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OF THE
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STRICTLY CONFIDENTIAL
CLASS II - FOMC

TO: Federal Open Market Committee **DATE:** July 26, 1989

FROM: Normand Bernard N.B.

FOR INFORMATION

Attached are a note from Mr. Truman regarding prospective FOMC participation in financing arrangements for Mexico and a memorandum from Mr. Maroni regarding Mexico's economic and financial situation.

Attachments

July 25, 1989

TO: Federal Open Market Committee

Subject: Mexico

FROM: Edwin M. Truman EMT

STRICTLY CONFIDENTIAL (FR)
Class II - FOMC

In connection with the agreement that was reached between Mexico and its bank advisory committee on Sunday evening on the main points of a financing package to support Mexico's economic reform and recovery program, the U.S. Treasury and the Federal Reserve agreed to work with other monetary authorities to develop short-term bridge financing of up to $2 billion to support Mexico.

Once all the details have been worked out, the Federal Open Market Committee will be asked to approve the Federal Reserve's participation through a swap arrangement in this bridge financing. It is expected that the combined U.S. share of the $2 billion facility will be $1.25 billion; however, $500 million of that amount would be effectively "locked up" in a non-transferable U.S. Treasury certificate of indebtedness. Staff are in the process of working out the precise details of the proposed arrangement, including the shares of the Treasury and Federal Reserve in it.

Attached is a paper on Mexico's economic and financial situation that was prepared by Yves Maroni of the Board staff as background for the Committee.

Attachment

Yves Maroni
July 25, 1989

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 were frozen beginning in mid-December 1987, and the peso/dollar exchange rate and minimum wages were frozen beginning in March 1988. The social pact was modified somewhat, effective January 1, 1989, to provide for the resumption of daily devaluations of the peso and to authorize increases in minimum wages and in many administered prices. As revised on January 1, the social pact was to have expired on July 31, 1989, but, on June 18, it was extended to March 31, 1990.

In 1989, daily devaluations of the peso under the pact are averaging 1 peso per day. Minimum wages were raised by 8 percent on January 1 and by a further 6 percent on July 1. The increases in many, but not all, administered prices on January 1 were mainly in the 30-40 percent range, and were comparable to the increase in producer prices in the previous 12 months (37.3 percent), but less than the increase in the CPI in the previous 12 months (51.7 percent). Under the pact, business is committed to absorb the impact of cost increases.

In 1988, the program brought about a rapid deceleration of recorded inflation and sharply lower nominal interest rates. However, real interest rates remained in excess of 3 percent per month on an ex post basis, real GDP growth slowed, the peso appreciated in real terms, the current account shifted from a $4 billion surplus in 1987 to a deficit of $2.9 billion in 1988, and international reserves, excluding gold, declined by $9.6 billion in the last eight months of the year. The reserve drain reflected concern over the viability of the exchange rate, large prepayments of private sector external debt at a discount, and policy uncertainties arising from last year's transition to a new administration.

In the first half of 1989, the monthly rate of inflation fluctuated narrowly and averaged about 1.5 percent, equivalent to about 20 percent at an annual rate. Ex post, real interest rates remained very high, although they have been declining this month. Economic activity is rising, especially in manufacturing. The current account deficit was about $1.3 billion in January-April, but the deficit for the year as a whole is likely to be just under $2.3 billion, about $650 million less than in 1988, as an increase in payments for imports and interest on the external debt is more than offset by an increase in export earnings, mainly attributable to continued strength in world oil prices. The drain on international reserves was temporarily halted early in the year after the new policies were announced, but it resumed on a moderate scale in March. Foreign exchange reserves may be as low as $4 billion, even after some replenishment from gold sales.

The 1989 budget aims to cut the overall fiscal deficit to about 7 percent of GDP from 12.3 percent in 1988, mainly through a decline in nominal interest rates that lower inflation would make possible. The failure of nominal interest rates to decline until the most recent weeks has placed achievement of this target in some jeopardy, although the strength of world oil prices is yielding higher-than-expected fiscal revenues and, if sustained until year-end, may well help to achieve the overall fiscal target. However, even if the 1989 fiscal deficit target is reached, a further reduction will be necessary to ensure that the recent low inflation rate can be sustained without the help of a social pact.

A six-year plan calling for a fiscal deficit of 3-4 percent of GDP was issued in May. The plan also calls for a real GDP growth rate of 6 percent by the end of the period. The government is proposing to maintain its anti-inflation stance and at the same time to intensify the restructuring of the economy. Steps to accelerate the privatization of public sector enterprises have been taken. A reform of the financial sector has been initiated. New rules to encourage foreign direct investment were announced in May.

The government has made a reduction of its external debt service payments a key element of its strategy to achieve the desired increase in the rate of real GDP growth. In negotiations concluded on July 23, 1989, Mexico and its Bank Advisory Committee reached an agreement in principle on a comprehensive financing package that includes provisions for principal reduction, interest reduction, and new money options.

On May 26, the government obtained IMF approval of an Extended Fund Facility (EFF) program and a Compensatory and Contingency Financing Facility (CCFF) drawing. A three-year Paris Club rescheduling was agreed May 30. Four World Bank loans totalling $1.96 billion were approved in June. A portion of the funds made available by the IMF and the World Bank, supplemented by funds from the Japanese government and some of Mexico's own resources, will be available to support debt reduction and debt service reduction operations. The total expected from all sources for these operations is $7 billion.

The outlook for the Mexican economy depends importantly on what happens to oil prices. However, even if they remain close to present levels in real terms, the Mexican government may have to devalue the peso modestly, and will need to build on the record of fiscal restraint compiled by the last administration and to continue the restructuring of the economy, if sustainable growth of 4-5 percent per year is to be achieved and the external accounts are to remain in reasonable balance. Continued external financing will also be required. Given all that Mexico has been through over the past seven years, this will be difficult but not impossible.

Economic Activity

In 1988, Mexico's real GDP rose 1.1 percent and industrial production by 2.1 percent. This compares with a real GDP growth of 1.5 percent and an increase of 4.1 percent in industrial production in 1987. In the first quarter of 1989, real GDP was 1.8 percent higher than a year earlier. Industrial production in January-April was about 3.1 percent higher than a year earlier. The government forecasts a 1.5 percent increase in real GDP this year.

In 1988, Mexico's real GDP and industrial production index were essentially at their 1981 levels.

Price and Wage Policy

Public sector prices and private sector prices that are subject to price control were frozen between mid-December 1987 and the end of 1988. On January 1, 1989, many, but not all, of the previously frozen prices were increased by 30-40 percent. These increases were comparable to the increase in producer prices in the previous 12 months (37.3 percent), but less than the 12-month increase in the CPI (51.7 percent). Among the items whose prices were not increased are gasoline, electricity for residential consumption, and public transportation.

Minimum wages (the minimum wage is not uniform throughout the country) were frozen from March 1, 1988, to the end of the year. They were raised by 8 percent on January 1, 1989, and by a further 6 percent on July 1. In combination, these two increases amount to 14.5 percent. This is slightly less than the 12-month rate of increase in the CPI, which amounted to 17.6 percent in June. In real terms, minimum wages are estimated to have declined by more than 40 percent in the past seven years.

