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FROM: Normand Bernard N.B.

The attached memorandum provides background information for the Committee's decision on the proposed "bridge loan" to Mexico. The memorandum, entitled "Assessment of the Mexican Economic Situation and Prospects," was prepared by Yves Maroni of the Board's Division of International Finance.

Attachment

Yves Maroni
October 25, 1988

Assessment of the Mexican Economic Situation and Prospects

Overview

In December 1987, Mexico adopted a new anti-inflation program, backed by an acceleration of the trade liberalization underway since 1985 and a stepped-up effort to restructure the economy. The program involved expenditure cuts, revenue increases, and a social pact under which public sector prices and controlled private sector prices have been frozen since mid-December 1987, and the peso/dollar exchange rate and minimum wages have been frozen since March 1988. The program has brought about a rapid deceleration of recorded inflation and sharply lower nominal interest rates. However, economic activity has been slowing, calculated real interest rates remain high, and the budget deficit has not yet declined enough to ensure that the recent low inflation rate can be sustained.

Moreover, the trade surplus has shrunk from a monthly level of $1 billion in June 1987 to only about $174 million in August 1988, and the current account has shifted to a deficit of $330 million in the second quarter of 1988 from surpluses of $1.4 billion in each of the first two quarters of 1987. High import levels and falling oil export prices have been the main causes of this deterioration. The decline in oil revenues has jeopardized the achievement of the budgetary goals and forced the authorities to cut public expenditures repeatedly this year.

Large prepayments of private sector external debt at large discounts have taken place in the past 12 months. In addition, since April 1988, there has been a capital outflow reflecting doubts as to the viability of the fixed peso/dollar exchange rate and uncertainties linked to the July presidential elections and the transition to a new government on December 1. As a result, international reserves, excluding gold, have declined by about $7.2 billion in the past 5-1/2 months, from the record level of $14.9 billion at the end of April.

On October 16, 1988, President de la Madrid announced new steps in response to the decline in world oil prices. These were the acceleration of the privatization program, a tightening of monetary policy, new cuts in public expenditures amounting to less than 0.2 percent of GDP, and an approach to external sources of credit for additional financing. At the same time, President-elect Salinas signed a 30-day extension of the freeze to December 31.

Discussions have begun with the World Bank for a financing package that may total about $1.5 billion and an application is being made to the IMF for assistance under the Compensatory and Contingency Financing Facility (CCFF). CCFF assistance is based on a complex formula, but it would appear that Mexico may obtain as much as $600 million from this facility.

On October 17, the U.S. Treasury Department and Federal Reserve welcomed the new Mexican economic measures, declared that Mexico's strengthened economic policies merited support, and announced that they were prepared to develop a short-term bridge loan of up to $3.5 billion, depending on the development of loan programs by Mexico with the World Bank and the International Monetary Fund.

The outlook for the Mexican economy depends importantly on what happens to oil prices. However, even if they rise moderately from present levels, the new Mexican government will have to devalue the peso, build on the record of fiscal restraint and consolidation compiled by the outgoing government, and continue with the restructuring of the economy, if sustainable growth of 4-5 percent per year is to be achieved. Additional external financing will also be required. Given all that Mexico has been through over the past six years, this will be difficult but not impossible.

Economic Activity

In the first half of 1988, Mexico's real GDP was 1.6 percent above a year earlier and industrial production was 3.2 percent higher. However, this recorded growth is measured against a relatively depressed level of activity in the first half of 1987. In fact, industrial production peaked in the fourth quarter of that year, and, on a seasonally adjusted basis, it fell from that quarter to the first quarter this year and again from the first to the second quarter in 1988. The successive 12-month rates of increase in industrial production have been getting progressively smaller. In June, this rate was 2.1 percent, well below the average of 11.6 percent in the fourth quarter of 1987. Even with no further decline in the industrial production index in the second half of 1988, in the fourth quarter it will be below the corresponding levels of 1987. For the year as a whole, the index may average about the same as, or slightly more than, in 1987.

In 1987, real GDP rose by 1.4 percent. Most observers expect that 1988 GDP growth will be about 0.5 percent.

Price and Wage Policy

Public sector prices and private sector prices that are subject to price control have been frozen since mid-December 1987. Minimum wages (the minimum wage is different in different parts of the country) have been frozen since March 1.

Private sector prices not subject to price control and wages that are determined in periodic contractual negotiations are constrained by moral suasion. Organized labor and businesses have made a commitment to hold the line as far as possible, in consideration of the continuation of the freeze in public sector prices, controlled private sector prices, and the exchange rate. The government is able to put pressure on non-complying businessmen by threatening, or actually instituting, reductions in import duties on competing goods or tax audits. However, some labor unions, notably that of the petroleum workers, are very powerful, and it appears that this union obtained a very large wage increase in April.

In June, price distortions became evident for the first time. Cattlemen were said to be refusing to sell their stock at the official price, and beef was reported to have disappeared from store shelves in Mexico City and Guadalajara. Milk, eggs, and cooking oil also were difficult to find. However, the announcement, last August, that the freeze was being extended for another three months did not include any price corrections. Instead, the government obtained a pledge from business leaders to reduce their prices by an average of 3 percent over the next three-and-a-half months. On October 16, the freeze was extended by President-elect Salinas for one more month, to the end of December.

The monthly rate of increase in the CPI has declined almost without interruption since reaching a peak of 15.5 percent in January 1988. In September, the CPI rose by 0.6 percent, the lowest monthly rate recorded in 12 years. Most of the increase was accounted for by higher rents, private school tuition, and fresh vegetables. The September CPI was still 95 percent higher than a year earlier, but this compares favorably with the peak 12-month rate of 180 percent recorded in

February. The October CPI increase is projected at about the same rate as that for September. Such an increase would bring the 12-month rate down to 81 percent.

Exchange Rate and Trade Policies

The peso-dollar exchange rate has been frozen since March 1, 1988, after being almost unchanged during the previous 10 weeks. But, in the first nine months of 1988, the Mexican CPI has increased by about 45 percent. As a result, in these nine months, the peso has appreciated in real terms against the dollar by about 20 percent, when the calculation is based on relative consumer prices. Moreover, the dollar has appreciated against the G-10 currencies thus far this year by about 5 percent. This makes the peso's overall real appreciation larger still.

In part at least, the loss of competitiveness that the peso's real appreciation implies is mitigated for export industries to the extent that the trade liberalization measures put into effect last December and more recently are lowering the costs of imported inputs. As a result, up to a point, the real appreciation of the peso may be tolerable, especially since the peso was widely thought to have been undervalued when the new policies were instituted last December, in the sense that the rate was lower than would be required for Mexico to run a small current account deficit at then-prevailing oil prices.

