DOCUMENT OF INTERNATIONAL MONETARY FUND
AND NOT FOR PUBLIC USE

FOR AGENDA

EBS/85/276

CONFIDENTIAL

December 12, 1985

To: Members of the Executive Board

From: The Secretary

Subject: Mexico - Use of Fund Resources

Attached for consideration by the Executive Directors is a paper on a request by Mexico for a purchase equivalent to SDR 291.375 million for emergency assistance following the September earthquakes. A draft decision appears on page 10. This subject will be brought to the agenda for discussion on a date to be announced.

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

Att: (1)

CONFIDENTIAL

INTERNATIONAL MONETARY FUND

MEXICO

Use of Fund Resources

Prepared by the Western Hemisphere Department
(In consultation with the Exchange and Trade Relations,
Legal, and Treasurer's Departments)

Approved by S.T. Beza and Manuel Guitián

December 12, 1985

Contents | Page

I. Introduction

In a letter dated December 11, 1985 addressed to the Managing Director (Attachment I), the Secretary of Finance and Public Credit of Mexico and the Director General of the Bank of Mexico inform the Fund of the extensive destruction caused by two earthquakes that struck Mexico City and other major areas of the country on September 19 and 20, 1985, and make a request to purchase an amount equivalent to 25 percent of quota--i.e., SDR 291.375 million under the Fund's tranche policies--to assist the country in meeting its foreign exchange needs. The letter indicates the main elements of the policies that the authorities plan to pursue to deal with the external and internal imbalances that they face. The authorities also express their intention to request additional financial resources from the Fund in support of their adjustment effort as soon as the formulation of the economic program for 1986 is completed.

On December 23, 1982 (EBS/82/168) the Fund approved Mexico's request for use of Fund resources in an amount equivalent to SDR 3,611.2 million (310 percent of the present quota), of which SDR 200.6 million represented a first credit tranche purchase and SDR 3,410.6 million the amount available under an extended arrangement covering the three-year period through December 1985. Mexico purchased SDR 2,207 million during the first two years of the arrangement, representing the entire entitlement for this period. The first purchase under the third year of the arrangement (for SDR 295.8 million) took place immediately after Board approval of the program for the third year, at the conclusion of the 1985 Article IV consultation on June 7, 1985 (EBM/85/91). However, because of noncompliance with some of the quantitative performance criteria for end-June and end-September 1985, Mexico did not make the purchase scheduled for end-August and end-November; a total of SDR 907.9 million remains undrawn under the current extended arrangement (Attachment II).

At present, Fund holdings of Mexican pesos subject to repurchases amount to SDR 2,703.4 million (or about 232 percent of quota). If the requested emergency purchase is approved, Fund holdings of Mexican pesos subject to repurchases would rise to SDR 2,994.8 million (or 257 percent of quota), as is shown in Table 1. A waiver of the limitation in Article V, Section 3(b)(iii) would be needed.

II. Economic Developments Preceding the Earthquakes

1. The program for 1985

The program for 1985 called for a continuation of the general policy strategy pursued in the two previous years and included measures adopted by the authorities to deal with the slippages that had occurred in the implementation of the program in late 1984 and early 1985. The public finances continued to be given central attention, and the overall public sector deficit was expected to decline by an additional 2.1 percentage points of GDP in 1985, to 4.1 percent of GDP. This deficit was to be financed almost in its entirety from domestic resources. The cutback in the public sector deficit, intensification of the trade liberalization effort, and the pursuit of flexible exchange and interest rate policies were expected to strengthen economic performance and to improve confidence. The growth of real GDP was expected to be about 3 1/2 percent in 1985, inflation was projected to decline to less than 45 percent, and international reserves were to increase by US$500 million.

2. Recent developments and performance under the program

Performance under the program in the first half of 1985 was weaker than had been expected, and four out of the seven quantitative performance criteria for the end of June were not met. Preliminary data for the end of September indicate that as of that date deviations from these four performance criteria continued (Table 2).

During the first semester of 1985 the overall public sector deficit reached Mex$1,047 billion (Table 3), exceeding the limit established under the program by some Mex$205 billion (the equivalent of about 0.4 percent of GDP); according to preliminary data, fiscal performance deviated further from the program in the third quarter of the year. These deviations reflected in part the effects on receipts of the softening of the international oil market, but other public sector revenues also have been weaker than had been expected and certain categories of spending registered larger increases than had been programmed.

Public sector revenues have been affected adversely by certain measures which had been designed to assist taxpayers in the aftermath of the 1982 crisis, including tax deductions for accelerated depreciation and to help cover exchange losses. In addition, there appears to have been an intensification of tax evasion, particularly with respect to the value added tax. As a result of these various factors, tax revenues of the Federal Government have declined in real terms this year, notwithstanding the recovery of economic activity. Furthermore, revenue performance has been affected by lags in the adjustment of public sector prices relative to inflation.

Although total public sector outlays declined in real terms in the first half of 1985, there were sharp increases in central government transfers outside the consolidated public sector; during this period current transfers (in real terms) increased by more than 50 percent in relation to the first half of 1984. Capital expenditures also rose in real terms, but interest payments (domestic and external) declined in real terms over the same period.

In the external sector, official net international reserves declined by US$3.3 billion during the first nine months of the year compared with the program's objective of containing the losses over this period to no more than US$100 million. The current account was approximately in balance during the first half of 1985, compared with strong surpluses in 1983-84 (Table 4); it should be noted, however, that a part of the weakening of the current account may have reflected the intensification of underinvoicing of exports and overinvoicing of imports in response to the widening of the exchange rate differential between the two exchange markets. Total export earnings recorded in the first half of 1985 were 13 percent lower (in U.S. dollar terms) than in the corresponding period of 1984. Oil export earnings were 14 percent below the level of the first half of 1984, reflecting declines in both crude oil prices and volume. Other export receipts fell by almost 11 percent from the first half of 1984 to the first half of this year. Such exports were affected adversely by the recovery of domestic demand and the erosion of competitiveness that took place through the first quarter of 1985; as was just noted, however, their behavior also may have reflected increased underreporting. Imports rose sharply from the first half of 1984 to the first half of 1985, reflecting the expansion of domestic demand, the appreciation of the currency and the relaxation of import licensing controls; private imports grew by about 59 percent (in U.S. dollar terms).

