The original documents are located in Box B80, folder "Mexico 4/76 - 10/77 (2)" of the Arthur F. Burns Papers at the Gerald R. Ford Presidential Library.

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D.C. 20551

September 17, 1976

CONFIDENTIAL (FR)
CLASS II FOMC

TO: Federal Open Market Committee

FROM: Arthur L. Broida ALB

SUBJECT: Paper on Mexican Economic Situation

Attached for your information is a paper entitled "Analytical Aspects of the Mexican Economic Situation" and a two-page summary thereof. The paper was prepared by Messrs. Maroni and Truman of the Board's Division of International Finance.

Attachment

RESTRICTED

Summary of Analytical Aspects of the Mexican Economic Situation

This paper is in two parts. Part I analyzes the macro-economic setting of the Mexican economy in light of the recent sharp (37 per cent) depreciation of the Mexican peso. Part II analyzes several aspects of the peso depreciation itself.

Part I argues that prior to the September 1 depreciation of the peso the Mexican economy was in a situation of excess demand accompanied by very high inflation rates. This situation was largely stimulated by an expansion in the size of the public sector and the public-sector deficit. The expansion in the public sector led to a growing current-account deficit. At the same time private investment was stagnating. Consequently, the crucial objective of any Mexican economic stabilization program to complement the peso's depreciation must be to shift resources into the external sector. Part I analyzes, in turn, Mexican budget policy, monetary policy, investment, and wages and prices. It concludes that domestic aggregate demand should be restrained through a reduction in the size of the public-sector deficit. This will allow a tightening of monetary policy that would both support aggregate-demand policy and encourage a net inflow of capital. Finally, real wages should be restrained, if not reduced, to curb private consumption. The crucial issue in this last area is not how large the direct price effects of the peso's depreciation will be but rather how much will be passed through into increases in nominal wages. To date, we have little specific information that the Mexican authorities are willing or able to take the necessary policy actions in these areas.

RESTRICTED

Part II first traces the cause of the peso's depreciation on September 1 to a steady deterioration of the country's external trade and financial position. The proximate cause was the low level of Mexico's foreign exchange reserves. The size of the peso's depreciation is next discussed. This section reaches the conclusion that the 37 per cent depreciation of the peso that has occurred does not seem out of line with what might reasonably be expected, although it is on the high side of that range. The following section discusses the outlook for the Mexican Current Account under the assumption that the Mexican authorities will adopt an adequate economic stabilization program. It concludes that over the shorter term of a year or so some improvement might be expected in three specific areas: tourism, net earnings of border assembly plants, and net earnings from border transactions. The outlook for the Mexican capital account is also discussed briefly. Finally, a review of Mexico's reserves and its prospects for borrowing from the U.S. Treasury or the International Monetary Fund is presented.

RESTRICTED

Analytical Aspects of the Mexican Economic Situation

CONTENTS

RESTRICTED

CONTENTS (Cont.)

~~RESTRICTED~~

Analytical Aspects of the Mexican Economic Situation

I. Analysis of The Macro-Economic Setting

The principal malady of the Mexican economy over the past 3-1/2 years has been excess demand originating in the public sector. Real GDP increased at a historically high average rate of about 7-1/2 per cent per year in 1972-73, but slackened off somewhat to 5.9 and 4.0 per cent in 1974 and 1975 respectively. (See Table 1.) A sharp rise in the relative size of the public sector beginning in 1972 was incompletely offset by a rise in public-sector revenues. Although a substantial proportion of the consequent increase in the public-sector deficit was financed externally, this added to the external debt, and the excess demand and accompanying inflation added to the current-account deficit. Private and particularly public consumption expanded rapidly. Public investment increased, while private investment declined as a per cent of GDP. (See Table 2.) In large part because of the reduced rates of private investment the Mexican economy, at least in the short run, has by all reports, only limited unutilized capacity available. Consequently, the crucial objective in any Mexican economic stabilization program to complement the recent depreciation of the peso is to shift resources into the external sector and away from other uses. To accomplish this shift two adjustments will probably be required: reduction in the size of the public-sector deficit as a percentage of GDP and maintenance of a restored international competitive position. Both adjustments will tend to reduce the real income of the Mexican population.

A. Budget Policy

In 1972, the size of the consolidated public sector began to increase from about 14 per cent of GDP before 1972 to above 20 per cent in 1975.*/ (See Table 3.) This was the result of a deliberate policy to expand the size of the public sector, which had been relatively small, and to increase rates of public investment. While the share of public-sector revenues in Mexican GDP also rose, the increase was not as large as the increase in the share of expenditures. Hence the size of the public-sector deficit rose from under 3 per cent of GDP before 1972 to almost 9 per cent in 1975.

Current data are available only for the revenues and expenditures of the Federal Government, and the latest data are only for May, 1976. (See Table 4.) These data suggest no substantial decline in the absolute size of the public sector deficit in the first five months of this year, through the rate of increase may have been arrested.

We see no evidence that the absolute size of the Mexican public-sector deficit is related to the slowdown in Mexican real growth. But the cyclical position of Mexico, or more accurately Mexico's relative cyclical position, has contributed to Mexico's balance-of-payments problem. Mexico was probably surprised and was certainly disadvantaged when it experienced positive real growth of 5.9 per cent and 4.0 per cent in 1974 and 1975 at the same time that its major trading partner -- the United

*/ As is the case for many countries, data on the size of the public sector and its deficit can be compiled under many different definitions. The definition used in the text includes the Federal Government, Federal District, Social Security, budgetary controlled Decentralized Agencies and Enterprises (the number of such units increased in 1973), and the deficit financing of the largest non-budgetary controlled public enterprises.

States -- was experiencing negative real growth. The adverse cyclical income effects on Mexico's balance of payments were substantial, on the order of $500 million over the two years combined. The lagged effects of sluggish external demand and, perhaps, high inflation rates on its domestic economic growth are continuing. (See Table 5 showing the sluggish growth of industrial production through May (the latest month available) except in the petroleum, petrochemical, and, more recently, the mining sectors.)

