FOR AGENDA

EBS/09/46
Supplement 1

CONFIDENTIAL

April 8, 2009

To: Members of the Executive Board

From: The Acting Secretary

Subject: **Mexico—Assessment of the Impact of the Proposed Flexible Credit Line Arrangement on the Fund's Finances and Liquidity Position**

The attached paper on the assessment of the impact of the proposed flexible credit line arrangement on the Fund's finances and liquidity position is being issued as a supplement to the paper on an arrangement for Mexico under the Flexible Credit Line (EBS/09/46, 4/7/09), which is tentatively scheduled for discussion on **Friday, April 17, 2009**. At the time of circulation of this paper to the Board, the Secretary's Department has received a communication from the authorities of Mexico indicating that they consent to the Fund's publication of this paper.

Questions may be referred to Mr. Hatanpaa, FIN (ext. 35484).

This document will shortly be posted on the extranet, a secure website for Executive Directors and member country authorities.

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INTERNATIONAL MONETARY FUND

Mexico—Assessment of the Impact of the Proposed Flexible Credit Line Arrangement on the Fund's Finances and Liquidity Position

Prepared by the Finance and Strategy, Policy and Review Departments

(In consultation with other Departments)

Approved by Andrew Tweedie and Philip Gerson

April 7, 2009

1. **This note assesses the impact of the proposed Flexible Credit Line (FCL) arrangement for Mexico on the Fund's finances and liquidity position, in accordance with the policy on the FCL.**[1] The proposed arrangement could cover a 12-month period, and be in an amount of SDR 31.528 billion (1,000 percent of quota). The full amount of access proposed would be available throughout the arrangement period, in one or multiple purchases.[2] The authorities intend to treat the arrangement as precautionary.

I. Background

2. **Mexico had several Fund arrangements in the 1980s and 1990s until it extinguished its remaining outstanding credit in 2000** (Table 1). From 1983 to 2000, Mexico had two arrangements under the Extended Fund Facility (EFF) and three Stand-By Arrangements (SBAs). In February 1995, the Fund approved an SBA equivalent to SDR 12.1 billion (688 percent of quota) to support Mexico's adjustment program to deal with a major financial and economic crisis. Under that arrangement, Mexico made purchases totaling SDR 8.8 billion, and its outstanding credit peaked at SDR 10.6 billion (607 percent of quota) at end-1995 (Figure 1). After regaining access to international capital markets in the second half of 1996, Mexico made sizable advance repurchases. In July 1999, an SBA equivalent to SDR 3.1 billion was approved as the recovery in economic performance was disrupted by unsettled conditions in international capital markets. Solid performance under the program supported by this last SBA allowed Mexico to extinguish all its outstanding obligations to the Fund through a series of advance repurchases before the SBA expired in November 2000.

[1] See *GRA Lending Toolkit and Conditionality—Reform Proposals* (SM/09/69, 3/13/09), *GRA Lending Toolkit and Conditionality—Reform Proposals* (SM/09/69, Sup. 2, 3/24/09), and *The Acting Chair's Summing up of GRA Lending Toolkit and Conditionality—Reform Proposals* (BUFF/09/50, 3/27/09).

[2] If the full amount is not drawn in the first six months of the arrangement, subsequent purchases are subject to a review of Mexico's continued qualification for the FCL arrangement.

