FOR AGENDA



SM/84/155

CONTAINS CONFIDENTIAL
INFORMATION

July 2, 1984

To: Members of the Executive Board

From: The Acting Secretary

Subject: Mexico - Staff Report for the 1984 Article IV Consultation

Attached for consideration by the Executive Directors is the staff report for the 1984 Article IV consultation with Mexico. A draft decision appears on page 34.

It is proposed to bring this subject to the agenda for discussion on Monday, July 30, 1984.

If Executive Directors have technical or factual questions relating to this paper prior to the Board discussion, they should contact Mr. Loser (ext. (5)8373).

Att: (1)

Other Distribution:
Department Heads

CONTAINS CONFIDENTIAL
INFORMATION

INTERNATIONAL MONETARY FUND

# MEXICO

## Staff Report for the 1984 Article IV Consultation

Prepared by the Staff Representatives for the
1984 Consultation with Mexico

Approved by Eduardo Wiesner and Manuel Guitian

July 2, 1984

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## I. Introduction

The 1984 Article IV consultation discussions 1/ with Mexico were held in Mexico City during May 2-23, 1984. The Mexican representatives in the consultation discussions included the Secretary of Finance and Public Credit; the Director General of the Bank of Mexico; the Under Secretary of Finance and Public Credit; the Under Secretary of National Banking; the Under Secretary of Budget and Planning; the Under Secretary of External Trade; the Under Secretary of Internal Trade; and senior officials of various ministries, the Bank of Mexico, public enterprises and other government agencies. The staff representatives during the discussions were Claudio Loser (Head-WHD), Jose Gil Diaz (WHD), Menachem Katz (FAD), Sergio Leite (CBD), Paulo Neuhaus (ETR), Luis Valdivieso (WHD), and Marcela Toso (Secretary-WHD).

On December 23, 1982 (EBM/82/168) the Fund approved Mexico's request for access to Fund resources for the equivalent of SDR 3,611.2 million (450 percent of Mexico's quota in effect at the time), of which SDR 200.6 million was granted under the first credit tranche and the remainder under an extended arrangement covering the three-year period through December 1985. The program for the second year of the arrangement was approved by the Fund on March 2, 1984 (EBM/84/35).

Mexico made all scheduled purchases under the EFF through May 1984, the most recent date for which Fund resources were made available. As of May 31, 1984, the Fund's total credit outstanding to Mexico stood at SDR 1,805.6 million, or 154.9 percent of Mexico's quota of SDR 1,165.5 million, of which SDR 1,008.8 million was financed from ordinary resources and the remainder from borrowed resources under the policy of enlarged access. Full use of the remaining resources under the extended arrangement would raise the Fund's credit to Mexico to 206.3 percent of quota at the end of 1984 and 309.8 percent at the end of 1985. Further information on Mexico's relations with the Fund is presented in Appendix I.

The last Article IV consultation discussions with Mexico together with a review under the EFF were held in the period March 7-26, 1983 in Mexico City. The resulting reports (SM/83/70 and SM/83/86) were considered by the Executive Board at EBM/83/75 on May 23, 1983.

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1/ Mexico has accepted the obligations of Article VIII, Sections 2, 3, and 4.

## II. Background Developments and Performance Under the Program

### 1. Developments prior to the program

Following several years of rapid economic expansion, Mexico experienced serious economic difficulties in 1982. The sharp rise in public spending that dominated aggregate demand developments in the period 1979-82 led to a widening of the public sector deficit. This resulted in a rise in domestic costs and prices, and a surge of imports which eroded Mexico's international competitiveness and weakened the balance of payments. The deterioration in the public finances became more pronounced after the softening of the international oil market in the second half of 1981. As a result, the overall public sector deficit reached the equivalent of almost 15 percent of GDP in 1981 and about 18 percent of GDP in 1982 (Table 1). This growing fiscal gap was covered by increasing the share of domestic financial savings channeled to the public sector, at the expense of private credit, and by engaging in a very large volume of foreign borrowing.

The deterioration in the public finances and the accelerating rate of inflation raised doubts about the sustainability of existing economic policies and led to significant capital flight which reached a pace that led to a sharp depreciation of the Mexican peso in February 1982. However, the impact of the exchange rate adjustments on competitiveness was soon eroded by increases in wages and prices. Some efforts were made subsequently to stabilize the economy but they were insufficient to restore confidence and capital flight resumed. By mid-1982 the access of Mexico to international capital markets was drastically curtailed, and in August of 1982 the Bank of Mexico withdrew from the exchange market. A dual exchange market was introduced and foreign commercial banks were asked to roll over the public sector external amortization payments as they became due, while a broader refinancing agreement was being sought.

In September 1982, in a major policy shift, the authorities nationalized the private Mexican commercial banks, introduced generalized exchange controls, extended substantial subsidies through the exchange system, applied import-licensing requirements to virtually all imports, eliminated financial deposits denominated in foreign currencies, intensified domestic price controls, and reduced interest rates. These measures aggravated the already difficult foreign exchange situation and led to the emergence of a parallel market, the appearance of external payments arrears, and the disruption of imports. By late 1982, the Mexican economy was in a severe recession and prices were increasing at a rate of over 10 percent a month (Charts 1 and 2). Concurrently, the current account of the balance of payments moved from a deficit to a surplus because of the virtual unavailability of foreign financing (Table 2 and Chart 3). However, because of the large private capital flight that had taken place during the year, the overall balance of payments showed a deficit of about US$7 billion in 1982, with the result that the reserves of the Bank of Mexico were virtually depleted.

Table 1. Mexico: Summary Accounts of the Public Sector

(In percent of GDP)

| | 1979 | 1980 | 1981 | 1982 | 1983 Prog. | 1983 Prel. | 1984 Prog. |
|---|---|---|---|---|---|---|---|
| Public sector revenue | 17.8 | 18.8 | 17.1 | 18.6 | 20.6 | 21.9 | 20.9 |
| Taxes on petroleum sector | 1.5 | 3.8 | 4.0 | 4.9 | 6.0 | 6.7 | 6.2 |
| Other federal government taxes | 11.4 | 11.4 | 11.3 | 10.3 | 10.6 | 10.4 | 10.2 |
| Other federal government revenue | 0.6 | 0.7 | 0.9 | 1.1 | 0.8 | 1.4 | 0.6 |
| Social security contributions | 2.6 | 2.5 | 2.9 | 2.4 | 1.8 | 2.1 | 1.9 |
| Federal District | 0.4 | 0.4 | 0.3 | 0.3 | 0.1 | 0.2 | 0.2 |
| Operating surplus of public enterprises (net) | 3.0 | 4.0 | 1.7 | 4.5 | 5.8 | 7.9 | 8.0 |
| PEMEX | (3.1) | (4.8) | (4.2) | (6.6) | (7.1) | (10.8) | (9.9) |
| Electricity | (-0.2) | (-0.3) | (-0.3) | (-0.7) | (-0.4) | (-1.1) | (-0.7) |
| CONASUPO | (-0.2) | (-0.7) | (-1.4) | (-0.8) | (-0.6) | (-1.3) | (-0.9) |
| Railways | (-0.1) | (-0.2) | (-0.3) | (-0.2) | (-0.1) | (-0.3) | (--) |
| Other | (0.4) | (0.2) | (-0.5) | (-0.4) | (-0.1) | (-0.2) | (-0.3) |
| Less: taxes paid by public enterprises | -1.6 | -4.0 | -4.0 | -4.9 | -6.0 | -6.8 | -6.2 |
| Capital revenue of public enterprises | 0.1 | 0.1 | 0.1 | 0.1 | -- | -- | 0.1 |
| Additional revenue 1/ | -- | -- | -- | -- | 1.4 | -- | -- |
| Public sector expenditure 2/ | 24.5 | 26.4 | 31.7 | 36.4 | 29.1 | 30.3 | 26.4 |
| Government consumption | 8.8 | 9.1 | 10.2 | 11.0 | 7.9 | 10.1 | 8.7 |
| Wages and salaries | (5.4) | (5.1) | (5.4) | (5.9) | (4.0) | (4.8) | (3.9) |
| Goods and services | (2.3) | (2.2) | (2.8) | (3.3) | (1.7) | (3.0) | (2.5) |
| Transfers to local governments | (1.1) | (1.8) | (2.0) | (1.8) | (2.2) | (2.3) | (2.3) |
| Current transfers and subsidies | 2.7 | 4.0 | 2.9 | 2.5 | 2.1 | 2.5 | 2.1 |
| Interest payments | 2.0 | 1.9 | 3.1 | 5.6 | 6.0 | 8.5 | 6.4 |
| Unallocated current expenditure 3/ | -- | -- | -- | -- | 0.9 | -- | -- |
| Exchange losses | -- | -- | -- | 4.0 | -- | 0.6 | 0.3 |
| Financing requirements, rest of public sector (net) 4/ | 0.9 | 1.4 | 1.5 | 1.4 | 1.2 | 0.6 | 0.7 |
| Additional expenditure 5/ | -- | -- | -- | -- | 1.4 | -- | -- |
| Unclassified (Ajenas) | 0.6 | -- | 0.8 | 0.9 | 0.1 | 0.6 | 0.2 |
| Capital expenditure | 9.5 | 9.9 | 13.2 | 11.0 | 8.3 | 7.4 | 8.1 |
| Investments | (7.6) | (9.3) | (12.9) | (10.6) | (7.5) | (6.9) | (8.0) |
| Of which: PEMEX | /3.0/ | /2.9/ | /3.9/ | /3.0/ | /1.8/ | /2.0/ | /2.0/ |
| Financial investments and other 6/ | (1.9) | (0.6) | (0.3) | (0.4) | (0.7) | (0.4) | (--) |
| Other unallocated | -- | -- | -- | -- | 1.2 | -- | -- |
| Overall balance | -6.6 | -7.6 | -14.6 | -17.8 | -8.5 7/ | -8.4 | -5.5 |
| Foreign financing (net) | 2.5 | 2.6 | 7.4 | 3.7 | 2.6 | 3.5 | 2.4 |
| Domestic financing (net) | 4.1 | 5.0 | 7.2 | 14.1 | 5.9 | 4.9 | 3.1 |
| Memorandum items | | | | | | | |
| Petroleum exports | 3.1 | 5.3 | 5.5 | 8.8 | 8.5 | 11.1 | 10.1 |
| Current balance of public sector | 2.7 | 2.2 | -1.5 | -6.9 | 2.2 | -1.1 | 2.5 |
| Current balance excluding PEMEX | 0.9 | 1.0 | -2.0 | -9.1 | -0.2 | -5.6 | 6.2 |
| Operating expenditure of public enterprises | 8.5 | 9.0 | 10.6 | 10.8 | 9.8 | 11.7 | 11.6 |

Sources: Secretariat of Finance and Public Credit; Secretariat of Programming and Budget; and Fund staff estimates.

1/ Revenue measures not included in the budget but were to be adopted during the course of the year.

2/ Exclusive of operating expenditure of public enterprises. Net operating surplus of public enterprises is shown under public sector revenue.

3/ Includes expenditure authorized by the budget but not allocated by category.

4/ Includes net lending operations and residual financing by the public sector.

5/ Includes expenditure not included in the budget but dependent on the availability of additional revenue.

6/ Includes acquisition of property and financial investment.

7/ Excludes the financing of trust funds of the Bank of Mexico, equivalent to 0.2-0.3 percent of GDP.

Table 2. Mexico: Summary Balance of Payments

(In billions of U.S. dollars)

| | 1979 | 1980 | 1981 | 1982 | 1983 Prel. | 1984 Proj. EBS/84/1 | 1984 Rev. | 1983 Jan.-March | Prel. 1984 Jan.-March |
|---|---|---|---|---|---|---|---|---|---|
| Current account | -5.5 | -7.7 | -13.9 | -5.6 | 5.4 | -1.0 | 1.4 | 1.1 | 1.9 |
| Trade balance | -2.2 | -1.7 | -3.1 | 7.7 | 14.5 | 9.9 | 13.0 | 3.7 | 4.2 |
| Exports, f.o.b. | 9.9 | 16.9 | 20.9 | 22.1 | 22.2 | 23.9 | 24.6 | 5.2 | 6.3 |
| Petroleum and derivatives | (4.0) | (10.4) | (14.6) | (16.5) | (16.0) | (16.3) | (16.2) | (3.8) | (4.3) |
| Other | (5.9) | (6.5) | (6.3) | (5.6) | (6.2) | (7.6) | (8.4) | (1.4) | (2.0) |
| Imports, f.o.b. | -12.1 | -18.6 | -24.0 | -14.4 | -7.7 | -14.0 | -11.6 | -1.5 | -2.1 |
| Public sector | (-4.0) | (-6.7) | (-8.8) | (-5.4) | (-4.2) | (-6.2) | (-5.5) | (-0.9) | (-1.1) |
| Private sector | (-8.1) | (-11.9) | (-15.2) | (-9.0) | (-3.5) | (-7.8) | (-6.1) | (-0.6) | (-1.0) |
| Travel | 0.7 | 0.6 | 0.2 | 0.6 | 1.2 | 1.3 | 1.3 | 0.3 | 0.5 |
| Border transactions | 0.4 | 0.4 | -- | -0.2 | -0.2 | 0.2 | -0.2 | -0.1 | -0.1 |
| Factor income | -4.0 | -6.0 | -9.5 | -11.7 | -8.9 | -10.9 | -11.2 | -2.7 | -2.7 |
| Interest payments | -3.7 | -5.4 | -8.4 | -11.3 | -9.8 | -11.2 | -11.9 | -2.9 | -3.0 |
| Other | -0.3 | -0.6 | -1.1 | -0.4 | 0.9 | 0.3 | 0.7 | 0.2 | 0.3 |
| Other services and transfers (net) | -0.4 | -1.0 | -1.5 | -2.0 | -1.2 | -1.5 | -1.5 | -0.1 | -- |
| Capital account | 5.1 | 11.2 | 22.7 | 8.9 | 0.5 | 3.0 | 1.9 | 0.7 | -0.2 |
| Official capital (net) | 3.3 | 4.7 | 17.8 | 6.8 | 4.7 | 4.0 | 4.0 | 1.0 | 0.5 |
| Medium and long term | 3.1 | 4.0 | 9.0 | 5.6 | 16.0 | 3.9 | 4.0 | 1.6 | 0.4 |
| Short term (net) | 0.2 | 0.7 | 8.8 | 1.2 | -11.3 | 0.1 | 0.0 | -0.6 | 0.1 |
| Private capital | 1.8 | 6.5 | 4.9 | 2.1 | -4.2 | -1.0 | -2.1 | -0.3 | -0.7 |
| SDR allocation and gold valuation | 0.6 | -- | -- | -- | -- | -- | -- | -- | -- |
| Errors and omissions | 0.5 | -2.5 | -7.6 | -10.1 | -0.4 | -- | -- | -0.5 | -1.0 |
| Monetary authorities (increase -) | -0.7 | -1.0 | -1.2 | 6.8 | -5.5 | -2.0 | -3.3 | -1.3 | -0.7 |
| Of which: arrears | -- | -- | -- | 1.4 | -1.1 | -0.3 | -0.3 | -0.1 | -0.3 |

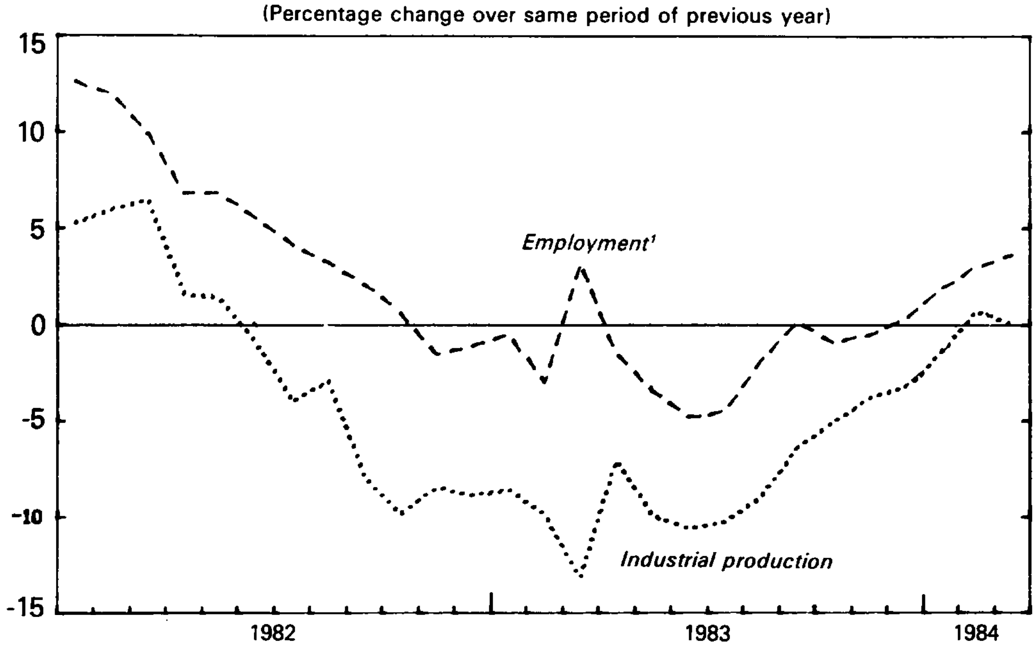
Sources: Mexican authorities; and Fund staff estimates.