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 government's commitments regarding the exchange rate, public sector prices, and controlled private sector prices. 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 are very powerful and are able to obtain larger wage increases than non-unionized workers, whose wages are often a function of the minimum wage in their region.

There have been few instances of shortages caused by the price rigidities inherent in the social pact. In June 1988, 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, these shortages appear to have been overcome, partly through increased imports, and there have been no new reports of scarcities in recent months.

In 1988, the monthly rate of increase in the CPI declined almost without interruption from its peak of 15.5 percent in January 1988 until, in September, it reached 0.6 percent, the lowest monthly rate recorded in 12 years. Since then, the monthly rate of increase has fluctuated narrowly, averaging 1.5 percent in the first half of 1989. This is equivalent to about 20 percent at an annual rate. A fractionally lower monthly rate of increase in the CPI is possible in the second half. If it materializes, the government's forecast of an 18 percent inflation rate for the year as a whole may be realized.

The CPI's 17.6 percent 12-month rate of increase in June, compares with a 12-month rate of increase of 180 percent in February 1988. The Mexican authorities hope that, within two to three years, this rate can be reduced to levels comparable with those of the major industrial countries that are Mexico's principal trading partners.

Exchange Rate and Trade Policies

The peso-dollar exchange rate was frozen from March 1, 1988, to the end of the year, after being almost unchanged during the previous 10 weeks. But, in 1988, the Mexican CPI increased by about 51 percent. As a result, in these 12 months, the peso appreciated in real terms against the dollar by about 29 percent, when the calculation is based on relative consumer prices. Moreover, in 1988, the dollar appreciated against the G-10 currencies by about 3.7 percent. This implies that the peso's overall real appreciation was even larger. Indeed, the IMF index of

Mexico's real effective exchange rate was 29.7 percent higher in December 1988 than a year earlier.

In part at least, the loss of competitiveness that the peso's real appreciation implies was mitigated for export industries to the extent that the trade liberalization measures put into effect in December 1987 lowered 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 in December 1987, 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 probably disappeared in the latter months of 1988, especially since oil prices weakened markedly during the year. 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 remained. Nevertheless, the real appreciation appears to have adversely affected trade flows and capital movements.

With the resumption of the daily peso devaluations on January 1, 1989, the real appreciation of the peso against the dollar stopped. Indeed, as increases in the Mexican CPI remained relatively low, a slight real depreciation began. It amounted to about 1.7 percent against the dollar in the first half of the year. At an annual rate, the 1-peso-per-day devaluations will increase the peso price of the dollar by about 16 percent by the end of the year. If U.S. inflation is 5 percent, and if Mexico's CPI increases by 18 percent, the peso will, in fact, depreciate in real terms against the dollar by slightly more than 3 percent.

If world oil prices remain as firm as they have been in recent months, Mexico may need only a modest one-time devaluation (about 5 percent) to restore confidence in the viability of its exchange rate policy. It is even possible that, with a comprehensive debt settlement with the banks, providing a substantial measure of debt reduction and debt service reduction as well as new money, there might be a large enough increase in market confidence to obviate the immediate need for any one-time devaluation.

In the recently approved IMF program, the Mexican authorities recognized the importance of an "appropriate" exchange rate policy, noted that the daily peso crawl initiated this year, was adopted "with a view to maintaining the level of external competitiveness," and committed themselves to manage exchange rate policy "so as to be consistent with the attainment of the balance of payments and inflation objectives of the program, also taking into account the behavior of international reserves, the trade balance, and the real effective exchange rate."

Trade and Current Account Performance

In 1988, the trade surplus shrank to $4.1 billion from $10 billion in 1987. For the first time since March 1982, a monthly trade deficit was recorded in September. For the year as a whole, imports were 55 percent higher than in 1987, while exports were only 3 percent higher. Non-petroleum exports were about 20 percent higher, but oil exports were 22 percent lower. External interest payments increased by about $800 million. A $2.9 billion current account deficit resulted, after a $4 billion surplus in 1987.

The surge in imports in 1988 resulted mainly from the trade liberalization measures introduced at the end of 1987 as part of the strategy of opening the Mexican economy. It was also stimulated by the real appreciation of the peso during the year. Additionally, it reflected the price and quantity effects of last year's drought.

The greater part of Mexico's imports consists of intermediate goods. In 1988, they accounted for about 69 percent of the total, capital goods for only 21 percent, and consumer goods for 10 percent. The rise in imports 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 62 percent of the rise, capital goods for 21 percent, and consumer goods for only 17 percent. The private sector accounted for about 81 percent of Mexico's 1988 imports, 4 percentage points more than in 1987. In dollar terms, the private sector absorbed more than 88 percent of the increase in imports in 1988.

The increase in <u>non-oil exports</u> recorded in 1988 (20 percent) was smaller than the year-earlier increase (24 percent). Indeed, it would have been even smaller if there had not been a 48 percent increase in the earnings from the in-bond assembly plants that operate near the U.S. border. When this group is excluded, the 1988 increase in the remaining non-oil exports was only 16 percent. Manufactured goods exports increased by 17 percent last year, down from 39 percent in 1987. Mining exports increased by 14.6 percent in 1988, up slightly from 13 percent in 1987. Agricultural exports were 8.3 percent higher last year, partially retracing a 24 percent decline in 1987.

Since 1981, the growth of non-oil exports and, in particular, of exports of manufactured goods, has been dramatic. Non-oil exports have tripled in dollar terms between 1981 and 1988. They accounted for less than 29 percent of total exports in 1981, but for over 70 percent of the 1988 total. Manufactured goods have increased more than four-fold in this period. They were only 13 percent of total exports in 1981, and only 46 percent of non-oil exports, but, in 1988, they accounted for more than 71 percent of non-oil exports and for 50.5 percent of total exports. In contrast, the share of exports of mining and agricultural products has remained virtually unchanged in this period.

Between 1981 and 1988, earnings from petroleum exports declined by 54 percent and their share of total exports fell from over 71 percent to less than 30 percent. The volume of crude oil exported in 1988 was about 20 percent larger than in 1981, but the average price was only $12.16 per barrel in 1988 compared with about $33 per barrel in 1981. The average price realized in 1988 was nearly $3 less than projected by the Mexican authorities at the beginning of the year, and nearly $4 less than the average 1987 price. Since, over a full year, oil export earnings change by about $500 million for every $1 change in the average oil export price, Mexico earned from crude oil in 1988 about $1.5 billion less than it had projected and $2 billion less than in 1987.

In the first four months of 1989, import payments appeared to level off at about their peak levels of the last four months of 1988. At this level, they were still about 40 percent higher than a year ago. Export earnings have been bolstered by firmness in oil export prices and by continued strength in earnings of the in-bond plants. But exports of manufactured goods in these four months were only 8.5 percent higher than in the same period of 1988. At an annual rate, the trade surplus in January-April was about $3.5 billion.

For 1989 as a whole, imports may be expected to be 10 percent (nearly $2 billion) higher than in 1988. External interest payments are likely to be about $1 billion higher, mainly because they are based on interest rates prevailing three to six months earlier, and world interest rates rose in the last half of 1988 and the first half of 1989. However, petroleum export earnings may well be $1.4 billion higher than in 1988, assuming that the price of Mexican oil averages $15 per barrel. (In the first five months of the year, the average oil export price was more than $15.50 per barrel.) It may also be estimated that non-oil exports are likely to be about $2 billion higher than in 1988, mainly because of the booming earnings of the in-bond assembly plants.