Net official capital outflows in the first half of 1985 were somewhat smaller than envisaged in the program, mainly because of the postponement of the prepayment of US$950 million to commercial banks agreed to in the context of the multiyear restructuring arrangement. Other sources of official financing fell short of the original estimates, however, reflecting reductions in the use of credits to finance agricultural imports because of very good harvests, delays in the disbursement of loans from multilateral institutions, and the lower use of certain foreign loans because of cuts in public investment. Private capital outflows continued, notwithstanding a rise in real terms in domestic interest rates, apparently reflecting uncertainties about the exchange rate.

During the first quarter of 1985 there was a real effective appreciation of the Mexican peso 1/ of almost 8 percent in the controlled market. The appreciation of the real effective exchange rate was virtually halted in the second quarter of the year, but during this period the exchange rate in the controlled market came under substantial pressure. The differential between the exchange rates in the controlled market and the parallel market began to widen in the second quarter of the year and reached 45 percent by early July, after having ranged between 11 and 22 percent during the first 4 1/2 months of the year. On July 10, 1985 the authorities allowed commercial banks to operate in the

---

1/ The real effective exchange rate of the Mexican peso described here is calculated as a trade-weighted index involving eight partner countries. Prices are taken from line 63 of the IFS (wholesale price index) for the trading partners and line 64 (consumer price index) for Mexico.

parallel market; on July 24, they devalued the peso in the controlled market by 17 percent; and on August 5, they abandoned the system of announcing the daily rate of depreciation in the controlled market for one month ahead and adopted instead a managed float. 1/ Following the devaluation in late July, the real exchange rate for the peso in the controlled market stood at about the average level prevailing in late 1983 and early 1984. Since then the rate in the controlled market has been depreciated at a rate somewhat faster than domestic inflation, but the differential between the controlled and the parallel market rates has again widened to about 40 percent (Table 5). With the adoption of these measures, the drain on international reserves was halted, and in the latter part of August and during the months of September and October the net international reserve position of the Bank of Mexico was strengthened.

In the area of commercial policy, on July 25, 1985 the authorities announced a significant liberalization of imports from quantitative restrictions and modified the import tariff schedule to improve its structure and reduce the number of duty rate categories. The action taken raised the proportion of imports free from permit to about 61 percent of the value of total 1984 imports, compared with the program target to raise this proportion to between 35 and 45 percent by the end of 1985. 2/ The new import tariff schedule includes nine duty rates ranging from zero to 50 percent. The process of realigning the tariff schedule has not been completed, however, and a few items remain in the 100 percent tariff category. In general, tariff rates under the new schedule increase with the degree of processing of the product, and products that are produced domestically tend to have higher rates. As a result of the changes in tariff rates and other steps taken in the first half of 1985, the dispersion of the tariff schedule has been reduced but the weighted tariff (on the basis of 1984 imports) has been increased somewhat. In addition, the authorities have established official reference prices for certain goods and are in the process of completing antidumping legislation.

In the field of monetary and credit policy the rapid growth of the net domestic assets of the Bank of Mexico in the first half of 1985 resulted in a substantial decline in official international reserves (Table 6). The ceilings on the Bank of Mexico's net domestic assets and on its net credit to the public sector were exceeded by large margins at midyear and the deviations increased in the quarter ended September 1985. The growth of central bank credit reflected the financing needs of the public sector, the drawdown by the banks of excess reserves held at the beginning of the period, and the impact on bank deposit growth of outward capital movements. The drawdown of excess reserves on the part

---

1/ A brief description of the exchange system currently operative in Mexico can be found in Attachment II. A more comprehensive description is contained in EBS/85/188 (8/9/85).

2/ See EBS/85/70 (3/25/85), page 8, paragraph 19.

of the commercial banks permitted bank credit to the private sector to rise more than had been contemplated in the program during the first semester of 1985, notwithstanding the weaker-than-projected growth of bank liabilities to the private sector. The growth trend of credit to the private sector from the financial system was reversed drastically in July and August, following the introduction of additional reserve requirements on commercial banks. Since then, commercial banks have been subject to a marginal reserve requirement equivalent to 90 percent of their liabilities to the private sector, to be held either in the form of government securities or on deposit with the central bank.

Economic growth in the first half of 1985 proceeded more rapidly than had been envisaged under the program; industrial production in the first semester was 6 1/2 percent higher than a year earlier, notwithstanding a decline in petroleum production. However, the pace of economic activity seemed to have moderated by midyear, particularly in the manufacturing sector. The rate of inflation averaged less than 3 percent a month in the first half of 1985, approximately in line with the path of prices expected under the program. This outcome, however, reflected the absorption of some of the domestic demand pressures during this period by a larger-than-planned loss of international reserves as well as lags in adjustment of public sector prices and tariffs behind general price increases. As the exchange rate became more flexible, domestic demand pressures on prices have been felt more directly and the rate of price increase has accelerated to about 4 percent a month since August.

A Fund staff mission visited Mexico City in late August-early September, just before the earthquakes, and discussed with the authorities possible corrective actions to deal with the difficulties that had emerged in the implementation of the program. On the basis of the discussions, it became apparent that even with major efforts to tighten policies, it would be extremely difficult to reverse the deviations from the program before the close of the year. In the absence of additional corrective measures, it was estimated that the fiscal deficit would exceed 8 percent of GDP in 1985. It was recognized that the continuation of a large fiscal imbalance would put significant pressure on domestic prices, particularly since the authorities were not in a position to cushion such pressures by further drawdowns of international reserves.

Steps that might be taken to strengthen the public finances were reviewed, including various measures to increase public sector revenues and the implementation of additional expenditure cuts. There was also a discussion of how credit policy would need to be handled to assure a satisfactory balance of payments performance. In this connection, there was an examination of interest rate management, with particular emphasis on the need to ensure that rates were sufficiently competitive from the international standpoint and to eliminate distortions that had developed in the yields of various financial instruments in the domestic market. The discussion brought out that preferential interest rate schemes needed to be reexamined, as the rapid expansion of this kind of operation was affecting adversely the allocation of resources.

It was estimated at that time that the external current account was likely to be in balance in 1985, compared with a surplus of about US$2 billion envisaged in the program. The capital account was expected to show a negative balance, reflecting mostly net private sector outflows. As a result, net international reserves were expected to show a large decline, instead of the increase of US$500 million envisaged in the program. There was general agreement that exchange rate policy would need to be flexible in order to arrest the loss in reserves and to provide incentives to the growth of nonpetroleum exports, and the mission urged the authorities to eliminate the remaining distortions implicit in the maintenance of a dual exchange market. The importance of an effective and firm implementation of the recently announced liberalization of commercial policy to improve the efficiency of the economy and foster exports also was highlighted.

