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AGENDA**

EBS/84/1
Supplement 1
Correction 1

CONFIDENTIAL

February 29, 1984

To: Members of the Executive Board
From: The Secretary
Subject: Mexico - Extended Arrangement - Program for the Second Year

The following corrections have been made in EBS/84/1, Supplement 1
(1/30/84):

Page 25, last line: for "US\$300 billion." read "US\$300 million."

Page 29, Table 10, last column, line 19: for "(8.0 to 10.0)"
read "(8.6 to 10.0)"

Corrected pages are attached.

Att: (2)

ratio would peak at 59 percent in 1987, in reflection of amortization of the debt restructured in 1982-84. Thereafter, the debt service ratio would decline to 49 percent in 1988 and 43 percent in 1989. In spite of the increase in the debt service ratio through 1987, the ratio of debt to GDP would decline steadily from 32 percent in 1984 to 25 percent in 1989; however, the gross financing requirements will become larger after 1985 as the grace period for the recently concluded re-financing operations comes to an end. The decline in the ratio of effective debt (net of gross official reserves) to GDP would be even more pronounced, from 30 percent in 1984 to 21 percent in 1989. The ratio of interest payments to GDP, net of interest on gross reserves, which is an alternative measurement of the debt burden, shows a steady decline during the program period and would continue to decline further through 1989.

e. Balance of payments projections

The current account deficit of US\$1 billion projected for 1984, which is considerably lower than that originally projected in late 1982, reflects the reduction of the trade surplus from an abnormally high level observed in 1983, as well as a continued increase of interest payments. Nonfactor services are projected to be broadly in balance in 1984.

Exports are expected to increase from US\$22 billion a year in 1982-83 to US\$24 billion in 1984. Most of the increase is expected to come from nonpetroleum exports, in response to the improved competitiveness of the Mexican economy and continued economic recovery abroad. A small increase is projected for petroleum exports, in response to the increase of heavy crude prices that was announced in late 1983. Total imports are projected to increase by 65 percent (to US\$14 billion) in 1984, reflecting the recovery of domestic activity in general and investment in particular, the replenishment of stocks, the acceleration in the pace of import permit authorizations, and the reduction of tariffs on a considerable number of items. Net factor income payments of some US\$11 billion in 1984 would continue to represent a large share of external outlays. The bulk of these payments will consist of interest payments on public debt, which are projected to rise from an estimated US\$7.8 billion in 1983 to US\$8.2 billion in 1984, owing to an increase in the stock of debt at largely unchanged average interest rates; interest payments by the private sector and by the commercial banks are projected to increase from US\$2.7 billion in 1983 to over US\$3 billion in 1984.

Net capital inflows are expected to increase from US\$1.9 billion in 1983 to US\$3 billion in 1984, mainly because the net outflow of private capital is projected to diminish while net public sector borrowing is expected to be around US\$4 billion. Accordingly, net international reserves of the Bank of Mexico are projected to increase by US\$2 billion in 1984, including reductions in nonrescheduled external payments arrears amounting to about US\$300 million. Gross official reserves (excluding

gold) measured as months of imports and interest payments, which had fallen to the equivalent of less than one month of payments in 1982, recovered to two-and-a-half months of payments in 1983 and are projected to increase to nearly three-and-a-half months of payments in 1984.

7. Performance criteria for the second year of the arrangement

For 1984, specific quarterly limits have been set with respect to the public sector deficit and its financing (Table 9). Access of the public sector to credit from the Bank of Mexico has been subject to ceilings, and a limit of US\$4 billion has been placed on the public sector's net use of foreign credit. In addition, financial intermediation conducted by the national development bank and most official trust funds is subject to a quarterly limitation. However, official financial intermediation may be increased beyond the established limits, subject to a reduction by a corresponding amount in the ceilings on the overall public sector deficit. A quarterly ceiling has been placed on the expansion of the net domestic assets of the Bank of Mexico, consistent with the inflation objectives and the achievement of a US\$2 billion improvement in the net international reserves during 1984. Quarterly targets also have been established on the changes in net international reserves to help guide the management of the exchange rate policy, and the authorities have stated that they would eliminate any outstanding external payments arrears in the course of 1984.

