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EBS/85/99

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April 23, 1985

To: Members of the Executive Board
From: The Secretary
Subject: Mexico - Real Effective Exchange Rate - Information Notice

There is attached for the information of the Executive Directors an information notice on the real effective exchange rate of the Mexican peso.

Mr. Pujol (ext. 8480) is available to answer technical or factual questions relating to this paper.

Att: (1)

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INTERNATIONAL MONETARY FUND

MEXICO

Real Effective Exchange Rate--Information Notice

Prepared by the Western Hemisphere Department and the
Exchange and Trade Relations Department

(In consultation with other departments)

Approved by S.T. Beza and Manuel Guitián

April 23, 1985

The recent evolution of the real effective exchange rate for the Mexican peso, as measured by the index developed in connection with the information notice system 1/ is set out in the attached table and chart. Based on this index, as of February 1985 the Mexican peso had appreciated in real effective terms by more than 10 percent since the last occasion on which the Executive Board had an opportunity to discuss exchange rate developments in Mexico--the Article IV consultation in July 1984. The appreciation is estimated to have amounted to 11.5 percent in the period July 1984 to February 1985.2/

In December 1982 the Mexican authorities replaced the generalized system of exchange controls that had prevailed since September 1982 by the introduction, on a temporary basis, of a new dual exchange system consisting of a controlled market covering about 80 percent of external transactions and a free market covering the remaining transactions. All operations in the controlled market are carried out for the account of the Bank of Mexico. The free market is operated by the commercial banks, but the Bank of Mexico intervenes in this market occasionally. Access to the free market has at times been restricted by limits on the value of individual transactions and, as a consequence, a parallel market has developed. Since January 1985 the discount in the parallel market has been around 10 percent when compared with the free market.

1/ This index is based on a weighting scheme that takes into account Mexico's bilateral non-oil trade flows with the group of 36 core exporters of manufactures.

2/ A different index--limited to Mexico's eight major non-oil trading partners--has been used as one of the indicators to monitor changes in the real exchange rate of Mexico under the EFF program. That index shows a cumulative appreciation of 14.6 percent in the period July 1984 to February 1985.