The Mexican authorities were in the process of assessing the situation and reviewing policy options when the earthquakes struck Mexico City.

III. Effects of the Earthquakes

1. The extent of the damage

On September 19 and 20, Mexico City and certain other areas of the country were struck by two earthquakes. The number of deaths is estimated at around 7,000; the injured numbered up to 30,000; and over 20,000 families were left homeless.

Physical damage was substantial, particularly in Mexico City where 3 out of 16 major districts were severely affected. Health and education facilities were the hardest hit; all four major hospitals in Mexico City collapsed, reducing available beds in the city by over 50 percent. Most schools in Mexico City--about 900 buildings--and some 300 schools in other areas of the country suffered major damage. Some 35,000 to 40,000 private dwellings were seriously damaged, and about half of them will have to be reconstructed. Preliminary estimates point to a total loss of about 500 buildings (some 980,000 square meters of government office space and 1,000,000 square meters of commercial office space), and at least 600 other buildings will require major repairs. Tourist facilities also were seriously affected, and some 13,000 hotel rooms will need to be reconstructed or rehabilitated. The damage to industry seems to have been concentrated in the garment sector, and about 500 small- and medium-size factories located in the downtown area of Mexico City were destroyed. Losses in stocks and equipment of other industries also have been substantial. In the area of infrastructure, the main damage was to public telephone and telecommunications systems, and the private television networks. In addition, serious disruptions in water supply were experienced, as one of the main aqueducts in the southern part of Mexico City was seriously damaged.

Preliminary official estimates released ten days after the disaster estimated the physical damage to be some US$3 billion (Table 7). An IBRD evaluation mission that visited Mexico City in the first week of October tentatively estimated the replacement costs at about US$6 billion (the equivalent of 3 1/2 percent of GDP), without taking into account possible relocation costs and development of new infrastructure associated with relocation. Based on its experience with other countries that have suffered large physical damages, the IBRD mission observed that the reconstruction effort is likely to take a long period, with only about half of the total reconstruction being accomplished in the first four years.

More recently, the Economic Commission for Latin America released a study 1/ of the impact of the earthquakes which estimates total damage at about US$4 billion (2.7 percent of the estimated GDP for 1985); about 10 percent of this estimate refers to indirect costs resulting from losses in income or production in the aftermath of the earthquakes. This study confirms the preliminary findings that the sectors most affected where public sector offices, education and hospital facilities, communication systems, and private housing.

2. Economic implications of the earthquakes

It is still early to assess the full impact of the earthquakes on the balance of payments and on the public finances. However, according to preliminary official estimates, the current account of the balance of payments might be affected adversely by as much as US$700 million this year, mainly because of additional imports (US$300 million), the loss of tourist income (US$300 million), and reduced non-petroleum exports (US$100 million). No estimate is yet available of the effects on earnings of in-bond industries or on other items of the current account. At the same time, it should be noted that some losses will be offset by inflows arising from the settlement of insurance claims.

According to preliminary official estimates, the post-earthquake current account of the balance of payments is projected to show a deficit of US$0.5 billion for 1985 as a whole (Table 8). On capital account, the Mexican authorities are currently expecting about US$1,250 million to US$1,450 million of emergency relief financing, of which US$950 million would consist of the deferred payment to commercial banks and the rest would come from various bilateral and multilateral financing agencies. On the basis of these estimates, which include a net outflow of some US$3 billion in private capital, the authorities project

---

1/ United Nation, Economic Commission for Latin America, Daños Causados por el Movimiento Telúrico en México y sus repercusiones sobre la Economía del País, October 1985 (85-10-121).

that the net international reserves would decline by US$2.5 billion to US$2.7 billion in 1985.

In regard to the public finances, the Mexican authorities envisage additional domestic borrowing requirements associated with the immediate tasks of demolition, rehabilitation and, to a lesser extent, reconstruction of the order of Mex$150 billion (0.3 percent of GDP) in 1985.

3. Economic policies in the aftermath of the earthquakes

The letter of the authorities (see Attachment I) states their intention to continue with the adjustment program designed to correct the external and internal imbalances confronting Mexico. They note that recent developments have reinforced their view that policies need to be strengthened in order to reduce the vulnerability of the Mexican economy to exogenous shocks.

The authorities point out that the reconstruction process will require a strengthening of the savings effort to prevent domestic inflation from intensifying and that steps are being taken therefore to reduce the overall public sector deficit. The 1986 budget proposal which was recently submitted to Congress calls for a very sharp reduction (of about 4.7 percentage points of GDP) in the overall financing requirements of the public sector during 1986. The major thrust of the adjustment effort contemplated in the budget is to come from both a reduction in current expenditures and a substantial rise of public sector receipts. Some reduction in capital expenditures also is envisaged in the budget, but more importantly there has been a revision in investment priorities to make room for reconstruction outlays.

The authorities also indicate that their financial program will seek to make suitable provision for the growth of credit to the productive sectors, while being consistent with a reduction of inflation and a strengthening of the international reserve position of the country. In channeling the available credit, they stress that care will be taken to rationalize further the allocation of financial subsidies.

On the external front, the authorities emphasize that particular attention will be given to policies that protect the balance of payments and encourage the growth of exports. In this context, they propose to follow a flexible exchange rate policy designed to facilitate a strengthening of the country's international reserve position and avoid distortions in the economy. In the area of commercial policy, they indicate that the efforts to liberalize trade will be consolidated and continued in the future. They also note that, in line with their efforts to contribute to the reduction of protectionist barriers to world trade, Mexico has now presented a formal request for admission to the General Agreement on Tariffs and Trade (GATT). Furthermore, they reiterate their intention not to impose new or intensify existing restrictions on payments and transfers for current international transactions, introduce new multiple currency practices, or impose new or intensify existing import restrictions for balance of payments purposes.

Finally, the authorities indicate their desire for continued collaboration with the Fund in finding solutions to Mexico's balance of payments problems and announce their intention to request the support of the Fund for the economic program they are developing for 1986.