However, what undervaluation there was is in the process of disappearing, if it has not entirely disappeared already as oil prices have declined. Many Mexican officials have suggested that, when an index of Mexican production costs is used instead of the CPI in making the comparison, a comfortable margin of peso undervaluation remains.

Nevertheless, the real appreciation appears to have adversely affected trade flows and capital movements.

Trade and Current Account Performance

The current account and trade surpluses have been shrinking since mid-1987. In August 1988, the trade surplus was only about $174 million, the lowest in over six years, and one-sixth as high as in June 1987. In January-August 1988, imports were 54 percent higher than in the same 1987 period, while exports were 4 percent higher. Non-petroleum exports were 25 percent higher, but oil exports were 18 percent lower.

The year-over-year gain in non-oil exports shown in January-August 1988 is about the same as was recorded in January-August 1987. However, this is due to a surge in the year-over-year gains for the in-bond assembly industries to 59 percent in January-August 1988 from 14 percent 12 months earlier. When this group is excluded, the year-over-year gain for the remaining non-oil exports was 21 percent in January-August 1988, compared with 27 percent in January-August 1987. Moreover, when manufactured exports alone are considered, the year-over-year gain for January-August 1988 was 22 percent, compared with 46 percent for January-August 1987. Manufactured exports accounted for 71 percent of the January-August 1988 non-oil exports and for 49 percent of that period's total exports.

Imports consist primarily of intermediate goods. They account for 70 percent of the total, capital goods for only 21 percent, and consumer goods for less than 10 percent. The rise in imports from January-August 1987 to the same period in 1988 affected all three types of goods. Consumer goods showed the highest percentage increase, but this reflects the low base from which the growth is measured. In dollar terms, intermediate goods accounted for 63 percent of the rise, capital goods for 22 percent, and consumer goods for only 14 percent.

The average price of Mexican crude oil exported in January-July was $12.94 per barrel. However, world oil prices fell in September and early October, and the average Mexican export price was only $9.60 in the first half of October. For the year as a whole, it seems likely that the average export price will be about $12. This is $3 less than projected at the beginning of the year, and $4 less than the average 1987 price. Since, over a full year, oil export earnings change by $500 million for every $1 change in the average oil export price, Mexico is likely to earn from crude oil in 1988 $1.5 billion less than it had projected and $2 billion less than in 1987.

Non-oil exports may be as much as $2 billion higher in the whole of 1988 than in 1987. This represents a 14.5 percent increase, which compares with a 23.4 percent increase from 1986 to 1987. Imports may be close to $5 billion higher in 1988, largely as a result of the import liberalization program that is part of the strategy of opening the Mexican economy, but also because of the price and quantity effects of the drought. As a result, the trade surplus, which reached $10 billion in 1987, may be only $5 billion this year.

External interest payments are likely to be about $800 million higher in 1988 than in 1987 mainly because of the increase in world interest rates in 1988. However, because official reserves have fluctuated around a higher level this year than last year, interest income will be about $300 million more in 1988 than in 1987.

The current account, which was in surplus by about $1.4 billion in each of the first two quarters of 1987 and still showed a $500 million surplus in the first quarter of 1988, shifted to a $330 million deficit in the second quarter. For the year as a whole, a $1.7 billion current account deficit is likely. Since there was a $3.9 billion surplus in 1987, the prospective deterioration would amount to about $5.6 billion.

Capital Movements

In the first quarter, and especially in March, there were large capital inflows in response to the combination of high nominal interest rates and a fixed, or almost fixed, exchange rate. However, as interest rates declined, and as the peso's real appreciation began to create doubts as to the sustainability of the fixed exchange rate, capital flows were reversed. The capital outflow was intensified in June and July by political uncertainty associated with the presidential and congressional elections that were held on July 6 and that resulted in strong gains by the opposition and widespread claims of voting irregularities. The outflow abated somewhat in late July and especially in late August, but it intensified in September, and especially early October, when the decline in world oil prices cast new doubts about the viability of the fixed exchange rate.

A significant part of the capital outflow appears to have taken the form of prepayments of private sector debts at substantial discounts. Bank of Mexico Director General Miguel Mancera told a Mexican bankers' convention on August 4 that these prepayments were about $2 billion during the first half of 1988. Private sector debt prepayments began on a large scale in the fourth quarter of 1987, when they are estimated to have been $3.5 billion.

International Reserves

Mexico's international reserves excluding gold, which were about $12.5 billion at the end of 1987, were about $2 billion higher at the end of March, but, in that month, there were large drawings on the commercial bank financing package negotiated in 1986, on the IMF, and on World Bank loans. Small gains were recorded in April, but reserves turned down in May and continued to decline thereafter, as the Bank of Mexico supported the exchange rate in the face of renewed capital outflows. At the end of July, reserves excluding gold were about $10.5 billion, $4.5 billion less than the late April peak. A further $2.7 billion decline has occurred since then. At present, reserves excluding gold amount to the equivalent of about 3 months' imports of goods and services at their estimated 1988 rate. Gold holdings of more than 2.5 million ounces are worth about $1.1 billion at recent market prices.

Fiscal Policy and Budgetary Performance

The strengthened anti-inflation program adopted last December aimed to raise the "primary" fiscal surplus (which excludes interest payments on the public debt) to 8.3 percent of GDP in 1988 from 5.4 percent in 1987, and to lower the overall deficit to 10 percent of GDP from 16 percent in 1987.

However, public sector revenues are falling short of expectations, mainly because of the decline in oil export prices and the extension of the freeze on public sector prices beyond its originally planned expiration date of March 1.

Public sector revenues from petroleum change by about 0.3 percent of GDP for each change of $1 in the average oil export price. The 1988 budget was originally formulated on the assumption that the oil export price per barrel in 1988 would average $15. Given the more likely outcome of an average price of $12, a shortfall in revenues of 0.9 percent of GDP will result. In addition, the original budget was formulated on the assumption that the peso/dollar exchange rate would continue to crawl after March 1. In fact, it has been frozen, so that an additional shortfall of perhaps 1.5 percent of GDP has resulted from the lower conversion rate.