CHART 1

MEXICO

# INDICATORS OF ECONOMIC ACTIVITY

(Percentage change over same period of previous year)



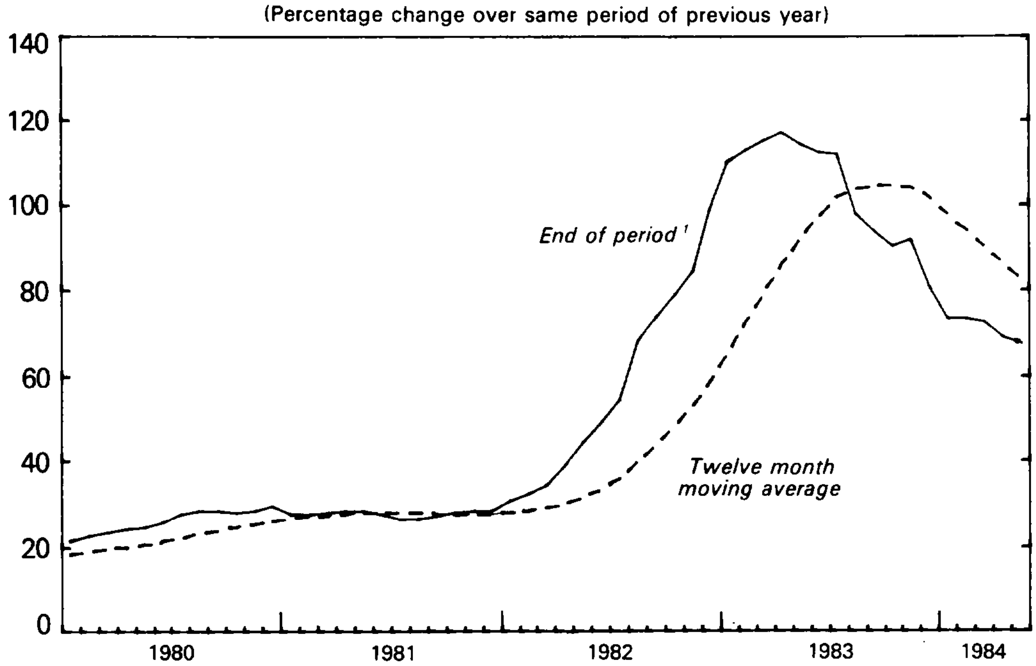

Sources: Bank of Mexico; and IMSS.
[1]Social Security participants.

CHART 2

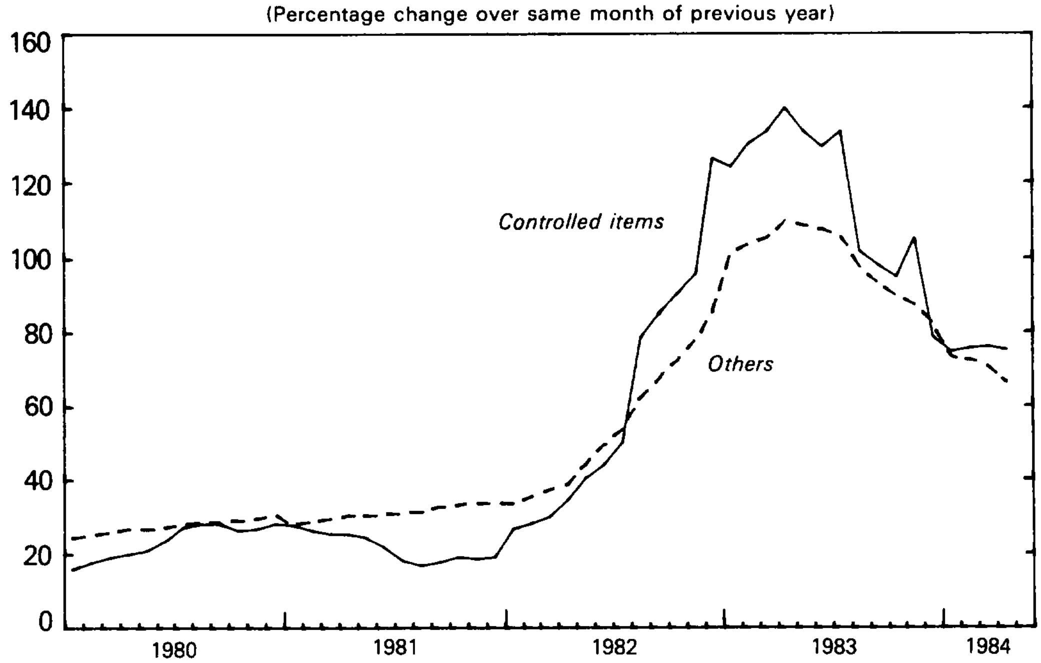
MEXICO

## CHANGES IN THE NATIONAL CONSUMER PRICE INDEX

(Percentage change over same period of previous year)




(Percentage change over same month of previous year)




Source: Bank of Mexico.

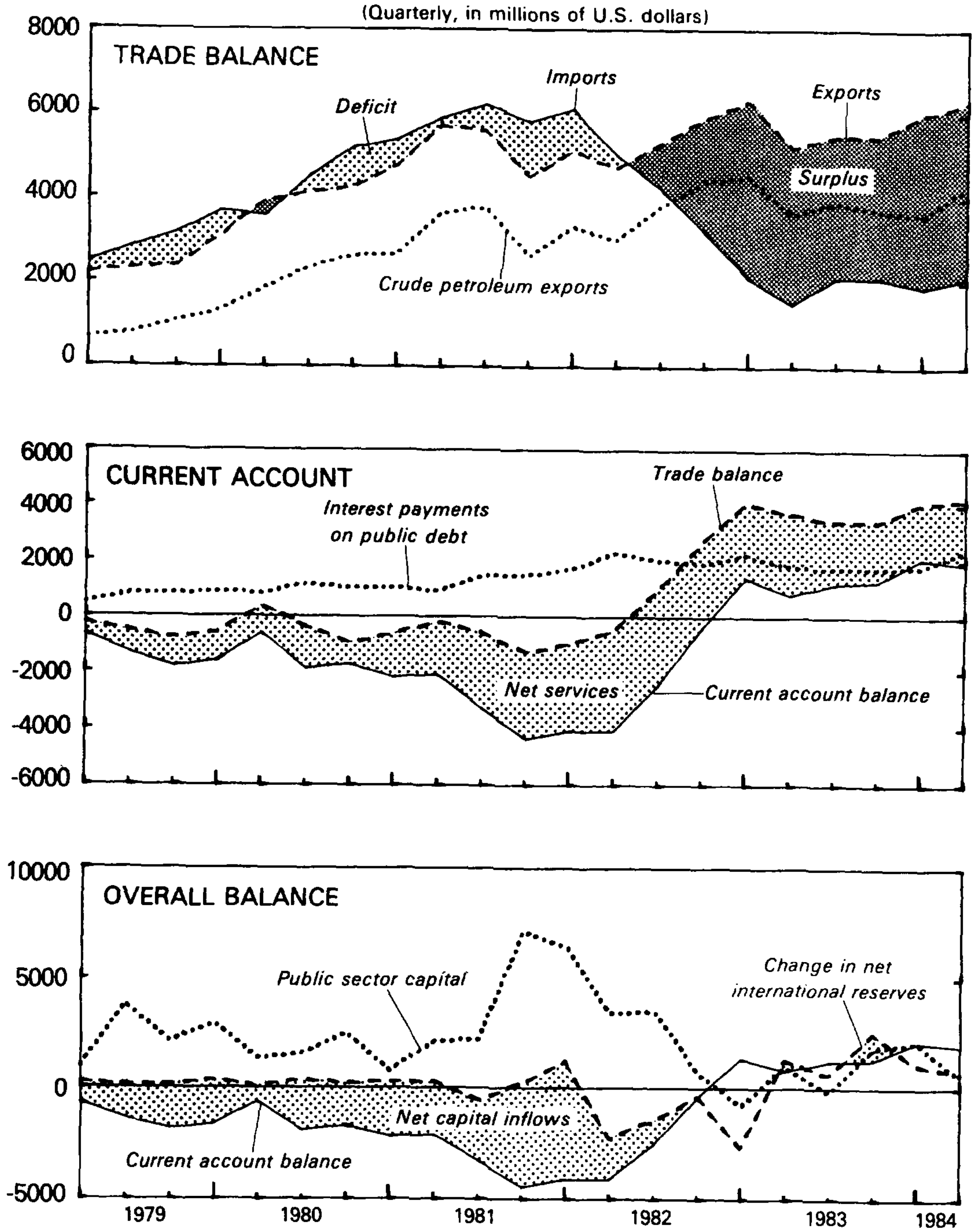
[1] Percentage change over same month of previous year.

CHART 3

MEXICO

# BALANCE OF PAYMENTS

(Quarterly, in millions of U.S. dollars)




Source: Bank of Mexico; and staff estimates.

## 2. Developments during the first year of the adjusment program

In late 1982 Mexico embarked on a major adjustment effort, supported by an extended arrangement approved by the Fund for the period 1983-85. The economic program aimed at restoring the medium-term viability of the economy, primarily through a reduction in the public sector deficit; the reduction was to be from about 18 percent in 1982 to the equivalent of 8 1/2 percent of GDP in 1983, 5 1/2 percent in 1984, and 3 1/2 percent in 1985. High priority was given to the objectives of slowing inflation and reducing reliance on foreign financing, with a view to creating the conditions for a return of confidence and the resumption of sustained growth. The program also sought to restore external competitiveness, to achieve a liberalization of the exchange and trade system, and to follow a more realistic interest rate policy. These policies were reinforced by major efforts to restructure the terms of the external debt.

The current Administration, which took office on December 1, 1982, proceeded with boldness in the implementation of the adjustment program, and it was able to achieve a major turnaround in economic conditions. As a consequence, in 1983 Mexico started to move away from the situation of crisis that had characterized the economy in 1982.

The deficit of the public sector was reduced as programmed in 1983. Receipts for the year as a whole increased by the equivalent of 3 percent of GDP to somewhat above the levels originally programmed, on the strength of the comprehensive set of measures introduced in late 1982 and a more realistic pricing policy for the goods and services provided by the public sector. In turn, expenditures declined by the equivalent of 6 percent of GDP, on account of a sharp curtailment of operating and capital expenditure. However, they were higher than had been planned, to a large extent because interest payments were larger than had been budgeted.1/

In December 1982 the Government announced the termination of the generalized system of exchange controls and the introduction, on a temporary basis, of a new dual exchange system with a controlled market--covering about 80 percent of transactions--and a free market covering the remaining external receipts and payments. The establishment of the controlled market rate involved an immediate depreciation of some 35 percent to Mex$95 per US$1. This rate was to be adjusted periodically on the basis of developments on inflation and the balance of payments. Since the initial adjustment in December 1982, the controlled market rate has been adjusted daily by Mex$0.13 per U.S. dollar, resulting in

1/ The sharp turnaround in the direction of fiscal policy is highlighted by the calculations of the fiscal impulse, as described in the accompanying "Recent Economic Developments". The impulse generated by fiscal policy moved from consistently positive (expansionary) magnitudes prior to 1983 to a very sizable negative (contractionary) change in 1983, in excess of the actual decline in the deficit, thus reflecting the considerable effort undertaken during that year.

a cumulative depreciation of 49 percent (in terms of local currency per U.S. dollar) through the end of 1983. The opening free market rate in December 1982 was 58 percent more depreciated than the controlled market rate; the rate remained broadly unchanged until September 1983 when it also began to slide at Mex$0.13 per U.S. dollar per day. By the end of the year, the differential between the two rates had declined to about 11 1/2 percent. The indicators of competitiveness show a marked gain in 1983 compared with previous years (Chart 4). On the basis of relative prices, the effective exchange rate index in the fourth quarter of 1983 was 27 percent more depreciated than the average for 1978-82. On the basis of unit labor costs, which is probably a more accurate indicator of competitiveness, the real depreciation was 62 percent.

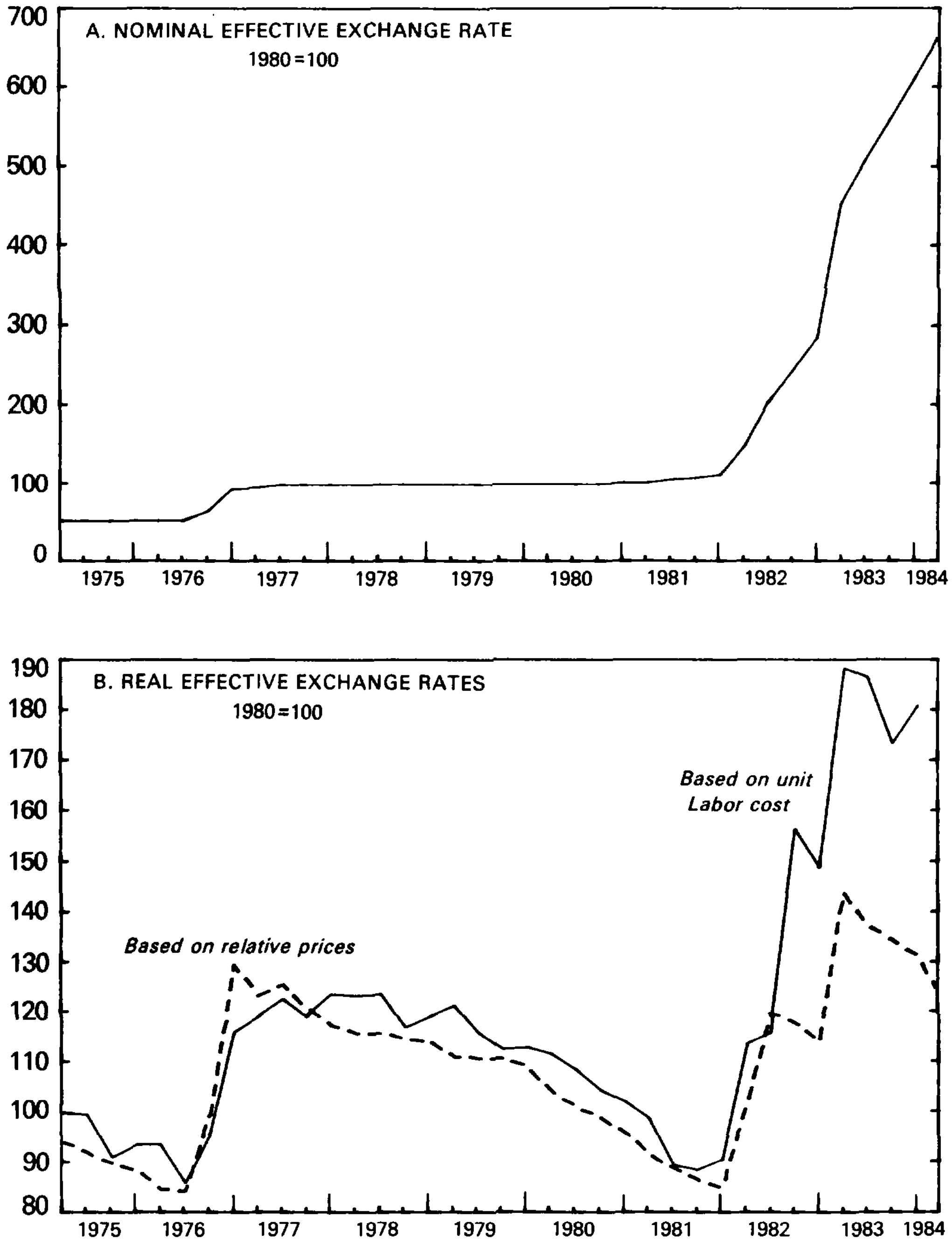
Minimum wages rose by just under 45 percent during 1983, which was well below the rate of inflation for the year. In January 1983 there was a major liberalization of the price controls applicable to the private sector, together with some additional adjustments in public sector prices. However, the authorities announced controls on a group of 17 products, to be subsidized in varying degrees by the Government, to protect the purchasing prices of the lower income segments of the population.

In late 1982 interest rates paid on bank deposits were increased, reversing the policies that had been introduced in September 1982 (Chart 5). These rates remained stable in 1983 but, in the presence of falling rates of inflation, real rates increased. After some decline in the first quarter of 1983, financial savings started recovering, reflecting the impact of the adjustment program on confidence. Even though the liabilities of the financial system to the private sector increased considerably less than inflation during 1983 as a whole (Table 3 and Chart 6), the deceleration in credit expansion, because of the reduced public sector deficit and the sluggish demand for private credit, permitted a sharp increase in net international reserves.

