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Economic and Financial Developments in Mexico
in 1965

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Economic and Financial
Developments in Mexico in 1965

In 1965, the Mexican authorities moved to dampen the economic boom which was beginning to produce dangerous inflationary strains. They sharply cut back public investment spending and reduced the scale of Bank of Mexico financing of the Government. As effective demand moderated, upward price pressures abated. At the same time, the rate of GNP growth slowed down substantially, though it still exceeded 5 per cent in real terms.

The cut back in public investment also enabled the authorities to curtail public borrowings abroad. This curtailment was the principal factor contributing to a moderate decline in Mexico's gold and foreign exchange holdings. The decline in reserves, reversing the trend of the previous two years, occurred in the face of a reduction in the deficit of the balance of payments on current account and an increased flow of direct private investment capital from abroad. The reduced reliance on foreign borrowings helped, at least for the time being, to keep the external debt service burden from rising much above its already high level.

The abatement of inflationary strains was achieved at the cost of a slower GNP growth, but the growth recorded in 1964 could not long have been sustained without serious domestic distortions and a deterioration of the external position. Already, in 1964, prices were beginning to rise after several years of stability, the trade deficit was widening, mainly due to a spurt in imports, and the reserves of the Bank of Mexico were kept from turning down only because of an enormous increase in borrowings abroad.

The developments of 1965 produced a sounder base on which to build sustainable growth with reasonable price stability and external balance. But a more dynamic rise in exports of goods and services and/or in private foreign investment and a larger supply of domestic savings would seem to be needed if a rate of GNP growth approaching that of 1964 is to be recorded year after year without disruptive outbreaks of inflationary strains.

Economic Activity and Prices

In 1965, Mexico had a 5.4 per cent increase in real GNP, close to the 6 per cent average of the last 15 years, but down from a near record 10 per cent in 1964. Industrial production rose 6.2 per cent, down from nearly 13 per cent in 1964, an all-time high. (See Table 1.)

Table 1

Mexico -- Index of Industrial Production
(1958=100)

	<u>1st Quarter</u>	<u>2nd Quarter</u>	<u>3rd Quarter</u>	<u>4th Quarter</u>
1962	133	129	125	129
1963	141	143	139	140
1964	157	166	156	159
1965	172	173	159	169

The signs of overheating of the economy, which were widespread in 1964 and early in 1965, abated somewhat during the year. The cost of living index last December was 4.5 per cent higher than a year earlier, the largest year to year increase since 1960, but the bulk of this increase occurred in the first half, and there was only a 1 per cent rise in the second half. (See Table 2-a). The index of wholesale prices last December was only 0.2 per cent higher than a year earlier, in contrast to a 5.5 per cent increase in 1964. (See Table 2-b).

Table 2-a

Mexico -- Index of the Cost of Living
(1939=100)

	<u>March</u>	<u>June</u>	<u>September</u>	<u>December</u>
1962	748.4	748.3	752.0	755.9
1963	755.4	754.3	756.1	755.1
1964	770.2	767.8	775.1	781.9
1965	791.1	806.8	803.0	817.1

Table 2-b

Mexico -- Index of Wholesale Prices
(1954=100)

	<u>March</u>	<u>June</u>	<u>September</u>	<u>December</u>
1962	140.2	141.3	143.1	141.9
1963	142.2	142.2	142.0	142.4
1964	146.5	147.8	148.7	150.3
1965	150.7	151.7	151.2	150.6

Fiscal Position

The slowdown in the rate of growth and the abatement of price pressures reflect mainly the adoption of a less expansionary fiscal policy following the change of administration in December 1964. The new administration cut back public investment spending by about a fourth from the very high levels reached in 1964 when the outgoing administration attempted to complete before leaving office many projects which it started. Operating expenditures continued to rise, in part to cover agricultural and railroad subsidies. However, revenues also rose, and the net result was a substantially lower government deficit in 1965 than in 1964. The reduced level of public investment spending was still above the 1963 level, and was the second highest in history. (See Table 3.)

Table 3

Mexico -- Revenues and Expenditures
of the Central Government
(in billions of pesos)

	<u>1965</u> <u>Estimated</u>	<u>1964</u> <u>Actual</u>	<u>1963</u> <u>Actual</u>
Revenues	20.5	18.5	15.6
Expenditures	<u>23.2</u>	<u>22.6</u>	<u>17.7</u>
Operating Outlays	17.6	15.3	12.7
Investment Outlays	5.6	7.3	5.0
Deficit	- 2.7	- 4.1	- 2.1

Private Spending

With government investment at a lower rate in 1965 than in 1964, total investment grew more slowly -- about 4 per cent in current prices, according to preliminary data, compared to 29 per cent in 1964. That it grew at all, reflects the buoyancy of private investment, for which data are not yet available. In addition, private consumption remained strong. The Bank of Mexico took steps to encourage the banks to develop their financing of purchases of non-luxury consumer durable goods by those sectors of the population which normally do not have access to bank credit.