One problem that has reportedly contributed to the expansion of the public-sector deficit is a lack of adequate administrative controls on the expenditure side, particularly regarding the Decentralized Agencies and Enterprises. The consequences of this deficiency became particularly acute as the public sector was allowed to expand after 1971. The Mexican authorities apparently recognize the need for reform in this area. President Echeverria's new program as outlined by Mr. Fernandez Hurtado, refers to a planned reduction in the public sector deficit "through strict programming and surveillance of public expenditure to attain quantitative goals related to the adjustment process of the economy." But we do not know the specifics of what the Mexican authorities have in mind, and any results in this area will no doubt be slow in coming.

On the revenue side, roughly half of the Federal Government's current revenues are raised through income taxes. But observers have commented that the tax system is complex with important instances of inconsistent treatment of the same form of income. It is badly in need of reform and rationalization. These characteristics of the tax system have contributed to the Government's failure to achieve its revenue targets in recent years. The Echeverria program mentions the need for increasing public sector revenues but is not specific except in calling for (1) an export surtax, (2) a reduction of tax rebates for exports, (3) a reduction of import taxes, (4) an excess profits tax, and (5) special fiscal treatment of private enterprises seriously affected by the exchange-rate depreciation. The first three types of measures are designed primarily to offset, in part, the effects of the depreciation on the external sector and not for revenue purposes.

The only specifics on the fiscal program that have been revealed are (1) a reduction in average import tariffs from 20 per cent to 9 per cent, which will have a negligible effect on revenues since the peso price of imports on which duties are levied will increase pari passu with the 58 per cent depreciation; (2) a reduction in the import tariff to finance export promotion from 2 to 1 per cent; (3) a one-year 20 per cent export tax on fish and agricultural products, and a one-year 7.5 per cent export tax on manufactured goods, which together might increase revenues by 5,000 million pesos; and (4) a removal of subsidies on exports of manufactured goods, which amounted to 1,861 million pesos in 1975. The net fiscal effects of these actions might lower the public-sector deficit by about 7,000 million pesos or about 0.7 per cent of GDP in 1976.

We understand that prior to the depreciation of the peso, technicians at the Bank of Mexico were tentatively talking about lowering the public-sector deficit from 9 per cent of GDP in 1975 to 3.5 per cent in

1978. We do not know how firm these plans were, whether they have been changed, or how they might be implemented.

B. Monetary Policy

The Bank of Mexico is required to help finance the Government's deficit. Thus, it has little independent scope to exercise monetary restraint. As the public-sector deficit grew, its financing placed an increasingly heavy drain on the internal savings of the country. Table 3 shows that, in 1975, more than 50 billion pesos were raised from internal sources to help finance the deficit, nearly five times as much as in 1971. As a percentage of GDP, the internal financing of the deficit was over twice as large in 1975 as in 1971. The Bank of Mexico had long been forcing the banks to absorb large amounts of Government securities through the reserve requirements, but this became increasingly difficult to accomplish as the size of the fiscal deficit grew rapidly, and the Bank of Mexico found itself obliged to hold increasing amounts of these securities. As a result, the rate of growth of the money supply, which had been averaging about 11 per cent in the years 1966-71, jumped to over 20 per cent. This was accompanied by increasing tightness of credit to the private sector, as reserve requirements were raised drastically. Interest rates in Mexico are administered and the process of changing them is cumbersome, often involving the introduction of a new financial instrument. The principal tool of monetary control is a complex set of reserve requirements. Nevertheless, it is useful to look at what has been happening over the past several years to the course of monetary policy and the growth of the money supply.

Except for an explosion in the rate of growth of the Mexican money supply -- defined as coin and currency plus demand deposits -- in 1972, which probably contributed substantially to the subsequent imbalances that developed in the Mexican economy, the course of monetary policy -- judging by the behavior of the money supply -- has been at best neutral. (See Table 6.) In 1973 and 1974, the growth in the money supply was slightly more rapid than the rate of growth of consumer prices. (See Tables 6 and 7.) In 1975, the growth in the money supply became marginally more expansionary. Through May of this year, which is the last month for which data are available, the growth of the money supply (year over year) has edged down slightly from over 20 per cent to under 20 per cent*/ while consumer prices were rising at year-over-year rates around 15 per cent.

We do not know what has happened to Mexico's money supply between May and August. The Echeverria program states that "a system of regulated credit growth will be established by the Bank of Mexico for use by the private and public sectors." We do not know what this new system involves, but as a practical matter, the Bank of Mexico cannot refuse credit to the Government. Thus, success in tightening monetary policy depends upon success in reducing the public-sector deficit and upon the amount of external financing for the deficit that is available.

Interest rates on deposits in Mexican financial institutions are administered by the Bank of Mexico. The fact that Mexican interest rates

---

*/ The Bank of Mexico releases money supply data on a seasonally-adjusted as well as a not-seasonally-adjusted basis. The seasonal factors are apparently large. On a seasonally-adjusted basis the money supply in May 1976, was 8.2 per cent above December, 1975. On a not-seasonally-adjusted basis, the money supply shows a decline of 4.3 per cent. On both bases the money supply in May was 19.7 per cent above the level a year earlier.

were not permitted to rise in line with interest rates on dollar-denominated assets in 1973-74 must have contributed to some net private capital outflow in these years. (See Table 8.) Banks were authorized to issue six and nine months certificates of deposits in early 1974. Initially, however, these instruments had relatively unattractive yields. In 1975 the interest-rate differential shifted more in favor of the large Mexican CDs as U.S. interest rates declined, and in August of this year the maximum interest rates payable on small CDs was raised by 1 percentage point while that on large CDs was raised 1.25 percentage points.