A partial offset to the revenue shortfall is provided by the program to privatize public sector enterprises. In the first nine months of 1988, sales completed under this program had a value of about 1.6 trillion pesos. Sales expected to be finalized in October and November are valued at another 1.7 trillion pesos, and could have a value of 4 trillion pesos if two mining enterprises that are up for sale can be sold. The proceeds of these sales to be collected in 1988 are expected to be less than the full value, as part of the payments are likely to be deferred. As a guess, the amount to be collected in 1988 from these privatizations may reach 2.4 trillion pesos (0.6 percent of GDP) if the two mining firms are not sold, or 3.8 trillion pesos (0.9 percent of GDP) if they are sold.

On the other hand, in August, when the social pact that freezes the peso/dollar exchange rate, minimum wages, public sector prices, and controlled private sector prices was extended for another three months, the government agreed to lower income taxes by 30 percent for individuals earning up to four times the minimum wage in each region, and eliminated a 6 percent value-added tax on processed foods and medicines, effective September 1. These measures, which represent concessions to organized labor in return for labor's agreement to the continued minimum wage freeze, further weakened the fiscal position, albeit not in a major way.

The freeze extension has also kept public sector wage costs below original projections. While this is providing a partial offset to the revenue shortfall, the authorities have had to trim expenditures in other ways in an attempt to reach the primary surplus and overall deficit targets in peso terms.

Since the beginning of the year, the authorities have announced expenditure cuts totalling about 13 trillion pesos, or 3.2 percent of the estimated 1988 GDP. The latest expenditure cut, ordered on October 16, 1988, amounted to 590 billion pesos, or 0.15 percent of the estimated 1988 GDP. As such, the contribution that this cut makes toward the containment of the 1988 fiscal deficit is minimal. However, on an annualized basis, this is equivalent to 0.7 percent of GDP.

However, the progress in reducing expenditures in real terms has been hampered by deviations by some of the public entities, notably PEMEX and the government of the Federal District, which appear to be exceeding their budgeted allotments. A significant deviation relates to large wage and salary increases granted by PEMEX in April. It is known also that, in June and July, the public sector made emergency imports to maintain domestic supplies of grains, which were reduced by the effects of the drought in Mexico, and of fresh meat, which became scarce when cattlemen refused to sell at official prices.

In the first half of 1988, the primary surplus was 28 percent higher in real terms than in the same period of 1987. Programmable expenditures (which exclude interest payments and transfers to the states under revenue-sharing arrangements) were about 15 percent lower in real terms than in the first half of 1987. Revenues were about 5 percent lower in real terms.

Transfers to the states were about 10 percent lower. But, nominal interest rates on the domestic debt rose to higher levels in the first quarter of 1988 than had been expected, and their subsequent decline was halted at higher levels than had been hoped. As a result, in real terms, domestic interest payments were 12 percent higher in the first half of 1988 than in the same period of 1987. For their part, external interest payments were 15 percent lower in real terms than in the first half of 1987, because they required fewer pesos under the fixed exchange rate than was budgeted on the assumption that the peso/dollar exchange rate would crawl after March 1. Nevertheless, total interest payments were nearly 5 percent higher in real terms in the first half of 1988 than in the same period of 1987.

Finally, lending to the private sector by public sector development banks and trust funds was nearly 22 percent higher in real terms in the first half of 1988 than in the same period of 1987.

Altogether, the overall deficit in the first half of 1988 was about 4 percent lower in real terms than in the same period of 1987. For the year as a whole, the overall deficit will need to be considerably lower in real terms than the 1987 deficit in order to reach the target of 10 percent of GDP. This will be difficult but not impossible to achieve. However, because real interest rates on the domestic public debt have remained so high, the so-called operational balance of the public sector, which was expected to be about zero, is expected to be in deficit.

Looking to the future, Mexico needs to make a further fiscal effort in revenues and/or non-interest expenditures to reach a deficit level consistent with relative domestic price stability, such as existed in the 1960s, when the overall deficit was about 3 percent of GDP.

Monetary Policy

Nominal interest rates were raised sharply in late December and January, but fell dramatically from late February to early June. They have changed little since then, although the nominal annual rate on 28-day Treasury bills has edged up slightly at successive weekly auctions since early August. On October 18, this rate was 45.5 percent, 523 basis points higher than on July 26, and 206 basis points higher than at the October 11 auction, but down from 151.7 percent at the February 23 auction. The March-May decline was cushioned by Bank of Mexico open market operations, designed to offset large private capital inflows from abroad. The subsequent relative stability was made possible by the Bank's decision to absorb significant amounts of bills that the market would not hold. In real terms, ex-post, rates were negative in December 1987, but turned strongly positive in the first quarter of 1988. With inflation at the monthly rate of 0.6 percent (the September rate), the real yield on 28-day Treasury bills sold in September was about 38 percent, ex-post.

Bank credit to the private sector has been constrained by a ceiling amounting, in nominal terms, to 85 percent of the average of such credit outstanding in December. However, the private sector has been able to finance itself outside of banks, as large firms, which generally earned large profits in 1987 and appeared to be continuing to do so in 1988, either used their internally generated funds for their own purposes or lent them to other firms at the Treasury bill rate plus spreads of 3 percentage points and up, depending on the risk involved.

At the end of July, the narrowly defined money supply was about 131 percent higher than a year earlier. This percentage is less than the 12-month rates of increase recorded in each of the previous six months, but it is more than the 12-month rate of increase in the CPI in the same period (122 percent), which is consistent with some remonetization of the economy. In real terms, the narrow money supply was about 4 percent higher in July 1988 than in July 1987.

On October 16, 1988, President de la Madrid announced that a more restrictive monetary policy was being adopted, and the 206 basis point increase in the Treasury bill rate at the October 18 auction testifies to it.

Structural Adjustment Policies

The privatization program is moving forward, although progress continues to be slow. Bureaucratic resistance, stemming from a fear of accompanying job losses, or from a fear of being accused, at a later date, of having "squandered the national patrimony," appears to be the main reason for the slow pace of the program. However, financing problems are also involved, as in the case of the Cananea Mining Company, a large copper producing firm. The sale of that firm was announced in April. The buyer, a Mexican conglomerate, was to have paid for it by surrendering Mexican public sector debt paper that it was to have bought with foreign bank financing, presumably in the secondary market. But the lead bank, First Chicago, reportedly had difficulty marketing the financing package to other participating banks and withdrew from the deal. Another bank stepped in and proposed a new financing plan, but the

Mexican authorities rejected the conditions that this bank introduced, and the sale was suspended. In September, the authorities announced that new bids would be accepted up to October 24.

In the five years up to the end of 1987, 107 non-strategic public sector enterprises were privatized and another 211 were liquidated or ceased to exist, while 58 new public enterprises were created. Another 17 enterprises were privatized in the first nine months of 1988. A variety of steps have been taken to raise productivity in enterprises remaining under state ownership.