IV. Staff Appraisal and Proposed Decision

In late 1982 Mexico developed an adjustment program aimed at dealing with the major external and internal disequilibria that it confronted. The economic program pursued by the Mexican authorities since late 1982, which was supported by an extended arrangement, brought about a marked turnaround in economic conditions in 1983 and 1984. Difficulties in the implementation of the program became apparent in the latter part of 1984 and early 1985, however, and corrective measures were introduced in a number of areas as a basis for the 1985 economic program. The actions taken did not prove sufficient to permit achievement of the objectives of the program, particularly in a setting of weakening of the international oil markets, and the balance of payments experienced a major deterioration. These problems have been aggravated by the September earthquakes.

In addition to the loss of life, the earthquakes have resulted in severe physical destruction and economic disruption. Assessment of the damage (and of their economic repercussions) is still in progress, but on the basis of the data available Mexico is expected to have an additional balance of payments need as a consequence of the earthquakes. The situation that has developed calls for the implementation of measures to strengthen domestic savings and economic performance in general to lay the bases for sustained economic growth. In the meantime, the Mexican authorities wish to request financial assistance from the Fund to bolster the reserve position and to increase confidence.

In their letter the authorities have indicated their intention to seek additional financial assistance from the Fund as soon as they complete work on the economic program for 1986. The letter recognizes that the new program will have to intensify the efforts to redress the external and internal imbalances that Mexico has experienced in recent years, and the authorities have outlined the general features of the policies that they intend to pursue in the fiscal, monetary, exchange and trade areas. The authorities have indicated in their letter that they do not intend to impose new or intensify existing restrictions on payments and transfers for current international transactions, or introduce any new multiple currency practices, or impose any new or intensify any existing import restrictions for balance of payments purposes.

In view of the foregoing, the staff believes that Mexico's use of Fund resources in the amount requested is in accordance with Fund practice regarding the provision of financial assistance in cases of natural disaster. Accordingly, the following decision is proposed for adoption by the Executive Board:

1. The Government of Mexico has requested a purchase equivalent to SDR 291.375 million.

2. The Fund notes the intentions of the Government of Mexico as stated in its letter dated December 11, 1985, and approves the purchase in accordance with the request.

3. The Fund waives the limitation in Article V, Section 3(b)(iii).

Table 1. Mexico: IMF Position
(December 1982-December 1985)1/

	Transactions in 1982 2/	Transactions in 1983	Transactions in 1984	Transactions Jan.-Nov. 1985 3/	Proposed Emergency Purchase
	(In millions of SDRs)				
Purchases	200.6	1,003.2	1,203.8	295.8	291.4
Ordinary resources	200.6	501.6	601.9	20.0	291.4
Credit tranches	(200.6)	(—)	(—)	(—)	(291.4)4/
Extended arrangement	(—)	(501.6)	(601.9)	(20.0)	(—)
Borrowed resources	—	501.6	601.9	275.8	—
Repurchases	—	—	—	—	—
Total credit outstanding (end of period)	200.6	1,203.8	2,407.6	2,703.4	2,994.8
	(In percent of quota)				
Purchases	17.2	86.1	103.3	25.4	25.0
Total credit outstanding (end of period)	17.2	103.3	206.6	231.9	256.9

Source: International Monetary Fund.

1/ Partials may not add up to totals because of rounding.
2/ There were no purchases outstanding prior to December 1982. More details on the transactions with the Fund are provided in Attachment I.
3/ No purchases were made after June 1985 because of noncompliance with the quantitative performance criteria set for the end of June 1985.
4/ Emergency assistance purchase.

Table 2. Mexico: Extended Arrangement--Quantitative Performance Criteria for the Third Program Year

	Dec. 1984	1985 Targets and Ceilings Jan.-Mar. Prog.	Jan.-Mar. Actual	Apr.-June Prog.	Apr.-June Actual	July-Sept. Prog.	July-Sept. Actual	Oct.-Dec. Prog.
(In billions of Mexican pesos)								
Nonfinancial public sector cumulative deficit 1/ 2/	1,826	430	361	840	1,047	1,240	2,374 3/	1,785
Unpaid interest accrued to the Bank of Mexico on claims on the nonfinancial public sector	491	805	801	805	805	705	673	568
Net credit to the nonfinancial public sector by the monetary authorities 4/								
Unadjusted	3,740	3,748	3,718	3,895	3,987	3,897	4,493	3,695
Adjusted 5/		3,958		4,426	6/	4,676	6/	4,902
Cumulative changes in financial intermediation (effective flow) 7/	414	130	--	230	181	300	...	350
Cumulative changes in net domestic assets of the monetary authorities (effective flow) 8/	-53	127	122	179	439	45	806	184
(In millions of U.S. dollars)								
Cumulative net foreign borrowing by the public sector 1/	2,189	500	290	500	33	800	...	1,000
Cumulative change in net international reserves of the monetary authorities 1/	2,990	-1,000	-867	-900	-1,927	-100	-3,301	500

Sources: Mexican authorities; and Fund staff estimates.

1/ Limit tested at end of each period.
2/ Effective flows of financing measured on cash basis, cumulative from beginning of year.
3/ Preliminary estimate.
4/ Effective stocks calculated by adding effective flows to nominal stock outstanding as of the end of 1984.
5/ Ceiling can be adjusted upwards by an amount equivalent to the commercial banks' lending to the nonfinancial public sector resulting from implementing mandatory portfolio requirements. The counterpart of this adjustment would be a downward adjustment of the mandatory portfolio requirements on commercial banks by the same amount as the upward adjustment of the Bank of Mexico's lending to the nonfinancial public sector allowed under the program.
6/ Upward adjustment in ceiling is not applicable because the counterpart measure of reducing the mandatory portfolio requirements on commercial banks was not undertaken (see footnote 4).
7/ The operations of financial intermediation involve the net lending operations to the private sector by the development banks and official trust funds.
8/ 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.