As a result, a current account deficit of under $2.3 billion is likely in 1989. The IMF estimate of the current account deficit is $4.8 billion. However, the IMF assumes an average oil export price of $12 per barrel, rather than $15, and an interest rate of 10.5 percent, rather than 10 percent, on the external debt. The IMF also projects lower net receipts from other services and transfers than would seem to be likely.

Capital Movements

In the first quarter of 1988, 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, the 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, 1988, 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. The outflow was fueled in the last few months of the year by the uncertainties regarding the future course of economic policy under the new administration that was to take office on December 1.

After President Salinas was inaugurated and the guidelines of the new economic policy became known, the capital outflow ceased for a time, and there was even a modest capital inflow in January and February 1989. But, capital outflows resumed in March, as speculation increased regarding the prospect of a major devaluation when the social pact expired -- then scheduled for the end of July -- and as news reports on the debt negotiations with commercial banks revealed a wide gap between the positions of the parties.

A significant part of the capital outflow in 1988 appears to have taken the form of prepayments of private sector debts at substantial discounts. These prepayments appear to have begun on a large scale around mid-1987, when negotiations for the refinancing of private sector debts registered under the FICORCA plan were nearing a conclusion. The refinancing agreement, which was signed in August 1987, provided for a 20-year repayment term, including 7 years of grace, and many creditors chose to offer substantial discounts to debtors who would prepay these debts, rather than waiting for such an extended period. The Bank of Mexico estimates that about $6.2 billion in such debts were prepaid in late 1987 and in 1988. While private sector debt prepayments may be continuing in 1989, they are likely to be on a greatly reduced scale, as much of the remaining private sector debt appears to be owed by debtors lacking the needed capacity to make even the discounted payments or who have exhausted it.

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 1988, 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 1988, reserves excluding gold were about $5.3 billion, $9.6 billion less than the late April peak. Reserves rose by about $350 million in January and February 1989, but then turned down again. At present, reserves excluding gold may be as low as $4 billion even after some replenishment from gold sales. This would be equivalent to only about 5 weeks of imports of goods and services at their projected 1989 rate.

At the end of 1988, Mexico held more than 2.5 million ounces of gold. After the sales mentioned above, the remaining holdings are worth about $500 million at recent market prices.

Fiscal Policy and Budgetary Performance

Since 1982, Mexico has sharply curtailed the growth of public sector expenditures. In 1988, these expenditures represented about 7 percent less, in relation to the country's GDP, than they did in 1982. The growth of expenditures for purposes other than to pay interest on the public debt has been even more drastically curtailed: in 1988, these expenditures accounted for nearly 15 percent less, in relation to GDP, than they did in 1982. On the other hand, interest payments have surged by 8 percent in relation to GDP, and accounted for nearly 17 percent of GDP in 1988 -- 13 percent for payments on the domestic debt, 4 percent for external interest payments.

At the same time, Mexico has suffered a loss of public sector revenues equivalent to more than 1 percent in relation to GDP since 1982. This is more than accounted for by the collapse of oil prices, which has reduced public sector revenues by the equivalent of about 3 percent in relation to GDP.

As a result, the overall public sector deficit declined from nearly 17 percent of GDP in 1982 to about 12.3 percent in 1988. The "primary" balance, which excludes interest payments on the public debt, has shifted from a deficit of 5 percent of GDP in 1982 to a surplus of about 6 percent of GDP in 1988. The "operational" deficit, which excludes the inflationary component of interest payments on the peso denominated debt, declined from 7.1 percent of GDP in 1982 to 4.4 percent in 1988.

The strengthened anti-inflation program adopted in December 1987 aimed to raise the primary surplus 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 about 16 percent in 1987. It aimed also to eliminate the operational deficit. However, as the results for 1988 cited in the previous paragraph indicate, there was some slippage, reflecting in part a shortfall in public sector revenues and in part higher-than-expected expenditures in some areas of the budget.

The shortfall in public sector revenues mainly resulted from the decline in oil export prices, the exchange rate freeze, 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 prepared on the assumption that the oil export price per barrel would average $15 in 1988. Since it averaged slightly more than $12, a shortfall in revenues of 0.9 percent of GDP resulted. 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 was frozen, so that an additional shortfall of perhaps 1.5 percent of GDP resulted from the lower conversion rate.

On the expenditure side, there were deviations from the budget by some of the public entities, notably PEMEX and the government of the Federal District, which exceeded their allotments. A significant deviation related to large wage and salary increases granted by PEMEX in April 1988. In addition, in June and July 1988, 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.

On the other hand, the freeze extension throughout 1988 kept public sector wage costs below original projections. While this provided a partial offset to the revenue shortfall, the authorities were forced to trim expenditures in other ways in an attempt to reach the 1988 primary surplus and overall deficit targets in peso terms. Over the course of the year, expenditure cuts equivalent to 3.2 percent of the estimated 1988 GDP were announced.

The 1989 fiscal plans aim to lower the overall deficit to 7 percent of GDP from 12.3 percent in 1988, to raise the primary surplus to 7.6 percent of GDP, and to lower the operational deficit to 2.5 percent of GDP. Some improvement is expected from increased tax revenues, including the imposition of a 10 percent import duty on many goods that formerly were admitted duty free or at a 5 percent rate, and increased efficiency in public sector firms, but the reduction in the overall deficit reflects mainly reduced domestic debt service, as a result of a decline in domestic interest rates that lower inflation would make possible.

In the first quarter, fiscal performance was better than expected. In real terms, the overall deficit was 62 percent lower than in the same period of 1988, the primary surplus was about 4 percent higher, tax collections (excluding petroleum receipts) were 11 percent higher, Federal government programmable expenditures (i.e., subject to discretionary control) were more than 15 percent lower, and the programmable expenditures of the public enterprises were about unchanged.

For the most part, the first-quarter results were also better than projected in the original budget. This was especially true of tax collections, petroleum receipts, the Federal government programmable expenditures, and the primary surplus. However, interest payments were higher than budgeted, and the operational deficit was higher than expected, owing to the continuing high real interest rates.

The outlook for the year as a whole will depend largely on the future course of domestic interest rates and of oil prices. Domestic interest rates rose sharply during the second quarter instead of falling, and, while they began to decline in July, it is unlikely that, over the year as a whole, they will be as low as seems to be assumed. On the other hand, public sector revenues may exceed expectations if the recent firmness in oil prices is prolonged.

Even if the 1989 goal for the overall deficit is exceeded, it is not likely to be by more than about 1 percent of GDP. This would still represent substantial progress. However, because real interest rates on the domestic public debt have remained so high, the "operational" deficit of the public sector may not decline significantly from its 1988 level.

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 rose sharply in late December 1987 and January 1988, as monetary policy was tightened and sharp price increases took effect at the start of the strengthened anti-inflation program, but they fell dramatically from late February to early June as the monthly inflation rate declined. The March-May 1988 decline in interest rates was cushioned by Bank of Mexico open market operations, designed to offset large private capital inflows from abroad.

