from the banking community He explained that, despite repeated attempts, he was unsuccessful at persuading bankers to present their account of the Mexican debt negotiation process and final agreement The Chairman wondered whether, as reported by certain media, the considerable pressure the United States Treasury applied on the banks to obtain their cooperation could have anything to do with the banks' reluctance to testify

Secretary Mulford described the objectives of the strengthened debt strategy, the contents of the Mexican debt relief package and its benefits for Mexico He then touched upon the financing agreements reached between the Philippines, Costa Rica, Chile, and their respective creditors Secretary Mulford concluded his testimony by offering a cautiously optimistic assessment of the debt strategy A copy of his written statement is attached

Following Secretary Mulford's testimony, Chairman Fauntroy asked if the alleged pressure on banks by Treasury was applied to obtain deeper discounts, new monies, or both, and if similar arm-twisting tactics will be needed in the future Secretary Mulford, denying that any pressure was ever exerted, noted that Treasury had sent a basic message to the banking community during the Mexican debt negotiation, to the effect that banks could choose any of three options proposed but that they had to choose one In other words, doing nothing was not an acceptable option

Congressman Leach, the only Republican Member present, first praised the Secretary for having brought Mexico's debt negotiation to a successful conclusion, and then queried whether the zero-coupon bond scheme used did not amount to a form of subsidy to Mexico financed by U S taxpayers Secretary Mulford responded that since the Mexicans are investing in U S securities it is the United States, as the borrower, which sets the rate of return on the transaction On several occasions Congressman Leach noted the conspicuous absence of oil exporting countries in international debt negotiations He stressed that it was their petrodollar funds that were lent to developing countries in the 1970s

Congressman Kennedy argued that the U S Treasury was overly optimistic in its estimates of the reduction of the Mexican debt He also said that he did not believe the United States should put any more money in the international financial institutions (IFIs) until commercial banks agreed to assume a more generous stand in debt reduction packages Congressman Kennedy also wondered why the United States, which enjoys an enormous amount of influence within the IMF and the World Bank, could not use this power to entice banks to participate more substantively in debt reduction packages In this context, he mentioned that Article VIII of the IMF's Articles of Agreement might give some legal basis for compelling participation of commercial banks in debt relief schemes Secretary Mulford appeared to understand what Congressman Kennedy meant, but did not address the question directly

Congressman McMillen focussed on Panama and asked if a debt relief program were in the making Secretary Mulford replied that Panama has arrears of $540 millions to the IMF, World Bank, and the IDB and that no progress could be made toward the design of an economic program for the country until this issue is resolved

Attachment

TEXT AS PREPARED
FOR RELEASE UPON DELIVERY
EXPECTED AT 9:30 A.M
FEBRUARY 7, 1989

Statement of the Honorable
David C. Mulford
Under Secretary of the Treasury for International Affairs
before the Subcommittee on
International Development, Finance, Trade and Monetary Policy
of the
Committee on Banking, Finance, and Urban Affairs
U.S. House of Representatives

Mr Chairman and Members of the Subcommittee.

Last spring Secretary Brady launched the Administration's initiative to strengthen the international debt strategy. In the past year, these concepts have been forged into far-reaching country reform programs, concrete actions by the IMF, World Bank and creditor governments, and financing packages between debtor countries and their creditor banks which include substantial reduction of debt and debt service burdens

The watershed agreement between Mexico and its commercial banks was formally completed last Sunday with the signing ceremony in Mexico City. Costa Rica and its creditors have reached an agreement in principle on a comprehensive debt and debt service reduction package. Chile's buyback of commercial bank debt in November was financed by resources made available under the strengthened debt strategy. Last month, the Philippines undertook a highly successful direct buyback of commercial bank debt as one of the elements of its new financing package with commercial banks.

I am thus pleased to inform the Subcommittee that the strengthened debt strategy is very much alive and well My progress report today will reiterate the objectives of the strategy, outline creditor government actions, detail the reform efforts in some of the debtor countries, and focus on the design and benefits of the financing agreements in Mexico, Costa Rica, and the Philippines.

NB-665

Objectives of the Debt Strategy

The major tenet of the debt strategy can be summarized in one sentence. Highly indebted countries must successfully implement market-oriented macroeconomic and structural policy reforms in order to achieve sustained growth and ultimately resolve their debt servicing problems. In advancing the strengthened debt strategy, our key objectives are to

- Reinvigorate the policy reform efforts in the highly indebted countries. While a number of the major debtors initiated vital macroeconomic and structural reform programs, by the end of 1988 efforts to sustain these programs in several countries were stalled by debtor fatigue and pessimism. The strengthened debt strategy, by offering the prospect of significant debt and debt service reduction by the commercial banks, has provided important incentives for many debtor countries to maintain difficult but essential reform efforts. The strategy reaffirms the role of the IMF and the World Bank in encouraging strong debtor reforms, in particular measures to encourage repatriation of flight capital and investment.

- To mobilize financial resources from the private sector more effectively in support of debtor reforms By the end of 1988, new lending from commercial banks had virtually dried up, banks were disposing of their LDC exposure in the secondary market, and low investment and continued capital flight hobbled economic growth in debtor countries. The strengthened debt strategy is designed to harness commercial bank willingness to engage in debt and debt service reduction for the benefit of debtor countries, as a complement to new lending by a smaller group of banks, and to develop measures to promote new investment and capital repatriation.

- To redirect IMF and World Bank resources to back debt and debt service reduction for commercial banks. In order to strengthen the capacity of the IMF and World Bank to promote meaningful reform programs in debtor countries, the strengthened debt strategy permits debtor countries to use resources from the international financial institutions (IFIs) to back the reduction of debt and debt service by commercial banks IFI resources can be used to finance cash buybacks of bank debt, to purchase collateral for debt and debt service reduction instruments, and to provide limited interest support for such instruments

- To provide continued creditor government support Creditor governments continue to play an important role under the strengthened debt strategy through their contributions to the international financial institutions, rescheduling of official debt in the Paris Club, ongoing export finance, and efforts to reduce (where appropriate) impediments to debt and debt service reduction stemming from tax, regulatory, and accounting regimes

The strengthened debt strategy has been broadly endorsed by the international community. Last May, the IMF and the World Bank moved expeditiously to adopt guidelines governing their support for debt and debt service reduction. Several debtor countries have subsequently adopted medium-term, market-oriented economic reform programs, with greater recognition of the importance of measures to promote investment and capital repatriation This is the first essential step in the process

The second step for most countries has been the negotiation of multiyear rescheduling agreements with official creditors in the Paris Club. The final step -- negotiations with commercial bank creditors -- has now been completed for three countries -- Mexico, the Philippines, and Costa Rica. Venezuela and Morocco are now actively negotiating with their banks Other countries are moving to avail themselves of similar support within the next year as they adopt strong medium-term economic reform programs with the IMF and World Bank These countries include Bolivia, Nigeria, Ecuador, and Uruguay. The new president of Brazil has indicated he will announce his program after his inauguration in March