On October 16, 1988, President de la Madrid ordered an acceleration of the privatization program. Unless unforeseen difficulties arise, an additional 51 enterprises are to be privatized in October and November alone. Completion of the sale of Mexicana airline was announced on October 24.

Since 1985, Mexico has greatly reduced import licensing requirements, has lowered the maximum import duty from 100 to 20 percent, and has abandoned the use of high arbitrary prices to assess customs duties. Mexico has also become a full member of the GATT.

Some of the rules inhibiting foreign direct investment have been eased, and some investments with 100 percent foreign ownership have been approved. A debt-equity swap program was initiated in May 1986, but it was suspended in October 1987 to permit a review of its inflationary potential and of the benefits that Mexico derives from it. Recent reports indicate that it is being at least partially reinstated.

Mexico's Relations with the IMF

Mexico has performed well under past IMF-supported programs, although it fell out of compliance with the 1983-85 Extended Fund

Facility arrangement nine months before its expiration and had to forgo the last three drawings. The most recent program, an 18-month stand-by arrangement for SDR 1.4 billion, expired in April 1988 after all tranches had been drawn. The last tranche required a waiver because of deviations from some of the performance criteria.

Mexico's quota in the IMF is SDR 1,166 million ($1,515 million at 1 SDR = $1.30). Under a stand-by arrangement, normal maximum access is 90 percent of quota at an annual rate. In Mexico's case, this would amount to SDR 1,049 million ($1,364 million). The IMF also has a Compensatory and Contingency Financing Facility (CCFF) that provides compensation for export shortfalls, for excesses in cereal import costs, and for such contingencies as an upward deviation in world interest rates from what was assumed in a stand-by program. Under the export-shortfall part of the CCFF, Mexico might obtain 40 percent of quota in the absence of a stand-by arrangement or 65 percent of quota in conjunction with a stand-by arrangement. The former is equivalent to SDR 466 million ($606 million) and the latter to SDR 758 million ($985 million). Under the cereal-import part of the CCFF, Mexico might obtain another 17 percent of quota, whether or not it had a stand-by arrangement, or SDR 198 million ($258 million). Under the contingencies part of the CCFF, Mexico might obtain another 40 percent of quota, or SDR 466 million ($606 million), but only if it had a stand-by arrangement.

The maximum access to the CCFF is 122 percent of quota. In Mexico's case, this would amount to SDR 1,423 million ($1,849 million). In combination with a one-year stand-by arrangement, Mexico might obtain a total of SDR 2,472 million ($3,213 million) from the IMF.

Mexico's Relations with the World Bank

Since July 1986, the World Bank has approved eight policy-based loans for Mexico totalling $2.7 billion for trade liberalization, export promotion, industrial and agricultural credit system reform, steel sector restructuring, and agricultural and fertilizer sector reforms.

Another six policy-based loans totalling about $2 billion are in various stages of preparation. One of them, for industrial restructuring ($250 million), is scheduled for Executive Board action in December. The others would support fiscal and regulatory reforms to relieve constraints on the development of the industrial sector, provide further assistance to the trade liberalization program, help to strengthen policies and institutions in the irrigation and drainage sector and in the mining sector, and extend further assistance to the development of non-traditional exports.

The World Bank also has in the pipeline for Mexico eight project loans, the largest one of which, for $460 million to finance two hydroelectric projects, is scheduled for Executive Board action in December.

Mexico has opened discussions with the World Bank for three fast-disbursing policy-based loans to support structural adjustment actions. Their total is expected to be $1.5 billion. One is expected to be a broad-based structural adjustment loan designed to eliminate subsidies, further fiscal consolidation, and facilitate the transition from the social pact that has formed the basis of economic policy in 1988. The second would involve industrial restructuring, and the third would support public enterprise reforms.

The Outlook for 1989 and Beyond

So long as world oil prices remain depressed, Mexico will face serious short- and medium-term economic and financial difficulties and will require additional external resources. Moreover, it should be emphasized that each of the illustrative scenarios discussed below assumes that Mexico will follow restrained monetary, fiscal, and wage policies, and an exchange rate policy that maintains the international competitive position of its exports at a level that would involve a devaluation of 10-15 percent sometime over the next few months. The projections also assume that growth in the OECD region, world interest rates, and the international value of the dollar will be consistent with recent staff forecasts.

In the absence of additional external financial resources and on the assumption that the Mexican oil export price will average $11 per barrel in 1989 and will rise by $0.50 per barrel in each subsequent year, Mexico will be unable to achieve the rates of GDP growth that it desires (4 and 5 percent in 1990-92) and, if it tries to achieve them while continuing to service its external debt in full, it will run out of international reserves before the end of 1990.

In order to achieve the desired growth rates while continuing to service the external debt in full and maintaining international reserves at a level equivalent to three months' of imports of goods and services, Mexico would need additional external resources, i.e., beyond what was in sight before October 1, 1988, totalling about $19 billion over the next four years, and presumably more in ensuing years, so long as its oil export price followed the path assumed above.

A more likely scenario, under the same oil price assumption, would combine a slower growth path with additional external financing totalling $12.4 billion in the next four years. In this scenario, the GDP growth rate is only 1 percent in 1989, and rises by one percentage point in each of the next three years. Additional external financing is envisaged of $600 million in 1988, $4.3 billion in 1989, $4,075 million in 1990, $2,150 million in 1991, and $1.3 billion in 1992.

This scenario probably does not involve sufficient growth to be politically acceptable in Mexico. On the other hand, the current account deficit peaks in 1989 at $2 billion and declines thereafter, giving way to small surpluses in 1991 and 1992. External debt service continues uninterrupted and international reserves, excluding gold, rise in line with imports of goods and services so as to maintain close to a three-month coverage.

An illustrative breakdown of the additional external financing (over and above what was already in sight on October 1, 1988) might consist of:

(a) additional disbursements from the World Bank of $600 million in 1989, $800 million in 1990, $500 million in 1991, and $400 million in 1992,

(b) recourse to the IMF in the amount of $600 million in 1988, $1.5 billion in 1989, $1 billion in each of the next two years, and $900 million in 1992,

(c) Paris Club reschedulings covering 100 percent of principal and interest falling due in the next three years ($1.2 billion in 1989, $875 million in 1990, and $650 million in 1991),

(d) foreign commercial bank loans of $600 million in 1989 and $1 billion in 1990, and

(e) additional loans by bilateral official creditors of $400 million in 1989 and $400 million in 1990 (over and above their "normal" financing of $1.2 billion a year).