Rates began to rise in early August 1988, slowly at first, more rapidly after monetary policy was tightened again in mid-October in connection with other policy actions taken at that time and the announcement of a $3.5 billion U.S. bridge loan that was not used. At the end of 1988, the nominal annual rate on 28-day Treasury bills was 52.4 percent, 12 percentage points higher than on July 26, but down from 151.7 percent at the peak on February 23.

After President Salinas took office and the 1989 economic policy was announced, foreign exchange pressures moderated, and interest rates eased until mid-March. However, as exchange market nervousness increased in ensuing weeks, rates turned up again. At the June 27 auction, the 28-day Treasury bill rate was 57.5 percent, 10.5 percentage points higher than on March 14, and 5 percentage points higher than at the end of 1988. Increased market confidence generated by the announcement that the anti-inflation pact was being extended through March 1990 and by reports that progress was being made in Mexico's debt negotiations with foreign commercial banks allowed this rate to decline by 11 percentage points in the first three weekly auctions in July.

In real terms, rates ex-post were negative in December 1987, but turned strongly positive in the first quarter of 1988. With inflation at the monthly rate of 1.5 percent (the average monthly rate in the first half of 1989), the real yield on 28-day Treasury bills sold on June 27, 1989, was about 31 percent, ex-post. Even after the 11 percentage point decline, the real yield on the bills sold July 18 was still about 22 percent, ex-post.

In 1988, bank credit to the private sector was constrained by a ceiling amounting, in nominal terms, to 85 percent of the average of such credit outstanding in December 1987. However, the private sector was able to finance itself outside of banks, as large firms, which generally earned large profits in 1987 and 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.

The growth of the money market outside banks tended to weaken the Bank of Mexico's monetary policy. As a result, in October 1988, the credit ceiling was lifted from bank operations with bankers' acceptances, freeing the banks to compete for funds with the non-bank market, and a 30 percent liquidity reserve requirement was imposed on the liabilities involved. Within a few weeks, the banks had shifted much of their liabilities to the newly freed instrument. In early April, interest rates on other bank liabilities were decontrolled and the banks' reserve requirements were restructured to reduce their use to channel resources to the government and enable the banks to channel more funds toward the private sector.

At the end of April, the latest month for which data are available, the narrowly defined money supply was 24 percent higher than a year earlier. This percentage compares with a 12-month rate of increase of 146 percent in April 1988, which was the all-time high. But it was more than the 12-month rate of increase in the CPI in the 12 months ended in April 1989 (19 percent), which is consistent with some remonetization of the economy. In real terms, the narrow money supply was about 4 percent higher in April 1989 than in April 1988.

<u>Structural Adjustment Policies</u>

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. Its sale was announced in April 1988. 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. However, all bids were rejected as inadequate in early November. The sale of Mexicana Airlines has likewise been announced several times, only to fall through each time.

In the period December 1982-March 1988, 232 non-strategic public sector enterprises were privatized and another 272 were liquidated or ceased to exist, while 58 new public enterprises were created. The process has continued after March 1988, but the number of enterprises involved is not known. In October, an acceleration of the divestiture program was ordered. In October-November, the Compania Mexicana del Cobre, a large copper mining firm, and Aerovias de Mexico, an airline formerly known as Aeromexico, not to be confused with Mexicana Airlines, were privatized. A number of steps have been taken to raise productivity in enterprises remaining under state ownership, and more are to be taken with the support of an IBRD loan approved last month.

Since 1985, with the support of two IBRD loans, 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.

After taking steps on an ad hoc basis over the past five years to ease some of the rules inhibiting foreign direct investment and allow some investments with 100 percent foreign ownership, the government announced in May 1989 new regulations simplifying the registration and approval of foreign investment, setting guidelines for allowing 100 percent or majority foreign ownership, and facilitating foreign participation in the Mexican stock market.

A debt-equity swap program was initiated in May 1986. However, criticism of its inflationary effects and of the subsidy it gave foreign investors who would have made their investment even without it led to a decision to suspend acceptance of new applications in October 1987, although operations already approved were allowed to proceed. About $2.7 billion in investments have been carried out under debt-equity swap operations, slightly more than half of this amount ($1,450 million) in 1987 alone.

As part of the agreement in principle on the comprehensive financing package that was announced on July 23, 1989, Mexico agreed to a resumption of debt-equity swaps. Debt-equity conversions will be available to creditor banks under Mexico's privatization program, as well as for certain infrastructure projects to be determined by Mexico, for a total amount equivalent to $1 billion of debt annually during the period of January 1990 through June 1993.

Including investments under debt-equity swaps, foreign private direct investment inflows in 1987 totalled about $3,250 million. In 1988, when investments under debt-equity swaps were less than $900 million, total direct investment inflows amounted to about $2.6 billion. The Mexican government has indicated a willingness to restart the program in connection with privatization operations which are projected to be substantial.

The new administration has pledged to carry out an extensive deregulation program. This program will be supported by an IBRD loan. As a first step, a liberalization of the financial sector has been launched, with the support of another IBRD loan.

The administration has also pledged to continue the structural adjustments begun by its predecessor. Plans are being developed to involve the private sector in the financing of investment in what have traditionally been public sector projects, e.g., toll roads.

In January 1989, the government arrested the leaders of the petroleum workers union on charges of arms smuggling and other crimes. The union's leadership was notoriously corrupt and represented a major obstacle to the structural adjustment efforts of the government.

Long Range Planning

A six-year plan calling for real GDP growth of 6 percent and a fiscal deficit of 3-4 percent of GDP by 1994 was issued May 31, 1989. The plan contemplates raising the rate of investment from 19 percent of GDP in 1983-88 to about 23 percent in 1989-91 and close to 26 percent in 1994. It envisages exports rising more slowly than real GDP because it assumes that oil exports will remain constant in real terms. It implies that the negotiations with foreign creditors will lead to a large reduction in the net transfers of resources abroad, in that it postulates that these transfers, which, in recent years, represented about 6 percent of GDP, will average 1.7-2.1 percent of GDP in 1989-91 and 1.5-1.7 percent by 1994.

Details are lacking as to how real GDP growth is to be accelerated while the fiscal deficit/GDP ratio is sharply reduced, although the plan makes clear that the private sector would be expected to provide the principal impetus toward higher GDP growth. Undoubtedly, a lowering of domestic interest rates as inflation abates must play a large role in reducing the fiscal deficit. However, additional efforts to cut non-interest expenditures and/or increase revenues are likely to be needed.

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. A stand-by arrangement for SDR 1.4 billion, approved in November 1986, 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.

A three-year, SDR 2,797 million (about $3.6 billion) Extended Fund Facility (EFF) arrangement and a Compensatory and Contingency Financing Facility (CCFF) drawing of SDR 453.5 million (about $570 million) were approved May 26, 1989. The program's performance criteria will be adjusted for changes in oil prices and world interest rates. The equivalent of 30 percent of the EFF funds will be set aside for debt reduction operations. An additional 40 percent of Mexico's IMF quota (about $600 million) will be available for interest support operations.

Mexico's Relations with the Multilateral Development Banks

Since July 1986, the World Bank has approved twelve policy-based loans for Mexico totalling $4.5 billion in support of wide-ranging structural reforms. Three of these loans, totalling $1.5 billion, were approved June 13, 1989, and provide that 25 percent of the proceeds will be available for debt reduction operations. Over the next three years, the World Bank is expected to provide about $1.7 billion in financial support for Mexico for debt and debt-service reduction operations.