Role of Creditor Governments

Creditor governments have moved rapidly to support the strengthened debt strategy. At their urging, the IMF and the World Bank developed and put into place guidelines for IFI support for debt and debt service reduction A number of creditor countries have pledged financial support to enhance specific financing packages. The Government of Japan is in the process of providing $10 billion to support the strengthened debt strategy with specific commitments so far for Mexico, the Philippines, and Costa Rica. The United States, through USAID, has provided concessional resources to both the Philippines and Costa Rica to back debt and debt service reduction In addition, official export credit agencies continue to provide critical trade finance to many of the major debtor countries

Creditor governments have also made substantial contributions through Paris Club reschedulings. Reflecting the medium-term horizon of the debt strategy, the focus of the Paris Club is now on multi-year rescheduling agreements (MYRAs) for the debtor countries Since in many cases creditor governments have been willing to reschedule interest as well as principal on official loans, the official reschedulings have continued to provide "new money" and therefore more relief than bank reschedulings Official relief continues to be available only for countries with an IMF adjustment program

The U S. Government and other official creditors are also providing special treatment ("Toronto terms") to the least developed countries which are pursuing sound economic reform programs In addition, the U.S government has announced a willingness to forgive up to $1 billion in economic assistance loans to Sub-Saharan African countries pursuing economic reform programs Congress has appropriated funds for this purpose, nine countries have signed agreements, and four more countries have been declared eligible for the program.

Creditor governments have also initiated efforts to identify and, where appropriate, remove any impediments to debt and debt service reduction in their tax, regulatory, and accounting regimes. In the United States, the Securities and Exchange Commission has clarified the accounting treatment for the debt reduction bonds and debt service reduction bonds held by banks as a result of the Mexican financing package. In addition, the Department of the Treasury has clarified the tax treatment of the new bonds, in particular the determination of the amount of the tax loss. Neither the SEC clarification nor the Treasury clarifications break new ground, but instead rely on longstanding standards and rules to remove uncertainties as to how these financial instruments would be treated.

I would now like to brief you on concrete developments in specific debtor countries.

Mexico

Mexico has maintained a strong record of implementing macroeconomic and structural reforms in its efforts to resolve its debt problem. Mexico's past adjustment performance -- exchange rate reform, tax reform, liberalization of its trade regime, industrial diversification, and measures to reduce the fiscal deficit and curb inflation -- has provided the backdrop for economic recovery. However, the fall in oil prices in 1986, following on the 1985 earthquake, disrupted Mexico's economic progress. While the Mexican economy has been recovering from these shocks, growth has been sluggish, key debt ratios have remained high, and substantial financing gaps have persisted even after significant adjustment in the trade balance.

The Administration of President Salinas has pressed forward with reform efforts, including efforts to reduce the size and scope of the public sector. Recently, Mexico has taken measures to privatize the state airline, its major copper mine, and the state telephone company (one of the five largest companies in Mexico). Deregulation has been pressed in the trucking industry and the financial sector. New regulations have significantly liberalized Mexico's foreign investment regime These regulations streamline and expedite registration requirements, increase the transparency of Mexico's foreign investment laws, reduce performance requirements, and open up areas formerly excluded from foreign participation.

Mexico's agreements with its key creditor groups incorporate all elements of the strengthened debt strategy:

- Strong macroeconomic and structural reforms as conditions for drawing IMF and World Bank resources,
- Meaningful debt reduction;
- Substantial debt service reduction;
- New money;
- Bank waivers to permit subsequent debt buybacks;
- Full participation by commercial banks;
- IMF and World Bank enhancements in support of debt and debt service reduction;
- Substantial debt/equity swaps;
- Capital repatriation; and
- Multiyear Paris Club rescheduling;

Mexico and its creditor banks completed negotiations on a comprehensive medium-term financing package in July 1989. Signature of the final agreement started last Sunday, with the actual exchange of debt instruments expected by the end of March. The financing package provided commercial banks with a choice of vehicles to participate:

- **Debt Reduction Bonds** that replace existing medium-term debt at a discount of 35% with full repayment occurring in 30 years.

- **Debt Service Reduction Bonds** that carry a fixed interest rate of 6.25% with full repayment occurring in 30 years.

- **New financing** during 1989-92 equal to a total of 25% of existing exposure that has not been converted into debt and debt service reduction instruments

The debt reduction and debt service reduction bonds are supported by enhancements totaling $7.1 billion from the IMF, World Bank, Japan, and Mexico's own resources The principal of both bonds will be fully secured by collateral in the form of 30-year zero coupon bonds. Interest payments will be enhanced by 18 months of rolling interest support.

The United States Department of the Treasury will sell Mexico sufficient non-marketable 30-year zero-coupon Treasury bonds to be used as collateral for these transactions. Pricing zero-coupon bonds is complicated by a number of factors. At the time of the pricing Treasury had only issued non-marketable zero coupon bonds on two other occasions -- the Morgan/Mexican debt reduction deal in 1987-88 and the initial issue of zeros to REFCORP in October, 1989 Furthermore, Treasury has not itself issued zero coupon bonds directly in the public market. The Treasury STRIPS market, a derivative market resulting from the stripping of Treasury coupon instruments by market participants, remains smaller than the coupon market and somewhat volatile. As a result, there were few pricing precedents and no easy or obvious market guidance since a number of possible pricing benchmarks exist.

The Treasury pricing decision for the zero-coupon bond for Mexico was based on principles reflecting both the size of the Mexican transaction and the precedent of the 1987-88 Mexican purchase of zeros. The earlier Mexican deal was priced off the coupon rate because the STRIPS market was deemed to lack sufficient depth and the size of the transaction was large relative to the then outstanding STRIPS market. The current transaction size of approximately $35 billion face amount is even larger relative to the STRIPS market today. Treasury judged that the STRIPS quotation would again be inappropriate for pricing a transaction of this size and scope. The existing STRIPS yields would be severely affected if a transaction the size of the $35 billion face amount of Treasuries for Mexico were issued in the public market It is likely that the STRIPS yields would be driven toward the coupon yields

The specific pricing formula for the Mexican transaction involved the average 30-year U.S. Treasury coupon borrowing rate for the 3-day period ending January 5, 1990 of 8.05% A fee was charged by Treasury in the form of an adjustment of the annual yield by 1/8%, which is identical to the fees charged for Treasury special issues over many years. The Treasury's final borrowing rate from Mexico was 7 925%

<u>Benefits to Mexico of its Agreement with Commercial Banks</u>
The commercial bank package will generate substantial debt and debt service reduction benefits for Mexico·

- Over 85% of Mexico's bank debt will undergo substantial cuts in interest or principal.

- Mexico's debt obligations to commercial banks will be slashed significantly.

  -- The debt reduction bonds cut bank debt immediately by about $7 billion
  -- The debt service reduction bonds are the economic equivalent of a further implicit reduction in the stock of debt of $7.75 billion
  -- Up to an additional $3 5 billion of debt will be retired in the debt/equity swap program by 1992

- o Debt service savings total over $12 billion during the 1989-92 period.