Significant progress was made during 1983 in reducing the rate of inflation. The monthly rate of increase of the consumer price index, which by the beginning of 1983 had reached close to 11 percent, dropped to an average of about 4 percent in the second half of 1983; the consumer price index increased by 81 percent in the 12 months ended in December 1983, after having risen by about 100 percent in the previous 12 months. Contributing to this result was not only the tightening of demand management policies but also the pursuit of a moderate wage policy as described above. Approximately one third of the recorded inflation in 1983 was accounted for by corrective price increases in the public sector or in items subject to price controls (see Chart 2).

Developments with regard to output and employment were not encouraging in 1983. The contraction in output that occurred in the second half of 1982 and the first half of 1983 was substantial and real GDP declined by 4.7 percent in 1983. However, the decrease had virtually stopped by the fourth quarter when signs of recovery could be observed, including some rise in total employment.

CHART 4
MEXICO
# NOMINAL AND REAL EFFECTIVE EXCHANGE RATE INDICES[1]



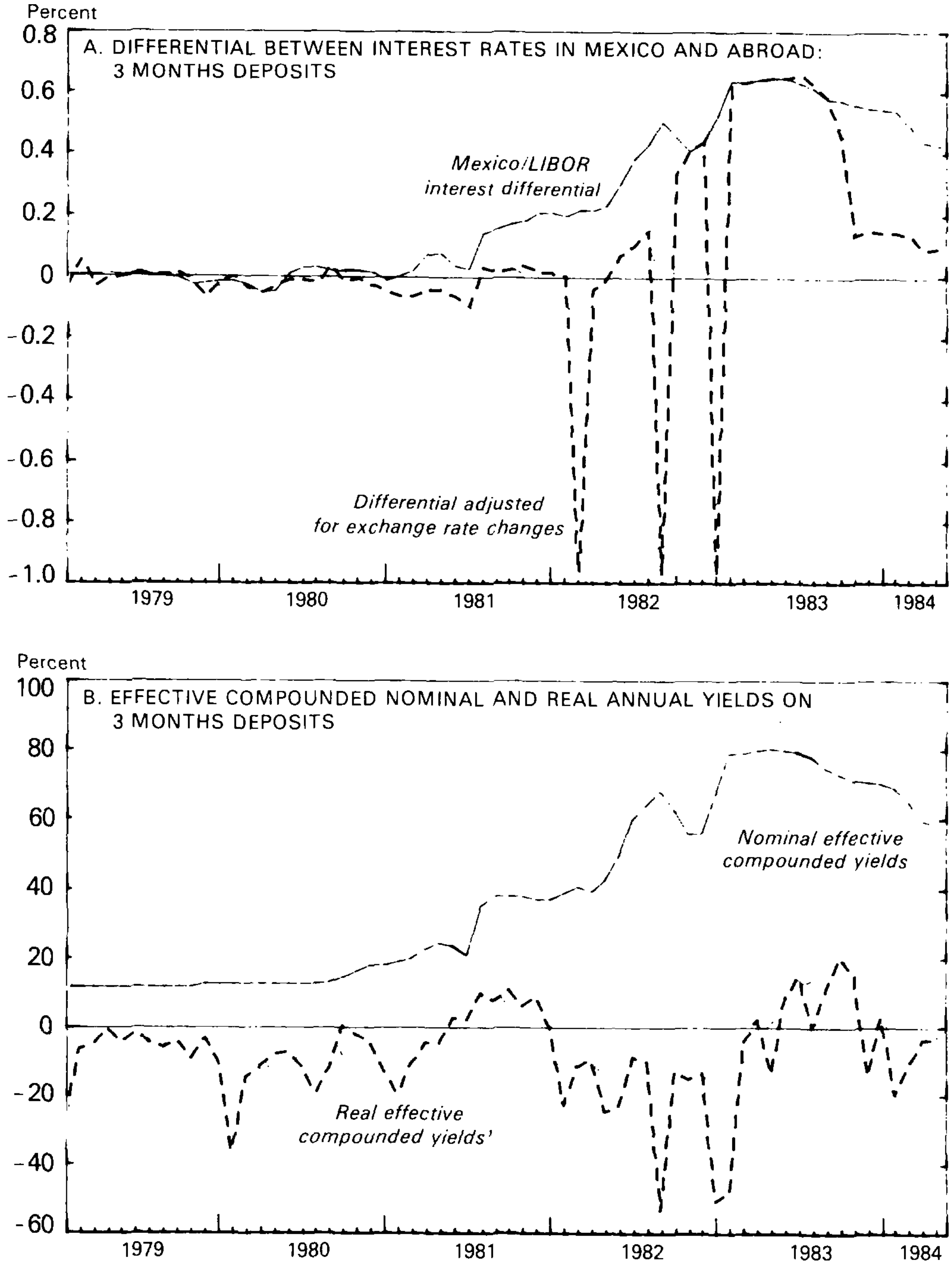

Source: Bank of Mexico and Fund staff estimates.

[1]Defined in terms of Mexican pesos per unit of foreign exchange. Based on the controlled market rate starting in August 1982. Decline reflects appreciation.

CHART 5

MEXICO

## INTEREST RATE MOVEMENTS ON PESO DENOMINATED INSTRUMENTS



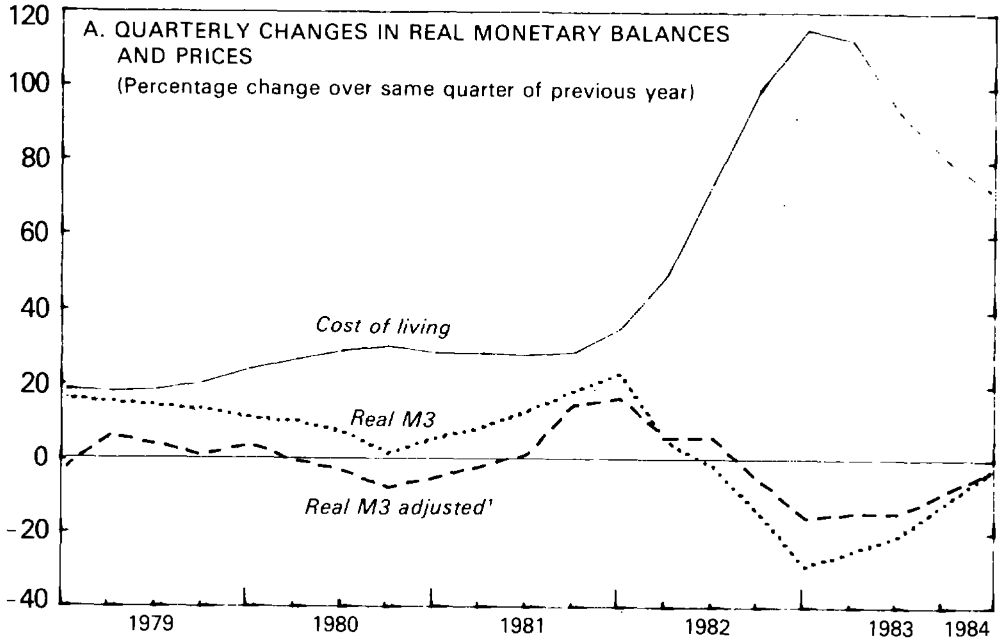

Source: Bank of Mexico and Fund staff estimates

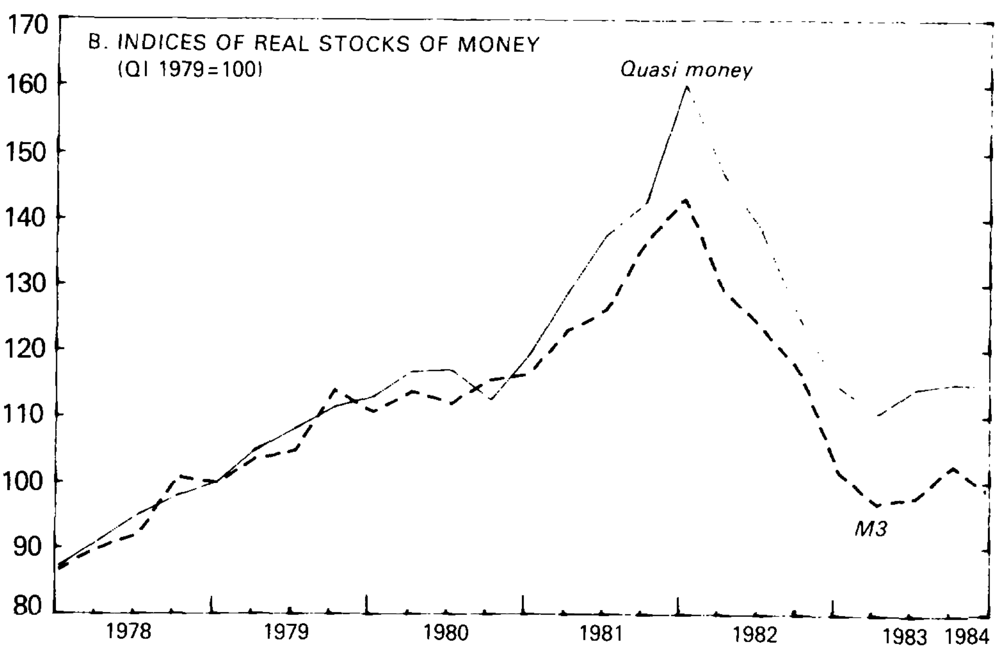
[1] Adjusted for the monthly annualized cost of living index

CHART 6

MEXICO

# INDICATORS OF REAL MONETARY BALANCES AND PRICES




Source: Bank of Mexico and Fund staff estimates.

[1] Changes in the real stock of M3, adjusted for changes in estimated real GDP.

Table 3. Mexico: Summary Operations of the Financial System

| | Actual Stocks Dec. 1983 | Effective Flows 1/ | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | | | | | | | Jan.-Mar. | |
| | | 1979 | 1980 | 1981 | 1982 | 1983 | 1983 | 1984 |
| | (In billions of Mexican pesos) | | | | | | | |
| | I. Bank of Mexico | | | | | | | |
| Net international reserves | 504.2 | 9.0 | 24.1 | 30.1 | -387.1 | 678.6 | 144.1 | 112.9 |
| Net domestic assets | 184.2 | 28.2 | 23.6 | 57.7 | 613.0 | -501.1 | -186.0 | -141.1 |
| Net credit to the public sector 2/ | 2,975.4 | 97.2 | 140.8 | 251.7 | 696.6 | 748.2 | 92.6 | -8.9 |
| Net credit to official trust funds 3/ | 149.2 | 7.1 | 6.5 | 11.0 | 48.6 | 58.3 | 15.7 | 27.4 |
| Credit to banks | 124.7 | 2.9 | 23.3 | -0.5 | 178.9 | -237.4 | -52.3 | 0.3 |
| Credit to private sector | 29.0 | 0.2 | 0.5 | 1.1 | 2.7 | 4.2 | 0.3 | 1.1 |
| Liabilities to banks | -2,546.8 | -97.7 | -160.6 | -211.9 | -335.1 | -962.6 | -140.3 | -363.4 |
| Other (net) 4/ | -547.3 | 18.5 | 13.1 | 6.3 | 21.3 | -111.8 | -275.4 | -497.0 |
| Note issue | 688.4 | 37.2 | 47.7 | 87.8 | 225.9 | 177.5 | -41.9 | -28.2 |
| | II. Financial System | | | | | | | |
| Net foreign assets | 628.3 | 15.8 | 38.7 | 22.5 | -397.4 | 681.2 | 146.4 | 87.2 |
| Net domestic credit | 9,743.9 | 319.2 | 389.1 | 928.1 | 1,150.3 | 1,568.1 | 76.8 | 555.4 |
| Net credit to the public sector 5/ | 8,003.1 | 158.7 | 203.9 | 594.7 | 1,224.1 | 931.6 | 15.1 | 174.3 |
| Credit to the private sector 5/ | 2,429.6 | 158.8 | 250.7 | 310.2 | -102.8 | 688.8 | 36.7 | 178.7 |
| Other (net) 4/ | -335.0 | 1.7 | -65.5 | 23.2 | 29.0 | -52.3 | 116.5 | -478.9 |
| Medium- and long-term foreign obligations | 4,757.8 | 63.0 | 98.1 | 263.7 | 6.7 | 196.6 | 13.6 | 47.8 |
| Liabilities to nonbank public financial intermediaries | 390.4 | 15.5 | 17.9 | 54.8 | 30.8 | 174.2 | 10.9 | 1.1 |
| Liabilities to private sector 6/ | 5,224.0 | 256.5 | 311.8 | 632.1 | 715.4 | 1,878.5 | 198.7 | 593.7 |
| Of which: capital and reserves | 95.5 | 8.5 | 11.5 | 14.4 | 14.0 | 27.3 | 2.8 | 8.4 |
| | (Percentage change in relation to note issue at the beginning of the period) | | | | | | | |
| Bank of Mexico's net domestic assets | ... | 25.1 | 15.8 | 29.3 | 215.1 | -98.1 | -36.4 | -20.5 |
| Bank of Mexico's net credit to public sector | ... | 86.6 | 94.2 | 127.6 | 244.4 | 146.4 | 18.1 | -1.3 |
| Note issue | ... | 33.1 | 31.9 | 44.5 | 79.3 | 34.7 | -8.2 | -4.1 |
| | (Percentage change in relation to liabilities to private sector at the beginning of the period) 7/ | | | | | | | |
| Net domestic credit | ... | 44.3 | 39.8 | 72.0 | 58.9 | 47.5 | 3.9 | 10.6 |
| Net credit to the public sector 5/ | ... | 22.0 | 20.9 | 46.1 | 62.7 | 28.2 | 0.1 | 3.3 |
| Credit to the private sector 5/ | ... | 22.1 | 25.7 | 24.1 | -5.3 | 20.9 | 1.9 | 3.4 |
| Liabilities to the private sector 6/ | ... | 35.7 | 38.4 | 51.5 | 68.8 | 58.4 | 6.5 | 11.6 |
| | (In percent of GDP) | | | | | | | |
| Net domestic credit | 55.9 | 10.4 | 9.1 | 15.8 | 12.2 | 9.0 | ... | .. |
| Net credit to the public sector 5/ | 45.9 | 5.2 | 4.8 | 10.1 | 13.0 | 5.3 | ... | .. |
| Credit to the private sector 5/ | 13.9 | 5.2 | 5.9 | 5.3 | -1.1 | 4.0 | ... | .. |
| Liabilities to the private sector 6/ | 30.0 | 8.4 | 7.3 | 10.8 | 7.6 | 10.8 | ... | .. |
| Memorandum item | | | | | | | | |
| Credit to the private sector as proportion of liabilities to private sector | 46.5 | 61.9 | 80.4 | 49.1 | -14.4 | 36.7 | 18.5 | 30.1 |

Sources: Bank of Mexico; and Fund staff estimates.

1/ Effective flows excluding valuation adjustments for exchange rate changes in foreign currency denominated accounts.

2/ Excludes net credit to official trust funds.

3/ Excludes FICORCA.

4/ Includes official capital, gold price adjustments, valuation adjustments to Fund transactions and net unclassified.

5/ Includes credit financed with medium- and long-term foreign liabilities of the public sector channeled through the banking system.

6/ Excludes liabilities to the public sector previously classified as belonging to the private sector.

7/ Changes are effective flows in relation to the nominal stock of liabilities to the private sector at the beginning of each period.

The impact of the adjustment program was particularly evident in the balance of payments. The current account shifted from a deficit of US$5 1/2 billion in 1982 to a surplus of US$5 1/2 billion in 1983, and the overall balance moved from a deficit of nearly US$7 billion to a surplus of US$5 1/2 billion. This swing in the balance of payments was to a large extent the result of a very sharp contraction of imports and the virtual cessation of capital flight. Imports are estimated to have been reduced by approximately one half to about US$7 1/2 billion in 1983 (see Table 2). In turn, the errors and omissions of the balance of payments dropped from a negative US$10 billion in 1982 to an estimated US$0.4 billion in 1983, largely reflecting the decline in unrecorded capital outflows. The strength of the current account and the availability of some US$4.7 billion in net official capital permitted Mexico to rebuild its international reserves and repay a large part of the arrears that had accumulated in 1982.

With respect to the negotiations with foreign creditors, a US$5 billion loan from commercial banks was contracted by the Government in March 1983, and was disbursed in parallel with purchases from the Fund. Moreover, a total of US$18.8 million of external public sector short- and medium-term obligations falling due between August 23, 1982 and December 31, 1984 were restructured over a period of eight years, with a four-year grace period.1/ Negotiations were also completed with commercial banks and other private foreign creditors for the refinancing of a total of US$11.6 billion of private sector external obligations at maturities that vary between six and twelve years, with three- to four-year grace periods. Moreover, negotiations were undertaken for the restructuring of Mexican private sector obligations guaranteed by official credit agencies abroad.