The World Bank has another five policy-based loans for Mexico, totalling $1.7 billion, in various stages of preparation. A number of project loans are also in the pipeline for Mexico. A $460 million loan to finance two hydroelectric projects was approved in June.

The Inter-American Development Bank (IDB) has not made policy-based loans, but has concentrated on project loans. Since last November, the IDB has approved two loans to Mexico for the agricultural credit system totalling $340 million.

In 1988, Mexico received from the World Bank gross disbursements of $1,347 million (net disbursements of $674 million) and from the IDB gross disbursements of $280 million (net disbursements of $77 million).

Mexico's Relations with Official Creditors

On May 30, 1989, the Paris Club agreed to reschedule over 10 years, including 6 years of grace, 100 percent of principal falling due between June 1, 1989, and May 31, 1992, and 100 percent of interest due in the first year, 90 percent in the second year, and 80 percent in the third year. The payments rescheduled total about $2.5 billion. The Paris Club also agreed to keep Mexico on cover for new export credits.

Mexico had obtained an earlier rescheduling from the Paris Club in September 1986. On that occasion, the Paris Club agreed to reschedule obligations totalling about $1.9 billion, consisting of all principal due through March 1988 and 60 percent of interest due through 1987.

Mexico's Relations with Foreign Commercial Banks

Since 1982, Mexico has dealt with foreign commercial banks through a Bank Advisory Committee, consisting originally of 13 banks, but recently enlarged to 15 members. Prior to 1989, it has obtained in this manner three loans from the banks, and has negotiated a public sector debt restructuring of older debts on three occasions.

Disbursements under these three concerted loans have totalled $14.3 billion, but $250 million was repaid in advance in January 1985, in consideration of the relief obtained in the 1984 debt restructuring. The public sector debt restructuring obtained from the banks in 1987 extended the repayment term of loans totalling $43.7 billion to 20 years, including 7 years of grace, and lowered the spread to 13/16 percent.

In a debt-for-bonds auction in March 1988, Mexico achieved a $1.1 billion net reduction in outstanding external debt to banks and a small net saving in external interest payments. About $3.7 billion in debt was retired at a discount averaging about 30 percent. The bonds issued in the operation, totalling about $2.6 billion, are guaranteed as to principal by U.S. Treasury zero coupon bonds that Mexico acquired from the Treasury for $492 million.

In negotiations concluded on July 23, 1989, Mexico and its Bank Advisory Committee reached agreement in principle on a comprehensive financing package. The financing package provides each creditor bank three basic options: principal reduction, interest reduction, and new money. Each creditor bank will be asked to select one or more of these options.

Under the debt-reduction and debt-service reduction options, creditor banks would exchange their medium- and long-term loans for new 30-year bonds to be issued by Mexico. Principal-reduction (discount) bonds will be issued in exchange for existing loans at a discount of 35 percent, with a floating interest rate of LIBOR plus 13/16 percent. The interest-reduction (par) bonds, which would be exchanged for existing loans at par, will bear interest at a fixed rate of 6-1/4 percent.

Principal payments on the new bonds will be collateralized by U.S. Treasury zero-coupon obligations or comparable collateral purchased by Mexico. Interest payments will be supported on a rolling basis for at least 18 months and up to 24 months by a collateral account established by Mexico. Support for both types of bonds will come from $7 billion of enhancements from the International Monetary Fund, the World Bank, Mexico, as well as development loans from Japan. Banks that elect these options will also be eligible after July 1996 to "recapture" some of the lost value of their former claims depending on Mexico's earnings from oil exports at that time and going forward.

Creditor banks that provide new money will be asked to commit over a four-year period a total of 25 percent of their existing medium- and long-term loans that are not exchanged for principal-reduction or interest-reduction bonds. The new loans would be repayable in 15 years, with seven years of grace, and would bear interest at LIBOR plus 13/16 percent.

Mexico's Relations with the International Bond Market

In early June 1989, for the first time since 1982, a Mexican public sector entity (the National Foreign Trade Bank) placed privately a five-year $100 million Eurobond issue with investors in Asia, Europe, and Latin America. The issue carried a coupon rate of 10-1/4 percent and was priced to yield about 17 percent.

The Outlook for 1989 and Beyond

As long as world oil prices remain near their present level in real terms, Mexico will face serious short- and medium-term economic and financial difficulties and will require additional external resources. In the longer run, however, barring a renewed decline in world oil prices, or a sharp rise in world interest rates, or an economic recession in the OECD countries, Mexico may hope to overcome these difficulties, providing it continues to follow restrained monetary, fiscal, and wage policies, and an exchange rate policy that maintains the international competitive position of its exports.

Assuming that Mexico will adhere to such a course and that it will remain in compliance with the quantitative performance criteria of its IMF program and carry out the structural reforms supported by its World Bank policy-based loans, it will be able to count on all of the external financial assistance already negotiated and in prospect. Under these conditions, a medium-term projection of Mexico's balance of payments may be as shown in Table A, attached to this paper. The assumptions underlying this projection are shown below:

	1989	1990	1991
Real GDP Growth in Mexico (%)	1.5	3.5	4.5
Reserve Cover (number of days of Imports of Goods and Services)	64	67	70
Average Oil Export Price ($/Barrel)	15	14.5	15
Crude Oil Export Volume (mbd.)	1.3	1.28	1.26
Increase in Earnings from:			
In-Bond Plants (%)	25	16	18
Other Non-Oil Exports (%)	10	8	14
Increase in Imports (%)	10	11	13
Interest Rate on Foreign Assets (%)	9	9	9
Interest Rate Plus Spread on External Debt (%)	10	10	10
Increase in Other Service Receipts (%)	9	8	9
Increase in Other Service Payments (%)	7.5	8	9
Increase in Foreign Private Direct Investment (%)	6	7	8
Discount on Debt-Equity Swaps (%)	16.7	16.7	16.7
Change in dollar value of debt denominated in other currencies due to change in value of dollar against these currencies ($ billions)	-1.63	1.77	1.75
New Financing World Bank/IDB ($ billions)	2.1	2.6	2.6
New Financing from Bilateral Official Creditors and Suppliers ($ billions)	2.2	2.4	2.4
Drawings from the IMF ($ billions)	1.45	1.17	1.17
Paris Club Rescheduling ($billion)	0.54	0.92	0.70

The projection shows that, if Mexico is to achieve the assumed growth rates while continuing to service its external debt in full and maintaining international reserves at the indicated level, it will face a financing gap that may be summarized as follows:

Mexican Financing Gap, 1989-91
(billions of dollars)

	1989	1990	1991	Total*
Financing Needs*	-13.63	-15.09	-15.57	-44.29
Current Account Deficit	-2.26	-3.54	-4.05	-9.85
Amortization of Debt	-7.08	-7.86	-7.55	-22.49
Interest Income Not Repatriated	-1.99	-1.93	-1.85	-5.77
Mexican Export Credit	-0.77	-0.83	-0.94	-2.54
Increase in Net Reserves	-1.53	-0.93	-1.18	-3.64
Non-Bank Financing Available*	10.35	11.38	11.65	33.38
Debt-Equity Swaps	1.00	1.00	1.00	3.00
Other Foreign Direct Investment	1.83	1.96	2.11	5.90
Loan Disbursements				
IMF	1.45	1.17	1.17	3.79
World Bank/IDB	2.10	2.60	2.60	7.30
Bilateral Official Creditors and Suppliers	2.20	2.40	2.40	7.00
Paris Club Rescheduling	0.54	0.93	0.70	2.17
Other Non-Bank Financing	1.23	1.32	1.67	4.22
Financing Gap*	-3.28	-3.71	-3.92	-10.91
Commercial Bank Debt Restructuring	0.94	1.89	1.89	4.72
Commercial Banks - Other Financing	2.34	1.82	2.03	6.19

* Details may not add to totals due to rounding.