The Mexican government cannot afford for balance-of-payments or other reasons to lower interest rates. In fact, since real interest rates on short-term assets appear to be negative in Mexico, there may be room to raise them substantially. The only mention of interest-rate policy in the Government's new program which was announced on September 1 was the statement that "interest rates for small savers will be increased." At present we have no further information about what the Bank of Mexico plans to do with its interest-rate policy or monetary policy in general.

C. Investment

Between 1970 and 1975 real private investment increased only 12.5 per cent as real GDP rose 31 per cent. In 1975 real private investment is estimated to have been less than in 1974.*/ This stagnation in private investment is due to several factors. Two are most prominent. (1) Private entrepreneurs were distrustful of President Echeverria when he took office in December, 1970. His administration was committed to adjusting Mexico's

*/ Quarterly national income statistics are not available for Mexico.

severely skewed income distribution and, by implication, threatened the continuation of the previous administrations' extremely favorable environment for private investment. (2) It seems clear that there was some crowding out of private investment in 1975. Between 1970 and 1975 private consumption rose 27 per cent in real terms, real public consumption rose 77 per cent, and real public investment rose by more than 100 per cent.

Some of these public investment projects were related to social programs -- housing and rural development -- but many were designed to add directly to the capital stock -- petroleum, petrochemicals, steel, fertilizers.*/ Unfortunately, except in petroleum, the payoff to these large projects will not come until 1977 and later. In the meantime, these projects absorb resources and place strains on the domestic economy and the Mexican balance of payments.

The Government's new program announced on September 1 indicated that there would be no reduction in the rate of public investment in productive activities and social services. (Presumably, President Echeverria meant that there would be no reduction in the real rate of public investment.) Two implications can be drawn from this aspect of the Government's program: (1) These public investment projects will continue to contribute to an expansion of the nominal size of public sector expenditures and most of them are being undertaken by decentralized enterprises that are

*/ Data on the split between social and industrial investment do not appear to be available.

under only loose financial control by the Federal Government. (2) Until these public investment projects begin to yield positive returns, the productive capacity of the overall Mexican economy will be under strain. There appears to be little slack available to reduce the external deficit on current account (with the possible exception of the tourist industries and the border assembly plants); consequently, the reduction in the current-account deficit must occur through a reduction in real absorption rather than through an increase in real output.

D. Wages and Prices

Data on wage rates and earnings rates in Mexico are not readily available. The best proxy is the series for minimum wage rates in Mexico City. (See Table 9.) Increases in official minimum wages tend to set the standard for other wage settlements. Between January 1974 and January 1976, when the most recent adjustment in minimum wages occurred, real wages increased by almost 13 per cent, while real GDP increased by only 10 per cent.

An adjustment in wages for government workers is due on September 30. This, in turn, is likely to lead to an increase in minimum wages. President Echeverria has promised that this adjustment would be designed to compensate for the purchasing power lost since January. Mr. Fernandez Hurtado has indicated privately that the Government does not feel it can afford politically to enforce a reduction in real wages. In fact, union leaders have threatened a general strike unless nominal wages are increased by 65 per cent. If this is the case, then it will prove difficult to restrain the growth of private consumption to the extent necessary to permit an expansion in private investment and a reduction in the current account deficit. A successful depreciation leading to an improvement in the country's current account requires a reduction in real absorption in the case where an economy has little or no excess capacity.

On the price side, the situation is even more precarious. From April through July, the month-to-month increase in the Mexican consumer price index declined to under 1 per cent -- compared with month-to-month increases of over 1 per cent in late 1975 and early 1976 -- and the year-over-year increase declined to about 13 per cent from the early pattern of over 15 per cent. (See Table 7.) Generalized price increases accompanying the recent substantial depreciation of the peso will add to these inflationary pressures.

The Mexican government has indicated its intention to hold down the rate of inflation and mop up excess profits resulting from the depreciation. It remains to be seen how successful it will be in this effort. The crucial issue is probably not how large the direct price effects of depreciation are but rather how much will be passed through into increases in nominal wages. One step the Government can take and has indicated it will take is in the area of prices of services supplied by the public sector. Prices in this sector have tended to lag behind increases in the general price level and increases in costs. *Ceteris paribus*, any tendency to hold down these prices further would only add to the size of the public-sector deficit and produce further distortions in the economy.

II. Analysis of the Peso Depreciation

The Mexican current account position deteriorated rapidly after 1972. (See Table 10.) Moreover, in 1973 the Mexican inflation rate began to diverge substantially from that of the United States, to whose currency the peso had been pegged at an unchanged rate since 1954. This cumulative divergence continued through mid-1976. Thus, it became increasingly clear to many observers that the peso would have to be devalued or allowed to depreciate; the only question was when. Mexico's gross reserves of foreign exchange declined from $1,142 million on March 31, 1976, to an estimated $537 million on August 9 -- despite a drawing of the full $360 million Federal Reserve swap line on April 9, 1976 and drawings on Euro-credits. (See Table 11.) Mexico was apparently able to rebuild its foreign exchange reserves by over $250 million between August 9 and August 31 through heavy official borrowing on the private market. But the prospects of a significant underlying improvement in Mexico's reserves over the following several months were dim.

Consequently, Mexico's Secretary of Finance and Public Credit, Mr. Mario Ramon Beteta, announced late on August 31, that the fixed peso-dollar exchange rate was being abandoned and that the peso would be allowed to float subject to central bank intervention to prevent speculative and erratic fluctuations. The peso quickly depreciated about 40 per cent to a price of over 20 pesos per U.S. dollar compared with 12.50 per dollar at the old parity. On September 13, the peso was appreciated about 3 per cent and stabilized at 19.70/19.90 per dollar, equal to a

58 per cent increase in the peso price of the U.S. dollar or to a 37 decline in the dollar value of the peso.