Table 3. Mexico: Summary Public Sector Operations, 1982-85

	1982	1983	1984	Prog. 1985	Jan.-June 1984	Jan.-June 1985
(In billions of Mexican pesos)						
Overall deficit	-1,679.4	-1,464.1	-1,825.9	-1,785.0	-580.0	-1,046.7
Foreign financing	351.9	606.0	376.9	28.0	161.1	62.7
Domestic financial system financing	1,134.2	745.2	1,121.1	1,437.0	276.7	512.6
Placement of government securities with the private sector	193.3	112.9	327.9	320.0	142.2	471.4
Public sector receipts	2,850.0	5,894.8	9,481.8	13,744.6	4,351.0	6,458.0
Petroleum exports	812.0	1,939.4	2,780.0	3,541.0	1,319.0	1,662.0
Other PEMEX receipts	155.7	604.5	1,064.0	1,577.0	485.0	733.0
Other public enterprises	505.6	883.8	1,701.0	2,631.6	738.0	1,236.0
Federal Government	1,077.3	2,001.8	3,242.8	4,922.0	1,509.0	2,289.0
Social security	280.7	424.5	633.0	988.0	265.0	500.0
Federal District	25.6	40.7	61.0	85.0	35.0	38.0
Public sector outlays	4,529.6	7,358.9	11,307.7	15,529.6	4,931.0	7,504.7
Wages and salaries	788.7	1,204.5	1,925.6	2,557.5	748.9	1,171.0
Interest payments	812.7	2,181.7	3,093.7	4,468.4	1,336.0	1,922.0
Current transfers	265.2	492.0	531.0	764.0	184.0	438.0
Revenue sharing	211.7	378.3	643.0	892.0	295.0	451.7
Exchange losses	372.0	110.0	206.0	150.0	150.0	150.0
Financing requirements of the rest of the public sector	243.2	135.5	286.3	140.4	163.0	183.6
Other current expenditure 1/	881.7	1,474.0	2,661.4	3,469.5	1,257.0	1,833.8
Other capital expenditure 2/	954.4	1,382.9	1,960.7	3,087.8	797.1	1,354.6
Memorandum items						
Current account	742.5	-102.1	111.0	1,236.9	211.1	289.9
GDP	9,417.0	17,142.0	29,438.0	43,510.0	...	...
(Percentage change in real terms) 3/						
Overall balance	23.2	-56.8	-24.6	-31.5	...	14.6
Public sector receipts	9.0	2.4	-2.8	1.5	...	-5.8
Petroleum exports	57.0	18.3	-13.3	-10.8	...	-20.0
Other PEMEX receipts	-20.2	92.3	6.4	3.8	...	-4.0
Other public enterprises	1.1	-13.4	16.4	8.3	...	6.3
Federal Government	-3.5	-7.4	-2.1	6.3	...	-3.7
Social security	6.9	-25.1	-9.8	9.3	...	19.8
Federal District	-14.3	-21.3	-9.4	-2.4	...	-31.1
Public sector outlays	13.9	-19.5	-7.1	-3.8	...	-3.4
Wages and salaries	10.4	-24.4	-3.3	-7.0	...	-0.7
Interest payments	66.4	33.0	-14.3	1.1	...	-8.7
Current transfers	-2.3	-8.1	-34.7	0.8	...	51.1
Revenue sharing	12.1	-11.5	2.8	-2.9	...	-2.8
Exchange losses	...	-85.4	13.2	-36.5	...	-49.0
Financing requirements of the rest of the public sector	132.6	-72.4	27.7	-65.7	...	-28.5
Other current expenditure 1/	-9.0	-17.2	9.2	-8.7	...	-7.4
Other capital expenditure 2/	-23.1	-28.2	-14.3	10.3	...	7.9

Table 3. Mexico: Summary Public Sector Operations, 1982-85
(Concluded)

	1982	1983	1984	Prog. 1984
	(In percent of GDP)			
Overall deficit	-17.8	-8.5	-6.2	-4.1
Foreign financing	3.7	3.5	1.3	0.1
Domestic financial system financing	12.0	4.3	3.8	3.3
Placement of government securities with the private sector	2.1	0.7	1.1	0.7
Public sector receipts	30.3	34.4	32.2	31.6
Petroleum exports	8.6	11.3	9.4	8.1
Other PEMEX receipts	1.7	3.5	3.6	3.6
Other public enterprises	5.4	5.2	5.8	6.0
Federal Government	11.4	11.7	11.0	11.3
Social security	3.0	2.5	2.2	2.3
Federal District	0.3	0.2	0.2	0.2
Public sector outlays	48.1	42.9	38.4	35.7
Wages and salaries	8.4	7.0	6.5	5.9
Interest payments	8.6	12.7	10.5	10.3
Current transfers	2.8	2.9	1.8	1.8
Revenue sharing	2.2	2.2	2.2	0.3
Exchange losses	4.0	0.6	0.7	1.2
Financing requirements of the rest of the public sector	2.6	0.8	1.0	0.3
Other current expenditure 1/	9.4	8.6	9.0	8.0
Other capital expenditure 2/	10.1	8.1	6.7	7.1
Memorandum item				
Current account	-7.9	-0.6	0.4	2.8

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

1/ Includes current floating debt and other residual operations.
2/ Includes capital transfers and capital floating debt.
3/ Nominal rate of increase deflated by the average rate of increase in consumer prices over corresponding period of preceding year.

Table 4. Mexico: Summary Balance of Payments, 1982-85 1/

(In billions of U.S. dollars)

	1982	1983	Prel. 1984	Prog. 1985	Jan.-June 1984	Jan.-June 1985
Current account	-6.2	5.3	4.0	2.1	3.4	0.1
Trade balance	7.6	14.6	14.0	11.8	8.0	4.6
Exports, f.o.b.	22.1	23.1	25.2	25.8	13.0	11.3
Petroleum and derivatives	16.5	16.0	16.6	15.8	8.5	7.2
Other	5.6	7.1	8.6	10.0	4.6	4.1
Imports, f.o.b.	-14.4	-8.6	-11.3	-14.0	-4.9	-6.7
Public sector	-5.3	-4.2	-4.8	-4.5	-2.2	-2.4
Private sector	-9.1	-4.3	-6.5	-9.5	-2.7	-4.3
Travel	0.6	1.2	1.3	1.3	0.9	0.8
Border transactions	-0.2	--	-0.2	-0.5	--	-0.2
Factor income	-12.5	-9.4	-10.2	-9.3	-5.1	-4.7
Interest on public debt	-7.9	-7.3	-8.4	-7.6	-4.1	-3.8
Other interest payments	-4.3	-2.9	-3.4	-2.8	-1.7	-1.4
Other	-0.3	0.8	1.6	1.1	0.8	0.5
Other services and transfers (net)	-1.8	-1.0	-0.9	-1.2	-0.4	-0.4
Capital account	-0.6	0.2	-1.0	-1.6	-1.5	-2.0
Official capital (net)	6.8	4.7	2.2	0.1	0.9	0.1
Medium- and long-term	5.6	16.0	2.0	...	0.7	0.1
Short-term (net)	1.2	-11.3	0.2	...	0.2	--
Private capital	-7.4	-4.5	-3.2	-1.7	-2.4	-2.1
Nonbank long-term	3.1	0.8	0.5	...	0.4	0.1
Commercial banks	-1.6	0.3	0.6	...	-0.1	-0.6
Short-term and errors and omissions	-9.0	-5.7	-4.2	...	-2.7	-1.6
SDR allocation and gold valuation	--	--	--	--	--	--
Monetary authorities net international reserves (increase -)	6.8	-5.5	-3.0	-0.5	-1.9	1.9
Of which: arrears (decrease -)	1.4	-1.1	-0.3	--	-0.3	--
	(End of period)					
Memorandum items						
Net international reserves	-2.0	3.5	6.5	7.0	5.4	4.6
Gross reserves 2/ in months of merchandise imports	0.1	5.0	7.8	7.4	7.0	5.4