Using different assumptions, the IMF had estimated a three-year financing gap of $18.4 billion, whereas the Economic Subcommittee of the Bank Advisory Committee estimated a three-year gap of only $8.2 billion.

Concluding Comments

The Mexican population has endured heavy sacrifices since 1981, with a stagnant GDP, a more than 40 percent decline in real wages for workers earning minimum wages or wages linked to minimum wages, a 17 percent decline in manufacturing employment, and a high level of partial or disguised unemployment, for which no reliable data exist. In the July 1988 presidential and congressional elections, the opposition made strong gains, and President Salinas, who took office December 1, is under great pressure to deliver on his promise to revive economic growth. He has made a debt reduction and/or a debt service reduction a key to his policy of reviving growth. Sporadic demands that Mexico suspend external interest payments or limit them to a fraction of export earnings have been rejected in the past, but may gain respectability if economic growth does not revive relatively soon or if international reserves run out before the needed external financing from commercial banks becomes available.

Table A

Mexico: Balance of Payments Projection--(millions of dollars)

Projected Real GDP Growth (%):		1.1	1.5	3.5	4.5
Reserve Cover (number of days):		54.5	64	67	70
Interest Rates Fixed					
	1987	1988	1989	1990	1991
Merchandise Exports	22,255	22,996	26,400	27,718	30,806
Crude Oil	7,877	5,885	7,118	6,774	6,899
Refined Oil Products	753	826	1,018	984	1,018
In-Bond Industries	1,598	2,337	2,921	3,389	3,999
Other Non-Oil	12,027	13,948	15,343	16,570	18,890
Merchandise Imports	(12,223)	(18,903)	(20,793)	(23,139)	(26,230)
Trade Balance	10,032	4,093	5,607	4,579	4,575
Services (net)	(6,714)	(7,610)	(8,482)	(8,785)	(9,347)
Service Receipts	7,647	8,837	9,587	10,226	10,923
Interest -- Official	587	647	479	608	698
Interest -- Private	1,301	1,665	1,996	1,938	1,852
Other Service Receipts	5,759	6,525	7,112	7,681	8,373
Service Payments	(14,361)	(16,447)	(18,069)	(19,011)	(20,270)
Interest Payments	(8,097)	(8,892)	(9,948)	(10,289)	(10,830)
Other Service Payments	(6,264)	(7,555)	(8,122)	(8,722)	(9,440)
Unilateral Transfers (net)	649	616	620	670	720
Current Account	3,967	(2,901)	(2,256)	(3,536)	(4,051)
Debt Amortization	(10,099)	(8,204)	(7,083)	(7,861)	(7,550)
Pre-1989 Debts	(6,599)	(5,736)	(5,963)	(6,421)	(5,710)
Post-1988 Debts	0	0	(120)	(440)	(840)
Debt Prepayments	(3,500)	(2,468)	(1,000)	(1,000)	(1,000)
Non-Debt Financing	2,346	(2,220)	567	993	1,419
Debt-Equity Swaps	1,450	868	1,000	1,000	1,000
Other Private Dir. Inv.	1,798	1,727	1,831	1,959	2,115
Interest Not Repatriated	(1,301)	(1,665)	(1,996)	(1,938)	(1,852)
Other Private Capital	1,000	(2,453)	500	800	1,100
Mexican Export Credit	(601)	(697)	(767)	(829)	(945)
Debt Financing	10,580	6,140	10,305	11,330	11,362
IBRD/IDB	1,188	1,627	2,100	2,600	2,600
IMF	774	480	1,447	1,170	1,170
Bilat. Official & Suppliers	2,000	2,100	2,200	2,400	2,400
Paris Club Rescheduling	1,140	165	545	925	701
Commercial Bank Restructur.	0	0	944	1,887	1,887
Commercial Bank - Other	4,372	1,138	2,342	1,824	2,034
Other - for Private Sector	1,106	630	727	524	570
Change in Reserves	(6,794)	7,185	(1,534)	(926)	(1,180)
Reserves at Year-End	12,464	5,279	6,813	7,739	8,919
Pvt.For.Assets at Year-Emd	19,975	22,428	21,928	21,128	20,028
External Debt at Year-End	103,976	98,683	100,271	105,515	111,079

RESTRICTED

TABLE 1
MEXICO: BASIC DATA

Population (mid-1988)	84.5 million	Population Growth (1979-88)	2.5%
GDP (1988)	$189 billion	GDP per capita (1988)	$2,240

GDP Origin (%)	1978	1987	Ratios to GDP (%)	1975	1988
Agriculture	10.2	8.7	Gross Dom. Savings	19.1	18.9
Oil, Gas & Mining	2.7	5.1	Gross Dom. Investment	24.2	20.5
Manufacturing	24.8	25.8	Net Debt	25.1	47.7
Commerce	25.2	27.2	Imports (goods & services)	14.5	18.7
Other	37.1	33.2			

Export Composition (%)	1975	1988	Import Composition (%)	1975	1988
Agriculture & Fishing	26.9	13.9	Consumer Goods	6.8	10.2
Oil, Gas & Petrochemicals	13.3	29.2	Intermediate Goods	64.4	68.5
Metals & Minerals	12.4	6.4	Capital Goods	27.7	21.3
Manufactures	43.9	50.5			

Export Destination (%)	1975	1988	Import Origin (%)	1975	1988
U.S.	57	69	U.S.	62	67
EEC	9	11	EEC	17	14
Japan	4	5	Japan	5	6

Political Situation: Presidential and congressional elections held 7/6/88. Opposition made strong showing and claimed voting irregularities. Govt. party has slim majority in lower house. President Salinas took office 12/1/88 for a six-year term.
Current IMF Relations: Three-year, SDR 2,797 million EFF arrangement, and SDR 453.5 million CCFF drawing approved 5/26/89. Up to 30 percent of EFF funds available for debt reduction operations. Latest consultation paper: 5/89.
Current Relations with Banks: In negotiations concluded on July 23, 1989, Mexico and its Bank Advisory Committee reached an agreement in principle on a comprehensive financing package that includes provisions for principal reduction, interest reduction, and new money options.
Current Relations with Official Creditors: Since 7/86, IBRD has approved twelve policy-based loans totaling $4.5 billion in support of wide-ranging structural reforms. Five more policy-based loans totaling about $1.7 billion under preparation. Since 11/88, IDB has approved two agricultural credit loans totaling $340 million.
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 through end-1988. Since 1/1/89, rate crawling by average of 1 peso per day.
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. Paris Club agreed 5/30/89 to reschedule all principal of debts to official creditors due between 6/1/89 and 5/31/92 and 100 percent of interest due in first year, 90 percent in second year, and 80 percent in third year.