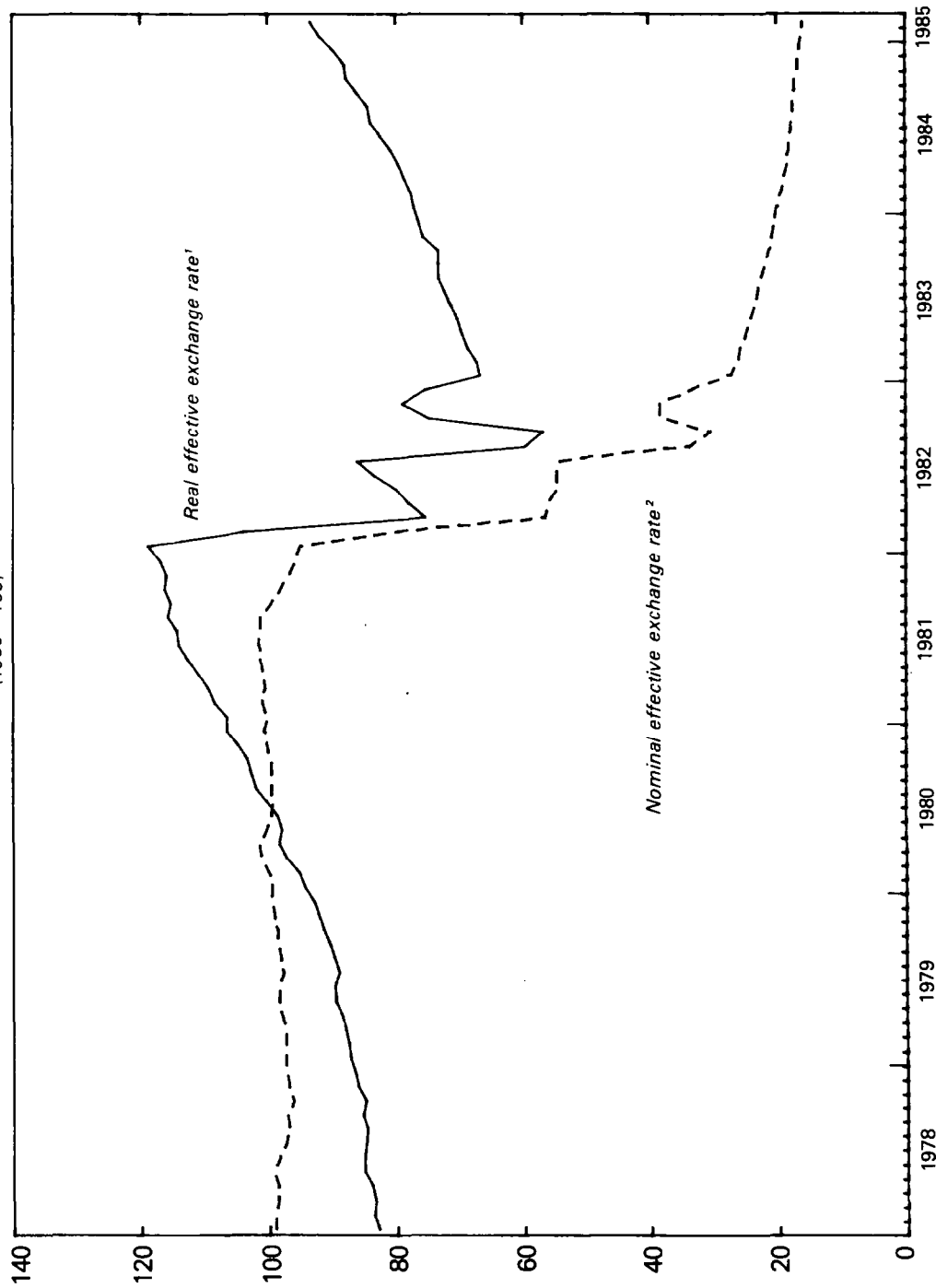
The exchange rate initially set in the controlled market on December 20, 1982 involved a devaluation in terms of U.S. dollar per peso of some 17 percent in relation to the previous "ordinary" rate and of 41 percent in relation to the previous "preferential" rate.^{1/} Following this initial devaluation, the Mexican peso in the controlled market has been depreciated daily in relation to the U.S. dollar by predetermined amounts (initially at Mex\$0.13 per U.S. dollar a day). The free market rate opened on December 20, 1982 at about Mex\$150 per U.S. dollar and, after a small appreciation, remained virtually unchanged in the range of Mex\$147-149 until September 1983, when the rate of depreciation of Mex\$0.13 per day in relation to the U.S. dollar was also extended to the free market. The pace of the daily depreciation in relation to the U.S. dollar was stepped up in both the controlled and the free market to Mex\$0.17 on December 6, 1984, and to Mex\$0.21 on March 6, 1985.

As can be seen in the attached table, at the beginning of 1983 the peso was very depreciated compared with the preceding years and this was an important factor behind the major strengthening of the balance of payments of Mexico. The current account of the balance of payments recorded a surplus of US\$5.2 billion in 1983 and one of US\$4.1 billion in 1984. The gain in net international reserves was substantial in this period; reserves increased by US\$5.5 billion in 1983 and US\$3 billion in 1984. During the course of 1983 and 1984, however, the rate of depreciation by Mexico did not match the differential of inflation between Mexico and its major trading partners, and the competitive margin available in early 1983 was progressively eroded. The Mexican peso appreciated in real effective terms by 24 percent from December 1982 to February 1985, or to a level similar to that prevailing in late 1979. This development, together with a rise in domestic demand, resulted in a deceleration in the rate of growth of nonpetroleum exports and of nonfactor services--such as tourism--in the second half of 1984.

The Bank of Mexico's net international reserves continued to rise in the second half of 1984, but this was followed by a decline of US\$0.9 billion in the first quarter of 1985. While a significant part of this reserve loss is explained by a concentration of public sector external amortizations payments in the period December 1984-March 1985, the erosion of competitiveness and a weakening of demand management policies in late 1984 seem to have contributed to the reserve loss. The authorities took a number of fiscal and monetary adjustment measures in February and March 1985, together with the acceleration of the pace of daily depreciation on March 6, 1985, in order to stabilize the balance of payments position and to curb inflation.