If any of these amounts are beyond the capacity of the entities involved, the shortfall would have to be added to the amounts that other entities with greater lending capacity might provide. Alternatively, additional resources would permit faster growth.

If the oil price is assumed to average $2.50 per barrel more than in the base case (i.e., $13.50 in 1989, rising by $0.50 per barrel in each of the next four years), the additional foreign exchange earnings that Mexico would derive would total $1,250 million a year, or $5 billion over the period in question. This would allow imports to rise at a rate that would permit the GDP growth path to approach the 4-5 percent rate that Mexico desires to achieve in 1990-92. But Mexico would still need to obtain the $12.4 billion in additional external financing described above. Alternatively, the additional financing might be reduced, the GDP growth path remaining unchanged. Or these two possibilities might be combined in some suitable way.

A worst-case scenario assumes that the Mexican oil export price averages $9 per barrel throughout the next four years. In this case, the drain on reserves reappears, necessitating an even sharper slowdown in real GDP growth than in the base case, or an even larger amount of external financing, or some combination of the two.

TABLE 1 RESTRICTED

MEXICO: BASIC DATA

Population (mid-1986)	80.5 million	Population Growth (1979-86)	2.5%
GDP (1986)	$174 billion	GDP per capita (1986)	$2,160

GDP Origin (%)	1978	1986	Ratios to GDP (%)	1975	1986
Agriculture	10.2	9.9	Gross Dom. Savings	19.1	n.a.
Oil, Gas & Mining	2.7	3.7	Gross Dom. Investment	24.2	18.4
Manufacturing	24.8	24.3	Net Debt	25.1	53.6
Commerce	25.2	23.7	Imports (goods & services)	14.5	14.7
Other	37.1	38.4			

Export Composition (%)	1975	1986	Import Composition (%)	1975	1986
Agriculture & Fishing	26.9	12.1	Consumer Goods	6.8	7.4
Oil, Gas & Petrochemicals	13.3	36.4	Intermediate Goods	64.4	66.8
Metals & Minerals	12.4	4.7	Capital Goods	27.7	25.8
Manufactures	43.9	39.3			

Export Destination (%)	1975	1986	Import Origin (%)	1975	1986
U.S.	57	72	U.S.	62	72
EEC	9	12	EEC	17	15
Japan	4	6	Japan	5	7

Political Situation: Labor restless owing to erosion in real wages. Business criticizing excessive government spending, tight credit, and exchange rate freeze. Presidential and congressional elections held 7/6/88. Opposition made strong showing and claims voting irregularities. Govt. party will have slim majority in lower house. Next president takes office 12/1/88 for a six-year term.
Current IMF Relations: 18-month stand-by for SDR 1.4 billion approved 11/19/86 has been fully drawn. Final tranche required waiver. Latest consultation paper: 2/88.
Current Relations with Banks: Auction of Mexican bonds backed by U.S. Treasury zero-coupon bonds to retire some of public sector debt to banks at a discount held 2/26/88. About $3.7 billion in debt was retired at an average discount of about 30%. About $2.6 billion in new bonds was issued. Annual interest savings will be small.
Current Relations with Official Creditors: Since 7/86, IBRD has approved eight policy-based loans totaling $2.7 billion for trade liberalization, export promotion, industrial and agricultural credit system reforms, steel restructuring, and agricultural and fertilizer sector reforms. IDB approved $160 million agricultural credit loan 12/87.
International Competitiveness: Managed float achieved real depreciation of 44 percent between 6/85 and 3/87. Real appreciation of 25 percent in ensuing 12 months. Peso/dollar rate virtually unchanged for 10 weeks after 18 percent depreciation 12/14/87, then frozen since 3/1.
History of Debt Reschedulings: None before 8/82. In 8/82, principal payments of public sector debt to foreign banks rolled over for 90 days. Rollover stretched pending restructuring. $23.1 billion public sector debt restructured 8/83, 9/83, 10/83, 12/83, and 2/84. $11.6 billion unguaranteed private debts placed under government plans designed to promote restructuring. Paris Club restructuring of private debts to official creditors ($1.5 billion) agreed in principle 6/83, implemented beginning 3/84. Restructuring of $48.7 billion in public sector debts to banks due in 1985-90 agreed with Bank Advisory Committee 9/84. First phase of agreement signed 3/29/85. Second phase signed 8/29/85. New Paris Club rescheduling of debts to official creditors due from 9/22/86 to 3/31/88 and 60 percent of interest due up to 12/31/87 on such debts agreed 9/86. New restructuring of public sector debts to banks agreed 9/30/86 and signed 3/20/87 extends final maturity on $43.7 billion of such debts to 2006. Repayments begin in 1994. Agreement signed 8/14/87 extends same terms to private unguaranteed debts to banks covered by FICORCA.

October 25, 1988

TABLE 2a
MEXICO -- INTERNAL ECONOMIC INDICATORS
(Unless indicated, changes are from previous period)

	1983	1984	1985	1986	1987	1987 Q2	1987 Q3	1987 Q4	1988 Q1	1988 Q2	1988 Q3
Real GDP (% ch.) 1/	-5.3	3.7	2.7	-3.8	1.4	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Ind. Production (% ch.) 1/	-9.0	6.6	5.4	-4.9	4.1	0.0	8.4	11.7	5.2	1.2	n.a.
Wholesale Prices (% ch.) 2/	80.2	60.1	61.1	102.3	166.7	27.0	26.2	30.0	28.2	4.0	0.7
Consumer Prices (% ch.) 2/	80.8	59.2	63.7	105.7	159.2	25.4	24.6	34.2	31.5	7.2	3.2
Interest Rate 3/	52.3	47.7	71.2	99.2	121.8	91.6	89.9	121.8	91.8	40.4	42.2
Effective Annual Yield 3/	67.0	59.7	100.0	160.1	220.5	142.4	138.5	220.5	142.7	48.8	51.4
Money Stock (M1) (% ch.) 4/	41.5	62.4	53.5	72.5	129.7	99.6	122.4	129.7	140.2	137.7	n.a.
Public Sector Def./GDP (%) 5/	9.4	8.4	9.5	15.6	15.9	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