All performance criteria for the first year of the arrangement were observed (Table 4). However, the overall public sector deficit exceeded slightly the target for December 1983--a date that did not involve a test for purchases under the extended arrangement. The public sector deficit had remained below the program limits through November but increased in December, reflecting in part the delayed recording of certain foreign debt transactions, the settlement of transfers to various public enterprises and financial intermediaries, and the payment of interest on debt owed to the Bank of Mexico. The estimate of the deficit

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1/ The total refinancing package amounted to US$22.6 billion, if account is taken of U.S. dollar-denominated debt held by domestic banks, debt of the nationalized commercial banks, and the restructuring of suppliers' credits and other short-term obligations of PEMEX.

Table 4. Mexico: Extended Arrangement—Quantitative Performance Criteria Through December 1983

| | | 1983 | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | | Jan.-March | | April-June | | July-Sept. | | Oct.-Dec. | |
| | 1982 | Target | Actual | Target | Actual | Target | Actual | Target | Actual |
| | | (In billions of Mexican pesos) | | | | | | | |
| Net credit to the public sector by the monetary authorities 1/ | 2,024 | 2,525 | 2,132 | 2,689 | 2,148 | 2,791 | 2,230 | 3,097 | 2,839 |
| Cumulative overall public sector deficit 3/ | 1,761 | 360 | 190 | 690 | 350 | 1,005 | 629 | 1,500 | 1,523 2/ |
| Cumulative changes in net domestic assets of the monetary authorities (effective flow) 4/ | 577 | 21 | -186 | 44 | -261 | 44 | -557 | 104 | -502 |
| | | (In millions of U.S. dollars) | | | | | | | |
| Cumulative net foreign borrowing by the public sector 3/ | 6,807 | 1,250 | 1,034 | 2,500 | 789 | 3,750 | 2,555 | 5,000 | 4,686 |
| Cumulative change in net international reserves of the monetary authorities 3/5/ | -7,119 | — | 1,332 | 500 | 1,905 | 1,000 | 4,365 | 2,000 | 5,480 |
| Cumulative reduction in arrears 6/ | ... | ... | 62 | ... | 134 | ... | 521 | 600 | 1,088 |

Sources: Mexican authorities; and Fund staff estimates.

1/ Stock outstanding at end of period (adjusted for changes in exchange rate).
2/ Excludes public sector deposits with the banking system incorrectly classified as belonging to the private sector.
3/ Limit tested at the end of each period.
4/ Net domestic assets of the Bank of Mexico for purposes of the ceiling are defined as the difference between note issue and net international reserves of the monetary authorities.
5/ Includes as liabilities a balance of payments support loan from the BIS and payments arrears on account of interest due on foreign commercial bank loans to the private sector, and interest and amortization on suppliers' credits.
6/ Limit tested at the end of the calendar year.

is Mex$1,523 billion, compared with a target of Mex$1,500 billion on the basis of the definition used in the program for 1983.1/2/ The deficit amounts to Mex$1,464 billion on the basis of the definition incorporated in the program for 1984.

## 3. Program for 1984 and developments in the first quarter of the year

The economic program for 1984 envisages the continuation of the policies initiated in the first year of the adjustment effort. The main aims of the program for this year are a further reduction of inflation, continued satisfactory balance of payments performance, and a resumption of economic growth, albeit at a moderate pace. The program targeted a deceleration in the year-end inflation from some 80 percent in 1983 to about 40 percent in 1984, while real GDP was expected to grow by about 1 percent. The balance of payments was projected to remain strong throughout the year, and net international reserves were projected to increase by about US$2 billion on the basis of capital inflows and a small deficit in current account.

To attain these improvements in Mexico's economic performance, the public sector deficit is to be reduced from some 8 1/2 percent of GDP in 1983 to 5 1/2 percent in 1984, with the dependence on foreign financing declining to under US$4 billion for the year. Financial and incomes policies are to continue to complement the fiscal adjustment. The opening of the economy to greater external competition is to play a role in increasing the efficiency of resource use and achieving a better structure of investment.

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1/ For purposes of the financial program, the public sector deficit is defined as the sum of foreign financing and domestic bank and nonbank lending to the public sector. Foreign financing covers the net borrowing by the public sector, including development banks; in turn, domestic financing covers the financing provided by the banking system (net of deposits by the public sector) and the placement of securities with the public, mostly in the form of Treasury bills (CETES). The public sector deficit in 1983 included the financing provided by the Bank of Mexico to its trust funds and channeled to the private sector. The definition for 1984 follows a more traditional concept of public sector deficit and excludes the financing of trust funds by the Bank of Mexico and other net lending. However, this financing is currently covered under the ceiling on the operations of financial intermediation funded by domestic resources and under the aegis of the development banks and official trust funds.

2/ The measurement of the deficit includes net flows for certain deposits of the public sector, identified by the authorities in 1983 as having been misclassified previously as private sector deposits. These deposits have been identified as far back as the end of 1980 and have been reflected in the net domestic financing. The measurement for previous years may be distorted--probably overestimating the deficit--because no comprehensive record of these deposits held by public sector enterprises is available.

Developments to date have been positive, with Mexico complying with all the quantitative performance criteria of the program for the first quarter of the year (Table 5). While most targets were met with substantial margin, the ceiling of Mex$70 billion on financial intermediation by development banks and official trust funds was exceeded by about Mex$18 billion. However, this ceiling can be adjusted upward so long as the ceiling on the overall public sector deficit is correspondingly reduced. There was, in fact, sufficient margin under the limit for the public deficit to accommodate the excess on financial intermediation.

The public sector deficit for the first quarter of the year amounted to Mex$281 billion, considerably below the established target for the period, and only moderately above the deficit of Mex$274 billion observed in the same period of 1983; thus, for the quarter the deficit declined by 40 percent in real terms (Table 6). The composition of the deficit was different from that envisaged earlier, however, with a stronger-than-expected performance of the Federal Government and PEMEX being offset by a weaker-than-expected performance of the rest of the public sector, due in part to a faster increase in expenditure. The rate of growth in expenditures remained below the rate of inflation, while revenues were broadly in line with the increase in prices.

The overall fiscal position is likely to be strengthened in coming months as a result of recently introduced price adjustments. In particular, on April 13 the Government announced a 33 percent increase in gasoline prices and adjustments in the prices of other petroleum products and of certain consumer goods, mainly sugar and edible oil. Earlier during the year, prices were increased for electricity, telephone services, steel products, and fertilizers. The adjustments for some of these items were intended to offset in part the impact of the increased support prices for agriculture announced in May. In June the Government introduced, in connection with the minimum wage awards, other price adjustments, including that of "tortillas," but also announced that prices of electricity and gas for home consumption would not be modified for the remainder of the year, and that some earlier telephone rate increases were being rolled back.

In the monetary field, credit from the Bank of Mexico has continued to be restrained. The net domestic assets of the Bank of Mexico declined by Mex$141 billion, whereas the program had envisaged a decline of Mex$40 billion; this was accompanied by an accumulation of net international reserves larger than had been planned (see Table 3). At the same time, credit to the private sector increased substantially on the basis of a steady growth in financial savings placed with the banking system. The liabilities of the banking system to the private sector increased by about 12 percent in the first quarter, about in line with inflation when adjusted for seasonal factors. During that quarter, deposit rates were reduced in line with the expected deceleration of inflation, but real rates turned out to be negative on the basis of actual inflation. However, interest rates were raised in May, restoring positive real interest rates (see Chart 5).

Table 5. Mexico: Extended Arrangement—Quantitative Performance Criteria for the Second Year Program

| | 1983 | | 1984 | | | | |
|---|---|---|---|---|---|---|---|
| | | | Jan.-Mar. | | | Targets | |
| | Sept. | Dec. | Program | Actual | Apr.-June | July-Sept. | Oct.-Dec. |
| | (In billions of Mexican pesos) | | | | | | |
| Net credit to the public sector by the monetary authorities 1/ | 2,503 2/ | 2,971 | 3,023 | 2,962 | 3,205 | 3,397 | 3,734 |
| Cumulative overall public sector deficit 3/ | | | | | | | |
| Unadjusted | 629 | 1,523 | 330 | 281 | 640 | 980 | 1,524 |
| Adjusted 4/ | | | 312 | 281 | | | |
| Cumulative changes in financial intermediation (effective flow)5/ | | | | | | | |
| Unadjusted | 175 | 259 | 70 | 88 | 130 | 170 | 200 |
| Adjusted 6/ | | | 88 | 88 | | | |
| Cumulative changes in net domestic assets of the monetary authorities (effective flow) 7/ | -557 | -502 | -40 | -141 | -71 | -113 | -43 |
| | (In millions of U.S. dollars) | | | | | | |
| Cumulative net foreign borrowing by the public sector 3/ | 2,555 | 4,686 | 1,100 | 510 | 2,100 | 3,100 | 4,000 |
| Cumulative change in net international reserves of the monetary authorities 3/ 8/ | 4,365 | 5,480 | 300 | 756 | 800 | 1,300 | 2,000 |
| Cumulative reduction in arrears 9/ | 521 | 1,088 | ... | 280 | ... | ... | 280 |

Sources: Mexican authorities; and Fund staff estimates.

1/ Effective flows.
2/ Stock outstanding at end of November 1983 unadjusted for changes in the exchange rate (used as base).
3/ Limit tested at the end of each period.
4/ Limit adjusted downward by the equivalent of any excess of the flow of financial intermediation over its limit in the same quarter.
5/ Financial intermediation was not a performance criterion during 1983. Figures shown are for reference only.
6/ Any excess of the cumulative flow of financial intermediation over its limit for the quarter is deducted from the ceiling for the overall sector deficit.
7/ Net domestic assets of the Bank of Mexico for purposes of the ceiling are defined as the difference between note issue and net international reserves of the monetary authorities.
8/ Includes payments arrears on account of interest and amortization due on foreign suppliers' loans to the private sector not included in restructuring of external debt.
9/ Limit tested at the end of calendar year.

Table 6. Mexico: Summary Public Sector Operations, 1982-84

| | In billions of Mex$ | | | | | In percent of GDP | | | Change in GDP share | |
|---|---|---|---|---|---|---|---|---|---|---|
| | | | | Jan.-March | | | | | | |
| | 1982 | 1983 | 1984 Proj. | 1983 Prel. | 1984 Prel. | 1982 | 1983 | 1984 Proj. | 1983 | 1984 Proj. |
| Overall deficit 1/ | -1,679 | -1,464 | -1,524 | -273.9 | -281.1 | -17.8 | -8.4 | -5.5 | 9.4 | 2.9 |
| Public sector receipts 2/ | 2,818 | 5,881 | 8,994 | 1,171.5 | 2,012.8 | 29.9 | 33.7 | 32.5 | 3.8 | -1.2 |
| Petroelum exports | 830 | 1,939 | 2,784 | 409.5 | 638.3 | 8.8 | 11.1 | 10.1 | 2.3 | -1.0 |
| Other PEMEX receipts | 140 | 605 | 1,090 | 102.4 | 204.1 | 1.5 | 3.5 | 3.9 | 2.0 | 0.4 |
| Other public enterprises | 488 | 870 | 1,563 | 174.0 | 316.7 | 5.2 | 5.0 | 5.6 | -0.2 | 0.6 |
| Federal government | 1,080 | 2,042 | 2,992 | 391.8 | 683.1 | 11.5 | 11.7 | 10.8 | 0.2 | -0.9 |
| Social security | 254 | 384 | 522 | 86.1 | 152.9 | 2.7 | 2.2 | 1.9 | -0.5 | -0.3 |
| Federal District | 26 | 41 | 43 | 7.7 | 17.7 | 0.3 | 0.2 | 0.2 | -- | -- |
| Public sector outlays 2/ | 4,497 | 7,345 | 10,518 | 1,445.4 | 2,293.9 | 47.8 | 42.1 | 38.0 | -5.6 | -4.1 |
| Operating expenditure 3/ | 1,595 | 2,652 | 3,942 | 508.2 | 1,002.8 | 16.9 | 15.2 | 14.2 | -1.7 | -1.0 |
| Interest payments | 809 | 2,157 | 2,819 | 393.3 | 641.3 | 8.6 | 12.4 | 10.2 | 3.8 | -2.2 |
| Current transfers | 472 | 932 | 1,213 | 125.3 | 188.1 | 5.0 | 5.3 | 4.4 | 0.3 | -0.9 |
| Other current 4/ | 588 | 319 | 312 | 195.3 | 103.0 | 6.2 | 1.8 | 1.1 | -4.4 | -0.7 |
| Capital expenditure | 1,033 | 1,285 | 2,232 | 223.3 | 358.7 | 11.0 | 7.4 | 8.1 | -3.6 | 0.7 |
| Memorandum items | | | | | | | | | | |
| Current account | -654 | -195 | 680 | -50.6 | 77.6 | -6.9 | -1.1 | 2.5 | 5.8 | 3.6 |

Sources: Secretariat of Finance and Public Credit, Secretariat of Programming and Budget, and Fund staff estimates.

1/ Based on the definition used for the 1984 Program.
2/ Differs from Table 1 because public sector receipts and outlays are inclusive of public enterprises operating revenue and expenditure, respectively.
3/ Includes wages, goods and services, and unclassified (ADEFAS).
4/ Includes exchange losses, net financing requirements of the rest of the public sector, unclassified, and other residual operations.

There are clear signs that the economy is beginning to recover. Industrial output rose in the first quarter of 1984 compared with the last quarter of 1983, and it was only fractionally below the level prevailing in the first quarter of 1983 (see Chart 1). Developments in respect of inflation have been somewhat less favorable. The rate of inflation decelerated to 67 percent for the 12 months ended in May 1984 compared with about 81 percent in the 12 months ended December 1983. This rate of inflation was somewhat in excess of the program target, in part reflecting large public sector corrective price adjustments. It is estimated that almost two fifths of the increase in prices in the first quarter of 1984 can be attributed to adjustments in controlled prices. However, the less-favorable-than-anticipated price performance may also be attributed to a slow pace of import liberalization and to the 30 percent increase in the minimum wage awarded in December 1983.

During the first months of 1984, the balance of payments continued to be strong. Net international reserves increased by about US$1 billion in the period January-May, which was above the target of US$800 million for the first half of the year. In the first three months of 1984, the current account registered a surplus of almost US$2 billion, with the trade surplus exceeding US$4 billion (see Table 2). The value of petroleum exports increased by 13 percent and that of nonpetroleum exports by 40 percent. Imports increased from the extremely low levels of US$1.5 billion in the first quarter of 1983 to US$2.1 billion in the first quarter of 1984. The official capital account recorded only a moderate net inflow in that period, inasmuch as the first drawing under a US$3.8 billion loan from foreign commercial banks had not yet been made. The private capital account continued to record outflows, reflecting mostly the repayment of obligations by the private sector, and retained earnings on Mexican private investments abroad.

During 1984 the exchange rate in the controlled and the free markets continued to be depreciated at a daily rate of Mex$0.13 per U.S. dollar, or an annual rate of 33 percent on the basis of the exchange rate prevailing in the controlled market at the end of 1983. The rate of depreciation in the free market was 29 percent on an annual basis, and by the end of May the spread between the two rates had declined by 1/2 of 1 percentage point to 11 percent. The cumulative rate of depreciation for the first four months of the year fell short of the adjustment needed to avoid a loss in competitiveness based on movements of relative price indices. On that basis, the real effective exchange rate appreciated by about 7 percent during the period and was still more depreciated than the levels observed in the period 1978-82 (see Chart 4).

On April 27 the Government of Mexico signed a US$3.8 billion loan agreement with a group of about 500 commercial banks. Reflecting the improvement of Mexico's creditworthiness, the loan carries a ten-year maturity with five-and-a-half years of grace, which was a significant improvement over the six years with three years of grace on terms as compared with the loan obtained in 1983. In addition, spreads were reduced by 1 percentage point to 1 1/8 percent over the U.S. prime rate, and by 0.75 percentage point to 1 1/2 percent over LIBOR. The decline in participating banks from 526 in the 1983 operations to 500 in 1984 reflected to a large extent the merger of a number of smaller U.S. banks.

Mexico has continued to maintain close links with the IBRD during the period of the adjustment program. The IBRD operations cover major sectors of economic activity, and include project and program lending. In this connection, Mexico has recently concluded a general agreement with the IBRD on the structure of interest rates for credits based on funds obtained from that institution. The IBRD also has assisted Mexico in the evaluation of its current public investment program, as described in EBS/84/1, Supplement 2 (2/29/84) and has embarked on a number of joint studies covering industrial, trade and development finance policies.