Sources: Mexican authorities; and Fund staff estimates.

1/ Totals may not add due to rounding.
2/ Excludes gold holdings and credit balances under payment agreements.

Table 5. Mexico: Exchange Rates

(In Mexican pesos per currency unit, unless otherwise specified)

	U.S. Dollar Exchange Rate Actual				Effective Exchange Rate Index (1976-81=100)			
	End of Period		Average		Nominal Rate 1/		Real Rate 2/	
1979								
I	22.83		22.76		106.5		104.7	
II	22.84		22.83		105.8		104.2	
III	22.77		22.81		106.0		103.9	
IV	22.80		22.83		105.1		102.2	
Annual	22.80		22.80		105.7		103.7	
1980								
I	22.85		22.83		104.5		97.7	
II	22.93		22.85		104.5		94.8	
III	23.06		23.00		105.8		92.8	
IV	23.26		23.13		105.6		91.5	
Annual	23.26		22.95		105.1		93.8	
1981								
I	23.76		23.49		106.1		86.6	
II	24.44		24.09		106.8		84.3	
III	25.20		24.79		108.4		82.0	
IV	26.23		25.68		113.1		80.6	
Annual	26.23		24.51		108.5		83.2	
1982								
I	45.50		34.42		149.9		96.7	
II	48.00		46.78		202.6		114.0	
	(a) 3/	(b) 4/	(a)	(b) 4/	(a)	(b) 4/	(a)	(b) 4/
III	50.00	...	56.00	...	240.1	... 4/	112.5	...
IV	96.48 5/	148.50	55.90	80.13	279.9	401.2	108.8	154.4
Annual	96.48 5/	148.50	57.44	...	218.4	...	108.6	...
1983								
I	108.18 5/	148.65	102.28	148.72	448.2	651.7	137.1	199.3
II	120.01 5/	148.65	114.10	148.63	496.4	646.6	130.9	170.5
III	131.97 5/	149.39	125.99	148.39	543.3	639.9	128.2	151.0
IV	143.93 6	161.35	137.95	154.93	594.0	667.1	125.3	140.7
Annual	143.93 5/	161.53	120.17	150.29	520.5	651.1	129.7	162.2
1984								
I	155.76 5/	173.18	149.91	167.33	644.0	718.8	117.3	130.9
II	167.59 5/	185.01	161.74	179.16	693.4	768.1	112.8	124.9
III	179.55 5/	196.97	173.68	191.10	735.8	809.6	108.9	119.8
IV	192.56 5/	209.97	185.75	203.17	783.3	856.8	104.8	114.6
Annual	192.56 5/	209.97	167.77	185.19	714.2	788.4	110.4	121.9
1985								
I	208.09 5/	226.31	200.40	217.81	838.4	911.2	96.5	104.9
II	228.01 5/	245.42	218.50	235.97	922.0	995.7	96.8	104.5
July	280.92 5/	347.50	241.85	311.37	1,177.9	1,516.5	116.3	149.7
August	291.50 5/	332.50	286.16 6/	339.92 6/	1,227.7	1,458.3	115.9	137.7
September	305.10 5/	384.50	298.22 6/	357.55 6/	1,282.6	1,537.8	115.3	138.2

Sources: Bank of Mexico, International Financial Statistics; and Fund staff estimates.

1/ Weighted by non-oil trade with 8 major trading partners in 1980. Trade with these countries accounted for 90 percent of total imports and 80 percent of total exports.

2 Effective exchange rate index adjusted by movements in relative wholesale prices, except for Mexico. For this country, the index was adjusted by consumer prices.

3/ From August 6 to December 20, 1982, preferential rate and from December 20, 1982 onward the controlled market rate.

4/ From August 6 to December 20, 1982, free rate; from September 1 to December 20, 1982, the ordinary rate; and from December 20, 1982 onward, the free rate.

5/ Average rate between buying and selling quotations in the controlled market.

6/ Geometric average.