The analysis in Part I above indicated that if the depreciation of the peso is to be successful in restoring a sustainable pattern to the structure of Mexico's international transactions, it must be accompanied by a strong domestic economic stabilization program. Domestic aggregate demand should be restrained through a reduction in the size of the public sector deficit. Monetary policy should be tightened in support of aggregate-demand policy and to encourage a net inflow of domestic and foreign capital. Finally, real wages should be restrained, if not reduced, to curb private consumption.

On the assumption that Mexico adopts an adequate domestic economic stabilization policy in support of its new exchange-rate policy, we can analyze how an improvement in Mexico's external accounts will come about and over what time period. In the short run any improvement in the current account should be the result of an increase in tourist earnings and earnings on net border transactions and from border assembly plants. In the longer run of a couple of years we can expect some pick up in merchandise exports and reduction in merchandise imports.

A. The Balance of Payments Situation Prior to the Peso's Depreciation

The decision to let the Mexican peso depreciate was the culmination of a steady deterioration in the country's external trade and financial position, caused partly by internally generated inflationary pressures and partly by economic and financial developments in the rest of the world. The Mexican deficit on current account rose from an average of about $750 million in 1970-72, to $1.1 billion in 1973, and over $3.6 billion in 1975. (See Table 10.) The Mexican current account deficit was not directly affected by the increase in petroleum prices since Mexico, in 1973, was a only small net importer of petroleum and has since become a net oil exporter. The value of merchandise imports rose sharply partly because of the world-wide inflation and partly because of excess demand in the Mexican economy. The value of exports also rose, but less rapidly. The growth of Mexican exports was slowed in the last part of 1974 and in 1975 by the world recession, which also contributed to a 5 per cent decline in the country's important tourist earnings, and by the deterioration of its competitive position. (See Table 12 for data on the composition of Mexican exports and imports and Table 13 for data on the geographic distribution of its trade.) The deterioration of Mexico's competitive position and the influence of the U.S. recession was also reflected in the reduced net contribution of border assembly plants to the Mexican balance of payments and the reduction in the rate of increase of the net surplus on so-called border transactions.

To cover this growing current account deficit and net errors and omissions, which turned negative in 1973 -- presumably, reflecting capital flight -- a substantial increase in external borrowings was required. (See Table 14.) At the end of 1975, the external debt was estimated at $20-22 billion, consisting of about $14 billion in debts of the public sector (of which $11.3 billion carried an original maturity of one year or more) and private sector debts of $6-8 billion. Mexico's total external debt may well have climbed by at least another $2.5 billion since the end of 1975. Claims on Mexico by U.S. banks amounted to $11,537 million at the end of June, 1976, up $3,388 million from the end of September, 1975, when comprehensive data were first collected.

Two features of the growing Mexican external debt are (1) the growing concentration of the debt in accounts of the public sector and (2) the deterioration of the quality of the debt as a result of its shorter average maturity. The debt service on public debt of maturity of more than one year was 25 per cent of exports in 1975, having reached a peak ratio of almost 30 per cent in 1968; it was 18 per cent in 1974. For what the concept is worth, this ratio will definitely increase over the next several years.

B. The Size of the Peso's Depreciation

The Mexican peso has been allowed to appreciate slightly after its initial depreciation and has been effectively pegged at a rate *vis-à-vis* the U.S. dollar at which the dollar is 58 per cent more expensive in terms of pesos than it was from April 1954 through August 31, 1976. The question arises of how large a depreciation of the peso is appropriate.*/

One approach is to argue that the peso's value should be determined primarily by market forces of supply and demand. However, the Mexican authorities are unlikely to permit the peso to float freely for an

*/ We have been told that the IMF has calculated that the peso should depreciate by 40-50 per cent, but we do not know the basis of this calculation.

extended period of time. They argue that the peso market is not extensive enough to operate without a substantial central bank presence in the market. In fact, they have announced a new target rate (19.70-19.90 per dollar) for the peso without as yet declaring a new parity.

A second possible line of analysis is to apply (admittedly crude) relative purchasing-power-parity concepts to the question. From 1960 to about 1972, the rate of increase of consumer prices and the GNP deflator in the United States was roughly equal to the rate of increase in these price measures in Mexico. On the other hand, the rate of increase in wholesale prices was much more rapid in Mexico over this period.

In 1975, however, using 1970 as a base, the Mexican wholesale price index had increased 4 per cent more than the U.S. WPI (See Table 15.); over the same period, the Mexican consumer price index and GDP deflator increased about 27 per cent more than the similar U.S. price measures. (See Tables 7 and 16.) Moreover, by July 1976, the Mexican WPI had increased 18 per cent more than the U.S. WPI on a 1970 base, and the Mexican CPI had increased 36 per cent more on the same base.

Two conclusions can be drawn from these data. First, the 58 per cent rise in the peso price of the dollar has more than offset the price differential with the United States that had opened up on any price measure at the time of the depreciation. Second, the Mexican-U.S. price differential was widening and could reasonably be expected to widen further in the months ahead even without the depreciation.

A third possible line of analysis is to apply the price elasticities approach to estimate how large a devaluation of the peso would be necessary to achieve a given improvement in the Mexican current account over the same time period. However, estimates of the relevant price elasticities are not available for Mexico, and, given the rapid rate of inflation in Mexico, it would be necessary in any application of this technique to calculate how much of a particular depreciation of the peso would be eroded by subsequent price inflation.

The Treasury staff has made a crude calculation based on estimates of price elasticities of the demand for exports and imports of other countries and the assumption that the objective is to generate a $2.1 billion improvement in the Mexican current-account balance by 1978. In this calculation it is estimated that a 40-50 per cent increase in the peso price of dollars would be needed. This appears to be a realistic estimate based upon this approach.

A more eclectic approach can also be considered. Under this approach explicit recognition can be given to several important factors. First, the underlying rate of Mexican inflation is likely to be at least double that in the United States for at least the next two years. This is because of the build up of inflationary pressures in Mexico, on the one hand, and, on the other hand, the depreciation itself. Thus, under the most optimistic scenario, the Mexican price level is likely to increase 10-12 per cent more over the next two years than the U.S. price level. If the peso is to be fixed more or less permanently to the dollar again, then this amount must be added to the estimate of the needed depreciation.