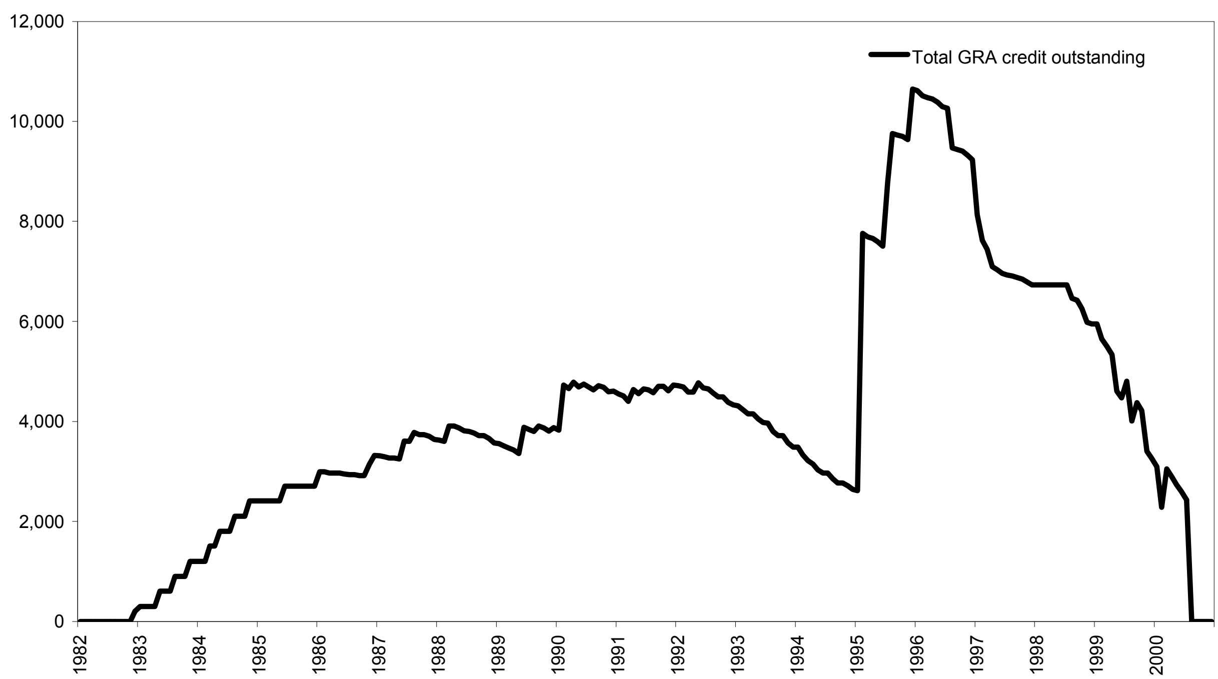
Table 1. Mexico: IMF Financial Arrangements, 1983–2000
(In millions of SDR)

Year	Type of Arrangement	Date of Arrangement	Date of Expiration or Canellation	Amount of New Arrangement	Amount Drawn	Purchases		Repurchases	Fund Exposure 1/
1983	EFF	1-Jan-83	31-Dec-85	3,410.6	2,502.7	1,003.1		0.0	1,203.8
1984						1,203.8		0.0	2,407.5
1985						295.8		0.0	2,703.3
1986	SBA	19-Nov-86	1-Apr-88	1,400.0	1,400.0	741.4	2/	125.4	3,319.3
1987						600.0		280.0	3,639.3
1988						350.0		419.0	3,570.3
1989	EFF	26-May-89	25-May-93	3,729.6	3,263.4	943.0	3/	639.6	3,873.6
1990						1,608.4		877.1	4,604.9
1991						932.4		807.4	4,729.9
1992						233.1		636.1	4,327.0
1993						0.0		841.7	3,485.2
1994						0.0		841.0	2,644.2
1995	SBA	1-Feb-95	15-Feb-97	12,070.2	8,758.0	8,758.0		754.1	10,648.1
1996						0.0		1,413.6	9,234.5
1997						0.0		2,499.2	6,735.2
1998						0.0		783.7	5,951.5
1999	SBA	07-Jul-1999	30-Nov-2000	3,103.0	1,939.5	1,034.4		3,726.7	3,259.2
2000						905.1		4,164.3	0.0

Source: Finance Department.

1/ As of end-December.
2/ Includes a first credit tranche purchase of SDR 291.4 million.
3/ Includes a purchase of SDR 453.5 million under the Compensatory Financing Facility.

Figure 1. Mexico: IMF Credit Outstanding, 1982–2000
(In millions of SDRs)



Source: Finance Department.