Table 6. Mexico: Summary Operations of the Financial System

	Actual Stocks Dec. 1984	Effective flows 1/ 1982	1983	1984	Prog. 1985	1985 Jan.-June Prog.	Actual
(In billions of Mexican pesos)							
I. Bank of Mexico							
Net international reserves	1,249.1	-387.1	678.5	501.0	166.0	-178.0	-405.5
Net domestic assets	-114.0	613.0	-501.0	-54.3	184.0	179.0	441.6
Net credit to the public sector 2/	3,740.1	685.4	754.7	751.3	-45.0	155.0	241.0
Net credit to official trust funds 3/	149.2	48.6	59.2	53.1	100.0	50.0	22.0
Credit to banks	124.7	178.9	-237.4	50.1	...	...	-39.0
Credit to private sector	43.9	2.7	4.2	6.1	2.0	1.0	1.7
Liabilities to banks	-3,761.1	-335.1	-962.7	-1,205.0	-422.1	-316.1	31.9
Other (net)4/	-410.8	32.5	-119.0	290.1	549.1	289.1	184.0
Note issue	1,135.1	225.9	177.5	446.7	350.0	1.0	36.1
II. Financial System							
Net foreign assets	1,370.0	-397.4	691.3	453.3	166.0	-178.0	-386.1
Net domestic credit	14,702.4	1,170.0	1,555.7	3,363.3	4,130.0	1,851.0	1,643.4
Net credit to the public sector 5/	10,918.1	1,224.1	931.6	1,034.8	1,474.0	745.0	659.9
Credit to the private sector 5/	4,644.8	-102.8	765.5	1,941.3	2,579.0	793.0	1,055.6
Other (net)4/	-860.5	48.7	-141.4	387.2	77.0	313.0	-72.1
Medium- and long-term foreign obligations	6,445.8	6.7	208.5	73.9	116.0	-15.0	-68.1
Liabilities to nonbank public financial intermediaries	553.6	30.8	148.6	159.4	--	--	128.9
Liabilities to private sector 6/	9,073.0	714.6	1,895.2	3,549.0	4,180.0	1,688.0	1,185.4
Of which: capital and reserves	170.2	14.0	27.3	74.7	...	...	41.1
(Percentage change in relation to note issue at the beginning of the period)							
Bank of Mexico's net domestic assets	...	215.1	-98.1	-7.9	16.3	15.8	38.9
Bank of Mexico's net credit to public sector	...	240.5	147.7	109.1	-4.0	13.7	21.2
Note issue	...	79.3	34.7	64.9	31.1	0.1	3.2
(Percentage change in relation to liabilities to private sector at the beginning of the period)7/							
Net domestic credit	...	59.9	47.2	64.2	47.9	21.5	18.6
Net credit to the public sector 5/	...	62.1	48.3	24.6	17.1	12.3	7.5
Credit to the private sector 5/	...	-5.3	23.2	37.1	29.9	9.2	12.0
Liabilities to the private sector 6/	...	36.6	57.5	67.8	48.5	19.6	13.4
(In percent of GDP)							
Net domestic credit	49.2	12.4	8.8	11.4	9.5	...	...
Net credit to the public sector 5/	37.1	12.9	9.0	4.4	3.4	...	...
Credit to the private sector 5/	15.8	-1.1	4.3	6.6	5.9	...	...
Liabilities to the private sector 6/	30.8	7.6	10.7	12.1	9.6	...	...
Memorandum item							
Credit to the private sector as a proportion of liabilities to private sector	51.2	-14.4	40.4	54.7	61.7	47.0	89.1

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 and accrued and unpaid interest on Bank of Mexico's claims on the nonfinancial public sector.

3/ Excludes FICORCA.

4/ Includes official capital, gold price adjustments, valuation adjustments to Fund transactions accrued and unpaid interest on Bank of Mexico's claims on the nonfinancial public sector, and net unclassified.

5/ Includes credit financed with medium- and long-term foreign liabilities of the public sector channeled through the banking system, but excludes government securities placed directly with the private sector.

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.

Table 7. Mexico: Cost of Reconstruction

(In millions of U.S. dollars)

	First Official Estimate of Total Costs Oct. 1, 1985	IBRD Preliminary Estimates of Reconstruction Costs During First Four Years		
		Demolition and Rehabilitation	Reconstruction and Other 1/	Total
Total	3,030	727	2,290	3,017
Hotels	90	40	165	205
Industry	120	64	223	287
Schools	90	48	41	89
Hospitals	300	60	260 2/	320 2/
Other public buildings	320	140	261	401
Commercial and retail private buildings	...	124	630	754
Housing	980	199	583	782
Telecommunications	300	23	82	105
Infrastructure	450	29 3/	45 3/	74 3/
Other	380	--	--	--

Sources: United Mexican States, Communications to the International Banking Community on Recent Economic Developments, October 1, 1985; and IBRD preliminary estimates based on official sources.

1/ Includes stocks, furniture, and equipment.
2/ Includes temporary hospital facilities.
3/ Includes municipal and Federal district infrastructure.

Table 8. Mexico: Official Estimates of the Balance of Payments for 1985 Post-Earthquakes

(In billions of U.S. dollars)

	1985	
	Original program	Official projection after earthquakes 1/
Current account	2.1	-0.5
Trade balance	11.8	8.7
Exports 2/	25.8	23.0
Imports	-14.0	-14.3
Services and transfers net	-9.7	-9.2
Capital account	-1.6	-3.5
Official capital	0.1	-0.5
Private capital 3/	-1.7	-3.0
Expected relief after earthquake	--	1.25-1.45
Commercial banks	--	0.95
International institutions	--	0.3-0.5 4/
Monetary authorities net international reserves (increase -)	-0.5	2.75-2.55

Sources: Data provided by the Mexican authorities; and Fund staff estimates.

1/ Based on data provided in Communication to the International Banking Community on Recent Economic Developments, United Mexican States, October 1, 1985.
2/ Includes in-bond industries.
3/ Includes errors and omissions.
4/ Excludes emergency purchase from the Fund.

Mexico, December 11, 1985

Mr. Jacques de Larosière
Managing Director
International Monetary Fund
700 19th Street, N.W.
Washington, D.C.

Dear Mr. de Larosière:

1. We greatly appreciate the positive indications we have received from the Fund as regards emergency assistance to help Mexico deal with the economic problems brought about by the earthquakes that struck Mexico City and other areas of our country in late September. Since that time we have been making an assessment of the extent of the damage suffered and have started to develop a reconstruction program. We have started to receive assistance from other multilateral agencies in carrying out the reconstruction task.

2. Notwithstanding the additional economic problems posed by the earthquakes, we wish to reaffirm our intention to continue our efforts to eliminate the external and internal imbalances experienced by Mexico in recent years.

3. Last March we had written to you about the economic program that we had planned to carry out during 1985 in line with our policy to continue the adjustment process of the Mexican economy. That program had received the support of the Fund in the context of the extended arrangement. We have encountered difficulties in implementing the program for 1985. Some of these have been of an internal nature, reflecting problems we have had in carrying out our policies; others have been related to developments outside our control, such as the weakening of the international petroleum market. These difficulties have been exacerbated by the earthquakes. We intend to ensure that the adverse effects of these events will not represent an irreversible setback to the achievement of our objectives of reestablishing price stability and a strong balance of payments, as a means of assuring sustained growth. Some corrective actions already have been taken and we have incorporated in the 1986 budget recently submitted to Congress additional measures aimed at regaining the momentum of our adjustment effort. Recent developments have reinforced our view that policies need to be strengthened in order to reduce the vulnerability of the Mexican economy to events beyond its control.