## III. Summary of Policy Discussions

The discussions with the authorities were held at a time when the Immediate Program for Economic Recovery (PIRE) had been in place for more than a year. This had been a difficult period of adjustment, but there were already clear signs of improvement in the economic performance. Recent developments had strengthened the public view that the program was being implemented successfully. However, the authorities were fully aware that further action was required in certain areas of policy. The authorities made clear their determination to continue carrying out the adjustments envisaged in the economic program for 1984-85 and also their willingness to strengthen their policy actions if circumstances indicated a need for corrective measures.

The authorities regard the objective of reducing inflation as central to the program, but they expressed concern about the feasibility of limiting inflation to 40 percent during 1984 as had been targeted and felt that, given the deviations that have occurred so far, inflation might turn out to be closer to 50 percent. They were aware of the impact of the minimum wage settlement on inflationary expectations, and at the time of the mission they indicated that they would make every effort to limit the size of the award. However, there was concern that the prevailing political conditions would preclude a truly low wage adjustment. Indeed, the authorities viewed any increase at or below 20 percent as encouraging and consistent with the achievement of a significant deceleration of inflation and the maintenance of an adequate degree of competitiveness. The serious pressures that the Government was confronting became evident in the demands of labor representatives that wages be increased by 40 percent. A minimum wage award of 20 percent was announced in June, yielding a cumulative increase of 56 percent for 1984. The authorities indicated that the wage award would be a key signal to expected price developments, and said that they would carefully monitor policies so as to assure progress on the price front.

## 1. Fiscal policy

The authorities are firmly committed to keeping the public sector deficit within the original limit set by the program, notwithstanding the fact that certain expenditure categories, particularly domestic and external interest rates, have been subject to unexpected upward pressures. The authorities are convinced that the substantial reduction of the public sector deficit in 1983 was an important factor of the initial success of the adjustment program.

In 1983 the adjustment of the public sector occurred in both revenues and expenditures. Tax rates were increased, public sector prices were adjusted in real terms, and current and capital outlays were curtailed sharply. The adjustment envisaged for 1984 is more modest, but the possible sources of adjustment are more limited as well; adjustment is to come mainly from a further curtailment of current expenditures and transfers, while providing room for a moderate real increase in capital expenditure.

With regard to public sector revenues, the authorities indicated that no major adjustments in the tax structure were being contemplated. In 1983 the revenue performance of some taxes had been disappointing, mainly as a result of the low level of economic activity, the foreign exchange losses for private enterprises, and the difficulties in implementing the new tax structure, particularly for the VAT. In 1984 these factors are expected to have lesser impact and revenues are expected to develop as projected. Only minor adjustments in the income tax structure have been introduced for 1984; there is to be a higher depreciation allowance for the year, and adjustments have been made to the income tax structure to offset the effect of inflation on incomes. The mission drew attention to some new sources of revenue that might be tapped, namely, the conversion of the import permit system to a comprehensive tariff scheme and the rationalization of the existing structure for tax exemptions.

The performance of revenues in the public sector in the first quarter of 1984 was encouraging, with domestic revenues having increased faster than inflation. However, petroleum export receipts increased at a somewhat lower rate than inflation as prices were stable in world markets, and the rate of depreciation of the peso lagged behind inflation. For the year as a whole, shipments of petroleum are expected to remain at around 1.55 million barrels a day. Prices are expected to remain at the current levels of US$29 per barrel for the lighter Isthmus crude, and at US$25.50 per barrel for the heavier Maya crude. The latter price includes the increase of US$0.50 a barrel announced in April 1984.

The adjustment in public sector prices in the first four months of the year are strengthening the public finances. The authorities stated that no major changes in public prices relative to inflation were expected to be necessary for the remainder of the year. Nevertheless, they would be following the trends of costs and prices very closely and would take further corrective action if needed. Recent announcements freezing the prices of some services in the public sector are not in line with the stated policies, however, and may give rise to some pressures on the budget.

Public sector expenditure is expected to continue to be subject to strict limits in 1984. Expenditure rose at a rate considerably below inflation during the first quarter of the year. However, operating expenditure of the public enterprises increased substantially in real terms when compared with the low levels observed during the first quarter of 1983 (see Table 6). The authorities expressed their intention to arrest increases in spending in excess of those envisaged in the budget, and indicated that they were acting to eliminate low priority programs both in the Federal Government and in the public enterprises. They also viewed the reduction in the size of the public sector as important in the effort to moderate expenditure. To this end, they were in the process of selling some public enterprises. An important step in that direction was taken at the time of the staff visit, when enterprises owned by the nationalized commercial banks valued at US$500 million were offered for sale. The assets have been offered to the private sector in packages to avoid that the least profitable enterprises remain in the public sector.

The authorities indicated their concern about the impact on the budget of rising internal and external interest rates. While the recent increases could be accommodated within the provisions of the budget, it was unlikely that further increases could be absorbed without major adjustments in public sector policies.

The 1984 budget contains an authorization for a contingent expenditure equivalent to about 1 percent of GDP, with two thirds of this amount included within the targeted public sector deficit. At the time the budget was approved, it was stipulated that this expenditure would be released in the second half of 1984 only if there was evidence that economic activity was not recovering and if noninflationary financial resources were available. The mission indicated that current conditions suggested that the contingency expenditure should not be mobilized, in order to avoid excessive demand pressures and adverse signals to the market. Officials thought that a case could be made for activating the contingent expenditure given the rise in interest costs, the continued sluggishness of economic activity, and apparent availability of "idle" domestic resources. However, a decision will be taken only in the second half of the year, when more information becomes available on economic performance.

2. Financial intermediation by the public sector

The authorities have traditionally distinguished between two kinds of overall public sector deficit, i.e., including or excluding net lending to the private sector by the development banks and the official trust funds. For purposes of the program, net lending financed by domestic private sector deposits was not included in the public sector deficit in 1983--except for the credit granted by the trust funds of the Bank of Mexico--since it has been regarded as financial intermediation between domestic savers and investors (Table 7).1/ Because of a rapid growth of financial intermediation in 1983, however, a ceiling of Mex$200 billion has been placed on credit granted by the development banks and official trust funds in 1984; this ceiling can be exceeded provided that the ceiling on the overall public sector deficit is correspondingly reduced, thereby allowing additional resources to be channeled to the private sector.

Table 7. Mexico: Financial Intermediation Operations

(In billions of Mexican pesos)1/

| | 1979 | 1980 | 1981 | 1982 | 1983 | Prog. 1984 | Prel. 1984 Jan.-Mar. |
|---|---|---|---|---|---|---|---|
| Total financial intermediation operations | 16.2 | 23.5 | -12.5 | 69.3 | 258.5 | 200.0 | 88.0 |
| Bank of Mexico official trust funds | 7.1 | 6.5 | 11.0 | 48.6 | 59.2 | ... | 27.0 |
| National development banks | 9.1 | 17.0 | -23.5 | 20.7 | 199.3 | ... | 61.0 |
| Credit to private sector | 24.6 | 43.9 | 9.3 | -1.4 | 187.6 | ... | 23.4 |
| Other | -15.5 | -26.9 | -32.8 | 22.1 | 11.7 | ... | 37.6 |
| Memorandum item | | | | | | | |
| Financial intermediation (in percent of GDP) | 0.5 | 0.5 | -0.2 | 0.7 | 1.5 | 0.7 | ... |

Source: Bank of Mexico.

1/ Effective flows adjusted for changes in the exchange rate.

1/ Foreign borrowing by development banks and official trust funds is included in the external debt ceiling and is counted as part of the public sector deficit.

Financial intermediation by development banks and official trust funds amounted to Mex$258 billion in 1983, and constituted about one third of the credit granted to the private sector by the banking system. To a large extent, the loans provided by these financial intermediaries are concessional. However, the authorities have reduced the size of the subsidies by increasing lending rates and by linking them to the average cost of funds. These measures have affected, among others, the largest trust funds, namely FOGAIN (a trust fund for industrial promotion), FIRA (a trust fund for agricultural restructuring), and FOMEX (a trust fund for export promotion). Moreover, significant efforts have been made to improve the recovery of loans granted by trust funds.

The authorities have expressed concern that the current operational ceiling, covering total net lending by development banks and official trust funds, implicitly assumes that all lending to the private sector is a contingent loss. The authorities have indicated that they would prefer a new mechanism to control financial intermediation. If it should be operationally feasible, they would like to move to a concept that would cover only the deficit that effectively results from these transactions after transfers from the Federal Government. The mission indicated that the concept being advanced by the authorities was valid from a fiscal standpoint, but it also noted that the current mechanisms provided a safeguard for demand management, because the ceiling also serves as a mechanism of monetary control on the operations of the development banks, which are exempt from reserve requirements. It was agreed that any change in monitoring should be adopted only after a careful examination of a new formulation, and on the basis of an adequate statistical base.

3. Monetary policy

In recent months monetary policy has continued to be cautious. Financial savings have grown steadily, signaling a restoration of public confidence. The rise in financial savings has made possible a rapid increase in credit to the private sector and a further accumulation of international reserves. Real balances stopped declining in mid-1983 and started increasing slightly subsequently, when adjusted for seasonal fluctuations (see Chart 6).

To a significant extent, the behavior of monetary aggregates has reflected realistic interest rates. However, real interest rates became negative in early 1984, reflecting lower nominal interest rates and a higher rate of inflation during the first quarter of 1984 but the increases announced in mid-May restored positive real rates (see Chart 5). The authorities indicated that interest rates were now consistent with the currently expected rate of inflation for the rest of the year.

Developments with regard to credit have been encouraging. The credit requirements of the public sector in the first quarter of 1984 had declined in real terms compared with those prevailing in the same quarter of 1983. Credit to the private sector grew rapidly, reflecting the decline in lending interest rates--which fell more than deposit rates--and the increase in economic activity. The spread between lending rates not subject to control and borrowing rates has narrowed significantly as a result of enhanced competition in the banking industry, the development of nonbank financial markets, and an improvement in the structure of charges.

Subsidies granted through the financial system continue to have adverse effects on the structure of interest rates, although rates on preferential credits are being brought more nearly in line with the average cost of funds. In this regard the mission was informed about a recently concluded agreement with the IBRD, and described above. The authorities stated their general agreement with the principle of market-related rates and noted that the most effective way to reduce financial subsidies would be the permanent reduction of inflation.

4. Wages and prices

The authorities viewed wage policy as a key element in their economic strategy. They noted that the moderation in wage awards in 1983 had contributed significantly to the attainment of the price objectives. Average real minimum wages had declined by about 17 percent from 1982 to 1983, but they felt that a further significant decline would be politically difficult in 1984. The authorities said that they had been hoping to maintain in 1984 the average purchasing power of minimum wages observed in 1983. However, they indicated that some decline was inevitable if progress was to be made in slowing inflation.

At the time of the mission, the negotiations had started within the Tripartite Council of Representatives--including government, labor and the private sector--and the authorities noted that this process precluded direct control over the possible outcome. The mission stated that it was important to be cautious on wage adjustments to ensure the reduction of inflation, the maintenance of competitiveness, the continuation of economic recovery, and a sustained increase in employment. The authorities were of the view that a wage award of 20 percent (which would result in a cumulative increase of 56 percent for the year) would still be consistent with an inflation rate of less than 50 percent this year. However, they also were aware of the effect that the size of the wage award would have on expectations.

The number of products subject to price controls was significantly reduced in 1983, and continued flexibility is being exercised in the management of the remaining controls. However, the authorities have stated that they will pay due regard to the impact of price increases on the purchasing power of lower income groups and on the availability of basic goods. Tight controls are applied on prices of a basket of seventeen basic products which are being directly subsidized by the Federal Government. Nonetheless, the prices for these items have been adjusted upwards broadly in line with inflation, to avoid an undue burden on the budget. The mission warned about the dangers of price controls for efficiency and the availability of goods. The authorities indicated that they intend to reduce the scope of the subsidies while maintaining efficiency.

5. External policies

In 1983 and early 1984, the balance of payments has been strong. However, some concerns have emerged as regards the appropriateness of the exchange rate and trade policies of Mexico.

a. Exchange system

Exchange rate policy discussions focused on three main issues: the recent apparent loss of competitiveness, the possible unification of the markets, and the difficulties caused by the informal market across the U.S. border. The mission noted the magnitude of the exchange rate adjustment in 1982-83, but emphasized the need to assess the appropriateness of the current daily rate of depreciation in light of the current rate of inflation. In particular, the recent real appreciation of the peso in terms of relative prices was giving rise to some concerns about the adequacy of the current rate.

In their response the authorities stressed that the current indicators of the real exchange rate--both on the basis of relative prices and relative wages--showed that the currency was still quite low as compared with the period 1978-82. They believed that a significant margin of undervaluation continued to prevail. However, they did not envisage a further erosion in competitiveness, as they expected inflation to decelerate in the remainder of the year. Moreover, they argued that net international reserves had continued to increase rapidly as a result of a strong current account surplus. The mission cautioned that this apparent strength of the balance of payments could reflect in part import control, and that a continued reduction in competitiveness could result in a reversal in the trends observed in the current and the capital account. The authorities stated that the external situation was being monitored closely and, if it should prove necessary, the rate of depreciation would be modified.

The current management of the free market rate and the existence of an informal market, with an ongoing premium for the U.S. dollar of about 10 percent over the free market rate at the time of the discussions, were viewed with concern by the mission. At present, commercial banks limit the access to the free market on the basis of daily allocations to individuals and enterprises. Although these limits are established for individual transactions by commercial banks, no limits exist on the number of transactions that could be effected by any single individual or firm in different banks. The authorities indicated that foreign exchange is available for bona fide transactions and that any liberalization in access would risk feeding speculation. The mission noted that a more flexible management of the free market exchange rate would be appropriate to reduce pressures in the foreign exchange market. The authorities preferred not to modify current policies since they expected the peso discount in the informal market to disappear soon, as a result of the tightening of monetary conditions that had been undertaken. However, they said that they would follow closely developments in the markets, and would review possible alternatives if needed. Since the mission's departure the exchange rate for the U.S. dollar in the parallel market has declined somewhat, but the differential has not yet been eliminated.

The mission also inquired about the intentions of the authorities on the unification of the exchange rates in the controlled and the free markets. The authorities replied that they were committed to the eventual unification of the two markets, but they felt that the current arrangement should be continued for the time being, in light of the uncertainties prevailing in the foreign exchange markets.

b. Commercial policies

Efforts have been made to liberalize imports in recent months, but the degree of liberalization has been uneven among sectors and the current structure of protection may be detrimental to the efficiency of resource allocation and may be hampering the reduction of inflation. In particular, import liberalization appears to have been confined to goods not produced locally, thereby increasing protection for established industries.

Currently, some 80 percent of all tariff items, amounting to about 90 percent of total imports, are subject to prior authorization. The restrictiveness of the import system has been reduced since 1982 and import permits for use in the controlled market have been increased. The average monthly level of import authorizations during the first four months of the year was well in excess of the average level of import authorizations for the year 1983, reflecting higher authorizations for previously permitted imports and the selective liberalization of licenses for new items. However, some measures have been taken recently that indicate increased protection in certain areas. In particular, imports of many items were prohibited in order to protect particular sectors and to discourage the consumption of luxury items. In addition, legislation has been approved to protect selected domestic activities and the authorities are engaged in a major program for the purchase of locally produced goods by the public sector.

At present, imports continue to be low, although they have risen from the relatively low levels observed in early 1983. The authorities have emphasized that the level of unutilized import permits has remained high, in reflection of more liberal licensing. The mission stressed the need for further actions to liberalize and rationalize the system. It noted that current policies may have given rise to a situation in which increases in aggregate demand were not reflected fully in external transactions, thereby resulting in a smaller-than-expected decline in inflation and a less efficient structure of resource use in the economy. The mission also emphasized that delays in rationalizing the structure of protection and restoring more normal levels of imports might have adverse effects on export competitiveness, as restraints on imports had the effect of fostering an appreciation of the currency in real terms. Moreover, the effect of these measures would be difficult to reverse in the future. The mission finally indicated that it was very important to replace the licensing system by a tariff system, in order to improve resource allocation and strengthen the public finances.

The authorities said that they were aware of the importance of trade liberalization in controlling inflation and reducing distortions. Officials noted that renewed emphasis would be given to shifting from import permits to custom duties. However, the comprehensive reform of the protective system, initially envisaged for the first half of 1984, has been delayed at least to the second half of the year.

As for the efforts to improve Mexico's access to foreign markets, the authorities said they had achieved considerable progress in bilateral discussions with the United States that were aimed at obtaining agreement to include an injury test in the case of countervailing action against Mexican exports. Discussions on this issue are still taking place.

c. External debt management

(1) Private sector debt

During 1983 and early 1984 progress has been made in restructuring the external debt of the private sector that is currently under the facility for the coverage of foreign exchange risks (FICORCA), and in settling the payments for private sector obligations guaranteed by foreign official agencies. In particular, agreements have been signed with the United States and Spain and negotiations are well advanced with the United Kingdom and Canada. Moreover, Mexico is making best efforts to conclude bilateral agreements with the remaining creditors. All remaining external arrears which had emerged in 1982 were repaid in March 1984, contributing to the improvement of Mexico's creditworthiness and eliminating the only remaining exchange restriction.