	1987 Sep.	1987 Oct.	1987 Nov.	1987 Dec.	1988 Jan.	1988 Feb.	1988 Mar.	1988 Apr.	1988 May	1988 June	1988 July	1988 Aug.	1988 Sep.
Ind. Production (% ch.) 1/	12.8	10.4	12.4	12.2	6.8	7.7	1.3	2.7	-1.2	2.2	n.a.	n.a.	n.a.
Wholesale Prices (% ch.) 2/	7.8	8.8	6.4	12.4	18.1	5.7	2.7	1.9	1.0	1.0	1.6	0.1	-1.0
Consumer Prices (% ch.) 2/	6.6	8.3	7.9	14.8	15.5	8.3	5.1	3.1	1.9	2.0	1.7	0.9	0.6
Annualized % change 6/	141.3	143.4	141.3	224.3	318.5	324.9	199.0	89.9	48.8	32.1	25.1	20.1	13.4
Interest Rate 3/	89.9	90.0	103.9	121.8	154.1	153.5	91.8	65.2	50.7	40.4	40.3	41.2	42.2
Effective Annual Yield 3/	138.5	138.8	171.8	220.5	329.1	326.6	142.7	88.8	64.4	48.8	48.6	50.0	51.4
Money Stock (M1) (% ch.) 4/	122.4	131.4	140.9	129.7	131.9	143.0	140.2	145.7	134.1	137.7	131.3	n.a.	n.a.

1/ Period average. Percent change from year earlier.
2/ Based on end of period data. Annual data are December over December; quarterly data are end-quarter over end of previous quarter.
3/ Rate for 28-day Treasury bills, based on daily quotations in the secondary market. Data are averages for each month and for the last month of each quarter and year.
4/ Including dollar denominated demand deposits. Percent change from year earlier, based on end of period data.
5/ Overall public sector borrowing requirement. Includes net lending to the private sector by the development banks and official trust funds.
6/ Percent change from three months earlier at an annual rate.

October 25, 1988

TABLE 2b
MEXICO -- EXTERNAL ECONOMIC INDICATORS
(Unless indicated, changes are from previous period)

	1983	1984	1985	1986	1987	1987 Q2	1987 Q3	1987 Q4	1988 Q1	1988 Q2	1988 Q3
Exchange Rate 1/	143.9	192.6	372.2	925.3	2204.0	1350.7	1567.1	2204.0	2273.0	2273.0	2273.0
(% change) 2/	49.2	33.8	93.3	148.6	138.2	20.3	16.0	40.6	3.1	0.0	0.0
Real Exch. Rate Index 3/	71.7	83.8	86.3	60.4	55.5	54.0	57.8	56.6	64.5	69.5	n.a.
(% change)	-12.1	16.9	3.0	-30.0	-8.1	3.6	7.0	-2.1	14.0	7.8	n.a.
Oil Exports ($B) 4/	16.0	16.6	14.8	6.3	8.6	2.2	2.3	2.0	1.8	1.8	n.a.
Exports f.o.b. ($B) 5/	23.1	25.4	22.9	17.3	22.2	5.7	5.6	5.7	5.8	6.0	n.a.
(% change)	4.5	10.0	-9.7	-24.4	28.3	10.9	-2.2	1.4	1.2	3.7	n.a.
Imports f.o.b. ($B)	8.6	11.3	13.2	11.4	12.2	2.9	3.3	3.5	3.7	4.6	n.a.
(% change)	-40.4	30.9	17.3	-13.5	6.9	16.1	13.5	5.4	7.2	22.7	n.a.
Trade Balance ($B) 5/	14.5	14.1	9.7	5.9	10.0	2.8	2.3	2.2	2.0	1.4	n.a.
Current Account ($B)	5.4	4.2	1.2	-1.7	3.9	1.5	0.5	0.6	0.5	-0.3	n.a.
Total Reserves excl. gold ($B)	3.9	7.3	4.9	5.7	12.5	12.6	13.3	12.5	14.5	n.a.	n.a.

	1987 Sep.	1987 Oct.	1987 Nov.	1987 Dec.	1988 Jan.	1988 Feb.	1988 Mar.	1988 Apr.	1988 May	1988 June	1988 July	1988 Aug.	1988 Sep.
Exchange Rate 1/	1567.1	1638.2	1758.2	2204.0	2213.0	2273.0	2273.0	2273.0	2273.0	2273.0	2273.0	2273.0	2273.0
(% change) 2/	5.2	4.5	7.3	25.4	0.4	2.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Oil Exports ($M) 4/	744	747	673	610	628	565	608	602	659	570	572	582	n.a.
Exports f.o.b. ($M) 5/	1,887	1,963	1,833	1,899	1,811	1,915	2,036	1,948	2,057	1,969	1,850	2,000	n.a.
Imports f.o.b. ($M)	1,095	1,206	1,150	1,132	1,117	1,200	1,420	1,398	1,554	1,632	1,596	1,826	n.a.
Trade Balance ($M) 5/	792	757	684	767	694	716	616	550	503	337	255	174	n.a.
Current Account ($M)	208	224	124	248	139	193	173	15	-73	- 275	n.a.	n.a.	n.a.
Total Reserves excl. gold ($B)	13.31	13.16	12.93	12.46	12.31	12.54	14.52	14.88	14.27	n.a.	n.a.	n.a.	n.a.

1/ Pesos per dollar at end of period shown. Since 1982, quotations are for the "controlled rate".
2/ Based on end of period data. Monthly change at monthly rate; Quarterly change at quarterly rate.
3/ Index: 1980=100, from IMF "Indicators of Real Effective Exchange Rates". Annual data are averages for years shown; quarterly data are averages for the last month of each quarter.
4/ Crude oil, refined products, natural gas and petro-chemicals.
5/ Including exports of silver and value added by in-bond assembly plants.

October 25, 1988

TABLE 3
MEXICO -- EXTERNAL DEBT
(in billions of dollars)