  -- Annual interest payments to commercial banks will be cut by $1.5 billion (nearly one-third)
  -- Principal amortization payments will be reduced by $6 7 billion over this period

- o Of even greater importance, the burden of principal payments on $42 billion of Mexico's bank debt are lifted from the shoulders of the Mexican people, this is because Treasury 30-year zero-coupon bonds provided as collateral up front will assure full repayment of the remaining principal amounts of both the debt and debt-service reduction instruments in 2019.

- o Overall, the Mexican Government estimates that the <u>net effect</u> is that Mexico's <u>total</u> external debt will decline from $95 billion at the end of 1989 to the equivalent of $80 billion in March 1990 Furthermore, external net transfers will be reduced by more than $4 billion annually, which is equivalent to 4% of GDP

However, these positive results do not convey the full importance of the Mexican Agreement. To complete the assessment, it is necessary to compare these positive results with the results that would have flowed from the type of all new money solution that characterized the previous debt strategy:

- o Mexico's total debt in 1992 would have been some $24 billion higher than will now be the case, if we include the implicit effect of debt service reduction

- o Rather than perpetually rescheduling principal, the new agreement's defeasance arrangement removes from Mexicans the burden of future principal payments on $42 billion of Mexico's bank debt.

- o The medium-term time horizon of this package (four years) increases the stability of Mexico's economic and investment climate, as compared to the traditional 12-18 month financing pact, which we found could take most of that time to put together. Furthermore, the annual benefits of reduced interest payments, debt reduction, and defeasance extend well beyond the 1989-92 period of the package.

- o The new agreement frees up substantial Mexican resources for productive investment (about 4% of GDP), which otherwise would be used to service ever-growing debt

- The fact that virtually all of Mexico's commercial banks participated in this package contrasts sharply with the growing free rider problem under the old strategy Finally, there is no doubt that if the old strategy of concerted new lending had been tried for Mexico, the equivalent of $7 5 billion in new money would not have been forthcoming It was clear by the end of 1988 that most banks had decided to withdraw from providing fresh money to debtor countries This was one of the key reasons for changing the old debt strategy.

The final and perhaps most notable benefit of the agreement is the growing confidence in Mexico's economy. Since the agreement was announced last summer, domestic interest rates have fallen sharply, resulting in savings on servicing the government's domestic debt and a reduced fiscal deficit equivalent to 4-5% of GDP. In addition, net private capital inflows in 1989 totalled about $3 billion, indicating increased investor confidence. These positive developments, combined with Mexican reform efforts, have contributed to an expansion in the Mexican economy Growth has increased from 1 1% in 1988 to an anticipated 2.5% in 1989 The economy is expanding at a fairly rapid pace, with substantially lower inflation

These early indicators bode well for Mexico's capacity to achieve sustainable growth in the future. Current projections are that these benefits will help produce growth of 5-6 percent by 1994 and will halve Mexico's debt service and interest service ratios. For these benefits to crystallize, it will be vital for Mexico to sustain its reform efforts.

<u>Other Financing Packages</u>

The strengthened debt strategy is designed to be flexible and responsive to individual debtor country needs As a result of the case-by-case approach, the financing packages which emerged from debtor/bank negotiations in the Philippines and Costa Rica differ markedly from the Mexican package.

The agreement between the Philippines and its commercial banks places greater emphasis on new money and direct cash buybacks because Philippine conditions are materially different from those in Mexico. The Philippine economy has realized steady growth for a number of years and its debt burden is not as heavy as Mexico's. The Philippines also is the beneficiary of substantial foreign assistance commitments for the period ahead The impact of debt and debt service reduction would have been small relative to Philippine financing needs because medium-term bank debt only accounts for about 25% of total Philippine indebtedness.

These factors are reflected in the agreement reached between the Philippines and its commercial banks New lending was necessary to fill projected financing gaps, while direct cash buybacks were an efficient means of enlisting the support of banks prepared to exit the Philippines at a steep discount. The elements of this agreement include the following

- The Philippines completed a direct buyback of $1 3 billion in early January at a 50% discount. This is equivalent to a 20% reduction in its stock of medium-term commercial bank debt. The buyback was funded by IMF, World Bank, Philippine and official support totaling $667 million (including $95 million from the U.S. Agency for International Development).

- Banks rescheduled remaining outstanding debt.

- Pledges of voluntary new lending from commercial banks are currently more than $600 million and could go higher.

- Commercial banks have rescheduled the remaining debt and have granted waivers to permit the Philippines to launch additional debt and debt service reduction arrangements.

This agreement offers substantial benefits to the Philippines It fills the projected financing gaps for 1989-90 while achieving net debt reduction. After taking into account the substantial new lending contemplated, we estimate that the net debt reduction and the net debt service reduction on bank debt will still amount to 10%. Because the net debt reduction is permanent, these benefits will extend well beyond 1990 Further reduction of commercial bank debt is contemplated since the Philippines has committed to reopen its debt/equity swap program and expects additional debt and debt service reduction operations as a result of broad commercial bank waivers. These longer-term benefits should help to stabilize the medium-term economic and investment climate in the Philippines, provided of course that the Philippine government successfully implements needed reforms in its investment policies

The debt strategy is not only flexible enough to accommodate different debtor profiles, but is also designed to apply to smaller debtor countries such as Costa Rica. Costa Rica has a heavy debt burden and has significant projected financing gaps for several years. Negotiations with commercial banks were also complicated by Costa Rica's arrears problem, accounting for $325 million of $1.8 billion owed commercial banks.

In October 1989, Costa Rica reached agreement with its Bank Advisory Committee on a package we expect will be completed by spring 1990 The financing agreement deals effectively and stringently with the arrears problem, while realistically recognizing the limits on Costa Rica's capability to service its bank debt. Elements of the agreement include

- A projected cash buyback of outstanding debt, including arrears, at an 80% discount
- An exchange of the remaining principal for a par bond with a reduced interest rate of 6 25%
- Substantially less favorable treatment for the remaining arrears, which requires a 20% downpayment on the outstanding balance by Costa Rica, rescheduling of the balance for 15 years in a mortgage-style bond, and a market rate of interest.
- IMF, World Bank and official support to fund the buyback and provide interest support for the par bond
- Principal is not collateralized in this transaction

Given the depth of Costa Rica's discount, the direct benefits of the financing package to Costa Rica are very substantial We estimate that the arrangement, when implemented, would retire about 60% of Costa Rica's bank debt and reduce interest payments by about 60% annually. The agreement will put the troublesome arrears problem behind Costa Rica, and reduce Costa Rica's debt service burden to a level which reflects more realistically its ability to pay.

The new debt strategy was also used by Chile to implement its direct cash buyback in November. Chile chose not to enter into broad debt reduction negotiations with commercial banks because it is close to recovering voluntary access to financial markets and its earlier debt conversion programs were very successful in reducing its commercial bank debt. Instead, Chile completed a limited direct buyback, using resources from the international financial institutions to purchase $140 million in commercial bank debt at a discount of 41% The buyback should be viewed as the latest stage of the Chilean debt reduction program Since 1985, Chilean debt/equity swap and buyback programs have retired $7 8 billion in debt, equivalent to over half of its medium- and long-term commercial bank debt at end-1985 In many ways, Chile could be viewed as the laboratory for the strengthened debt strategy. The Chilean experiment indicates that a strong commitment to reform combined with reduction in bank debt can result in normalization of debt service and sustainable growth.