The mission noted that the extension of foreign exchange guarantees for outstanding loans under FICORCA had helped to resolve the problems that the private sector had confronted in 1982. However, the possible extension of such guarantees for new borrowings should be approached with great care, because of their potential effect on the conduct of monetary policy. The authorities stated their awareness of the possible costs of a forward cover scheme, but indicated that current policies precluded the emergence of subsidies, inasmuch as interest rate policy was consistent with the path of the currency depreciation.

(2) Public sector debt

The objective of public sector external public debt management has continued to be to reduce the reliance on foreign borrowing and to improve its term structure. The authorities were successful in reducing the net borrowing requirements in 1983 and in 1984. Moreover, the restructuring of the external public debt to foreign commercial banks completed in 1983 permitted a significant improvement in its profile. However, the debt service burden in the coming years remains high (Table 8). The authorities indicated that, in light of the balance of payments outlook, there was a need for a further restructuring of debt for the remainder of the decade, in order to deal with bunching of repayments and to create the conditions for a more normal access to capital markets in the future. In early June, at the International Monetary Conference in Philadelphia, senior representatives of the commercial banks' Advisory Committee for Mexico agreed, on the basis of a report by the Managing Director, to negotiate with the Mexican authorities a rescheduling of its public sector debt on the multiyear basis, compatible with Mexico's medium-term financial outlook. This approach was based on Mexico's current and prospective performance under its adjustment program.

## IV. Balance of Payments Prospects

### 1. Prospects for 1984

On the basis of the results in the first quarter of the year, the balance of payments projections for 1984 have been revised. The projected balance of current account is now projected to show a surplus of US$1 1/2 billion compared with a deficit of about US$1 billion envisaged earlier. The modification was mainly a reflection of the upward revision of the trade surplus by some US$3 billion, to US$13 billion, on the basis of a lower projection for imports and a very strong growth of nonpetroleum exports (see Table 2).

Exports are projected to increase from US$22 billion a year in 1982-83 to US$24 1/2 billion in 1984, mostly on account of the growth of nonpetroleum exports, in response to the recovery abroad and the prevailing level of competitiveness. Total imports are projected to increase by 50 percent to US$11 1/2 billion, as a result of a gradual recovery of domestic activity, the replenishment of stocks, and the acceleration of import permit authorizations. Net factor payments are projected to increase from US$9 billion in 1983 to US$11 billion in 1984, largely because of the increase in interest payments on external debt that stems from a rise in the stock of debt as well as from higher interest rates.

Net capital inflows are now expected to increase from US$0.5 billion in 1983 to US$2 billion in 1984, mainly because the net outflow of private capital (including debt amortizations) is projected to decline to some

Table 8. Mexico: Scheduled Amortization on External Debt Outstanding at End-1984 1/

(In billions of U.S. dollars)

| | Projected Debt Outstanding End-1984 | 1985 | 1986 | 1987 | 1988 | 1989 | 1990 | 1991 and After |
|---|---|---|---|---|---|---|---|---|
| I. Public sector debt (excluding IMF) | 68.8 | 10.0 | 9.3 | 13.3 | 11.8 | 9.7 | 7.7 | 7.0 |
| To banks | 54.2 | 8.0 | 7.2 | 11.4 | 9.5 | 8.4 | 6.4 | 3.3 |
| Of which: | | | | | | | | |
| Amortization of 1983 loan of US$5 billion | (5.0) | (--) | (1.3) | (1.7) | (1.7) | (0.3) | (--) | (--) |
| Amortization of 1984 loan of US$3.8 billion | (3.8) | (--) | (--) | (--) | (--) | (0.2) | (0.8) | (2.8) |
| Amortization of 1983-84 restructuring | (18.8) | (--) | (--) | (4.7) | (4.7) | (4.7) | (4.7) | (--) |
| To nonbanks 2/ | 14.6 | 2.0 | 2.1 | 1.9 | 2.3 | 1.3 | 1.3 | 3.7 |
| II. IMF repurchases | 2.6 | -- | 0.1 | 0.3 | 0.5 | 0.8 | 0.8 | 1.4 3/ |
| III. Private sector and nationalized banks | 23.3 | 1.2 | 1.2 | 1.0 | 3.1 | 2.9 | 2.7 | 11.2 |
| Of which: to banks | 21.0 | 0.8 | 0.5 | 0.7 | 2.8 | 2.7 | 2.6 | 10.9 |
| Total (I + II + III) | 94.7 | 11.2 | 10.6 | 14.6 | 15.4 | 13.4 | 11.2 | 19.6 |
| Of which: to banks | (75.2) | (8.8) | (7.7) | (12.1) | (12.3) | (11.1) | (9.0) | (14.2) |

Sources: Mexican authorities; and Fund staff estimates.

1/ Excludes amortizations on new borrowing after 1985.
2/ Includes C.C.C. credits.
3/ Includes repurchases with respect to projected purchases in 1985.

US$2 billion, while net public sector borrowing is projected to decline moderately, to US$4 billion. Thus, net international reserves of the Bank of Mexico are projected to increase by some US$3 billion in 1984, and gross official reserves (excluding gold) are projected to increase to over four months of imports and interest payments in 1984.

## 2. Medium-term projections

The medium-term balance of payments projections have been revised in light of recent developments and the prospects for foreign borrowing through the end of the decade. The major macroeconomic assumptions made in earlier exercises 1/ have been maintained, namely, the continuation of adjustment policies under the current program, leading to a real GDP growth of about 5 percent in the period 1985-90, the gradual convergence of domestic inflation to that of Mexico's major trading partners, and the maintenance of a strong balance of payments position.

On the basis of the above assumptions, the staff projects that Mexico's current account will remain approximately in balance over the period 1985-90 (Table 9). The virtual elimination of the current account surplus would reflect a recovery of private investment, being partly offset by the reduced public sector deficit. The value of exports is projected to grow at an annual average of 6 percent, with petroleum products continuing to account for the largest, albeit declining, share. Nonpetroleum exports would grow by some 9 1/2 percent a year, reflecting the maintenance of external competitiveness and continued economic expansion abroad. Imports are projected to grow at an annual average of about 10 percent in real terms from their relatively low levels in the base period, with a more pronounced increase in the earlier years. Net factor payments would decline as a proportion of GDP from 5 1/2 percent in 1984 to 2 1/2 percent in 1990 while nonfactor services and transfers would record a small annual surplus during the period.

The net foreign financing of the public sector would be reduced from about 2 percent of GDP in 1984 to an average of 0.4 percent of GDP in 1985-90, i.e., the bulk of the declining public sector financing needs would be covered from domestic sources. Virtually all of the net foreign financing of the public sector would originate from nonbank sources--largely multilateral and bilateral credits. Net private capital transactions are expected to be roughly in balance during the period, as the gradual resumption of private capital inflows in the form of direct investment and loans will be nearly offset by the amortization of private debt that has been rescheduled, mainly under the FICORCA scheme. The overall balance of payments would yield an average annual accumulation of net international reserves of around US$1 1/2 billion over the period.

1/ See EBS/84/1, Sup. 1 (1/27/84), pp. 28-30.

Table 9. Mexico: Medium-Term Balance of Payments Projections

(In billions of U.S. dollars)

| | 1984 | 1985 | 1986 | 1987 | 1988 | 1989 | 1990 |
|---|---|---|---|---|---|---|---|
| Current account | 1.4 | 0.8 | 0.6 | 0.6 | 0.6 | 0.1 | -0.6 |
| Trade balance | 13.0 | 10.6 | 9.7 | 9.4 | 8.9 | 7.7 | 7.2 |
| Exports | (24.6) | (25.6) | (27.2) | (29.0) | (30.9) | (32.9) | (35.1) |
| Imports | (-11.6) | (-15.0) | (-17.5) | (-19.6) | (-22.0) | (-25.2) | (-27.9) |
| Factor income | -11.2 | -10.3 | -9.7 | -9.4 | -9.0 | -8.5 | -8.8 |
| Of which: interest payments on public debt | (-8.8) | (-8.5) | (-7.9) | (-7.4) | (-7.0) | (-6.4) | (-6.5) |
| Other services and transfers | -0.4 | 0.5 | 0.6 | 0.6 | 0.7 | 0.9 | 1.0 |
| Capital account | 1.9 | 1.2 | 1.1 | 1.1 | 1.2 | 1.5 | 1.9 |
| Official capital | (4.0) | (1.2) | (1.1) | (1.1) | (1.2) | (1.5) | (1.2) |
| Private capital | (-2.1) | (--) | (--) | (--) | (--) | (--) | (0.7) |
| Monetary authorities (increase -) | -3.3 | -2.0 | -1.7 | -1.7 | -1.8 | -1.6 | -1.3 |
| Memorandum items | | | | | | | |
| Current account as percent of GDP | | | | | | | |
| At 1979 real exchange rate | 0.7 | 0.3 | 0.2 | 0.2 | 0.2 | -- | -0.2 |
| At current exchange rate | 0.9 | 0.5 | 0.3 | 0.3 | 0.2 | -- | -0.2 |
| Gross reserves, end of period 1/ | | | | | | | |
| In billions of U.S. dollars | 7.9 | 11.2 | 12.8 | 14.2 | 15.5 | 16.3 | 16.8 |
| In months of imports and total interest payments | 4.0 | 5.1 | 5.5 | 5.8 | 6.0 | 5.9 | 5.6 |

Source: Fund staff projections.

1/ Excludes gold and payments agreements.

In line with the above assumptions on net foreign borrowing by the public sector, and on the basis of the current maturity structure, the debt service ratio would increase from 48 percent in 1984 to 55 percent in 1985, reflecting a bunching of amortizations due on debt outstanding as of the end of 1984 (Table 10 and Appendix IV). After declining in 1986, the ratio would again increase to 56 percent in 1987, when the amortization of amounts restructured in 1982-84 would become due. Subsequently, the debt service ratio would decline steadily to 36 percent by 1990, reflecting both the limited resort to external borrowing and projected declines of world interest rates over the medium term. The ratio of public debt to GDP would fall from 32 percent in 1984 to 20 percent in 1990, and the ratio of total debt to GDP would fall from 44 percent to 26 percent. The ratio of public sector foreign interest payments to GDP, net of interest on gross reserves, would decline from nearly 4 percent of GDP in 1984 to 1 1/2 percent of GDP in 1990.

In June 1984 the Mexican authorities announced the approval of the National Development Financing Program for 1984-88. This program aims at strengthening domestic savings, obtaining a more efficient allocation of these resources, reducing the reliance on foreign borrowing, and strengthening the financial system. To achieve these objectives the authorities intend to continue with their present general policy stance, including a reduction in the public sector deficit in relation to GDP, and the maintenance of realistic exchange rates and interest rates, accompanied by efforts to improve the structure of external public and private debt. Moreover, the program emphasizes the need to coordinate commercial and exchange rate policies in improving economic efficiency.

Projections for 1985-88 presented in the program contrast somewhat with the staff's scenario, although the differences are generally small. The current account is projected to show an annual average deficit of about 0.5 percent of GDP, compared with the staff's projection of virtual equilibrium. This higher deficit is to be financed by somewhat larger official capital inflows and by a somewhat smaller buildup of gross reserves over the period. In particular, the authorities' projections scenario envisages that the exposure of commercial banks to the public and private sectors of Mexico would increase by an annual average of US$1 billion in 1985-90, or somewhat over 1 percent a year, whereas the staff had projected that the banks' exposure would decline by some US$0.6 billion a year, because of net repayments to the banks by the Mexican private sector. Under the authorities' scenario, the ratio of debt to GDP would decline to 29 percent by 1990, compared with a decline of 26 percent under the staff's projections.

Table 10. Mexico: Summary of External Public Debt Operations and Projections

(In billions of U.S. dollars)

| | | | | Prel. | Projected | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | 1980 | 1981 | 1982 | 1983 | 1984 | 1985 | 1986 | 1987 | 1988 | 1989 | 1990 |
| Total flows (net) | 4.7 | 17.8 | 9.0 | 3.8 | 5.3 | 2.5 | 1.0 | 0.8 | 0.7 | 0.7 | 0.4 |
| Direct debt 1/ | 4.8 | 17.8 | 6.8 | 4.7 | 4.0 | 1.2 | 1.1 | 1.1 | 1.2 | 1.5 | 1.2 |
| Disbursements | (8.5) | (22.6) | (11.8) | (11.8) | (10.5) | (11.2) | (10.5) | (14.9) | (13.3) | (12.5) | (11.0) |
| Amortizations due | (3.7) | (4.8) | (5.0) | (7.1) | (6.5) | (10.0) | (9.4) | (13.8) | (12.1) | (11.0) | (9.8) |
| Debt outstanding end-1982 | /3.7/ | /4.8/ | /5.0/ | /7.1/ | /6.5/ | /9.8/ | /9.1/ | /8.3/ | /6.2/ | /4.3/ | /1.8/ |
| Other (including 1982-84 restructuring) | /--/ | /--/ | /--/ | /--/ | /--/ | /0.2/ | /0.3/ | /5.5/ | /5.9/ | /6.7/ | /8.0/ |
| Bank of Mexico (net) 2/ | -0.1 | -- | 2.2 | -0.9 | 1.3 | 1.3 | -0.1 | -0.3 | -0.5 | -0.8 | -0.8 |
| Interest payments (total) | 4.0 | 5.5 | 7.9 | 7.0 | 8.8 | 8.5 | 7.9 | 7.4 | 7.0 | 6.4 | 6.5 |
| Debt service payments due 3/ | 7.8 | 10.3 | 12.9 | 14.1 | 15.3 | 18.5 | 17.4 | 21.5 | 19.6 | 18.2 | 17.1 |
| Debt service payments paid 3/ | 7.8 | 10.3 | 11.6 | 9.2 | 11.5 | 18.5 | 17.4 | 21.5 | 19.6 | 18.2 | 17.1 |
| | | | | | | | | | | | |
| External debt outstanding | 34.5 | 53.2 | 62.1 | 66.1 | 71.4 | 73.9 | 74.9 | 75.7 | 76.4 | 77.1 | 77.5 |
| Direct debt | 34.5 | 53.2 | 59.9 | 64.8 | 68.8 | 70.0 | 71.1 | 72.2 | 73.4 | 74.9 | 76.1 |
| Bank of Mexico | -- | -- | 2.2 | 1.3 | 2.6 | 3.9 | 3.8 | 3.5 | 3.0 | 2.2 | 1.4 |
| | | | | | | | | | | | |
| Memorandum items: | | | | | | | | | | | |
| Nationalized bank debt outstanding | 5.1 | 7.0 | 7.8 | 6.6 | 6.6 | 6.6 | 6.6 | 6.6 | 6.6 | 6.6 | 6.6 |
| | | | | | | | | | | | |
| Selected indicators (in percent) | | | | | | | | | | | |
| Effective interest rate | 12.4 | 12.5 | 13.7 | 10.9 | 12.8 | 11.7 | 10.6 | 9.8 | 9.2 | 8.3 | 8.4 |
| Debt service ratio (including IMF) 4/ | | | | | | | | | | | |
| On payments due | 31.3 | 33.8 | 42.4 | 49.8 | 47.7 | 54.7 | 48.2 | 55.6 | 47.2 | 41.0 | 35.8 |
| On actual payments | 31.3 | 33.8 | 38.2 | 32.5 | 35.8 | 54.7 | 48.2 | 55.6 | 47.2 | 41.0 | 35.8 |
| Interest payments ratios: | | | | | | | | | | | |
| To exports of goods and services | 16.1 | 18.0 | 26.0 | 24.7 | 27.4 | 25.1 | 21.9 | 19.1 | 16.9 | 14.4 | 13.6 |
| To GDP 5/ 6/ | 2.3 | 2.7 | 3.9 | 3.4 | 3.8 | 3.2 | 2.6 | 2.2 | 1.9 | 1.5 | 1.4 |
| External debt ratio to GDP (excluding IMF) 6/ | 21.7 | 28.6 | 31.4 | 32.1 | 32.1 | 29.8 | 27.5 | 25.3 | 23.5 | 21.7 | 20.1 |

Sources: Mexican authorities; Appendix IV; and Fund staff projections.

1/ Includes central government, government development banks, and forward petroleum sales contracts of Pemex. Includes net changes in short-term debt.
2/ Includes purchases from the Fund.
3/ Amortization of medium- and long-term debt and interest on total debt; includes the Fund.
4/ Ratio of debt service to exports of goods and services.
5/ Net of interest on gross reserves.
6/ GDP in dollars measured at the 1979 real exchange rate.