3. **Total external debt is moderate.**[3] External debt has been stable around 19 percent of GDP in recent years, but is projected to rise to about 25 percent of GDP in 2009 owing to the depreciation of the peso and the wider current account deficit. Short-term debt on a residual maturity basis accounts for just over one-quarter of this total. Gross public debt has stabilized at just under 40 percent of GDP in recent years, and while some increase is projected in the near-term, sustainability analysis shows debt remaining manageable under a range of scenarios, with no significant contingent liabilities incurred thus far during the crisis. Public external debt is estimated at about 10½ percent of GDP at end 2008.

II. Impact on the Fund's Finances and Liquidity Position

4. **Access under the proposed arrangement would be the largest Fund commitment to date and it could result in a record credit exposure.**[4] In terms of SDRs, the proposed FCL would be the largest General Resources Account (GRA) arrangement in the Fund's history, and more than 2½ times larger than Mexico's SBA in 1995. If the full amount available under the FCL—which the authorities intend to treat as precautionary—were drawn, Mexico's outstanding use of GRA resources would reach SDR 31.5 billion, one-third higher than the Fund's largest credit exposure to date.

5. **In case the full amount available under the proposed FCL is disbursed in 2009:**

- **Mexico's external debt would remain moderate, with Fund credit representing a significant part of this debt:** total external debt would rise to 30 percent of GDP initially, and public external debt would rise close to 21 percent of GDP, with Fund credit being almost 6 percent of GDP (Table 2). At it its peak in 2009, Mexico's outstanding use of GRA resources would account for almost one-fifth of total external debt, just over one-quarter of public external debt, and about one-third of reserves.

- **External debt service would be substantially higher in the medium-term, but this would likely be manageable assuming a recovery in the operation of international financial markets**. Mexico's projected debt service to the Fund would peak in 2013 at about SDR 16.2 billion, or 2.3 percent of GDP.[5] In terms of exports of goods and services, external debt service to the Fund would peak at about 7 percent, accounting for just over 45 percent of total public external debt service, which would increase to 15½ percent of exports of goods and services.

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[3] A more detailed description and analysis of external and public debt is provided in the staff report.

[4] The largest GRA commitment in SDR terms has been SDR 27.375 billion (Brazil's 2002 SBA following its augmentation in 2003), while the largest GRA credit exposure was SDR 23.359 billion (to Brazil in 2003).

[5] The figures on debt service used in this report are calculated assuming that full amount available under the arrangement is purchased upon approval of the arrangement, and that all repurchases are made as scheduled.

Table 2. Mexico: Capacity to Repay Indicators 1/

	2008	2009	2010	2011	2012	2013	2014
Exposure and Repayments (In SDR millions)							
GRA credit to Mexico	--	31,528.0	31,528.0	31,528.0	23,646.0	7,882.0	0.0
(In percent of quota)	--	(1,000.0)	(1,000.0)	(1,000.0)	(750.0)	(250.0)	(0.0)
Charges due on GRA credit 2/	--	708.7	939.6	939.6	892.8	434.2	41.6
Debt service due on GRA credit 2/	--	708.7	939.6	939.6	8,774.8	16,198.2	7,923.6
Debt and Debt Service Ratios 3/							
In percent of GDP							
Total external debt	18.2	30.2	29.6	28.6	26.0	22.7	21.0
Public external debt	10.2	20.6	20.5	19.2	16.4	12.8	10.8
GRA credit to Mexico	0.0	5.7	5.5	5.2	3.6	1.1	0.0
Total external debt service	4.0	6.6	5.2	6.0	6.5	7.2	5.7
Public external debt service	2.1	3.5	3.1	3.2	4.2	4.9	3.5
Debt service due on GRA credit	--	0.1	0.2	0.2	1.3	2.3	1.0
In percent of Gross International Reserves							
Total external debt	210.3	175.3	179.4	179.1	187.2	208.5	228.1
Public external debt	117.7	119.5	124.3	120.0	118.1	118.0	117.5
GRA credit to Mexico	--	33.1	33.1	32.3	25.9	10.2	0.0
In percent of Exports of Goods and Services							
Total external debt service	14.3	21.7	17.3	19.3	20.6	22.5	17.7
Public external debt service	7.4	11.4	10.3	10.4	13.2	15.5	10.8
Debt service due on GRA credit	--	0.4	0.5	0.5	4.2	7.2	3.2
In percent of Total External Debt							
GRA credit to Mexico	--	18.9	18.5	18.0	13.8	4.9	0.0
In percent of Public External Debt							
GRA credit to Mexico	--	27.7	26.6	26.9	21.9	8.6	0.0

Sources: Mexican authorities, Finance Department, World Economic Outlook, and IMF staff estimates.