Money and Credit

The Bank of Mexico provided less financing to the Government in 1965 than in 1964. At the same time, the Bank increased its sales of other financial assets from its portfolio to certain financial

institutions which continued to attract a growing amount of savings. The commercial banks and other financial institutions increased credit to the private sector by about 16 per cent during the year, only slightly less than the 17.4 per cent increase recorded the year before. (See Table 4.) As in most recent years, this expansion was mainly financed by attracting funds not payable on demand. These liabilities rose by about 18 per cent, only slightly down from the 21.4 per cent recorded in 1964.

Table 4

Mexico -- Selected Money and Banking Data
at end of specified periods
 (in billions of pesos)

	<u>Credit to the private sector</u>	<u>Liabilities not payable on demand</u>	<u>Money Supply (Seasonally Adjusted)</u>
1962 - I	40.65	32.21	17.63
II	41.73	33.16	18.16
III	42.71	34.70	18.79
IV	46.75	35.20	19.43
1963 - I	46.52	37.21	20.04
II	48.00	38.75	20.75
III	49.56	40.72	21.54
IV	51.52	41.66	22.75
1964 - I	53.21	43.26	23.81
II	55.28	45.49	24.66
III	59.12	48.50	26.00
IV	60.69	50.50	26.74
1965 - I	61.87	54.45	27.28
II	64.79	56.39	27.47
III	67.18	58.09	27.11
Oct.	69.52	58.73	27.45
Nov.	69.55	59.35	27.56
Dec.		59.56	28.26

The private "financieras" were authorized to raise funds by issuing 2-5 year financial certificates, and the Bank of Mexico undertook to stimulate such issues by agreeing to lend to the financieras against the guaranty of their holdings of Government securities up to an amount equal to 40 per cent of their issues of those certificates. The issuing institutions are prohibited from

repurchasing their own certificates in advance of maturity and from accepting them as collateral for loans. This is intended to ensure that their prices will fluctuate freely in the market, in contrast with most financial instruments in Mexico whose prices are pegged through repurchase commitments and/or facilities for loans secured by them.

At the end of last year, money supply seasonally adjusted was 5.7 per cent higher than at the end of 1964. Last year's rise took place in two spurts, one in the first quarter, the other in December. There was little change in the intervening eight months. This contrasts with a 17.5 per cent increase in the previous 12 months. Virtually all of the variation in money supply can be accounted for by factors of internal origin, since the Bank of Mexico's net international reserves showed only a minimal increase.

Interest rate movements were more moderate last year than in 1964. In December 1965, the average interest rates charged by selected banks in Mexico City on discounts, direct loans, and mortgage loans exceeded the levels of a year earlier by 30, 24 and 15 basis points respectively, while the rates on secured loans, equipment loans and industrial loans were lower by 21, 27, and 15 basis points respectively. (See Table 5.) By comparison, in December 1964, the rates on discounts, secured loans, and equipment

Table 5

Mexico -- Interest Rates

Average of rates charged by selected banks in Mexico City during specified periods (per cent)

	Short-term loans			Medium-term loans		
	Discounts	Direct Loans	Secured Loans	Equipment Loans	Industrial Loans	Mortgage Loans
1960 - Dec.	11.14	11.18	11.85	10.66	10.58	10.25
1961 - Dec.	11.28	11.41	10.76	11.09	10.54	9.00
1962 - Dec.	11.79	11.61	11.28	11.22	10.99	11.00
1963 - Dec.	10.80	12.38	10.81	10.96	10.85	11.33
1964 - March	10.75	11.55	11.46	11.77	10.95	9.83
June	11.82	11.50	10.97	11.34	10.37	10.63
Sept.	11.54	11.50	10.34	11.11	10.05	10.90
Dec.	11.46	11.32	11.61	11.30	10.23	10.83
1965 - March	11.85	11.63	10.01	11.06	10.47	10.45
June	11.39	11.65	11.08	11.31	10.35	10.50
Sept.	11.60	11.65	11.26	11.28	10.64	11.05
Dec.	11.76	11.56	11.40	11.03	10.08	10.98

loans exceeded the levels of a year earlier by 66, 80, and 36 basis points respectively, while the rates on direct loans, industrial loans and mortgage loans were lower by 106, 62, and 50 basis points respectively.