Assessment of the Debt Strategy

The financing agreements to date feature the new mechanisms for commercial bank support anticipated by the strengthened debt strategy and furnish new incentives for sustaining sound policies in debtor economies. The Mexican and Costa Rican packages assured comprehensive support by the full banking community, while the Philippine and Chilean arrangements focus on selective debt reduction. Good performance deserves such support by the commercial banking community Debtor nations cannot resolve their external debt problems through their own efforts alone

Practical implementation of the strategy has required an adjustment of expectations by both the debtor nations and commercial banks. Initial debtor country expectations of debt relief were high, while the extent of acceptable debt reduction varied from bank-to-bank.

My own sense is that many debtor countries and commercial banks are now coming to terms with the new reality Debtor countries are recognizing that debt relief alone is not a panacea for their economic problems. Sound policies are the essential prerequisite for success. In the agreements negotiated thus far, commercial banks have acknowledged that their diversified interests can only be reconciled through diversified options, that innovative forms of new lending are still possible, and that debt and debt service reduction for performing countries can support adjustment and improve the quality of their remaining claims.

Looking ahead, I would offer a note of caution to debtor nations and commercial banks alike:

- Debtor nations can not afford to relax their adjustment programs simply because they may be able to obtain a measure of debt relief. If the reform process is not sustained, these countries will have squandered their best opportunity to put their debt problems behind them.

- The strong reserve position of commercial banks, which we commend as financially prudent and conducive to debt reduction, should not be used as a screen for failing to negotiate solutions with the debtor countries Perpetual reschedulings, with minimal debt reduction, debt service reduction or new lending, can only contribute to future arrears and undermine the reforms needed for sustained growth

- Both debtor nations and commercial banks must avoid the temptation of funding medium-term gaps through arrears Such a temporary and illusory solution can only undermine the reform effort, dissipate market and investor confidence, and replace cooperation with confrontation

o Finally, no matter how overpowering the debt problem appears in its totality, we must continue to focus our efforts on a case-by-case basis on those elements of the problem which can be solved and then expand on our successes. We must continue to recognize that there are no easy, all encompassing global solutions

Conclusion

The international community has made significant progress in transforming the strengthened debt strategy from general concepts to practical results in the financing packages that have emerged thus far While it is still too early to assess the strategy fully, a number of important developments have already occurred·

o The strengthened debt strategy has already renewed resolve in a number of debtor countries to complete the adjustment process. Countries which have not yet completed financing packages, such as Venezuela, are making significant strides in reforming their economies

o The strategy is flexible. It can respond to specific country circumstances, whether the debtor is large or small, or close to returning to voluntary lending It can offer commercial banks a wide range of options to suit their particular needs

o The agreements in Mexico and the Philippines indicate that new bank lending and debt reduction can coexist in the same financing packages.

o The reduction in domestic interest rates and capital reflows in Mexico resulting from the bank package are evidence that perhaps the most important contribution of the strategy may be the restoration of confidence in the debtor country's economy

o The strategy has the potential to extract debtor countries from the spiral of constantly escalating debt This not only frees up resources for productive investment, but also boosts optimism in the debtor countries that sustained economic development and improved living standards are still achievable targets not just etherial goals.

- Finally, by combining fundamental economic reform in the debtor countries with substantial debt and debt service reduction by commercial banks, there is now a realistic hope that flows of capital in the form of repatriated flight capital and direct investment will be provided as the "new finance" needed by debtor countries to sustain their recovery Such a result offers a far more credible solution for long-term growth than a perpetual dependence on new rounds of concerted lending by unwilling commercial banks

Office Memorandum

TO The Managing Director

DATE February 2, 1990

FROM S T Beza MA

SUBJECT Mexico--Remarks for Signature Ceremony

Attached please find a proposed text in Spanish for your remarks on the occasion of the signature ceremony of the financing agreement with commercial banks, to take place this weekend in Mexico

Attachment

cc The Deputy Managing Director
Mr H Simpson

Comentarios del Señor Gerente En Ocasión de la Ceremonia de Firma del Acuerdo Financiero Entre Mexico y Bancos Comerciales, Mexico, D.F , Febrero 4, 1990

Excelentísimo Señor Presidente, Señores Secretarios de Estado, Distinguidos Huéspedes, Señoras y Señores

Asistimos hoy a un evento de trascendencia histórica para México y la comunidad financiera internacional Ciertamente el efecto de este acuerdo va más alla de las fronteras de México ya que servirá de ejemplo para otros países y entidades que se han visto afectados por el problema de la deuda.

El acuerdo que hoy se firma refleja el esfuerzo continuo de las autoridades mexicanas para llevar nuevamente al país por la ruta del crecimiento económico con estabilidad Se abre así un nuevo capítulo en las relaciones entre los países deudores y la comunidad financiera internacional.

El actual programa económico representa una etapa decisiva en el esfuerzo en que las autoridades mexicanas se han embarcado para lograr un mejor equilibrio económico y para modificar las estructuras productivas a fin de modernizar la economía Por medio de esta estrategia se busca alcanzar un desarrollo económico sostenido en el mediano plazo.

Se han obtenido ya logros importantes, pero el camino no ha estado libre de escollos. En tales momentos, han surgido muchas voces en México y en el exterior reclamando resultados inmediatos o sosteniendo tener curas milagrosas. Sin embargo, la experiencia ha demostrado que no existen soluciones fáciles y que no hay alternativas a perseverar sin titubeos en la ejecución de políticas económicas sensatas, como lo han hecho las autoridades mexicanas

Mirando hacia el futuro, la labor que espera a las autoridades es ardua, pero las perspectivas son alentadoras. Gracias a un esfuerzo de cooperación extraordinaria entre México y sus acreedores, el programa económico del país está siendo respaldado por un paquete de financiamiento creativo. Apoyado por recursos financieros del FMI, del Banco Mundial, y del Gobierno de Japón, este acuerdo permitirá una reducción en el servicio de la deuda por parte de Mexico en los próximos años Más aún, como respuesta positiva a las acciones de las autoridades económicas y a este acuerdo, se ha observado recientemente un mayor nivel de inversión y un reflujo de capital.

Después de estas operaciones, sin embargo, la tarea a afrontar por las autoridades seguirá requiriendo una atención continua La economía puede verse afectada negativamente por eventos externos tales como una baja en los precios de petróleo o un aumento en tasas de interés Pero aún si no intervienen estos factores adversos, es indudable que alcanzar un crecimiento económico sostenido no es fácil Las autoridades mexicanas saben que esto requiere mantener políticas que estimulen el ahorro, en alguna medida a través de una política fiscal firme, y que promuevan un uso eficiente de recursos, apoyado por un proceso de mayor competencia. Esto, por cierto, implica la compleja tarea de quitar privilegios a ciertos sectores y aplazar el consumo en beneficio de un mayor nivel de bienestar en el futuro.

