INTERNATIONAL MONETARY FUND

PRESS RELEASE NO. 82/72

FOR IMMEDIATE RELEASE
December 23, 1982

The International Monetary Fund has agreed to the use of Fund resources totaling SDR 3,611.25 million by the Government of Mexico. Of the total, which is equivalent to 450 per cent of Mexico's quota in the Fund, up to SDR 3,410.625 million may be drawn over the next three years under an extended arrangement in support of the Government's economic program, and SDR 200.625 million is available immediately for purchase in the first credit tranche. Drawings under the extended arrangement will be financed in part from the Fund's ordinary resources (SDR 1,123.5 million) and in part from resources borrowed by the Fund (SDR 2,287.125 million).

From 1977 to 1981 Mexico registered high rates of economic growth--more than 8 per cent per year--and a rapid expansion of employment, but this was accompanied by an acceleration of inflation and a weakening of the country's external situation. Consumer price inflation reached 28.7 per cent by the end of 1981, while the deficit of the current account of the balance of payments widened to US$12.9 billion in 1981 from US$7.5 billion in 1980. The most important factor behind these worsening trends was the expansionary stance of the public sector which registered an overall deficit equivalent to 15 per cent of gross domestic product (GDP) during 1981: there was a sharp acceleration in public spending while the growth of revenues slowed as petroleum export receipts stopped rising and the prices of public goods and services lagged behind inflation. To help finance the expanding public sector deficit, Mexico contracted a substantial amount of external debt in 1981, much of it short-term, at rising interest rates.

The marked deterioration of the public finances, together with a change in outlook in the international markets for petroleum and Mexico's other export commodities, led to growing doubts about the sustainability of the exchange rate policy then being pursued and gave rise to recurring episodes of capital flight. In early 1982 the Mexican authorities ceased supporting the exchange rate of the peso, resulting in a substantial depreciation of the currency. Large wage increases for the public sector in this period added to the difficulties and had an adverse effect on confidence. Later in 1982 the authorities introduced a number of restrictions into the exchange and trade system which, however, did not prevent the accumulation of substantial foreign payments arrears during the last four months of the year. The authorities also adopted several measures in the financial field, including the nationalization of the country's domestic private banks in September 1982, and attempted to tighten fiscal operations. In the latter part of 1982, capital inflows virtually ceased. The current account deficit declined sharply--to an estimated US$6.5 billion--in an inevitable adjustment to the weakening of the capital account, and the overall public sector deficit is estimated to have reached the equivalent of 16.5 per cent of GDP. This combination of a high public sector deficit and the increased unavailability of imports led to a rise of the estimated 12-month rate of inflation to over 90 per cent by the end of the year. The rate of growth, meanwhile, has practically come to a halt, as production bottlenecks began to develop in some sectors with the disruption of supplies from abroad and as investment in both the public and private sectors dropped.

The medium-term program, which the extended arrangement supports, is designed to lay the basis for a renewed growth of output and employment. Successful adjustment in Mexico's present circumstances requires the rapid reduction of the large imbalance in the public finances. Consequently, the key aim of the three-year extended arrangement with Mexico is to bring about a substantial improvement in fiscal performance and a strengthening of domestic savings.

The program envisages a reduction of the public sector deficit, from the equivalent of 16.5 per cent of GDP in 1982 to 8.5 per cent in 1983, 5.5 per cent in 1984, and 3.5 per cent in 1985. Such a cutback in the overall deficit of the public sector is expected to lower the pressures on domestic prices, make provision for a reasonable volume of credit to the private sector, and help rebuild net international reserves.

Reducing the public sector deficit in relation to GDP will require major efforts both to lower public sector expenditure in most categories and to increase revenues from most sources. To reduce public expenditures, the authorities intend to adopt measures of a structural nature as well as to implement general restraint by keeping all expenditure items under close scrutiny. There is to be a review of public sector institutions aimed at rationalizing public expenditure by eliminating or consolidating agencies or enterprises that fulfill similar functions. The authorities are assigning high priority to holding down current and operating expenditure, by increasing productivity, eliminating or reducing subsidies to both the private and public sectors, and by cutting back the growth of the wage bill through a freeze in hiring and the pursuit of a restrained wage policy in the public sector.