Second, it should be recognized that the Mexican authorities have said that they would reduce some import restrictions and remove their export subsidies following the depreciation of the peso. These actions are desirable in their own right and are a normal accompaniment to devaluations by developing countries. They serve, however, to reduce the size of the effective devaluation.

Third, given that the Mexican authorities have indicated their intention to fix eventually a new parity with the U.S. dollar (for the moment a rate of 19.70/19.90 per dollar has been chosen), given the fact that their reserves have been severely depleted, and given the fact that Mexico has built up a substantial external debt burden, it would be prudent for the Mexican authorities to err on the side of too large rather than too small a devaluation.

Finally, on a related point, the Mexican authorities have apparently indicated an interest in seeing a substantial initial depreciation of the peso that might be followed by a subsequent small appreciation. The rationale of this strategy might be to encourage a net capital inflow, since the expected appreciation would add to the expected return on peso-denominated assets. Similarly, the actual small appreciation of the peso subsequent to the initial depreciation may have served to increase confidence in the currency.

In summary, the depreciation of the peso that has occurred does not seem out of line with what might reasonably be expected, although it is on the high side of that range. This judgment is based, however, on the premise that an appropriate domestic economic stabilization program will be adopted in order to ensure that the effects of the depreciation on the Mexican balance of payments will not be eroded.

C. The Outlook for the Current Account

Under this heading it is reasonable to ask, first, what would be a realistic target for the Mexican current account. As a developing country it would be abnormal to expect Mexico to run a current-account surplus. On the other hand, the country cannot expect to add to its external debt at the rate it has over the past four years (1973-1976). Given the increase in nominal magnitudes since Mexico last appeared to be in balance-of-payments equilibrium in the early 1970s, one might take as a starting point a target for the Mexican current account of, say a deficit of $1-$1.5 billion, compared with the annual deficits in the earlier period of about $750 million.

One might ask next where this improvement might come from. Over the longer term of two to three years, one might expect it to come generally from an increase in current account receipts, including those from expanded oil exports, relative to current account payments. But, as we have already stressed, this will require a domestic economic stabilization program designed to restrain the growth of domestic demand and hold down, if not reduce, the level of real wages and incomes.

Over the shorter term of a year, one might expect some improvement in three specific areas aside from favorable cyclical effects as a result of higher U.S. growth and, perhaps, lower Mexican growth. The first area is tourism, where receipts declined by five per cent in 1975 and increased by only 16 per cent in 1974, compared with increases of 22 and 29 per cent in 1972 and 1973. (See Table 10.) On the payments side, Mexican tourist payments rose by 30 per cent in 1974 and 19 per cent in 1975, compared with 17 per cent in 1973. It is reported that the tourist industry is one sector where there definitely is excess capacity in Mexico. It can be expected that the income and price effects of the peso's depreciation will combine to produce a substantial increase in Mexican tourist receipts and at least a decline in the rate of increase in tourist payments.

The second area of possible immediate improvement is receipts from border assembly plants. Receipts from these installations increased by an average of over 50 per cent per year in 1972-74, but they stagnated in 1975. With the dramatic change in relative costs as a result of the peso's depreciation, it might be expected that there will be a revival in this area. But a crucial factor will be what happens to nominal wages in Mexico following the depreciation of the peso. If U.S. entrepreneurs are not convinced that the rate of increase in nominal wages will be held substantially below the increase in the peso price of the U.S. dollar, then one can expect no substantial gain in this area.

The third area of possible immediate improvement is net receipts from so-called border transactions. (There are the large volume of transactions that occur as border residents cross over to make purchases or work.) These net receipts had been increasing at around a 20 per cent annual rate from 1971 to 1973, but the rate of increase declined to 8 per cent in 1974 and under 6 per cent in 1975. As in the case of tourism, this is an area where income and price effects can have a relatively dramatic impact over a short period.

Over the longer term of a couple of years, one might expect a pick up in regular merchandise exports and a reduction in imports compared with what they otherwise might have been. Because many categories of imports are now subject to quantitative restrictions (leading to Mexican prices of imported goods -- prior to the depreciation -- that were as much as 25 per cent above the world price), the price effect of the devaluation on imports might be less than that on exports. On the other hand, the demand for Mexican exports other than manufactures may be relatively price inelastic; moreover, the value of imports is larger. On balance, we would look for about an equal impact on both types of trade.

D. The Outlook for the Capital Account

The first item to notice with respect to capital account transactions is that the Mexican authorities have wisely and pointedly declined to institute capital controls. They said explicitly that the country's tradition of free capital movements would be maintained and that Mexican financial institutions would receive adequate liquidity to assure that their commitments (to foreigners) would be met. This latter action might lead to an unwanted expansion or the prevention of a reduction in domestic liquidity, but it is the price that must be paid over the short run to maintain stability and guard against attempted capital flight.

In addition to relying, as was mentioned earlier, on a possible further small appreciation of the peso to add to the attractiveness of peso-denominated assets, the Mexican authorities might also consider tightening up on monetary policy and raising interest rates not only to dampen domestic demand but also to encourage a net capital inflow.

Finally, the primary objective of Mexican policy should be to reduce the rate of public-sector borrowing abroad and to replace it if possible by private-sector borrowing for investment. But progress in this area will depend on progress in reducing the current account deficit, which, in turn will depend on the adoption of an adequate domestic economic stabilization policy.