## V. Exchange Arrangements Subject to Fund Approval

The exchange system currently in effect in Mexico involves multiple currency practices subject to Fund approval under Article VIII, Sections 2 and 3 of the Articles of Agreement. These were most recently described in EBS/84/81, Sup. 1 (1/27/84). The changes in the system that have taken place since that time have been discussed in previous sections of this paper, and in the accompanying paper on recent economic developments.

Multiple currency practices arise from the operation of

(i) an exchange market comprising a controlled market rate for specified transactions;

(ii) three special rates applied to forward cover contracts for the payment of external obligations outstanding as of December 20, 1982. These exchange rates may give rise to multiple currency practices at the time of foreign exchange delivery, insofar as a divergence could arise between the value of the deposit and other related costs, including the interest foregone, and the actual exchange rate prevailing at the time;

(iii) a special rate set at Mex$50=US$1, subject to a forward cover premium, for the repayment of certain obligations by financial institutions and leasing companies; and

(iv) a free market rate for all other transactions.

The exchange restrictions resulting from the accumulation of payments arrears, including those relating to debt servicing and payments for imports, were eliminated in March 1984, when all remaining arrears were repaid.

## VI. Staff Appraisal

The economic program adopted by the Mexican authorities in late 1982, supported by an extended arrangement approved by the Fund, brought about a marked turnaround in economic conditions in 1983, and helped Mexico to recover from the serious crisis that had developed. Continuation of the adjustment effort in 1984 has consolidated earlier gains, and has been reflected in a further improvement in economic performance.

Central to the adjustment was a marked reduction in the public sector deficit from 18 percent of GDP in 1982 to 8 1/2 percent in 1983. Pursuit of a prudent fiscal management, together with appropriate incomes, exchange rate, and monetary policies, made it possible to reduce significantly the imbalances prevailing at the beginning of the program and to improve the balance of payments and price performance.

The program for 1984 aims at a substantial deceleration of inflation, a recovery in economic activity, and a further strengthening of the net international reserve position. The results available for the first quarter of 1984 are generally encouraging. Although economic activity is still quite weak, there are signs that a recovery is now taking place. The current account of the balance of payments registered a large surplus on the strength of a large trade surplus, and resulted in a significant increase in net international reserves. At the same time, the process of elimination of external payments arrears which had emerged in 1982 has been completed.

Even though inflation has continued to decline, it has proceeded at a faster pace than had been envisaged and, thus, remains a matter of concern. The behavior of prices reflects, in part, major corrective adjustments in public sector prices. However, the minimum wage award of December 1983 and a slower than expected pace of import liberalization probably also have contributed to the maintenance of a rate of inflation higher than originally planned.

The adjustment effort in 1984 is based on a reduction in the public sector deficit to the equivalent of 5.5 percent of GDP. The fiscal objectives for the first quarter of 1984 have been met, although a rapid increase in operating expenditures has been taking place in the public enterprises. The authorities are aware of the difficulties that would develop if expenditure growth is not contained, and they are revising the expenditure plan to ensure that necessary adjustments are made. In general, the authorities do not foresee a need to modify the original targets for the deficit, although the payment of interest because of higher internal and external rates will put a heavy burden on the public finances. The staff believes that the revenue system is broadly adequate. The authorities will need to show continued vigilance, however, in the implementation of public pricing policies, to ensure the continued healthy development of the public finances.

A contingency expenditure reserve was included in the 1984 budget, to be mobilized only in the event that economic activity were to remain weak and at the same time the inflation and balance of payments objectives were being achieved. The authorities have not yet arrived at a final decision on the use of the reserve. It is the view of the staff that it would be inadvisable, in light of the present rate of inflation, to contemplate any easing of the fiscal stance, and therefore the authorities would be well advised to forego the use of the reserve.

Monetary and credit policy has remained cautious since the beginning of the program. The growth of financial savings since mid-1983 has been encouraging, and has permitted sustained growth of domestic credit to the private sector and a continuing accumulation of net international reserves. The recent adjustments to interest rates, which have restored positive real rates, are a welcome development. The reduction in the spread between lending and borrowing rates also is a favorable development, particularly since it reflects an improvement in the efficiency of the banking industry and a reduction in financial subsidies. In this regard, the recent agreement with the IBRD, with respect to the structure of interest rates for credits based on funds provided by that institution, should contribute to a better use of resources. The staff believes that further efforts are required to lower financial subsidies, through both the reduction of inflation and through increasingly stringent control over the amounts of credit made available at subsidized rates.

Wage policy will continue to be critically important to reduce inflation and maintain external competitiveness. The recently announced increase in minimum wages, together with the awards at the beginning of the year, has threatened the achievement of the original inflation target for 1984, and thus it is not helping to reduce inflationary expectations. Lasting improvements in real wages can only be based on sound and sustained economic growth, and thus great care needs to be exercised in respect of future adjustments of wages.

Exchange rate policy in 1982-83 helped to restore the competitiveness of the economy and thus strengthen the balance of payments. In 1984 the authorities have continued to pursue a flexible exchange rate policy. The real effective exchange rate in terms of relative prices has appreciated because inflation has risen somewhat faster than envisaged under the program. However, the real value of the currency is still lower than in the period 1978-82. Moreover, measured by unit labor costs--which is a more accurate indicator of competitiveness--a considerable depreciation took place in 1982-83. The strong growth in nonpetroleum exports, and to some extent the limited rise of imports, attest to the competitive edge that Mexico has. The authorities envisage that in the coming months inflation will decelerate and that there will be no further loss in competitiveness in terms of relative prices; the authorities also have indicated that they intend to re-examine the exchange rate policy if available information indicates a need for such re-examination. While the staff would not disagree with this approach, it would urge the authorities to monitor closely developments in the current and the capital account of the balance of payments very closely, and be prepared to move without delay if action should be needed in respect of the exchange rate.

The existence of a dual exchange market has been considered transitory by the authorities, who have announced their intentions of the eventual unification, upon a return to more normal conditions in the foreign exchange and capital markets. While exceptional conditions may still prevail, the staff would note that it is important, as a minimum, to improve the access to the free market so as to make it a genuine safety valve for the system. The use of administrative controls in that market is encouraging the development of an informal foreign exchange market, which can hardly help confidence and undoubtedly fosters the creation of distortions.

With regard to commercial policies, advances have been made in recent months to reduce the restrictiveness of the import-licensing system. The increased availability of import permits has allowed for some recovery of private sector imports from the low levels of early 1983. Nevertheless, there remains serious limitations or prohibitions on the imports of items currently produced domestically. The relatively slow pace of import liberalization is a matter of concern. The maintenance of import protection gives rise to inefficiencies within both the import-competing and the export sectors, has an adverse short-term impact on domestic prices, is an inefficient means of balance of payments management, and is inimical to the long-term prospects of the economy. For these reasons the staff would urge that the pace of import liberalization be accelerated and that the system of permits be replaced as soon as possible by a comprehensive tariff system.

The progress made in restructuring the external public debt has improved significantly in its profile. Moreover, the reduction in net foreign borrowing by the public sector has greatly enhanced Mexico's creditworthiness in international capital markets. The elimination of the external payments arrears which had accumulated in 1982 and the gains made in restructuring private debt also have contributed to improve Mexico's external debt management. The staff would wish to caution against any extension of official exchange guarantees to new debt, given the possible adverse repercussions on financial policies. With regard to external debt management after 1984, the recent announcement that Mexico's external debt with commercial banks will be renegotiated on a multiyear basis is encouraging. It should be noted that any restructuring effort and access to new financing will require the continuous cooperation of the international financial community, and ought to be based on the pursuit of suitable economic policies by the Mexican authorities over the medium term.

The staff welcomes the elimination of external payments arrears. The authorities have indicated that the multiple currency practices, which are described in Section V above, are transitional measures, and they have stated their intention to continue their efforts to unify the exchange system. The staff, therefore, recommends temporary approval of these measures.

In summary, Mexico has made remarkable advances in its efforts to recover from the economic crisis which affected the country in 1981-82. During the past year and a half, the authorities have implemented policies which have led to a substantial change in the Mexican economic structure, and they have shown a great capacity to correct economic policies when required by circumstances. The policies of the program and their implementation have been broadly consistent with the recommendations reflected in the Chairman's summing up at the time of the last review of Mexico's extended arrangement. Nevertheless, in the period ahead, further adjustments are called for if Mexico is to return to the path of sustained economic growth with stability, which was characteristic of its past.

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

## VII. Proposed Decision

The following draft decision is proposed for adoption by the Executive Board:

### 1984 Article IV Consultation

1. The Fund takes this decision relating to Mexico's exchange measures subject to Article VIII, Sections 2 and 3, in light of the 1984 Article IV consultation with Mexico conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. Mexico maintains multiple currency practices as described in Section V of SM/84/155. In view of the circumstances of Mexico, the Fund grants approval of these multiple currency practices until February --, 1985, the completion of the next review under the extended arrangement, or the completion of the next Article IV consultation, whichever is earlier.

## Fund Relations with Mexico
(As of May 31, 1984)

I. Membership Status

(a) Date of Membership: December 31, 1945
(b) Status - Article VIII

### A. Financial Relations

II. General Department (General Resources Account)

(a) Quota: SDR 1,165.5 million

(b) Total Fund holdings of Mexican pesos: SDR 2,906.1 million or 249.3 percent of quota

(c) Fund credit: SDR 1,805.6 million or 154.9 percent of quota
Of which: SDR 200.6 million or 17.2 percent of quota under credit tranche
SDR 800.25 million or 68.85 percent of quota under EFF
SDR 800.25 million or 68.85 percent of quota under EAR

(d) Reserve tranche position: SDR 65.0 million

(e) Current Operational Budget: Not applicable

(f) Lending to the Fund: Not applicable

III. Current Stand-By or Extended Arrangement and Special Facilities

(a) Current extended arrangement
(i) Duration from January 1, 1983 to December 31, 1985
(ii) Amount: SDR 3,410.6 million
(iii) Utilization: SDR 1,600.5 million
(iv) Undrawn balance: SDR 1,805.6 million.

(b) Previous extended arrangement
(i) Duration: 1977 to 1979
(ii) Amount: SDR 518 million
(iii) Utilization: SDR 100 million

(c) Special facilities: CFF
(i) Year approved: 1976
(ii) Amount: SDR 185 million

IV. SDR Department

(a) Net cumulative allocation: SDR 290 million
(b) Holdings: SDR 0.591 million, or the equivalent of 0.2 percent of net cumulative allocations
(c) Current Designation Plan: not applicable

V. Administered Accounts (amounts)

(a) Trust Fund Loans: Not applicable
(b) SFF Subsidy Account: Not applicable

## B. Nonfinancial Relations

VI. Exchange rate arrangement: Since December 20, 1982 two foreign exchange markets have been operative in Mexico: a controlled market, covering specified transactions; and a free market. The exchange rates in both markets are established by the authorities, who currently preannounce the rates for period of four weeks in advance. As of May 31, 1984 the rate in the controlled market was Mex$163.64 per US$1 selling and Mex$163.74 per US$1 buying; this rate is being adjusted by Mex$0.13 a day. The free market rate, which had remained relatively stable since the beginning of 1983, started depreciating by Mex$0.13 per day since September 23, 1983. As of May 31, 1984 the free market rate was Mex$180.36 per US$1 selling and Mex$181.86 per US$1 buying. Three other special rates apply to forward cover contracts for the repayment of specified mediumand long-term obligations with foreign financial institutions.

VII. Last Article IV consultation and review under EFF: The last Article IV consultation discussions were completed by the Executive Board on May 23, 1983 (EBM/83/75). The relevant staff reports were SM/83/70 and SM/83/86. For consultation purposes, Mexico is in the 12-month cycle. The last review under the EFF and discussions of the 1984 program were completed by the Executive Board on March 2, 1984 (EBM/84/34 and EBM/84/35). The relevant staff report was EBS/84/1, Cor. 1, Sups. 1 and 2. With regard to exchange restrictions and multiple practices, the decision approved at the time reads as follows:

"Approval of Multiple Currency Practices and Exchange Restrictions

Mexico maintains multiple currency practices and exchange restrictions as described in Section V of EBS/84/1, Supplement 1. In view of the circumstances of Mexico, the Fund grants approval of these multiple currency practices and restrictions until the completion of the next review under the extended arrangement, or the completion of the next Article IV consultation, or March 2, whichever is earlier."

## Mexico--Basic Data

| Area and population | |
|---|---|
| Area | 1,958,201 sq. kilometers |
| Population (mid-1983) | 75.0 million |
| Annual rate of population increase (1977-83) | 2.7 percent |
| GDP (1983) | SDR 136 billion |
| | US$145 billion |
| | Mex$17,429 billion |
| GDP per capita (1983) | SDR 1,809 |

| Origin of GDP | 1980 | 1981 | 1982 | Prel. 1983 |
|---|---|---|---|---|
| | | (percent) | | |
| Agriculture, livestock, and fishing | 9.0 | 8.8 | 8.8 | 9.6 |
| Mining (including petroleum) | 3.2 | 3.5 | 3.8 | 3.9 |
| Manufacturing | 24.9 | 24.7 | 24.1 | 23.4 |
| Construction | 5.5 | 5.7 | 5.5 | 4.9 |
| Electricity | 1.5 | 1.5 | 1.6 | 1.7 |
| Commerce | 25.7 | 25.8 | 25.4 | 24.4 |
| Transport and communications | 7.5 | 7.7 | 7.5 | 7.5 |
| Financial services | 9.8 | 9.5 | 9.8 | 10.5 |
| Other services | 12.9 | 12.8 | 13.5 | 14.1 |

| Ratios to GDP | 1980 | 1981 | 1982 | Prel. 1983 |
|---|---|---|---|---|
| Exports of goods and services 1/ | 14.8 | 15.4 | 13.5 | 14.0 |
| Imports of goods and services 1/ | 19.4 | 22.4 | 16.1 | 11.3 |
| Current account of the balance of payments 1/ | -4.6 | -7.0 | -2.6 | 2.7 |
| Central government revenues | 15.9 | 16.1 | 16.3 | 18.5 |
| Central government expenditures | 19.0 | 22.9 | 24.9 | 25.9 |
| Public sector savings | 2.2 | -1.5 | -6.9 | -1.1 |
| Public sector deficit overall surplus or deficit (-)2/ | -7.6 | -14.6 | -17.8 | -8.4 |
| External public debt (end of year)1/ | 21.7 | 28.6 | 31.4 | 32.1 |
| Gross national savings | 24.0 | 23.2 | 17.8 | 20.2 |
| Gross aggregate investment | 28.1 | 29.0 | 21.2 | 16.5 |
| Money and quasi-money (end of year) | 29.2 | 32.3 | 34.3 | 29.4 |
| **Annual changes in selected economic indicators** | | | | |
| Real GDP per capita | 5.2 | 5.2 | -3.2 | -7.0 |
| Real GDP (at 1970 prices) | 8.3 | 7.9 | -0.5 | -4.7 |
| GDP at current prices | 39.4 | 37.4 | 60.3 | 85.1 |
| Domestic expenditures (at current prices) | 39.1 | 38.6 | 51.7 | 73.5 |
| Investment | (51.1) | (41.6) | (17.5) | (43.8) |
| Consumption | (35.0) | (37.4) | (65.3) | (81.9) |
| GDP deflator | 28.7 | 27.3 | 61.1 | 94.2 |
| Wholesale prices (annual averages) | 24.5 | 24.5 | 56.1 | 107.3 |
| Consumer prices (annual averages) | 26.3 | 27.9 | 58.9 | 101.9 |
| Central government revenues | 65.2 | 39.0 | 61.9 | 110.0 |
| Central government expenditures | 58.6 | 65.2 | 74.0 | 92.4 |
| Money and quasi-money | 38.3 | 52.0 | 70.1 | 58.8 |
| Money | (33.1) | (32.8) | (61.9) | (41.4) |
| Quasi-money | (41.3) | (63.3) | (74.0) | (66.4) |
| Net domestic credit 3/ | 39.9 | 72.1 | 58.9 | 47.5 |
| Credit to public sector (net) | (20.9) | (46.1) | (62.7) | (28.2) |
| Credit to private sector | (25.7) | (24.1) | (-5.3) | (20.9) |
| Merchandise exports (f.o.b., in U.S. dollars) | 70.7 | 23.7 | 5.7 | 0.5 |
| Merchandise imports (f.o.b., in U.S. dollars) | 53.7 | 29.0 | -40.0 | -46.5 |

| Federal government finances | 1981 | 1982 | Prel. 1983 | Budget 1984 |
|---|---|---|---|---|
| | (In billions of Mexican pesos) | | | |
| Revenue | 947.7 | 1,533.9 | 3,221.6 | 4,697.0 |
| Expenditures | 1,347.5 | 2,344.5 | 4,510.7 | 6,114.0 |
| Current account surplus or deficit (-) | -19.0 | -317.7 | -665.2 | -225.0 |
| Overall deficit (-) | -399.8 | -810.6 | -1,289.1 | -1,417.0 |
| Public sector finances | | | | |
| Current account surplus or deficit (-) | -87.0 | -654.0 | -195.0 | 680.0 |
| Overall deficit (-) | -858.0 | -1,679.0 | -1,464.0 | -1,524.0 |

| Balance of payments | 1980 | 1981 | 1982 | Prel. 1983 |
|---|---|---|---|---|
| | (In billions of U.S. dollars) | | | |
| Merchandise exports (f.o.b.) | 16.9 | 20.9 | 22.1 | 22.2 |
| Merchandise imports (f.o.b.) | -18.6 | -24.0 | -14.4 | -7.7 |
| Travel and border transactions (net) | 1.0 | 0.2 | 0.4 | 1.0 |
| Interest on public debt | -4.0 | -5.5 | -7.9 | -7.0 |
| Other interest payments | -1.4 | -2.9 | -3.4 | -2.8 |
| Other factor income (net) | -0.6 | -1.1 | -0.4 | 0.9 |
| Other services and transfers (net) | -1.0 | -1.5 | -2.0 | -1.2 |
| Balance on current and transfer accounts | -7.7 | -13.9 | -5.6 | 5.4 |
| Official capital (net) | 4.7 | 17.8 | 6.8 | 4.7 |
| Private capital and errors and omissions (net) | 4.0 | -2.7 | -8.0 | -4.6 |
| SDR allocations and gold revaluation | -- | -- | -- | -- |
| Change in official net reserves (increase -) | -1.0 | -1.2 | 6.8 | 5.5 |

| International reserve position | December 31 1980 | 1981 | 1982 | 1983 |
|---|---|---|---|---|
| | (In millions of SDRs) | | | |
| Monetary authorities (net)4/5/ | 2,902.9 | 4,188.5 | -1,780.1 | 3,353.1 |
| Monetary authorities (gross)5/ | 3,021.3 | 4,304.9 | 1,509.1 | 4,908.1 |

1/ GDP in dollars use as denominator measured at real exchange rate prevailing in 1979.