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

	1984	1985	1986	1987	1988	1988 Q1	1988 Q2	1988 Q3	1988 Q4	1989 Q1	1989 Q2
Real GDP (% ch.) 1/	3.7	2.7	-3.8	1.5	1.1	1.9	1.1	0.8	0.5	1.8	n.a.
Ind. Production (% ch.) 1/	6.6	5.4	-4.6	4.1	2.1	6.3	1.0	-0.3	1.5	3.5	n.a.
Wholesale Prices (% ch.) 2/	60.1	61.1	102.3	166.5	37.3	28.1	4.1	0.5	2.4	3.9	n.a.
Consumer Prices (% ch.) 2/	59.2	63.7	105.7	159.2	51.7	31.5	7.2	3.2	4.2	5.0	4.2
Interest Rate 3/	47.7	71.2	99.2	121.8	52.3	95.8	40.4	41.9	52.3	47.7	56.8
Effective Annual Yield 3/	59.7	100.0	160.1	220.5	67.0	152.1	48.8	51.0	67.0	59.8	74.4
Money Stock (M1) (% ch.) 4/	62.4	53.5	72.5	129.7	58.1	140.2	137.5	103.0	58.1	32.8	n.a.
Public Sector Def./GDP (%) 5/	8.5	9.6	16.0	16.1	12.3	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

	1988 June	1988 July	1988 Aug.	1988 Sep.	1988 Oct.	1988 Nov.	1988 Dec.	1989 Jan.	1989 Feb.	1989 Mar.	1989 Apr.	1989 May	1989 June
Ind. Production (% ch.) 1/	1.4	-2.3	2.2	-1.0	0.0	3.1	1.5	2.6	2.0	5.8	2.6	n.a.	n.a.
Wholesale Prices (% ch.) 2/	1.0	1.5	0.0	-1.1	-0.5	1.3	1.7	1.8	0.8	1.2	1.8	0.7	n.a.
Consumer Prices (% ch.) 2/	2.0	1.7	0.9	0.6	0.8	1.3	2.1	2.4	1.4	1.1	1.5	1.4	1.2
Annualized % change 6/	32.1	25.1	20.2	13.4	9.4	11.2	18.1	26.2	26.3	21.4	16.9	17.0	17.7
Interest Rate 3/	40.4	40.3	41.3	41.9	44.6	49.9	52.3	50.8	49.0	47.7	50.1	52.7	56.8
Effective Annual Yield 3/	48.8	48.6	50.1	51.0	55.0	63.2	67.0	64.6	61.8	59.8	63.5	67.6	74.4
Money Stock (M1) (% ch.) 4/	137.5	133.5	105.7	103.0	93.9	74.1	58.1	50.6	40.0	32.8	23.8	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.

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

	1984	1985	1986	1987	1988	1988 Q1	1988 Q2	1988 Q3	1988 Q4	1989 Q1	1989 Q2
Exchange Rate 1/	192.6	372.2	925.3	2204.0	2273.0	2273.0	2273.0	2273.0	2273.0	2373.0	2466.0
(% change) 2/	33.8	93.3	148.6	138.2	3.1	3.1	0.0	0.0	0.0	4.4	3.9
Real Exch. Rate Index 3/	97.1	100.0	70.0	64.4	79.6	74.7	80.5	86.3	85.1	83.6	n.a.
(% change)	16.9	3.0	-30.0	-7.9	23.5	14.0	7.8	7.2	-1.5	-1.7	n.a.
Oil Exports ($B) 4/	16.6	14.8	6.3	8.6	6.7	1.8	1.8	1.6	1.5	1.8	n.a.
Exports f.o.b. ($B) 5/	25.4	22.9	17.3	22.3	23.0	5.8	6.0	5.6	5.6	6.1	n.a.
(% change)	10.0	-9.7	-24.4	28.4	3.4	1.2	4.0	-6.5	0.6	7.9	n.a.
Imports f.o.b. ($B)	11.3	13.2	11.4	12.2	18.9	3.7	4.6	5.2	5.4	5.2	n.a.
(% change)	30.9	17.3	-13.5	6.9	54.7	7.2	22.7	12.6	4.9	-4.5	n.a.
Trade Balance ($B) 5/	14.1	9.7	5.9	10.0	4.1	2.0	1.4	0.4	0.2	0.9	n.a.
Current Account ($B)	4.2	1.2	-1.7	4.0	-2.9	0.7	-0.3	-1.5	-1.8	n.a.	n.a.
Total Reserves excl. gold ($B)	7.3	4.9	5.7	12.5	5.3	14.5	12.9	8.6	5.3	n.a.	n.a.

	1988 June	1988 July	1988 Aug.	1988 Sep.	1988 Oct.	1988 Nov.	1988 Dec.	1989 Jan.	1989 Feb.	1989 Mar.	1989 Apr.	1989 May	1989 June
Exchange Rate 1/	2273.0	2273.0	2273.0	2273.0	2273.0	2273.0	2273.0	2309.0	2341.0	2373.0	2403.0	2436.0	2466.0
(% change) 2/	0.0	0.0	0.0	0.0	0.0	0.0	0.0	1.6	1.4	1.4	1.3	1.4	1.2
Oil Exports ($M) 4/	570	561	593	413	469	482	560	613	553	679	692	n.a.	n.a.
Exports f.o.b. ($M) 5/	1,975	1,871	2,045	1,686	1,752	1,953	1,932	1,957	1,922	2,205	2,167	n.a.	n.a.
Imports f.o.b. ($M)	1,632	1,596	1,826	1,742	1,739	1,950	1,729	1,664	1,691	1,819	1,925	n.a.	n.a.
Trade Balance ($M) 5/	342	276	219	-56	13	4	203	292	231	386	242	n.a.	n.a.
Current Account ($M)	- 283	- 404	- 425	- 673	- 651	- 710	- 464	- 338	- 361	n.a.	n.a.	n.a.	n.a.
Total Reserves excl. gold ($B)	12.85	10.47	10.91	8.59	7.65	5.48	5.28	5.47	5.64	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: 1985=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.