Furthermore, the authorities will undertake a review of public investment projects with the view to reducing expenditures in sectors which in the recent past have registered very large increases in capital formation, particularly the energy and industrial sectors. In reviewing their investment program, the Mexican authorities intend to seek the assistance of the World Bank to ensure rapid and adequate progress in this endeavor.

With regard to public sector revenues, the authorities are carrying out major adjustments in public enterprise pricing policies, general taxation, and administrative fees. Public enterprise pricing policies are being reviewed with the aim of bringing them into line with domestic costs or with prices prevailing in international markets, depending on the particular circumstances of the enterprise or activity in question. Particularly large adjustments are involved for those prices that have lagged significantly behind inflation as it has accelerated. In regard to taxation, the authorities intend to raise collections by widening the tax base through the elimination of special exemptions, improving tax administration, and adjusting tax rates.

Mexico's economy has shown in the past a capability for growing at rates of around 6 per cent per year while maintaining internal and external stability. A resumption of such a stable growth pattern requires a reduction of inflation and the restoration of a strong balance of payments. The rate of inflation is expected to be reduced from the range of 90-100 per cent during 1982 (December 1981 to December 1982) to about 55 per cent during 1983 and to progressively lower levels in succeeding years. The current account deficit is expected to decline to US$4.25 billion in 1983, with further reductions taking place in 1984 and 1985. Together with the pursuit of tight monetary and flexible exchange rate policies, these developments are designed to permit a more efficient management of the country's resources and to reduce the scope and weight of the restrictions that currently apply to external transactions.

The strengthening of the fiscal and balance of payments situation under the program is intended to lower Mexico's reliance on external financing over the next few years, and thereby contribute to an easing of the debt servicing problems that Mexico has experienced in the recent past. The adoption of this medium-term economic program is facilitating Mexico's negotiations with the international banking community, in which the Managing Director and staff of the Fund have been importantly engaged, for the restructuring of Mexico's foreign debt in a manner consistent with an orderly management of its external obligations. It is estimated that net new financing of US$7 billion will be required in 1983 to ensure that the adjustment program is adequately financed. Of this amount, US$5 billion is being sought from the banks and US$2 billion from official sources.

The Managing Director has received authoritative assurances with respect to the fresh funds from official sources. The advisory group of bankers has informed the Managing Director that the responses to date to the request concerning the needed financing from the international banking community have been highly positive, and that these responses demonstrate the intention of the commercial banks to do their part. On the basis of this direct survey of commitments of the commercial banks made by the advisory group, the Managing Director concluded that there was sufficient assurance that the needed amounts were being made available to justify his recommendation to the Fund's Executive Board that it could approve the proposed arrangement with the expectations that it was being adequately financed to support the policies of the Mexican authorities.

In the area of monetary and credit policy, the operations of the Bank of Mexico will be subject to limits in line with the anti-inflation and balance of payments aims of the program. Domestic credit policy is designed to ensure that the private sector receives an appropriate share of private domestic financial savings. Interest rates will be managed flexibly, so they play their customary role in allocating credit and in promoting savings.

Incomes policy is of central importance in the adjustment program, as it affects not only the chances of curtailing the public sector deficit, but is also crucial to the goals of price, balance of payments, and exchange rate stability. The authorities intend that wage policy be forward-looking in the sense of being consistent with a declining rate of inflation and with the protection of employment. The authorities will seek to keep profit margins within reasonable bounds, and price controls that constrain private sector price decisions will be administered flexibly, in order to avoid discouraging production and employment.

Mexico's quota in the Fund is SDR 802.5 million. It presently has no outstanding purchases from the Fund.