The following are the quantitative performance criteria of the program: (1) a set of quarterly ceilings on the overall deficit of the public sector (paragraph 3 of the Technical Memorandum of Understanding attached to the letter of intent, EBS/84/1); (2) a set of quarterly ceilings on the public sector's net use of foreign credit (paragraph 1 of the Technical Memorandum); (3) a set of quarterly ceilings on the public sector's net use of credit from the Bank of Mexico (paragraph 2 of the Technical Memorandum); (4) a set of quarterly ceilings on the expansion of the Bank of Mexico's net domestic assets (paragraph 4 of the Technical Memorandum); (5) a set of quarterly ceilings on the amount of financial intermediation conducted by the national development banks and all official trust funds, including those of the Bank of Mexico but excluding FICORCA (paragraph 5 of the Technical Memorandum); (6) a set of quarterly targets for the net foreign assets of the Bank of Mexico (paragraph 6 of the Technical Memorandum); (7) the commitment to repay all outstanding arrears during 1984.

In addition, the general clause pertaining to the authorities' intentions in respect of multiple currency practices, restrictions on payments and transfers for current international transactions, bilateral payments agreements, and restrictions on imports for balance of payments reasons (paragraph 4(c) of the extended arrangement) remains in effect. Understandings with the Fund will have to be reached before January 1, 1985 on suitable performance clauses for the last year of the extended arrangement (paragraph 29 of the letter of intent of November 10, 1982).

Table 10. Mexico: Macroeconomic Projections

	1981	1982	Est. 1983	Projections		
				1984	1985	1985-88 1/
(Annual percentage changes)						
<u>Production and prices</u>						
Real GDP	8.3	-0.5	-3.3	1.0	5.0	5.0 (ave.)
GDP deflator	27.3	61.1	100.9	50.0	25.0	13.0 (ave.)
Consumer price index (end of period)	28.7	98.8	80.9	40.0	18.0	10.0 (ave.)
(As percent of GDP)						
<u>Balance of payments 2/</u>						
Trade balance	-1.3	4.0	9.1	6.1	5.3	3.7 to 5.3
Net factor payments abroad	-4.0	-5.7	-6.5	-6.5	-6.2	-5.1 to -6.2
Of which: interest payments						
on public external debt 3/	(-2.3)	(-4.1)	(-5.2)	(-5.0)	(-4.9)	(-4.0 to -4.9)
Other services and transfers	-0.5	0.1	0.1	--	0.1	0.1 to 0.2
Current account	-5.8	-1.6	2.7	-0.6	-0.8	-- to -1.2
Current account, excluding factor services	-1.8	4.1	9.2	6.1	5.4	3.8 to 5.5
Net official capital	7.4	3.6	2.6	2.4	1.7	1.6 to 1.7
Private capital (including errors and omissions)	-1.2	-5.6	-1.9	-0.6	0.1	0.1 to 0.3
Net international reserves (surplus -)	-0.5	3.6	-3.4	-1.2	-1.0	-0.5 to -0.9
<u>Public sector</u>						
Savings	-1.0	-6.6	-0.9	2.6	5.0	5.0 to 6.0
Capital revenue	0.1	0.1	--	--	0.1	--
Investment	12.9	10.5	7.1	8.0	8.6	8.6 to 10.0
Other capital expenditure	1.1	1.3	0.2	0.1	--	--
Overall deficit	-14.9	-18.3	-8.2	-5.5	-3.5	-3.0 to -3.5
Domestic financing	7.4	14.6	5.4	3.1	1.8	1.3 to 1.8
External financing	7.5	3.7	2.8	2.4	1.7	1.3 to 2.0
<u>Savings and investment</u>						
Gross national investment	29.0	20.9	16.6	19.5	20.6	20.6 to 24.0
Public sector	(12.9)	(10.5)	(7.1)	(8.0)	(8.6)	(8.6 to 10.0)
Private sector 4/	(16.1)	(10.4)	(9.6)	(10.9)	(12.0)	(12.0 to 16.0)
Gross national savings	23.2	19.3	19.3	18.3	19.8	19.8 to 24.0
Public sector	(-1.0)	(-6.6)	(-0.9)	(2.6)	(5.0)	(5.0 to 6.0)
Private sector	(24.1)	(25.9)	(20.2)	(15.7)	(14.8)	(14.8 to 19.0)
<u>External debt</u>						
Public sector external debt less gross international reserves of the Bank of Mexico 5/	20.5	32.0	41.3	38.8	35.9	29.4 to 35.9
Interest payments on public external debt net of interest earnings of the Bank of Mexico	2.2	4.0	5.1	4.7	4.5	3.5 to 4.5
(In billions of U.S. dollars)						
<u>External financing and reserves</u>						
External financing 3/	17.8	6.8	4.2	4.0	3.0	3.0 to 4.0
Change in net international reserves of the Bank of Mexico (increase -)	-1.1	6.8	-5.1	-2.0	-1.7	-1.4 to -1.8