E. The Outlook for Mexico's Reserves and Borrowing from Official Institutions

As is indicated in Table 11, Mexico has experienced in 1976 a substantial decline in its foreign exchange reserves amounting to an estimated $365 million from December 31, 1975, to August 31, 1976. In addition it has acquired a $360 million short-term official debt under the Federal Reserve swap network. Although at one point in August the Mexican authorities were apparently concerned that they lacked adequate international reserves to meet their reserve requirements against notes in circulation, this constraint has been relaxed through the subsequent depreciation of the peso which raised the peso value of Mexican reserves pari passu. Nevertheless, Mexico has a clear need to build up its foreign exchange reserves. This may be one reason why the Mexican authorities are unconcerned about a possible excessive depreciation of the peso.

If, nevertheless, the Mexican authorities need additional foreign exchange reserves to intervene in the exchange market or to repay the Federal Reserve swap drawing, they might turn to the U.S. Treasury or the International Monetary Fund.

The Mexican stabilization agreement with the U.S. Treasury is for $300 million. The first $50 million can be drawn immediately. Another $100 million can be drawn upon certification by the IMF management that the Mexican authorities have adopted a stabilization program that would make Mexico eligible, in the IMF staff's view, for a drawing from the upper IMF credit tranches. A final $150 million can be activated but must remain on deposit with the Exchange Stabilization Fund. A final provision in the Treasury's stabilization agreement with Mexico is that Mexico must first have drawn on the Federal Reserve swap line. It is not clear whether this means that a drawing on the ESF cannot be outstanding when the Federal Reserve swap is repaid. It apparently is clear that Mexico cannot draw on the ESF and immediately use the proceeds to repay the Federal Reserve System.

Turning to the IMF, with which the Mexican authorities are reportedly currently negotiating, Mexico could draw up to $730 million under the IMF's regular credit facilities -- that is, not including the Compensatory Financing Facility or the Extended Fund Facility. Mexico could, first, draw $113 million (SDR 98 million at $1.15 per SDR) equal to its reserve position in the IMF. To do this it would merely have to declare that it has a "balance of payments need." Mexico could, next, draw its first credit tranche of $154 million (one fourth -- SDR 92.5 million -- of its IMF quota of SDR 370 million enlarged by 45 per cent according to the Jamaica agreement to SDR 134 million and valued at $1.15 per SDR). To do this Mexico would have to outline for the IMF its intentions to follow corrective domestic and balance-of-payments adjustment measures. Finally, Mexico could enter into a stand-by agreement involving possible drawings on its three higher expanded IMF credit tranches totaling $462 million. Under this stand-by agreement the IMF would have to agree that Mexico had adopted an adequate balance-of-payments adjustment program. The agreement would normally involve conditions placed on Mexico's domestic economic policies. Any drawings under this agreement would normally be spread out over as much as 12 months. Any of Mexico's IMF drawings would have to be repaid in 3-5 years.

Prepared by Yves Maroni and Edwin M. Truman
Division of International Finance
September 15, 1976

Table 1

Mexico - Gross Domestic Product

1965 - 75

	GDP - Current Prices		GDP - Constant Prices	
	Billions of Pesos	Annual Change (%)	Billions of 1960 Pesos	Annual Change (%)
1965	252.0	-	212.3	-
1966	280.1	+11.2	227.0	+6.9
1967	306.3	+ 9.4	241.3	+6.3
1968	339.1	+10.7	260.9	+8.1
1969	374.9	+10.6	277.4	+6.3
1970	418.7	+11.7	296.6	+6.9
1971	452.4	+ 8.1	306.8	+3.4
1972	512.3	+13.2	329.1	+7.3
1973	619.6	+20.9	354.1	+7.6
1974	812.9	+31.2	375.1	+5.9
1975 p/	972.2	+19.6	390.1	+4.0

p/ Preliminary.

Source: Bank of Mexico.

Table 2

Mexico - Expenditure on

Gross Domestic Product

1965-75

A - Billions of Pesos Current Prices	1965	1966	1967	1968	1969	1970	1971	1972	1973	1974	1975p/
GDP	252.0	280.1	306.3	339.1	374.9	418.7	452.4	512.3	619.6	812.9	972.2
Consumption	210.1	231.1	251.0	278.3	305.4	344.9	375.2	416.2	496.5	660.4	798.3
Public	14.2	16.4	17.6	20.2	22.5	25.7	29.8	35.3	42.6	58.4	80.4
Private	195.9	214.7	233.4	258.1	282.9	319.2	345.4	380.9	453.9	602.0	717.9
Investment	44.1	50.4	59.4	65.8	72.7	82.2	82.2	101.2	131.0	173.7	205.8
Public	16.6	15.6	17.2	23.5	24.8	23.2	24.1	34.2	51.6	64.8	86.4
Private	27.5	34.8	42.2	42.3	47.0	59.0	58.1	67.0	79.4	108.9	119.4
Net Foreign Balance1/	-2.2	-1.4	-4.1	-5.0	-3.2	-8.4	-5.0	-5.1	-7.9	-21.2	-31.9
Imports	26.0	27.4	29.9	34.3	38.5	42.7	42.7	50.2	65.4	97.0	106.5
Exports	23.8	26.0	25.8	29.3	35.3	34.3	37.4	45.1	57.5	75.8	74.6
B - As % of GDP											
Consumption	83.4	82.5	81.9	82.1	81.4	82.4	82.9	81.2	80.2	81.2	82.1
Public	5.6	5.9	5.8	6.0	6.1	6.6	6.9	7.2	8.3	7.2	8.3
Private	77.7	76.7	76.1	76.1	75.4	76.3	76.3	74.3	73.3	74.0	73.8
Investment	17.5	18.0	19.4	19.4	19.4	19.6	18.2	19.8	21.1	21.4	21.2
Public	6.6	5.6	5.6	6.9	6.6	5.5	5.3	6.7	8.3	8.0	8.9
Private	10.9	12.4	13.8	12.5	12.8	14.1	12.9	13.1	12.8	13.4	12.3
Net Foreign Balance1/	-0.9	-0.5	-1.3	-1.5	-0.8	-2.0	-1.1	-1.0	-1.0	-2.6	-3.3

p/ Preliminary.