Las autoridades mexicanas han demostrado repetidamente su voluntad de actuar con energía y prontitud para modificar el curso de política a fin de preservar su programa económico. Si surge nuevamente la necesidad de responder a circunstancias cambiantes, México no debe estar solo la comunidad financiera internacional deberá continuar apoyando los esfuerzos de México para resolver sus problemas

Para finalizar, deseo enfatizar los elementos que hacen de este acuerdo un ejemplo en la estrategía de solución al problema de la deuda un esfuerzo interno fuerte y sostenido, en un marco de cooperación internacional y participación voluntaria de la comunidad financiera. El acuerdo que se firma hoy abre un camino lleno de oportunidades que estoy seguro permitirá enfrentar con renovado optimismo la tarea de mejorar las perspectivas de crecimiento en los países afectados por un alto endeudamiento.

Office Memorandum

TO Mr Bielaski

DATE March 7, 1990

FROM M Caiola

SUBJECT Mexico--Change in Number of Mission Members

The EFF Review Mission No 90143500, which left for Mexico on March 5, was originally approved in the six-month travel schedule as having six mission members We would like to inform you that the mission size was reduced and that only four staff members actually went

cc Mrs Braña

STB
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JB
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Office Memorandum

TO The Managing Director
The Deputy Managing Director

DATE February 21, 1990

OK
MD2
2/24/90

FROM S.T. Beza

SUBJECT Mexico--Staff Visit

You will recall that shortly before the recent Executive Board review of the extended arrangement for Mexico (EBM/90/12, 01/29/90), the Mexican authorities informed us that there appeared to be deviations with respect to the net international reserve target and the ceiling on the Bank of Mexico's net domestic assets for end-1989. Mexico's next purchase under the extended arrangement is dependent on observance of quantitative performance criteria for end-1989

The authorities were of the view that the deviations were mainly the result of transitory factors which would be self-reversing. They added, however, that they would take compensatory fiscal and monetary measures to ensure that the shortfall in net international reserves experienced in 1989 would be made up in 1990, and thus they agreed to consider modifications to quantitative performance criteria for the 1990 program approved recently by the Executive Board.

Accordingly, a mission consisting of Messrs. Loser (Head), Kalter, Khor (all WHD), and El-Erian (ETR) will visit Mexico City for about two weeks beginning March 6, 1990 to ascertain the extent and nature of the deviations with respect to the quantitative performance criteria for end-1989 and review recent economic trends. In this light the mission will discuss the adequacy of the policy measures being adopted by the authorities and seek agreement on the modifications needed in the performance criteria for 1990.

The mission also will discuss adjustments to performance criteria that will be called for because commercial bank flows in 1990 differ from those assumed in the program as a result of last minute changes to certain features of the financing package. These changes include a) the payment in the first quarter of the year of interest accruing through end-March 1990 and originally programmed to be paid in the period April-August, and b) the postponement to the fourth quarter of the year of disbursements of the 1989 interest relief which had been expected to take place in March. These changes would give rise to a shortfall in the accumulation of reserves (by some US$2 billion) in the first quarter of 1990, which would be fully offset in the fourth quarter. Therefore, a modification of quarterly performance criteria would be required, possibly including those in the fiscal area because of the acceleration of interest payments abroad during the year.

Following a 3.4 percent increase in December 1989, the consumer price index is reported to have risen by 4 8 percent in January 1990. This increase is much higher than that assumed in the program for 1990, and is attributed in part to some delays in the implementation of public sector price adjustments during December, including a 200 percent increase in public transportation fares it may also have reflected increases in prices by the private sector in excess of the wage-price guidelines The authorities have acknowledged the difficulty of achieving their 15 percent inflation target for 1990 but have reiterated their intention to implement policies consistent with this objective

The acceleration of inflation and the tightening of credit policy resulted in a rise in domestic interest rates in recent weeks. Annual interest rates on one-month treasury bills rose by 5 percentage points to about 45 percent a year Although interest rates are still in line with those assumed in the program for the first quarter of 1990, further increases would jeopardize the attainment of the fiscal targets during the year unless the primary fiscal surplus is larger than programmed The authorities are slowing the pace of expenditure relative to the program, but the mission will examine whether additional measures are needed to raise the primary surplus, including adjustments in public sector prices.

The mission will seek a modification of the target for the official international reserves in 1990 that would offset fully the shortfall experienced in 1989, emphasizing the fragility of the reserve position in light of the debt reduction operations and the importance of preserving the integrity of the program in an area in which there have been some problems. The mission also will seek that the replenishment of reserves take place as early as possible during the year The modification to the reserve targets will be accompanied by corresponding adjustments to the net domestic asset limits Although the authorities agreed to modify the reserve targets along the lines just described, discussions on these issues may turn out to be difficult. In this connection, the mission will stress that the authorities' willingness to modify the targets for 1990 to make up the 1989 shortfall was taken by Executive Directors as an important indication of the determination of the Government's commitment to the program

An area where additional problems may arise is that of the Bank of Mexico's net credit to the nonfinancial public sector While the overall fiscal targets for end-1989 appear to have been achieved, the composition of the public sector financing differed from that envisaged previously, with greater reliance on credit from the Bank of Mexico As a consequence, the end-1989 stock of Bank of Mexico net credit to the nonfinancial public sector is likely to have exceeded projections made in early December by Mex$6-7 trillion (about 1 1/4 percent of GDP), although it was still well within the 1989 program ceiling

Because the quarterly ceilings on the outstanding stock of net credit for 1990 (the only ceiling in the program defined in terms of stocks) are based on the early December projection, the authorities may seek a full adjustment of the ceilings for credit to the public sector in 1990 to reflect the actual end-1989 stock of credit The authorities may argue that maintaining the program ceiling for credit to the public sector recently agreed for 1990 would constrain them unnecessarily in the conduct of monetary policy. In the view of the staff, however, to the extent that the divergence between the actual outcome and the previous estimate for end-1989 was the result of transitory and reversible factors (such as the four-day end-year weekend) there may be no need to adjust the stock of credit to the public sector for 1990 The mission will emphasize the importance of a tight monetary policy in light of the underperformance on international reserves and recent price developments. Hence, the ceilings would be modified only if achievement of the program objectives were not at risk

After understandings on the above points are reached and a letter incorporating them is approved by management, the staff will issue a paper to the Board requesting, as needed, waivers for nonobservance of the end-1989 performance criteria and modifications of performance criteria for 1990 consistent with the reconstitution of foreign reserves and the final features of the financing package with commercial banks

This note has been reviewed by Messrs Ferrán and van Beek (WHD), Mr Brau (ETR), Ms. Ter-Minassian (FAD), Mr Surr (LEG), Mr Aghevli (RES), and Mr. Coats (TRE)

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

Office Memorandum

TO The Managing Director
The Deputy Managing Director

DATE February 21, 1990

FROM S T Beza

SUBJECT Mexico - Communication to the U S authorities

The attached draft incorporates our comments to the proposed communication in support of the Mexican request for bridge financing from the U S authorities

We suggest mainly editorial changes to the first two paragraphs of the draft prepared by the Mexicans However, we propose significant changes to the final paragraph because of the importance of corrective policy actions to protect the program, we also delete reference to the program being on track for 1990 Furthermore, we add that a mission will visit Mexico to reach understandings on performance criteria and that the results of the negotiations will be submitted for Executive Board consideration