4. On the basis of a preliminary assessment of the effects of the earthquakes, it is clear that, in addition to the loss of life, the infrastructure of Mexico City and other areas of the country experienced substantial damage. International telephone and telecommunication facilities were destroyed; major hospital centers in Mexico City were almost completely demolished; a large number of buildings collapsed or were damaged beyond repair (these include apartment buildings, homes,

hotels, offices of financial institutions, government buildings and schools); and there was considerable damage to water and sewerage systems. In addition, there are significant costs arising from some disruption in administrative activities and the loss of files and information systems. Replacement of the equipment that was lost will involve substantial imports; the earnings of the tourist industry (the second largest earner of foreign exchange in the country) will be affected adversely; and clothing industry exports will suffer because of the collapse of a large number of factories. Very preliminary estimates indicate that the physical damage exceeds US$3 billion (close to 2 percent of GDP).

5. As indicated in the budget message recently submitted to Congress, the reconstruction will require an additional savings effort if domestic inflation is not to be aggravated and international reserves weakened further. This will involve steps to increase public sector receipts and actions to curb public sector outlays other than for reconstruction, including a thorough reordering of priorities in respect of public sector investment. We will, therefore, take measures to continue the effort to reduce the overall public sector deficit.

6. The financial program that is being developed will seek to make suitable provision for the growth of credit to the productive sectors, including the needs arising in connection with reconstruction, while being consistent with a reduction of inflation and the strengthening of international reserves. Also, steps are being taken to improve the operations of financial intermediation of the development banks and official trust funds while at the same time a rationalization of financial subsidies is being undertaken.

7. As was indicated above we are very much aware that the earthquakes will add to existing pressures on the balance of payments, and thus we will give particular attention to policies that protect the balance of payments and encourage the growth of exports of goods and services. It should be noted that exchange rate policy has been modified, making it more flexible and assuring a freer access to the exchange markets by all sectors. We intend to continue to pursue a flexible exchange rate policy to strengthen our international reserve position.

8. Progress has been achieved in liberalizing commercial policy. We believe that such liberalization is essential to the achievement of a more efficient economy and a sustained growth of nonpetroleum exports. Last July a very large number of import categories was freed from prior import permit, and the import tariff schedule was modified to improve its structure and reduce the number of duty rate categories. Consistent with this policy, and in line with Mexico's efforts to contribute to the reduction of protectionist barriers to world trade, the Mexican authorities recently have applied for membership in the GATT. The trade liberalization efforts will be consolidated and continued in the future and it is our intention not to impose new or intensify existing restrictions

on payments and transfers for current international transactions, introduce any multiple currency practices, or impose new or intensify existing import restrictions for balance of payments purposes.

9. We have sought to reduce the burden of the external debt through a restructuring of the existing balances and the negotiation of lower interest rates, as well as through restraint in the use of new external financing. Under present circumstances, however, additional foreign credits will be needed to help meet the costs of the reconstruction effort. We have asked the World Bank and the Inter-American Development Bank to increase their credits to Mexico in support of the reconstruction program, and we have requested the international banking community for its support to help meet the immediate foreign exchange needs of our economy.

10. To ease the pressure on the Bank of Mexico's international reserves while policy measures to strengthen the balance of payments are taking hold, we wish to request an emergency purchase from the Fund for the equivalent of one credit tranche. A positive response of the Fund to our request will assist the Mexican economy in coping with the immediate adverse effects of the earthquakes. The Mexican authorities will continue to collaborate with the Fund in finding solutions to Mexico's balance of payments problems, and we would like to advise you of our intention to seek additional resources from the Fund in support of the economic program being formulated by the Government for 1986. As explained in this letter, the program aims at the continuation of the adjustment efforts initiated by the present Administration.

11. While purchases from the Fund above the first credit tranche remain outstanding, the Mexican authorities and the Fund will consult periodically, in accordance with the policies on such consultations, to examine the progress being made in implementing the policies designed to solve the existing balance of payments problems, with a view to adopting any additional measures that may be necessary to facilitate the required adjustment.

Sincerely yours,

Jesús Silva Herzog
Secretary of Finance and
Public Credit

Miguel Mancera Aguayo
Director General
Bank of Mexico

Fund Relations with Mexico
(As of November 30, 1985)

I. Membership Status
(a) Member since 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 3,868.9 million or 331.9 percent of quota

(c) Fund credit: SDR 2,703.3 million or 231.9 percent of quota
Of which: SDR 200.6 million or 17.2 percent of quota under credit tranche
SDR 1,123.5 million or 96.4 percent of quota under EFF
SDR 1,379.2 million or 118.3 percent of quota under EAR

(d) Reserve tranche position: None

(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 2,502.7 million
(iv) Undrawn balance: 907.9 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 0.357 million, or the equivalent of 0.12 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

VI. Overdue Obligations to the Fund
None

B. Nonfinancial Relations

VII. Exchange rate arrangement: Since August 5, 1985 two official markets have been operative in Mexico: a controlled market covering specified transactions amounting to about 80 percent of trade and payments transactions, and a parallel market. The controlled market rate is determined under a managed float system guided by a set of indicators whereas the parallel market rate is established by market forces. The controlled market rate undergoes daily unspecified discrete adjustments. Parties eligible to utilize the controlled market (with the exception of offices and agencies of the public administration) can choose to complete any transaction at a "retail rate" agreed between the parties and the financial institutions authorized to operate in this market, or at the "equilibrium exchange rate" of the day. The daily "equilibrium exchange rate" is determined each day at a fixing session at the central bank, where representatives of the various financial institutions operating in the market exchange bids for purchases and sales of foreign exchange; the central bank may also submit bids in these sessions. For transactions exceeding US$50,000, the parties concerned may make completion of the transaction contingent upon the equilibrium exchange rate achieving a particular minimum or maximum value. As of November 30, 1985 the "controlled market equilibrium exchange rate" was Mex$341.20 per U.S. dollar, the average "retail" rate was Mex$340.00 per U.S. dollar, and the spread between the exchange rates in the controlled market and the parallel market was about 40 percent.

VIII. Last Article IV consultation and review under EFF: The last Article IV consultation and discussions of the 1985 program were completed by the Executive Board on June 7, 1985 (EBM/85/91). The relevant supporting documents were SM/85/123, Cor. 1, 5/13/85 and SM/85/148, Cor. 1, 5/23/85. For consultation purposes Mexico is on the 12-month cycle.

IX. Technical Assistance: At the request of the Mexican authorities, during 1985 two technical teams from the Fiscal Affairs Department have provided technical assistance in the fields of direct and indirect taxation.