1/ National income accounts definition.

Sources: Bank of Mexico and World Bank.

Table 3
Mexico - Consolidated Public Sector Accounts
1965 - 75

A - Billions of Pesos	1965	1966	1967	1968	1969	1970	1971	1972	1973 p/	1974 p/	1975 p/
Revenues	29.6	32.1	34.3	38.3	43.5	48.4	52.5	58.0	77.4	95.7	125.4
Expenditures	38.8	36.5	40.6	50.5	55.3	56.4	62.7	77.7	114.7	145.7	200.6
Budgetary Deficit(-)	-9.2	-4.4	-6.3	-12.2	-11.8	-8.0	-10.2	-19.7	-37.3	-50.0	-75.2
Other 1/ Deficits (-) or Surpluses (+)	n.a.	n.a.	n.a.	n.a.	n.a.	-0.7	0.2	-3.0	-2.5	-4.0	-12.0
Overall Deficit	-9.2	-4.4	-6.3	-12.2	-11.8	-8.7	-10.0	-22.7	-39.8	-54.0	-87.2
Internally Financed	7.7	2.5	6.6	15.6	7.8	6.5	11.2	21.8	27.0	25.6	52.9
Externally Financed	1.5	1.9	-0.3	-3.4	4.0	2.2	-1.2	0.9	12.8	28.4	34.3
B - As % of GDP											
Revenues	11.7	11.5	11.2	11.3	11.6	11.5	11.6	11.4	12.5	11.8	13.0
Expenditures	15.4	13.1	13.2	14.9	14.7	13.4	13.8	15.2	18.5	19.0	20.7
Budgetary Deficit (-)	-3.7	-1.6	-2.0	-3.6	-3.1	-1.9	-2.2	-3.8	-6.0	-6.2	-7.7
Other 1/ Deficits (-) or Surpluses (+)	n.a.	n.a.	n.a.	n.a.	n.a.	-0.2	negl.	-0.6	-0.4	-0.5	-1.2
Overall Deficit	-3.7	-1.6	-2.0	-3.6	-3.1	-2.1	-2.2	-4.4	-6.4	-6.7	-8.9
Internally Financed	3.1	0.9	2.1	4.6	2.1	1.6	2.5	4.2	4.3	3.2	5.4
Externally Financed	0.6	0.7	-0.1	-1.0	1.0	-0.5	0.3	0.2	2.1	3.5	3.5

p/ Preliminary.
1/ Refers to public enterprises not controlled through the budget.

NOTE: The number of budgetary controlled enterprises increased in 1973, so that the data for 1973-75 are not strictly comparable with 1965-72.

Source: World Bank.

Table 4

Mexico - Revenues and Expenditures of

the Federal Government

Since 1970

(Annual Rates)

	Revenues		Expenditures		Deficit	
	in billion pesos	as % of GDP	in billion pesos	as % of GDP	in billion pesos	as % of GDP
1970	33.9	8.1	40.2	9.6	-6.3	-1.5
1971	36.5	8.1	41.3	9.1	-4.8	-1.1
1972	42.3	8.3	59.1	11.5	-16.7	-3.3
1973	53.8	8.7	81.2	13.1	-27.4	-4.4
1974	72.9	9.0	104.1	12.8	-31.2	-3.8
1975	103.1	10.6	145.1	14.9	-42.0	-4.3
1974 - I	61.2		75.6		-14.4	
II	71.2		85.2		-14.0	
III	71.2		96.8		-25.6	
IV	87.6		158.8		-71.2	
1975 - I	91.2		125.6		-34.4	
II	105.2		133.2		-28.0	
III	100.0		138.4		-38.4	
IV	116.0		183.2		-67.2	
1976 - I	116.0		157.6		-41.6	
Jan.	121.2		111.6		+ 9.6	
Feb.	88.8		140.4		-51.6	
Mar.	138.0		220.8		-82.8	
Apr.	124.8		164.4		-39.6	
May	164.4		174.0		- 9.6	
Jan.-May	127.4		162.2		-34.8	

Source: Bank of Mexico

Table 5

Mexico - Index of Industrial Production
Since 1970
(1970 = 100)

	Total		Manufacturing		Petroleum		Mining	
	Index	Change From Year Earlier (Percent)	Index	Change From Year Earlier (Percent)	Index	Change From Year Earlier (Percent)	Index	Change From Year Earlier (Percent)
1970	100.0	+6.3	100.0	+5.2	100.0	+16.0	100.0	+2.7
1971	102.0	+2.0	102.8	+2.8	102.4	+ 2.4	96.7	-3.3
1972	112.5	+10.3	112.7	+9.6	108.6	+ 6.1	101.2	+4.7
1973	123.4	+ 9.7	123.0	+9.1	110.0	+ 1.3	107.7	+6.4
1974	132.3	+ 7.2	131.5	+6.9	127.6	+16.0	119.2	+10.7
1975	137.7	+ 4.1	136.4	+3.7	141.0	+10.5	109.7	- 8.0
1974 - I	132.3	+11.5	132.7	+9.9	118.5	+17.9	122.9	+17.9
II	132.8	+ 9.0	134.0	+9.9	116.8	+ 7.7	117.4	+14.4
III	130.3	+ 4.7	127.7	+4.6	138.4	+22.4	121.6	+ 6.0
IV	133.9	+ 4.0	131.8	+3.4	136.8	+15.7	114.8	+ 4.8
1975 - I	131.5	- 0.6	129.9	-2.1	132.5	+11.8	118.3	- 3.7
II	141.3	+ 6.4	142.2	+6.1	139.2	+19.2	103.5	-11.8
III	137.8	+ 5.8	135.9	+6.4	141.3	+ 2.1	113.6	- 6.6
IV	140.0	+ 4.6	137.4	+4.2	151.2	+10.5	103.4	- 9.9
1976 - I	142.5	+ 8.4	142.4	+9.6	142.2	+ 7.3	103.3	-12.7
Jan.	138.5	+ 1.6	137.4	+1.0	138.4	+ 3.4	103.1	-13.2
Feb.	139.0	+ 7.5	139.0	+7.8	141.2	+12.6	94.7	-17.9
Mar.	150.1	+16.5	150.9	+20.9	147.0	+ 6.2	112.2	- 7.1
Apr.	141.9	- 2.7	139.2	-6.1	153.7	+10.8	102.3	- 3.9
May	147.2	+ 4.7	141.0	-0.6	172.8	+23.3	119.7	+31.3

Source: Bank of Mexico.