1/ Assumes full drawings under the FCL upon approval. The Mexican authorities have expressed their intention to treat the arrangement as precautionary, as balance of payments pressures have not materialized.
2/ Based on the rate of charge as of end-March 2009. Includes surcharges under the system currently in force and service charges.
3/ Staff projections for external debt, GDP, gross international reserves, and exports of goods and services, as used in the staff report that requests the proposed FCL, adjusted for the impact of the assumed FCL drawing.

6. **Reflecting the very high access under the arrangement, the impact on the Fund's liquidity, and on its potential credit risk exposure, would be very substantial:**

- **The proposed arrangement would reduce Fund liquidity by the full amount of available access** (Table 3). Approval of the proposed arrangement would reduce the one-year forward commitment capacity (FCC) by some SDR 31.5 billion. In addition to quota resources included in the FCC the Fund also has supplementary resources under the borrowing agreement with Japan.

- **If the resources available under the FCL were fully drawn, GRA credit to Mexico as a share of total GRA credit would exceed 60 percent.** As a result, the concentration of Fund credit among the top five users of Fund resources would increase markedly to about 93 percent, from 86 percent currently.

- **Potential GRA exposure to Mexico would be very large in relation to the current level of the Fund's precautionary balances.** If the resources available under the arrangement were fully drawn, Fund credit to Mexico would be equivalent to some 4½ times the Fund's current precautionary balances.

Table 3. FCL for Mexico—Impact on GRA Finances
(In SDR millions, unless otherwise indicated)

	As of 3/30/2009
Liquidity measures	
Current one-year Forward Commitment Capacity (FCC) 1/	96,088
Japan borrowing agreement, available resources	67,111
Reduction in FCC on approval of FCL	31,528
Prudential measures, assuming full FCL drawing	
Fund credit to Mexico	
In percent of total GRA credit outstanding 2/	61.3
In percent of current precautionary balances	454.4
Fund credit outstanding to five largest debtors	
In percent of total GRA credit outstanding, before approval	85.7
In percent of total GRA credit outstanding, upon approval of the FCL 2/	93.4
Memorandum items	
Current precautionary balances (end-April 2008)	6,939
Total FCL commitments, including proposed FCL	31,528
Quota of FTP members with actual and proposed FCLs, in percent of total quota of FTP members	1.8

Sources: Finance Department.

1/ The FCC measures the Fund's capacity to make new credit commitments over the next 12 months.
2/ Based on current Fund credit outstanding plus full drawings under the proposed FCL.

III. ASSESSMENT

7. **The proposed record high commitment has a very substantial, but manageable impact on the Fund's liquidity.** While the current liquidity position is sufficiently strong to accommodate the liquidity impact of the proposed arrangement, the liquidity position could change quickly, particularly if there is further demand for large arrangements. This underscores the need for continued close monitoring of liquidity, and to expedite the efforts to bring new borrowing agreements on line to supplement the Fund's resources.

8. **Mexico intends to treat the FCL arrangement as precautionary, but if it did prove necessary to draw, this would become the Fund's largest single credit exposure**. Mexico's overall external debt and debt service ratios are expected to remain moderate even with a drawing under the arrangement. Hence, given Mexico's sustained track record of implementing very strong policies, and commitment to maintaining such policies in future, Mexico's capacity to repay is projected to remain strong. Nonetheless, the scale of the Fund's potential exposure to Mexico—in conjunction with the recent increase in lending to other members and the prospects for further credit expansion in the pipeline—underscores the need to strengthen the Fund's precautionary balances.