^{1/} The exchange system in place before then had involved, since August 5, 1982 a two tier exchange rate, with a "preferential" rate applicable mainly to sales of exchange for the servicing of external debt and the purchase of most imports, and an "ordinary" rate applicable to the other external transactions.

CHART 1
MEXICO
INFORMATION NOTICE SYSTEM INDEX OF REAL EFFECTIVE EXCHANGE RATE
(1980 = 100)



¹Trade-weighted index of nominal exchange rates deflated by seasonally adjusted relative consumer prices; increases mean appreciation.

²Trade-weighted index of nominal exchange rates.

Discussions on the program for 1985, the third year under the extended arrangement approved by the Fund in late 1982, were conducted recently, and a letter from the Mexican authorities dated March 24, 1985 has been circulated to Executive Directors (EBS/85/70). The staff report, which is expected to be circulated in the next few weeks, will review recent developments and policies in Mexico and will evaluate the adjustment measures taken in February-March 1985.

Table. Mexico: Real Effective Exchange Rate and Related Series

(Indexes: 1980 = 100)

	Real Effective Exchange Rate <u>1/</u> <u>2/</u>	Nominal Effective Exchange Rate <u>1/</u>	Relative Consumer Prices (Local Currencies)	Exchange Rate in terms of U.S. dollars <u>1/</u>	Consumer Price Index (Seasonally Adjusted)	Consumer Price Index (Not Seasonally Adjusted)
Quarterly						
1979						
I	87.4	97.3	89.8	100.8	74.0	74.7
II	89.0	98.1	90.8	100.5	77.2	77.4
III	89.6	97.9	91.4	100.6	80.6	80.4
IV	92.0	98.9	92.9	100.5	84.9	84.1
1980						
I	95.5	100.1	95.4	100.5	90.8	91.6
II	98.2	100.4	97.8	100.4	96.5	96.8
III	101.6	99.4	102.1	99.8	103.4	103.2
IV	104.8	100.1	104.7	99.2	109.6	108.4
1981						
I	108.0	100.5	107.4	97.7	116.2	117.2
II	112.4	101.0	111.3	95.3	123.7	124.3
III	115.1	100.6	114.4	92.6	131.1	130.9
IV	116.3	96.8	120.2	89.4	141.1	139.3
1982						
I	99.4	77.5	129.0	70.3	154.3	155.6
II	80.4	55.1	145.9	49.1	178.3	179.4
III	67.4	39.5	173.8	34.4	217.4	216.8
IV	76.4	36.7	208.9	31.4	265.0	261.4
1983						
I	67.4	26.5	254.9	22.5	328.1	331.3
II	70.3	24.2	290.9	20.1	382.5	385.2
III	72.8	22.4	324.9	18.2	436.8	435.4
IV	75.0	20.8	360.6	16.6	497.1	489.9
1984						
I	77.7	19.4	401.0	15.3	567.1	573.1
II	80.8	18.2	444.1	14.2	641.7	646.5
III	84.6	17.5	484.2	13.2	713.6	711.0
IV	88.4	16.7	528.3	12.4	797.6	785.4
Monthly						
1984						
July <u>3/</u>	83.7	17.7	471.6	13.5	689.3	690.9
Aug.	84.3	17.4	483.6	13.2	712.5	710.5
Sept.	85.9	17.3	497.5	12.9	739.0	731.7
Oct.	87.5	17.0	513.5	12.6	769.1	757.3
Nov.	88.0	16.7	527.8	12.4	796.2	783.2
Dec.	89.6	16.5	543.6	12.1	827.4	815.6
1985						
Jan.	91.8	16.2	566.5	11.7	868.3	876.0
Feb.	93.2	16.0	582.0	11.5	899.2	913.7
Percentage change						
July 1984- Feb. 1985	11.5	-9.7	23.4	-15.3	30.7	32.2

Source: Information Notice System.

1/ Increases mean appreciation.

2/ Using seasonally adjusted consumer price indexes.

3/ Date of latest consideration by Executive Board.