The draft note has been reviewed by Mr Brau (ETR), Ms Ter-Minassian (FAD), Messrs Liuksila and Surr (LEG), Mr Aghevli (RES), and Mr Coats (TRE)

* * * * *

A more important point is that Ms Dawson and Mr Truman have informed me that the U S authorities do not wish to receive this kind of letter (Fund support of a bridge) at this time They told me that they had emphasized more than once to the Mexican authorities that there could be no bridge until after the forthcoming IMF mission has completed its work in Mexico

Attachment

cc Mr H Simpson

DIRECTOR GENERAL
DEL
BANCO DE MEXICO

México, D F , a 19 de febrero de 1990

SR MICHEL CAMDESSUS
Director Gerente
Fondo Monetario Internacional
Washington, D C

Estimado Michel

De acuerdo con nuestra conversación del jueves último, te envío con la presente un proyecto de la carta que podría ser dirigida por tí a los señores Nicholas Brady y Alan Greenspan

Aprovecho la ocasión para enviarte un saludo cordial

Con un abrazo

Miguel

MR. NICHOLAS BRADY
Secretary of the Treasury

MR ALAN GREENSPAN
Chairman
Federal Reserve System
Washington, D C.

Dear Secretary Brady·

As you are aware, the completion of Mexico's financing package, while constituting an important step forward in dealing with that country's financial difficulties, has ~~given rise to~~ been associated with a concentration of net interest payments in the first quarter of 1990, followed by ~~much~~ lower than ~~lighter~~ previously projected payments the following two quarters In fact, ~~as a~~ in the ~~result~~ context of the ~~final~~ agreement ~~between Mexico and~~ with its creditor banks, ~~that country~~ Mexico will have to make interest payments in the first quarter of 1990 greater than previously envisaged, whereas it will receive later in the year the bulk of the interest refund ~~accorded~~ being provided ~~with the~~ by commercial banks under the agreement ~~As all this~~ The shortfall in the first*, which totals over 2 billion dollars, ~~is happening in the same quarter when the~~ coincides with the repayment of the bridge loan for $1,271 million and the ~~payment~~ use of $1,300 million for enhancements As a result ~~fall due~~, the country's international reserves will decline to ~~dangerously~~ low levels

* quarter of the year

In view of the above, ~~I consider~~ the Mexican authorities' intention to draw on existing swap lines with the U.S financial authorities, in my opinion, would help ~~as most appropriate~~ to forestall disorderly conditions in the exchange market, thereby ~~since~~ strengthening Mexico's ~~the latter could jeopardize their~~ stabilization efforts

INSERT

The Fund has recently reviewed Mexico's economic performance in 1989 and approved their economic program for 1990 Although some deviations emerged with regard to the end of year targets, there is no question that performance in 1989 was generally satisfactory despite an extremely large short fall of external finance It is also our view that the program on the whole is on track and that the differences that emerged can be corrected in 1990 Moreover, I am encouraged by the prompt policy response of the authorities in this regard

Yours sincerely,

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The Fund recently reviewed Mexico's economic performance in 1989 and the economic program for 1990 under the extended arrangement Certain deviations emerged with respect to some end-1989 performance criteria, but the Executive Board found performance in 1989 to have been generally satisfactory Moreover, I have received assurances from the Mexican authorities that the policy stance in 1990 will correct fully the above-mentioned deviations The authorities have responded promptly by taking additional policy measures, and they have indicated their readiness to take further measures if these should be needed In this regard, a staff mission will visit Mexico soon to ascertain the progress being made in achieving the program objectives for 1990 and to reach understandings on the modifications to performance criteria needed to assure the success of the 1990 economic program The results of the mission would be presented to the Executive Board of the Fund for its consideration shortly after the return of the mission

Office Memorandum

TO The Managing Director DATE February 1, 1990

FROM S.T. Beza

SUBJECT Mexico

This note has been prepared for your visit to Mexico this weekend and seeks to highlight both positive aspects of Mexican economic developments and certain concerns that we have with regard to prospects An analysis of Mexican developments and policies, including the program for 1990, was presented in the recent staff paper (EBS/90/10), which served as a basis for last Monday's Executive Board discussion on Mexico

1 Among positive developments, the following might be emphasized

- Real GDP has risen at a rate of somewhat more than 2 1/2 percent in 1989 against 1 1/2 percent programmed, with investment growing by nearly 10 percent in real terms However, if private sector demand were to continue to expand at a very rapid pace, action would be required to avoid undue pressures on resources

- Efforts to lower inflation have met with considerable success. The 12-month rate of increase in consumer prices declined from 52 percent in December 1988 to less than 20 percent in December 1989 The 1990 program envisages some further drop in inflation

- The strengthening of the fiscal stance in 1989 was an important development. On the basis of available information the authorities appear to have observed the targets for the key fiscal aggregates for the year The program contemplates a further strengthening of the PSBR and the operational balance in 1990

- Major structural reforms have been implemented in the areas of fiscal (tax reform and divestiture), monetary (financial liberalization), trade (lifting of restrictions and lowering of tariffs), and foreign investment (reduction of barriers to entry) policies. In 1990 the authorities plan to proceed further with the privatization of public enterprises, actions to improve the efficiency of domestic distribution, and, in general, to simplify regulations governing the industrial sector

- The completion of the financing package with commercial banks has reduced uncertainties as regards the availability of foreign financing and has led to a reduction of external interest payments

- In response to domestic policies and support from the international financial community, there was a reflow of private capital in 1989, this is expected to continue, although at a slower pace, in 1990

2. At the same time, there are several areas of concern

- The external payments position remains vulnerable The level of official reserves is low, aggravated by the shortfall with respect to the end-1989 reserve target The authorities, however, have taken measures to tighten credit and domestic interest rates have increased sharply in recent weeks. Furthermore, the Government is holding back public expenditures of the central administration

- The recent need to raise interest rates may be indicating that the primary fiscal surplus should be raised to protect the objectives of the program Actions to strengthen the primary surplus could include adjustments of public sector prices (e g , gasoline and other petroleum products) which have been declining in real terms This would help to reduce price distortions which have emerged in the context of the PECE (which relate in part to agricultural pricing policies that are now being scrutinized)

- The present exchange rate policy, in combination with continued cautious wage policy and the pursuit of sound financial policies, would seem sufficient to assure an adequate external competitiveness. However, given the country's (relatively weak) international reserve position, exchange rate policy will need to be kept under close scrutiny It should be noted that there are some who hold the view (in Mexico and outside) that the reason interest rates are as high as they are in real terms in Mexico is because the general public is protecting itself against a probable sharp depreciation of the peso.