Sources: Mexican authorities; and Fund staff estimates.

1/ Where a range of values is given, it should not be inferred that the lower number necessarily pertains to 1985 and the higher to 1988; in some cases the opposite is true. By referring to the separate column for 1985 and to the text, the pattern of distribution of values over the period can be discerned in most cases.

2/ Based on Scenario A of Medium-Term Balance of Payments Projections. Ratios shown are calculated on the basis of GDP in U.S. dollars converted at the current exchange rate.

3/ Excludes interest payments on the external debt of the nationalized banking system.

4/ Includes inventory changes.

5/ Excludes the external debt of the nationalized banking system and of the Bank of Mexico.

of exports (in U.S. dollars) is projected to grow at an annual average rate of 5 1/2 percent, with petroleum products continuing to account for the largest, although declining, share. The value of nonpetroleum exports would grow at an annual average rate somewhat above 3 percent, reflecting the maintenance of external competitiveness and continued recovery abroad. Imports are projected to grow at an annual average rate of about 10 percent. Net factor payments abroad, although increasing in absolute terms from US\$10.9 billion in 1984 to an average of US\$11.7 billion in 1985-88, would gradually decline as a proportion of GDP from 5.1 percent in 1984 to 4.3 percent in 1985-88. Nonfactor services and transfers would remain in rough balance throughout the period. These projections are consistent with the National Development Plan's target of a moderate but sustained recovery of activity and, in particular, with an annual growth of real output of about 5 percent.

A set of somewhat more optimistic assumptions (see Scenario B, Statistical Appendix Table 43) would suggest equilibrium in the current account by 1988, on the basis of a 10 percent average annual rate of growth in nonpetroleum exports, and of 8 percent in imports. Such an outcome would be consistent with somewhat more restrained aggregate demand policies and a somewhat more aggressive exchange rate policy, and would involve a lower pace of external borrowing.

The net external financing needs of the public sector are projected to decline from 2.4 percent of GDP in 1984 to an average of 1.5 percent in 1985-88 in Scenario A, and they would be even smaller in Scenario B. In conjunction with the projected path of the current account and the gradual resumption of private capital inflows, this would permit an annual accumulation of net international reserves of the order of about US\$1 1/2 billion in 1985-88, well into the period of the repurchases from the Fund. Also, during this period the buildup of gross official reserves could be expected to reach about five months of imports and interest payments by 1988. The annual accumulation of reserves would be in excess of US\$2 1/2 billion if the assumptions described in Scenario B materialize, even with a smaller rate of foreign borrowing.

VI. Exchange Arrangements Subject to Fund Approval

The exchange system currently in effect in Mexico involves multiple currency practices and restrictions on payments and transfers for current international transactions subject to Fund approval under Article VIII, Sections 2 and 3 of the Articles of Agreement. These were initially described in EBS/82/208, Sup. 1 (12/13/82). The changes in the system that have taken place since that time have been discussed in previous sections of this paper.