July 26, 1989

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

	1982	1983	1984	1985	1986	1987	1988e	1989p
GROSS EXTERNAL DEBT	86.1	93.1	94.9	96.9	101.1	104.0	98.7	103.0
Long Term (incl. IMF)	60.0	82.9	88.5	91.4	95.2	98.2		
Public and guaranteed	51.6	66.9	69.8	72.7	76.0	82.8		
of which from:								
Official sources	7.0	6.7	7.0	8.8	10.7	15.9		
Financial institutions 1/	44.5	59.8	62.6	63.7	64.0	66.6		
Private Unguaranteed	8.1	14.8	16.3	15.8	15.1	10.2		
IMF Credit	0.2	1.3	2.4	3.0	4.1	5.2	4.8	
Short-term (e)	26.2	10.1	6.4	5.5	5.9	5.8		
(Arrears)	3.5	0.5	0.0	0.0	0.0	0.0	0.0	
EXTERNAL ASSETS	2.4	6.4	9.6	7.4	8.2	15.7	8.4	
Bank of Mexico (excl. gold)	0.8	3.9	7.3	4.9	5.7	12.5	5.3	
Commercial Banks	1.4	2.2	1.9	2.1	2.0	2.8	2.6	
Development Banks	0.2	0.3	0.4	0.4	0.5	0.4	0.5	
(Gold in millions of ounces)	2.1	2.3	2.4	2.4	2.6	2.5	2.6	
NET EXTERNAL DEBT	83.7	86.6	85.3	89.5	92.9	88.3	90.3	
TOTAL DEBT SERVICE (e)	16.7	14.9	17.4	15.7	13.0	14.7	14.6	16.6
Amortization (e) 2/	4.5	4.8	5.7	5.5	4.7	6.6	5.7	6.0
Public long-term	3.2	4.8	3.9	3.5	2.7			
Private long-term	1.3	0.0	1.8	2.0	2.0			
Interest	12.2	10.1	11.7	10.2	8.3	8.1	8.9	10.6
Public long-term and IMF	6.2	6.6	7.4	7.5	6.2			
Private long-term (e)	1.6	1.6	2.9	1.9	1.5			
Short-term (e)	4.4	1.9	1.4	0.8	0.6			
MEMORANDUM ITEMS								
Net Debt/GDP (%)	52.9	55.8	51.1	50.5	53.4	48.6	47.7	
Net Debt/Exp. (%) 3/	292.6	302.9	262.6	300.8	392.1	295.3	283.6	
Debt Service/Exp. (%) 3/	58.4	52.2	53.4	52.8	54.8	49.2	45.9	46.4
Interest/Exp. (%) 3/	42.6	35.3	36.0	34.3	35.2	27.1	27.9	29.7
Bank Claims (quarterly):								
All Banks 4/	59.0	62.8	72.3	74.5	74.2	75.8	69.3	67.4
Net, All Banks 4/	48.1	44.8	50.6	52.7	51.3	45.7	44.8	43.4
U.S. Banks 5/	24.4	26.3	26.5	24.9	23.7	22.7	17.9	17.3
U.S. Banks Exposure 5/	24.3	25.4	25.8	24.4	23.5	22.4	17.6	17.0
Bank Claims (semi-annual):								
All Banks 4/	62.9	69.3	70.7	71.7	70.9	69.9	62.8	
(Maturing in 1 year)	29.9	29.4	17.0	20.3	16.5	15.7	13.9	

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 1989; semi-annual data are for December 1988.
5/ Data for 1989 are for March.

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

	1981	1982	1983	1984	1985	1986	1987	1988e	1989p	1990p
JRRENT ACCOUNT	-13.9	-7.0	5.4	4.2	1.2	-1.7	4.0	-2.9	-2.3	-3.5
Trade Balance	-3.1	7.7	14.5	14.1	9.7	5.9	10.0	4.1	5.6	4.6
Exports (f.o.b.) 1/	20.9	22.1	23.1	25.4	22.9	17.3	22.3	23.0	26.4	27.7
Oil and Products 2/	14.6	16.5	16.0	16.6	14.8	6.3	8.6	6.7	8.1	7.7
Other	6.3	5.6	7.1	8.8	8.2	11.0	13.6	16.3	18.3	20.0
Imports (f.o.b.)	-24.0	-14.4	-8.6	-11.3	-13.2	-11.4	-12.2	-18.9	-20.8	-23.1
Services (net)	-11.1	-15.0	-9.4	-10.3	-9.5	-8.0	-6.7	-7.6	-8.5	-8.8
Receipts	9.5	6.5	5.5	7.1	6.8	6.4	7.7	8.8	9.6	10.2
Payments	-20.6	-21.5	-14.9	-17.4	-16.3	-14.4	-14.4	-16.5	-18.1	-19.0
(Interest on Debt)	-9.5	-12.2	-10.1	-11.7	-10.2	-8.3	-8.1	-8.9	-9.9	-10.3
Transfers (net)	0.3	0.3	0.3	0.4	1.0	0.5	0.7	0.6	0.6	0.7
PITAL ACCOUNT	23.2	6.8	-1.3	0.0	-1.5	1.8	1.2	-4.1		
Long-term (net)	13.0	8.4	-3.2	-2.3	-10.3	1.1	4.4	-0.6		
Direct Investment 3/	2.5	1.7	0.5	0.4	0.5	1.5	3.3	2.6	1.8	2.0
Other Long-term 4/	10.5	6.7	-3.7	-2.7	-10.8	-0.4	1.1	-3.2		
Short-term (net) 4/	10.2	-8.4	-8.4	-3.6	-1.8	0.7	-3.2	-3.5		
Debt Refinancing 5/	0.0	6.8	10.3	5.9	10.6	0.0	0.0	0.0		
RORS AND OMISSIONS	-8.2	-3.1	-1.0	-0.9	-2.1	0.5	0.9	-0.5		
SERVES AND RELATED ITEMS	-1.1	3.3	-3.1	-3.3	2.4	-0.6	-6.1	7.5		
Gold Valuation Adjustment	-0.1	0.1	0.0	-0.1	0.1	0.4	0.8	0.4		
SDR Allocation	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Change in net reserves	-1.1	3.2	-3.1	-3.2	2.3	-1.0	-6.9	7.1		
MORANDUM ITEMS:										
Net Interest Paid	7.0	10.9	9.2	9.6	8.3	6.9	6.2	6.6	7.5	7.7
Reserves/Average Monthly Imports 6/	1.1	0.3	2.0	3.0	2.0	2.6	5.6	1.8		
Current Account/GDP (%)	-9.2	-4.4	3.5	2.5	0.7	-1.0	2.2	-1.5	-1.2	-1.8
Current Acc't/Exp. (%) 6/	-45.9	-24.6	18.9	13.0	4.2	-7.0	13.3	-9.1	-6.4	-9.2
Oil Export Price ($/bbl.)	33.2	28.7	26.8	27.0	25.5	11.8	16.0	12.2	15.0	14.5

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

July 19, 1989

Bank Claims on Mexico
(billions of dollars)

I. All BIS Banks (from BIS semiannual "Maturity Survey"), December 1988

	All banks	U.S.[1] banks	Non-U.S. banks
A. Total claims	62.8	17.0	45.8
B. Claims due in one year or less	13.9	5.0	8.9

II. U.S. Banks (from U.S. quarterly "Country Exposure Lending Survey"), March 1989

Note: 109 banks reported exposure to Mexico in March 1989

	All U.S. banks	Nine largest	Next thirteen	All other
A. Total claims	17.3	11.8	2.4	3.1
(as percent of total capital)	(12.6%)	(21.0%)	(10.0%)	(5.5%)
B. Claims due in one year or less	3.9	2.4	0.7	0.8
C. Total exposure	17.0	11.9	2.4	2.7
of which: claims on nonresident offices of banks chartered in the country concerned	0.9	0.5	0.2	0.2

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

	March 1988	June 1988	Sept. 1988	Dec. 1988	March 1989
A. All BIS banks	73.4	70.1	70.4	69.3	67.4
B. U.S. banks	22.5	21.1	20.6	19.0	18.5

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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.