- Some Mexican representatives may show annoyance about the commitment to accumulate international reserves in 1990 for an amount equivalent to the shortfall observed in 1990, which they may view as a last minute imposition by the staff of the Fund The response would be to emphasize the importance of preserving the integrity (and continuity) of the program in an area in which the program had come under pressure Also, it might be noted that the willingness of the authorities to modify the targets for 1990 was taken by Executive Directors as an important indication of the determination of the Government to achieve the objectives of the program Lastly, you could say that a lot of money was at stake and we had to go to the Board with assurances that the authorities were committed to making the program work

* * * * *

You undoubtedly will be exchanging views with Mr. Brady and with commercial bankers

- For Mr Brady, it would be useful to remind him of the risks surrounding the program, particularly in the external sector, given the reduction of financing from the level we had originally envisaged in the program and the present reserve position after the Mexican contribution to the enhancements This has to mean that the Treasury has a continuing responsibility in assuring adequate financing for Mexico In another vein, we have received unofficial indications of a possible extension by the Treasury of a loan to the Bank of Mexico to bridge the release of the 1989 interest rebate by commercial banks to Mexico late in 1990. If this were the case, it would constitute a useful step by the U S. Government in support of the Mexican program

- For the commercial banks, they need to be reminded of the vulnerability of Mexico's program to external developments Thus, Mexico may need to turn to them for support not only because of developments in oil prices and interest rates, but perhaps more generally. The high exposure of multilateral and bilateral lenders would limit participation by these organizations in any contingent financing facility

Attached are tables of key indicators, including medium-term projections for the Mexican economy

Attachments

cc The Deputy Managing Director
Mr. H Simpson

table01, 2.1 90

Mexico Selected Social and Economic Indicators

Population (mid-1989)	85 7 million
Population growth (1981-89)	2 4 percent
Labor force growth (198-89)	2 5 percent
Open unemployment rate (1989)	3 1 percent
Life expectancy at birth (1987)	68 years
Infant mortality rate (1987)	38 per thousand
Population per physician (1987)	1,200
Population with access to safe water (1987)	74 percent
Pupils reaching grade six (1987)	54 percent
GDP per capita (1989)	US$2,340

	1986	1987	1988	Prel 1989
(Percentage change)				
Real GDP	-3 8	1 5	1 1	2 5
Real GDP per capita	-6 6	-0 8	-1 1	0 5
Real private consumption	-1 2	-0 7	1 6	1 6
Real fixed investment	-12 0	-0 6	6 1	9 6
Consumer price index (end of year)	105 7	159 2	51 7	19 7
Terms of trade	-28 2	10 4	-9 4	3 7
Exchange rate (Mex$/US$)	148 5	138 2	2 6	16 2
Real effective exchange rate	-23 5	3 3	28 8	2 4
Real minimum wage	-9 0	-5 3	-13 1	-6 5
(In percent of GDP)				
Primary fiscal balance	2 3	5 0	5 9	8 4
Public sector borrowing requirement	15 6	15 9	12 9	6 2
External current account	-0 9	2 7	-1 6	-2 7
Of which interest payments	6 4	5 9	5 0	4 8
Gross domestic investment	18 1	18 6	20 4	22 5
Gross national savings	17 2	21 3	18 8	19 7
External debt	75 8	74 0	54 3	48 5

Sources Mexican authorities and Fund staff estimates.

Mexico A Medium-Term Scenario

	Prel. 1989	Projection 1990	1991	1992	1993	1994	1995
	(Annual percentage change)						
Real GDP	2 5	3.5	4 5	5 5	6 0	6 0	6 0
Consumer price index (end of year)	19.7	15 0	10 0	8 0	6 0	6 0	6 0
	(In percent of GDP)						
External current account	-2 7	-2 4	-1 3	-1 0	-0 9	-0 7	-0 6
Of which interest payments	4 8	4 4	3 5	3 2	2 9	2 7	2 4
Primary fiscal balance	8.4	6 9	6 0	5 4	4 9	4 7	4 5
Public sector borrowing requirement	6.2	5 1	2 8	1 8	1 3	1 1	0 8
Gross domestic investment	22 5	23 4	24 5	25 2	26 4	27 1	27 4
Gross national savings	19.7	22 1	23 2	24 2	25 5	26 4	26 8
External savings	2 7	2 4	1 3	1 0	0 9	0 7	0 56
Fxternal debt	48 5	45 1	42 5	38 6	35 8	32 4	29 4

(In billions of U S dollars)

	1989-90	1991	1992
Benefits of debt package			
Net cash flow support	2 73	1 47	1 47
New money	0 83	0 38	0 38
Interest relief (net)	1 90	1 09	1 09
Debt subject to lower interest rate	22 5	22 5	22 5
Gross debt extinguished	6.8	--	--
Value of enhancements	7 1	7 4	7 7

Sources Mexican authorities and Fund staff estimates

Mexico Medium-Term Balance of Payments Scenario, 1988-95

(In billions of U S dollars)

	1988	Prel 1989	Prog 1990	Projections 1991	1992	1993	1994	1995
Current account	-2.9	-5 5	-5 1	-2 9	-2 6	-2 4	-2 2	-1 9
Merchandise trade	4 1	3 0	2 9	3 8	4 1	4 3	4 4	4 6
Exports	23 0	25 9	27 8	30 9	33 9	37 3	41 1	45 3
Of which petroleum	6 7	7 7	7 3	7 5	7.8	8 1	8 4	8 7
Imports	-18.9	-22 8	-24 9	-27 1	-29 8	-33 1	-36 7	-40 7
Net services and transfers	-7.0	-8 5	-8 0	-6 8	-6 8	-6 7	-6 6	-6 5
Of which interest 1/	-8.9	-9 6	-9 4	-8 2	-8 3	-8 3	-8 3	-8 2
Capital account	-4 0	4 5	4 4	3.2	3 1	3 2	3 1	3 1
Official capital	0 4	0 8	1 0	0 9	0 5	0 7	0.3	0 2
Commercial banks 2/	-1 5	-0 2	4 1	-0 5	—	0 4	0 4	0 4
Multilaterals	0.9	0 8	2 9	1 4	1 3	1 4	1 6	1 7
Bilaterals and suppliers 3/	0 8	1 5	2 6	1 9	1 1	0 2	-0 2	-0 5
Other (including short term)	0 2	-1 3	-8 6 4/	-1 8	-1 9	-1 3	-1.5	-1 5
Private capital	-4 4	3 7	3 4	2 3	2 7	2 6	2 8	2 9
Interest held abroad	-1 5	-1 7	-1 5	-1 5	-1 6	-1 6	-1 7	-1 7
Direct investment 5/	2 6	2 6	3 5	3 3	3 3	3 0	3 2	3 4
Other (including errors and omissions)	-5 5	2 8	1 4	0 6	1 0	1 2	1 3	1 3
Overall balance	6 9	-1 0	-0 7	0.3	0 5	0 8	0 9	1 2

Sources Mexican authorities and Fund staff estimates

1/ Starting in 1991, reflects debt and debt-service reduction operations
2/ Including impact of debt restructuring Excludes resources associated with interest relief after 1990 which are reflected as lower interest payments in the current account Disbursements in 1993-95 are assumed to take the form of new money similar to 1990-92 and rescheduling of most principal obligations falling due.
3/ Including impact of debt rescheduling
4/ Including outflows in support of enhancement operations for debt and debt-service reduction
5/ Including flows associated with debt-equity conversions

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

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Executive Board took following decision January 29, 1990:

QUOTE

Extended Arrangement - Second Year

1. (a) Mexico has consulted with the Fund in accordance with paragraph 4(b) 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, and to reach understandings regarding economic policies for 1990 and performance criteria for 1990.