Balance of Payments and Reserves

The slower pace of economic expansion was reflected in an improvement of the balance of payments on current account. (See Table 7.) The trade deficit was moderately smaller in 1965 than in

Table 7

Mexico's Balance of Payments
(in millions of U.S. dollars)

	<u>1965</u> ^{1/}	<u>1964</u>	<u>1963</u>
<u>I. Current Account</u>			
Exports	1142	1054	985
Imports	<u>1560</u>	<u>1493</u>	<u>1240</u>
Trade Balance	- 418	- 439	- 255
Tourism (Net)	158	140	126
Border Transactions (Net)	210	187	181
Bracero Remittances	12	29	31
Investment Income (Net)	- 297	- 291	- 240
Other Services (Net)	<u>- 25</u>	<u>- 33</u>	<u>- 47</u>
Current Account (Net)	<u>- 360</u>	<u>- 407</u>	<u>- 206</u>
<u>II. Capital Account</u>			
Official Loans (excl. Central Government)			
Receipts	344	695	386
Payments ^{2/}	- 395	- 311	- 231
Central Gov't Debt (Net)	22	- 24	35
Private Direct Investment	198	162	117
Portfolio Investment	<u>12</u>	<u>- 8</u>	<u>- 6</u>
Long Term Capital (Net)	181	514	301
Short Term Private Capital (Net)	<u>- 30</u>	<u>63</u>	<u>- 58</u>
Capital Account (Net)	<u>151</u>	<u>577</u>	<u>243</u>
<u>III. Central Bank Reserves</u> ^{3/}			
	49	- 40	- 123
<u>IV. Errors and Omissions (Net)</u>			
	<u>160</u>	<u>- 130</u>	<u>86</u>

^{1/} Preliminary.

^{2/} Includes amortization of loans to Mexico and disbursements of Mexican loans to foreigners to finance Mexican exports.

^{3/} Increase: -. Changes in gross reserves, as central bank obligations denominated in foreign exchange are domestically held.

1964. Exports were about 8 per cent higher, while imports were about 5 per cent higher. Tourist earnings and receipts from border transactions both showed substantial increases, but remittances by migrant workers employed abroad fell off following the virtual termination of the "bracero" program by the United States at the end of 1964.

At the same time, there was an even larger reduction in the recorded net inflow of capital. This was due mainly to a sharp cutback in public sector borrowings abroad. The use of new foreign medium term and long term credits by public agencies was cut about in half (to less than \$350 million from nearly \$700 million in 1964). With repayments of earlier loans continuing to rise and with Mexico beginning to extend credit on its own to stimulate its exports, the net inflow of medium and long term capital (including private direct investment) fell below \$200 million from more than \$500 million in 1964. At the same time, there was a recorded net outflow of short term private capital in place of the net inflow of 1964.

The cutback in public borrowings abroad was the main reason why Mexico's official reserves, which rose substantially in 1963 and somewhat less in 1964, fell back moderately last year. (See Table 6.) The Bank of Mexico's gross reserves of gold and foreign exchange declined by \$49 million, (to \$534 million), but most of this decline is accounted for by a reduction in the Bank's foreign exchange obligations which are domestically held. Net reserves (including some silver) rose \$7.4 million (to \$511 million).

Table 6.

Mexico's International Reserves
(in millions of U.S. dollars)

	<u>Gross Reserves of Gold and Foreign Exchange</u>	<u>Net Reserves (including some silver)</u>
December 1962	420	407
December 1963	543	476
December 1964	583	503
December 1965	534	511

External Debt

Mexico's external public debt with a maturity of one year or more rose by about \$50 million during 1965, in contrast to a \$400 million increase in 1964, and the total of this debt outstanding at the end of last year was about \$1,770 million. Public external debt of less than one year maturity may be estimated at \$300 million.

Debt service (amortization plus interest) last year required more than \$450 million. This is equivalent to more than 22 per cent of gross foreign exchange earnings from current transactions in 1965. A further 8 per cent was required to cover remittances of income on private foreign investments in Mexico (\$162 million in 1965). ^{1/}

The Mexican Government floated a \$27.5 million 15-year bond issue in the New York market last October. This was the fourth such issue since July 1963, when the Government re-entered the market for the first time in 50 years. The new issue was priced to yield 6.63 per cent. This compares with yields of 7 per cent on the July 1963 issue, 6.75 per cent on the April 1964 issue, and 6.43 per cent on the November 1964 issue. A fifth issue is in the offing.

The growth of U.S. banking claims on Mexico came to a halt last year, reflecting the general cut-back in Mexican borrowings abroad and sell-offs of such claims by U.S. banks to their foreign branches. These claims amounted to \$1,146 million at the end of the year, \$10 million less than at the end of 1964. (See Table 8.) In contrast, there was an increase of about \$300 million in 1964. Last year's small decline was the result of a \$25 million increase in short term claims (to \$669 million) and a \$35 million decrease in long term claims (to \$477 million).

Table 8

Claims on Mexico
Reported by Banks in the U.S.
(in millions of U.S. dollars)

	<u>Short Term Claims</u>	<u>Long Term Claims</u>	<u>Total</u>
December 1962	408	195	603
December 1963	465	322	787
December 1964	630	453	1,083
December 1964 ^{a/}	644	512	1,156
December 1965	669	477	1,146

^{a/} Differs from December 1964 data in line above because of the inclusion of certain claims held by banks which were not previously reported.

^{1/} This does not include about \$73 million of income which was not remitted abroad but was reinvested in Mexico.