	1981	1982	1983	1984	1985	1986	1987e	1988p
GROSS EXTERNAL DEBT	78.3	87.7	93.7	96.6	97.4	101.4	104.0	97.4
Long Term (incl. IMF)	53.3	61.6	83.6	90.2	92.0	94.8		
Public and guaranteed	43.1	51.6	66.8	70.1	72.2	75.0		
of which from:								
Official sources	5.4	7.0	6.7	7.5	8.6	10.7		
Financial institutions 1/	37.5	44.5	59.7	62.5	63.4	64.0		
Private Unguaranteed	10.2	9.7	15.6	17.7	16.8	15.8		
IMF Credit	0.0	0.2	1.3	2.4	3.0	4.1	5.1	
Short-term (e)	25.0	26.1	10.1	6.4	5.4	6.6		
(Arrears)	0.0	3.5	0.5	0.0	0.0	0.0	0.0	
EXTERNAL ASSETS	5.1	2.4	6.4	9.6	7.4	8.2	15.7	10.2
Bank of Mexico (excl. gold)	4.1	0.8	3.9	7.3	4.9	5.7	12.5	7.8
Commercial Banks	1.0	1.4	2.2	1.9	2.1	2.0	2.8	2.0
Development Banks	0.0	0.2	0.3	0.4	0.4	0.5	0.4	0.4
(Gold in millions of ounces)	2.3	2.1	2.3	2.4	2.4	2.6	2.5	
NET EXTERNAL DEBT	73.2	85.2	87.3	87.0	90.0	93.3	88.3	87.2
TOTAL DEBT SERVICE (e)	14.0	16.8	14.9	17.4	15.7	13.0	15.0	15.7
Amortization (e) 2/	4.5	4.6	4.8	5.7	5.5	4.7	6.8	7.0
Public long-term	3.7	3.3	4.8	3.9	3.5	2.7		
Private long-term	0.8	1.3	0.0	1.8	2.0	2.0		
Interest	9.5	12.2	10.1	11.7	10.2	8.3	8.1	9.0
Public long-term and IMF	4.8	6.2	6.6	8.6	7.5	6.2		
Private long-term (e)	1.3	1.6	1.5	2.2	2.0	1.5		
Short-term (e)	3.4	4.4	2.0	0.9	0.7	0.6		
MEMORANDUM ITEMS								
Net Debt/GDP (%)	48.4	53.9	56.2	52.2	50.8	53.6	48.7	46.4
Net Debt/Exp. (%) 3/	240.8	298.1	305.2	267.8	302.6	393.7	296.7	286.7
Debt Service/Exp. (%) 3/	46.1	58.7	52.1	53.5	52.8	54.9	50.3	51.5
Interest/Exp. (%) 3/	31.3	42.7	35.3	36.0	34.3	35.0	27.3	28.6
Bank Claims (quarterly):								
All Banks 4/	55.5	59.0	72.0	72.3	74.5	74.2	74.4	71.8
Net, All Banks 4/	43.3	48.1	53.9	50.6	52.7	51.3	45.7	41.8
U.S. Banks 5/	21.5	24.4	26.3	26.5	24.9	23.7	22.7	20.3
U.S. Banks Exposure 5/	21.8	24.3	25.4	25.8	24.4	23.5	22.4	19.9
Bank Claims (semi-annual):								
All Banks 4/	56.9	62.9	69.3	70.7	71.7	70.9	69.9	
(Maturing in 1 year)	27.7	29.9	29.4	17.0	20.3	16.5	15.7	

1/ Includes bonds outstanding totalling $3.7 billion in 1981, $4.1 billion in 1982, $3.8 billion in 1983, $3.3 billion in 1984, $3.1 billion in 1985, and $2.7 billion in 1986.
2/ Data for 1986 and subsequent years exclude debts paid through debt-equity swaps and under debt buy-back arrangements.
3/ Exports of goods and services.
4/ All BIS-reporting banks. Due to a change in BIS reporting, data for 1983 and subsequent years are not comparable with those for earlier years. Quarterly data are for March 1988; semi-annual data are for December 1987.
5/ Data for 1988 are for June.

October 25, 1988

TABLE 4
MEXICO -- BALANCE OF PAYMENTS
(in billions of dollars)

	1980	1981	1982	1983	1984	1985	1986	1987e	1988p	1989p
CURRENT ACCOUNT	-7.7	-13.9	-7.0	5.4	4.2	1.2	-1.7	3.9	-1.7	-2.0
Trade Balance	-1.7	-3.1	7.7	14.5	14.1	9.7	5.9	10.0	4.9	5.6
Exports (f.o.b.) 1/	16.9	20.9	22.1	23.1	25.4	22.9	17.3	22.2	22.0	23.4
Oil and Products 2/	10.4	14.6	16.5	16.0	16.6	14.8	6.3	8.6	6.5	5.9
Other	6.5	6.3	5.6	7.1	8.8	8.2	11.0	13.6	15.6	17.5
Imports (f.o.b.)	-18.6	-24.0	-14.4	-8.6	-11.3	-13.2	-11.4	-12.2	-17.1	-17.8
Services (net)	-6.3	-11.1	-15.0	-9.4	-10.3	-9.5	-8.0	-6.8	-7.3	-8.4
Receipts	7.7	9.5	6.5	5.5	7.1	6.8	6.4	7.5	8.4	9.5
Payments	-14.0	-20.6	-21.5	-14.9	-17.4	-16.3	-14.4	-14.3	-15.7	-17.8
(Interest on Debt)	-6.2	-9.5	-12.2	-10.1	-11.7	-10.2	-8.3	-8.1	-9.0	-10.8
Transfers (net)	0.3	0.3	0.3	0.3	0.4	1.0	0.5	0.7	0.7	0.7
CAPITAL ACCOUNT	12.4	23.2	6.8	-1.3	0.0	-1.5	1.8	1.2		
Long-term (net)	7.3	13.0	8.4	-3.2	-2.3	-10.3	1.1	4.4		
Direct Investment 3/	1.8	2.5	1.7	0.5	0.4	0.5	1.5	3.3	2.6	2.0
Other Long-term 4/	5.5	10.5	6.7	-3.7	-2.7	-10.8	-0.4	1.1		
Short-term (net) 4/	5.1	10.2	-8.4	-8.4	-3.6	-1.8	0.7	-3.2		
Debt Refinancing 5/	0.0	0.0	6.8	10.3	5.9	10.6	0.0	0.0		
ERRORS AND OMISSIONS	-3.8	-8.2	-3.1	-1.0	-0.9	-2.1	0.4	0.8		
RESERVES AND RELATED ITEMS	-0.9	-1.1	3.3	-3.1	-3.3	2.4	-0.6	-5.9		
Gold Valuation Adjustment	-0.1	-0.1	0.1	0.0	-0.1	0.1	0.4	1.0		
SDR Allocation	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0		
Change in net reserves	-0.9	-1.1	3.2	-3.1	-3.2	2.3	-1.0	-6.9		
MEMORANDUM ITEMS:										
Net Interest Paid	4.5	7.0	10.9	9.2	9.6	8.3	6.9	6.3	6.7	8.0
Reserves/Average Monthly Imports 6/	1.1	1.1	0.3	2.0	3.0	2.0	2.6	5.6	2.9	
Current Account/GDP (%)	-6.0	-9.2	-4.4	3.5	2.5	0.7	-1.0	2.1	-0.9	-1.0
Current Acc't/Exp. (%) 6/	-31.3	-45.9	-24.6	18.9	13.0	4.2	-7.0	13.1	-5.5	-6.2
Oil Export Price ($/bbl.)	31.1	33.2	28.7	26.8	27.0	25.5	11.8	16.0	12.0	11.0

1/ Includes non-monetary gold and silver, and value added by in-bond assembly industries.
2/ Includes natural gas and petrochemicals.
3/ Includes undistributed earnings of foreign subsidiaries operating in Mexico.
From 1986, includes debt-equity swaps.
4/ Data for 1982-85 includes payment of debts that were in fact restructured.
5/ Data for 1982 includes past due interest accrued, estimated at $1.5 billion.
6/ Of goods and services.