(b) Mexico, in the letter of January 15, 1990 from the Secretary of Finance and Public Credit of Mexico and the Director General of the Banco de

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Mexico has requested that the amount of the extended arrangement be augmented by an amount equivalent to SDR 466 2 million, for Mexico's use for interest support in connection with its debt and debt-service reduction operations

(c) Mexico, in the same letter, has requested that the Fund make available, in accordance with paragraph 2(d) of the extended arrangement, the equivalent of the set-aside amounts involved in the reductions which, pursuant to paragraph 2(d) of the arrangement, were made in the purchases already made under the arrangement, in an amount equivalent to SDR 209 79 million In making that request Mexico has represented that it has a need to make the requested purchase because of its impending payments for the discharge of liabilities under debt reduction transactions

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(d) Mexico, in the same letter, has also requested that the Fund make available, in accordance with paragraph 2(e) of the extended arrangement, the equivalent of the set-aside amounts involved in the reductions to be made, pursuant to paragraph 2(d) of the arrangement, in the purchases scheduled to become available under the arrangement during the remainder of 1990, in an amount equivalent to SDR 279.72 million, with corresponding adjustments to the phasing and discontinuance of the setting aside of amounts for debt reduction with respect to the purchases scheduled to become available under the arrangement during 1990.

2. The letter of January 15, 1990, and the Technical Memorandum of Understanding 1990 ("the Memorandum") attached thereto, and the other letter of January 15, 1990, from the Secretary of Finance and Public Credit of Mexico and the Director General of the Banco de

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Mexico, 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 the letter and attached Memorandum dated January 15 1990 and the other letter of January 15, 1990.

3 Accordingly, Mexico will not make purchases under this extended arrangement

(a) during any period until May 31, 1991 in which the data at the end of the preceding period indicate that

(i) the limit on the net domestic assets of the Banco de Mexico, as described in paragraphs 2 9, 11, 12, and 13 of the Memorandum, or

(ii) the limit on the overall Public Sector Borrowing Requirement, as described in paragraphs 4 11, 12, and 13 of the Memorandum, or

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(iii) the limit on the operational deficit of the nonfinancial public sector, described in paragraphs 5, 11, 12, and 13 of the Memorandum, or

(iv) the target for the primary surplus of the nonfinancial public sector, as described in paragraphs 6, 11, 12, and 13 of the Memorandum or

(v) the limit on the Banco de Mexico's net claims on the public sector, as described in paragraphs 10, 11 12, and 13 of the Memorandum, or

(vi) the target for the net international reserves of the Banco de Mexico as described in paragraphs 8, 11, 12, and 13 of the Memorandum or

(vii) the limit on the public sector's net

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use of foreign credit, as described in paragraph 3 of the Memorandum, is not observed or

(b) after August 31, 1990 and February 28 1991 respectively until the respective reviews have been completed and suitable performance clauses have been established as contemplated in paragraph 25 of the attached letter of January 15, 1990, or after such clauses, having been established, are not being observed

4 (a) The Fund notes the request for augmentation of the amount of the extended arrangement as described in paragraph 1(b) above, and finds, in the light of paragraph 3 of Decision No 9162-(89/65) adopted May 26 1989 that the arrangements for the financing of Mexico's program provide for appropriate debt-service reduction The Fund determines that these arrangements are

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consistent with the objectives of the program under the extended arrangement and with the Guidelines on Fund Involvement in the Debt Strategy, adopted May 23, 1989 The Fund notes Mexico's representation that the equivalent of the amount purchased for interest support will be used as part of the collateral required for debt and debt-service reduction operations in connection with the commercial bank financing package

(b) Accordingly, the Fund decides that

(i) For the purposes of the requested augmentation, paragraph 1 of the extended arrangement is amended by substituting "SDR 3,263 4 million", for "SDR 2,797 2 million".

(ii) Notwithstanding paragraph 4 of the extended arrangement, Mexico may purchase an amount equivalent to

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SDR 466 2 million under this arrangement, for use during the 90 days following the date of this decision, for the purchase of an equivalent amount of collateral for interest support in connection with Mexico's debt and debt-service reduction operations in accordance with its request, and

(iii) for the purposes of that purchase, the Fund waives the limits of Article V, Section 3(b)(iii)

5 (a) The Fund notes

(i) the request of Mexico as described in paragraphs 1(c) and (d) above, that the amounts set aside in 1989 and scheduled to be set aside in 1990 be made available to it

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pursuant to paragraphs 2(d) and (e) of the extended arrangement, and

(ii) Mexico's representation that it has a need to make those purchases because of impending payments for the discharge of liabilities under its debt reduction transactions

(iii) Mexico s representation that the equivalent of the amount to be purchased for debt reduction will be used as part of the collateral required for operations in connection with the commercial bank financing package.

The Fund, after examination of the request and a review of the financing of Mexico's program supported under the extended arrangement, has determined that the amounts so requested are needed

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for the making of payments in connection with Mexico's debt reduction operations, which are consistent with the objectives of the program under the extended arrangement.

(b) Accordingly, the Fund decides, notwithstanding paragraph 4 of the extended arrangement, that Mexico may purchase, for use during the 90 days following the date of this decision, for the purchase of an equivalent amount of collateral for debt reduction operations in accordance with Mexico's request

(i) the amount equivalent to SDR 209 79 million, equivalent to the reductions made heretofore under the first sentence of paragraph 2(d) of the extended arrangement,

(ii) the amount equivalent to SDR 279 72 million which is thirty (30)

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percent of the total of purchases that are scheduled to be made by Mexico in 1990 under the extended arrangement, in accordance with its paragraph 2(c)

(c) Paragraph 2(d) of the extended arrangement shall not apply to reduce the amounts of the purchases scheduled to become available under the extended arrangement during 1990.

6 (a) Paragraph 2(a) of the extended arrangement is amended by substituting "the equivalent of SDR 699 3 million until December 31, 1989, the equivalent of SDR 1,445.22 million until February 28, 1990, and the equivalent of SDR 1,608.39 million until May 31, 1990" for "the equivalent of SDR 699 3 million until February 28, 1990, and the equivalent of SDR 932 4 million until May 31, 1989 ", and

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paragraph 2(b) is amended by substituting "SDR 2,331 0 million" for "SDR 1,864 8 million"

(b) In accordance with paragraphs 2(b) and (c) of the extended arrangement, purchases under this extended arrangement shall not, without the consent of the Fund exceed the equivalent of SDP 1 771 56 million until August 31 1990, the equivalent of SDR 1,934 73 million until November 30, 1990, the equivalent of SDR 2,097.90 million until February 28, 1991 and the equivalent of SDR 2,331 00 million until May 31, 1991

7. Paragraph 5 of the extended arrangement is amended by adding, at its end, the words "or pursuant to Decision No 9331-(89/167), adopted December 19, 1989, on early repurchase expectations related to debt and debt-service reduction operations "

8. The Fund finds that the reviews contemplated in paragraphs 2(d)(iii) and 4(b) of the extended arrangement

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