2/ *Includes net deficit of public sector outside budget control.*

3/ Changes are effective flows in relation to the unadjusted stock of liabilities to private sector at the beginning of the period.

4/ Includes as liabilities disbursements under a BIS loan and arrears on interest payments on private debt with foreign commercial banks.

5/ Gold valued at December 1983 prices.

Mexico: Selected Economic and Financial Indicators

| | 1980 | 1981 | 1982 | Prog. 1983 1/ | Prel. 1983 | Prog. 1984 1/ |
|---|---|---|---|---|---|---|
| (Annual percent changes, unless otherwise specified) | | | | | | |
| National income and prices | | | | | | |
| GDP at constant prices | 8.3 | 7.9 | -0.5 | -- | -4.7 | 1.0 |
| GDP deflator | 28.7 | 27.3 | 61.1 | 80.7 | 94.2 | 50.0 |
| Consumer prices (end of period) | 29.8 | 28.7 | 98.9 | 55.0 | 80.8 | 40.0 |
| Overall public sector | | | | | | |
| Receipts | 47.1 | 37.1 | 73.2 | 97.9 | 108.7 | 59.0 |
| Outlays | 49.7 | 64.3 | 81.0 | 58.9 | 63.3 | 47.0 |
| External sector (on the basis of U.S. dollars) | | | | | | |
| Exports, f.o.b. | 70.7 | 23.7 | 5.7 | 13.4 | 0.5 | 8.1 |
| Imports, f.o.b. | 53.7 | 29.0 | -40.0 | 2.0 | -46.5 | 64.7 |
| Export volume | (23.5) | (23.6) | (19.6) | (5.9) | (5.7) | (6.0) |
| Import volume | (34.8) | (19.0) | (-43.7) | (-3.1) | (-44.6) | (56.1) |
| Terms of trade (deterioration -) | (21.4) | (-8.0) | (-17.0) | (-3.3) | (-1.3) | (-3.4) |
| Nominal effective exchange rate (appreciation -)2/ | -0.8 | 2.5 | 100.4 | ... | 137.2 | ... |
| Real effective exchange rate (appreciation -)2/ | -9.6 | -12.1 | 29.9 | -- | 19.3 | -- |
| Money and credit | | | | | | |
| Domestic credit (net)3/ | 39.8 | 72.0 | 58.2 | 54.6 | 47.5 | 36.3 |
| Public sector 3/ | (20.9) | (46.1) | (62.7) | (27.8) | (28.2) | (16.6) |
| Private sector 3/ | (25.7) | (24.1) | (-5.3) | (26.8) | (20.9) | (21.9) |
| Money and quasi-money (M3) | 38.3 | 52.0 | 70.1 | 51.9 | 58.8 | 43.3 |
| Velocity (GDP relative to M4) | 3.4 | 3.1 | 2.9 | 3.4 | 3.4 | 3.8 |
| Interest rate (annual rate, one-year term deposits)4/ | 28.0 | 35.0 | 50.0 | 55.0 | 47.4 | 44.0 |
| (In percent of GDP) | | | | | | |
| Overall public sector savings | 2.2 | -1.5 | 6.9 | 2.2 | -1.1 | 2.5 |
| Overall public sector deficit (-) | -7.6 | -14.6 | -17.8 | -8.5 | -8.4 | -5.5 |
| Domestic financing | 5.0 | 7.2 | 14.1 | 5.7 | 4.9 | 3.1 |
| Foreign financing | 2.6 | 7.4 | 3.7 | 2.6 | 3.5 | 2.4 |
| Gross domestic investment | 28.1 | 29.0 | 21.2 | 22.7 | 16.5 | 19.0 |
| Gross national savings | 24.0 | 23.2 | 17.8 | 20.5 | 20.2 | 18.3 |
| BOP-current account (deficit -) | -4.1 | -5.8 | -3.4 | -2.2 | 3.7 | -0.6 |
| At 1979 exchange rate | (-4.6) | (-7.0) | (-2.6) | (...) | (2.7) | (-0.5) |
| External public debt 5/ | | | | | | |
| Inclusive of Fund credit | 18.0 | 22.3 | 41.1 | 45.6 | 43.0 | 38.9 |
| At 1979 exchange rate | (19.9) | (26.7) | (31.5) | (...) | (30.9) | (30.0) |
| Interest payments on external public debt 6/ | 2.1 | 2.3 | 5.1 | 4.7 | 4.7 | 4.7 |
| At 1979 exchange rate | (2.3) | (2.7) | (3.9) | (...) | (3.4) | (3.6) |
| (In percent of exports of goods and services) | | | | | | |
| Debt service | | | | | | |
| Before rescheduling | 31.3 | 33.8 | 42.4 | 49.4 | 49.8 | 42.8 |
| After rescheduling | 31.3 | 33.8 | 38.2 | ... | 32.5 | 32.2 |
| (In billions of U.S. dollars) | | | | | | |
| Overall balance of payments | 1.0 | 1.2 | -6.8 | 2.0 | 5.5 | 2.0 |
| Gross official reserves (months of imports) | 2.5 | 2.5 | 1.4 | 2.5 | 8.0 | 6.7 |

Sources: Bank of Mexico; Secretariat of Programming and Budget; and Fund staff estimates.

1/ Annual changes and ratios to GDP in 1983 and in 1984 are those projected at the time of program inception.
2/ Measured in terms of local currency per unit of foreign exchange.
3/ Changes are effective flows adjusted for exchange rate changes in relation to total liabilities to private sector outstanding at the beginning of period
4/ Maximum authorized rate at the end of the period net of withholding tax; excludes compounding.
5/ Includes short-term debt, but net of gross international reserves.
6/ Interest paid on external public debt, net of interest earned on gross international reserves.

Mexico: External Public Sector Debt Indicators, 1979-1990

(In billions of U.S. dollars)

| | 1979 | 1980 | 1981 | 1982 | Prel. 1983 | Projected 1984 | 1985 | 1986 | 1987 | 1988 | 1989 | 1990 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| External debt operations (net) | 3.2 | 4.7 | 17.8 | 9.0 | 3.8 | 5.3 | 2.5 | 1.0 | 0.8 | 0.7 | 0.7 | 0.4 |
| Direct debt (net) | 3.3 | 4.8 | 17.8 | 6.8 | 4.7 | 4.0 | 1.2 | 1.1 | 1.1 | 1.2 | 1.5 | 1.2 |
| Medium and long-term debt | 3.1 | 4.1 | 9.0 | 5.6 | 16.0 | 4.0 | -2.8 | 1.1 | 1.1 | 1.2 | 1.5 | 1.2 |
| Disbursements | (10.4) | (7.8) | (13.8) | (10.6) | (23.1) | (10.5) | (7.2) | (10.5) | (14.9) | (13.3) | (12.5) | (11.0) |
| Restructuring of 1982-84 | /--/ | /--/ | /--/ | /--/ | /15.0/1/ | /3.8/2/ | /--/ | /--/ | /--/ | /--/ | /--/ | /--/ |
| Other loans | /10.4/ | /7.8/ | /13.8/ | /10.6/ | /8.1/ | /6.7/ | /7.2/ | /10.5/ | /14.9/ | /13.3/ | /12.5/ | /11.0/ |
| Amortizations due | (7.3) | (3.7) | (4.8) | (5.0) | (7.1) | (6.5) | (10.0) | (9.4) | (13.8) | (12.1) | (11.0) | (9.8) |
| Debt outstanding end-1983 | /7.3/ | /3.7/ | /4.8/ | /5.0/ | /7.1/ | /6.5/ | /9.8/ | /9.1/ | /8.3/ | /6.2/ | /4.3/ | /1.8/ |
| Of which: restructured | [--] | [--] | [--] | [1.3] | [4.9] | [3.8] | [--] | [--] | [--] | [--] | [--] | [--] |
| Restructuring of 1982-84 | /--/ | /--/ | /--/ | /--/ | /--/ | /--/ | /--/ | /--/ | /4.7/ | /4.7/ | /4.7/ | /4.7/ |
| New disbursements 1984-1990 | /--/ | /--/ | /--/ | /--/ | /--/ | /--/ | /0.2/ | /0.3/ | /0.8/ | /1.2/ | /2.0/ | /3.3/ |
| Short-term debt (net) 3/ | 0.2 | 0.7 | 8.8 | 1.2 | -11.3 | -- | 4.0 | -- | -- | -- | -- | -- |
| Of which: restructured amortization | (--) | (--) | (--) | (6.3) | (10.1) | (--) | (--) | (--) | (--) | (--) | (--) | (--) |
| Bank of Mexico (net) | -0.1 | -0.1 | -- | 2.2 | -0.9 | 1.3 | 1.3 | -0.1 | -0.3 | -0.5 | -0.8 | -0.8 |
| IMF | (-0.1) | (-0.1) | (--) | (0.2) | (1.1) | (1.3) | (1.3) | (-0.1) | (-0.3) | (-0.5) | (-0.8) | (-0.8) |
| Purchases | /--/ | /--/ | /--/ | /0.2/ | /1.1/ | /1.3/ | /1.3/ | /--/ | /--/ | /--/ | /--/ | /--/ |
| Repurchases | /0.1/ | /0.1/ | /--/ | /--/ | /--/ | /--/ | /--/ | /0.1/ | /0.3/ | /0.5/ | /0.8/ | /0.8/ |
| Other | (--) | (--) | (--) | (2.0) | (-2.0) | (--) | (--) | (--) | (--) | (--) | (--) | (--) |
| Interest payments | 2.9 | 4.0 | 5.5 | 7.9 | 7.0 | 8.8 | 8.5 | 7.9 | 7.4 | 7.0 | 6.4 | 6.5 |
| IMF | -- | -- | -- | -- | 0.1 | 0.1 | 0.3 | 0.3 | 0.3 | 0.3 | 0.2 | 0.2 |
| Other | 2.9 | 4.0 | 5.5 | 7.9 | 6.9 | 8.7 | 8.2 | 7.6 | 7.1 | 6.7 | 6.2 | 6.3 |
| Debt service payments 4/ | | | | | | | | | | | | |
| Amounts due | 10.3 | 7.8 | 10.3 | 12.9 | 14.1 | 15.3 | 18.5 | 17.4 | 21.5 | 19.6 | 18.2 | 17.1 |
| Amounts paid | 10.3 | 7.8 | 10.3 | 11.6 | 9.2 | 11.5 | 18.5 | 17.4 | 21.5 | 19.6 | 18.2 | 17.1 |
| Public debt outstanding, end of period | 29.9 | 34.5 | 53.2 | 62.1 | 66.1 | 71.4 | 73.9 | 74.9 | 75.7 | 76.4 | 77.1 | 77.5 |
| Direct debt | 29.8 | 34.5 | 53.2 | 59.9 | 64.8 | 68.8 | 70.0 | 71.1 | 72.2 | 73.4 | 74.9 | 76.1 |
| Medium- and long-term debt | (28.3) | (32.3) | (42.2) | (49.0) | (64.3) | (68.3) | (65.5) | (66.6) | (67.7) | (68.9) | (70.4) | (71.6) |
| Short-term debt | (1.5) | (2.2) | (11.0) | (10.9)5/ | (0.5) | (0.5) | (4.5) | (4.5) | (4.5) | (4.5) | (4.5) | (4.5) |
| Bank of Mexico | 0.1 | -- | -- | 2.2 | 1.3 | 2.6 | 3.9 | 3.8 | 3.5 | 3.0 | 2.2 | 1.4 |
| IMF | (0.1) | (--) | (--) | (0.2) | (1.3) | (2.6) | (3.9) | (3.8) | (3.5) | (3.0) | (2.2) | (1.4) |
| Other | -- | -- | -- | 2.0 | -- | -- | -- | -- | -- | -- | -- | -- |
| Memorandum items: | | | | | | | | | | | | |
| Nationalized bank debt outstanding | 2.6 | 5.1 | 7.0 | 7.8 | 6.6 | 6.6 | 6.6 | 6.6 | 6.6 | 6.6 | 6.6 | 6.6 |
| Interest payments of nationalized banks | ... | ... | ... | ... | 0.9 | 1.0 | 0.8 | 0.8 | 0.7 | 0.6 | 0.6 | 0.6 |
| Selected indicators (in percent) | | | | | | | | | | | | |
| Effective interest rates 6/ | 10.3 | 12.4 | 12.5 | 13.7 | 10.9 | 12.8 | 11.7 | 10.6 | 9.8 | 9.2 | 8.3 | 8.4 |
| Debt service ratio | | | | | | | | | | | | |
| Excluding the Fund | 63.0 | 30.9 | 33.8 | 42.4 | 49.5 | 47.4 | 53.8 | 47.1 | 54.0 | 45.3 | 38.7 | 33.8 |
| Including the Fund | 63.6 | 31.3 | 33.8 | 42.4 | 49.8 | 47.7 | 54.7 | 48.2 | 55.6 | 47.2 | 41.0 | 35.8 |
| Total on amounts paid | 63.6 | 31.3 | 33.8 | 38.2 | 32.5 | 35.8 | 54.7 | 48.2 | 55.6 | 47.2 | 41.0 | 35.8 |
| Interest payments to GDP 7/ | | | | | | | | | | | | |
| Excluding the Fund | 2.1 | 2.5 | 3.0 | 4.0 | 3.4 | 4.1 | 3.5 | 2.9 | 2.5 | 2.1 | 1.8 | 1.7 |
| Total, net of interest on gross reserves | 2.0 | 2.3 | 2.7 | 3.9 | 3.4 | 3.8 | 3.2 | 2.6 | 2.2 | 1.9 | 1.5 | 1.4 |
| Ratio of interest payments to exports of goods and services | 17.9 | 16.1 | 18.0 | 26.0 | 24.7 | 27.4 | 25.1 | 21.9 | 19.1 | 16.9 | 14.4 | 13.6 |
| External debt ratio to GDP 7/ | | | | | | | | | | | | |
| Excluding the Fund | 22.1 | 21.7 | 28.6 | 31.4 | 32.1 | 32.1 | 29.8 | 27.5 | 25.3 | 23.5 | 21.7 | 20.1 |
| Total, net of gross reserves | 20.7 | 19.9 | 26.7 | 31.5 | 30.9 | 29.7 | 26.7 | 24.0 | 21.6 | 19.5 | 17.6 | 16.0 |

Sources: Mexican authorities; and Fund staff estimates.

1/ Covers the refinancing from banks obtained in 1983.
2/ Covers refinancing from banks in 1984.
3/ Includes net disbursements of PEMEX contracts in 1980-83.
4/ Includes amortization on medium- and long-term debt and interest payments on total debt; includes Fund transactions.
5/ Includes amounts subject to postponement in 1982.
6/ Interest rate on average debt outstanding during the period.
7/ GDP in U.S. dollars valued at average real exchange rate prevailing in 1979.