October 25, 1988

September 16, 1988

Bank Claims on Mexico
(billions of dollars)

I. All BIS Banks (from BIS semiannual "Maturity Survey"), December 1987

	All banks	U.S.[1] banks	Non-U.S. banks
A. Total claims	69.9	24.5	45.4
B. Claims due in one year or less	15.7	6.5	9.2

II. U.S. Banks (from U.S. quarterly "Country Exposure Lending Survey"), March 1988

Note: 139 banks reported exposure to Mexico in March 1988

	All U.S. banks	Nine largest	Next thirteen	All other
A. Total claims	21.7	12.9	4.1	4.7
(as percent of total capital)	(16.6%)	(25.7%)	(17.5%)	(8.5%)
B. Claims due in one year or less	5.3	3.2	1.0	1.2
C. Total exposure	21.2	12.8	4.1	4.3
of which: claims on nonresident offices of banks chartered in the country concerned	1.0	0.5	0.3	0.3

III. Update on Total Claims (from other quarterly data)[2]

	June 1987	Sept. 1987	Dec. 1987	Mar. 1988	June 1988
A. All BIS banks	76.1	74.3	74.0	71.8	n.a.
B. U.S. banks	25.3	24.7	23.6	22.5	21.1

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[1] Excluding U.S. subsidiaries of foreign banks.

[2] Source: A) BIS Quarterly series; B) Claims on Foreign Countries Held by U.S. Offices and Foreign Branches of U.S.-Chartered Banks. For all BIS banks, coverage of the quarterly series was expanded in December 1983 and now exceeds that of the semiannual series. For U.S. banks, the quarterly series shown here differs from the Country Exposure Lending Survey as follows: a) the panel of reporting banks is different; b) the quarterly series shown here does not cover majority-owned foreign subsidiaries of U.S. banks; c) the quarterly series shown here includes local-currency claims on local borrowers. Note that the BIS quarterly data does not net intra-bank claims and liabilities as does the U.S. quarterly series shown here.

Yves Maroni
November 3, 1988

Supplement to October 25, 1988, Note Assessing the Mexican Economic Situation and Prospects

Since the October 25 note was prepared, the following additional information has become available.

Economic Activity

In July, the seasonally adjusted index of industrial production was 3 percent lower than in June and, apart for May, was lower than at any time in 14 months. Over the first seven months of 1988, industrial production, seasonally adjusted, was still nearly 3 percent higher than in the same period of 1987, but this reflects the relatively depressed level of activity in the early months of 1987.

Oil Exports

In September, the volume of crude oil exported by Mexico was about 25 percent lower than in August, mainly because of the disruptions caused by Hurricane Gilbert. The average price of the September exports was $11.23 per barrel, compared with $12.36 in August. As a result, the value of crude oil exported in September was only $339 million, a third less than in August.

In October, the volume presumably recovered, but the average price was probably lower than in September. The average price was $9.60 per barrel in the first half of the month. If it was $10.25 per barrel for the month as a whole, the value of crude oil exported in October will have been about $425 million, 17 percent less than in August.

Interest Rates

Since the auction of October 18, the rate on 28-day Treasury bills has increased by 12 basis points. At the auction of November 1, it stood at 45.64 percent. At this auction, and at the previous week's auction as well, a small amount of one-year notes was also sold. At both auctions, the authorities raised about 10 percent more than the amount of maturing securities. Secondary market rates for Treasury bills are tracking fractionally lower than the primary auction rate.

28-day bankers' acceptances issued November 3 carried interest rates ranging from 47.64 to 48.16 percent.

Monetary Aggregates

At the end of August, the narrowly defined money supply was about 105 percent higher than a year earlier. This was the lowest 12-month rate of increase in 13 months. It compares with a 107 percent increase in the CPI in the 12 months ending in August. In real terms, the narrow money supply was about 1.6 percent lower in August 1988 than a year earlier.

Privatization

On November 1, Nacional Financiera, the state development bank, announced that it had accepted an offer of $1.36 billion in Mexican external public debt paper for its interest in Compania Mexicana del Cobre, a large copper firm, and in a subsidiary producing sulphuric acid. The winning bid was submitted by a syndicate headed by a mining magnate (Jorge Larrea, who, at one time, owned stock in the company and was its director general). The syndicate includes an industrial development company that Larrea controls and the national miners union. The syndicate is reported to have financial backing from Morgan Guaranty.

The syndicate will acquire the external debt paper in an unspecified manner, presumably at a discount. The size of the discount is not known, but is likely to be smaller than currently prevails in the secondary market for Mexican external debt paper. (In recent months, large prepayments of Mexican private sector external debt have taken place at discounts reported to have been in the 30-40 percent range.) If the discount amounts to 35 percent, and if all of the funds needed to buy the external debt paper are newly borrowed abroad, the transaction will result in the substitution of $880 million of private external debt for $1.36 billion in public external debt, and the total Mexican external debt will have been reduced by about $480 million. If the syndicate uses funds it already holds abroad in acquiring the external debt paper, the reduction in the total external debt will be correspondingly larger.

The privatization of Compania Mexicana del Cobre is the largest sale concluded under this program. It is about as large as the combined amount of privatizations carried out since the program began nearly six years ago. In its statement disclosing it, Nacional Financiera also said that it would announce on November 7 its decision regarding the sale of its interest in another copper firm, Compania Minera Cananea, for which it has set a minimum price of $910 million.

The note of October 25 stated (p.15) that the sale of Mexicana airline was announced on October 24. In fact, it was another state-owned airline, Aerovias de Mexico, formerly known as Aero Mexico, that was sold. The announced sale price was 770 billion pesos ($340 million). It was bought by a group of Mexican investors who will control at least 65 percent of the capital. The airline pilots union has what appears to be an option for up to the remaining 35 percent. The details are to be worked out by the end of November. Payment "in cash" must be made by November 25. The source of the financing is not known. The sale of Mexicana airline is still pending.