Table 6

Mexico -- Money Supply (Coin and Currency plus Demand Deposits)
(1964 - May 1976)

	Amount outstanding[1/] (billions of pesos)	Percentage change from previous year
1964 - December	24,793.5	--
1965 - December	26,486.7	+6.8
1966 - December	29,395.8	+11.0
1967 - December	31,760.4	+8.0
1968 - December	35,892.8	+13.0
1969 - December	39,804.4	+11.2
1970 - December	43,999.9	+10.5
1971 - December	47,633.1	+8.3
1972 - December	57,736.5	+21.2
1973 - December	71,658.2	+23.8
1974 - December	87,412.3	+22.0
1975 - December	105,971.5	+21.2
1974 - Quarter I	73,901.0	+22.9
Quarter II	77,644.2	+21.7
Quarter III	81,048.4	+19.9
Quarter IV	85,069.2	+19.5
1975 - Quarter I	89,802.4	+21.5
Quarter II	95,620.0	+23.2
Quarter III	98,744.2	+21.8
Quarter IV	103,880.5	+22.1
1976 - Quarter I	108,313.5	+20.6
1976 - January	107,049.9	+22.1
February	108,621.1	+21.5
March	109,269.4	+18.4
April	111,263.5	+19.8
May	114,707.5	+19.7

1/ Seasonally adjusted.

Source: Banco de Mexico, Indicadores Economicos.

Table 7

Consumer Price Index in Mexico and the United States 1/ Since 1968

	Mexico		United States		Ratio of Mexican Index to U.S. Index (1970=100)
	Index 2/ (1970=100)	Change from Year Earlier (Percent)	Index (1970=100)	Change from Year Earlier (Percent)	
1968	91.7		89.6		102.2
1969	95.1	+3.7	94.4	+5.4	100.7
1970	100.0	+5.2	100.0	+5.9	100.0
1971	105.7	+5.7	104.3	+4.3	101.3
1972	111.0	+5.0	107.7	+3.3	103.1
1973	123.6	+11.4	114.4	+6.2	108.0
1974	151.3	+22.4	127.0	+11.0	119.1
1975	176.8	+16.9	138.6	+9.1	127.6
1974 - I	142.4	+22.2	121.6	+9.8	117.1
II	146.8	+22.2	125.0	+10.5	117.4
III	153.1	+21.9	128.9	+11.5	118.8
IV	162.8	+23.2	132.6	+12.1	122.8
1975 - I	168.5	+18.3	135.0	+11.0	124.8
II	173.4	+18.1	137.1	+9.7	126.5
III	179.9	+17.5	140.1	+8.7	128.4
IV	185.5	+13.9	142.3	+7.3	130.4
1976 - I	193.7	+15.0	143.7	+6.4	134.8
II	198.9	+14.7	145.5	+6.1	136.7
1976					
Jan.	190.4	+13.3	143.3	+6.8	132.9
Feb.	194.1	+15.2	143.7	+6.3	135.1
Mar.	196.6	+16.3	144.0	+6.1	136.5
Apr.	197.7	+15.6	144.6	+6.0	136.7
May	199.2	+15.3	145.5	+6.2	136.9
June	199.7	+13.3	146.3	+5.9	136.5
July	200.5	+13.2	147.1	+5.4	136.3

1/ Indices are averages for periods shown.
2/ Refers to consumer prices in Mexico City.

Source: International Monetary Fund, International Financial Statistics.

Table 8
Mexico - Selected Interest Rates in Mexico
and the United States since 1970
(Gross Average Rates)

	Mexico			United States	
	Promissory Notes	Six Month Certificates of Deposit		Six Month Certificates of Deposit	
	One mil. pesos or more	Less than 1 mil.pesos	1 mil.pesos or more	Less than $100,000	More than $100,000
1970- I	12.22	--	--	5.00	6.75
II	12.22	--	--	5.00	6.75
III	12.22	--	--	5.00	6.75
IV	12.22	--	--	5.00	5.63
1971- I	11.48	--	--	5.00	4.19
II	11.11	--	--	5.00	4.91
III	11.11	--	--	5.00	5.52
IV	11.11	--	--	5.00	4.83
1972- I	10.60	--	--	5.00	4.10
II	10.60	--	--	5.00	4.82
III	10.60	--	--	5.00	5.08
IV	10.60	--	--	5.00	5.44
1973- I	10.60	--	--	5.00	6.27
II	10.88	--	--	5.00	7.38
III	12.70	--	--	5.50	9.22
IV	12.70	--	--	5.50	8.62
1974- I	12.78	10.94	11.94	5.50	8.10
II	13.74	11.21	12.48	5.50	10.08
III	14.20	11.44	12.94	5.50	10.80
IV	14.20	11.44	12.94	5.50	8.69
1975- I	14.20	11.44	12.94	5.50	6.60
II	14.20	11.44	12.94	5.50	6.73
III	14.20	11.44	12.94	5.50	7.19
IV	14.20	11.44	12.94	5.50	6.16
1976- I	13.91	11.30	13.11	5.50	5.58
II	13.91	11.30	13.11	5.50	5.85
January	13.91	11.30	13.11	5.50	5.44
February	13.91	11.30	13.11	5.50	5.54
March	13.91	11.30	13.11	5.50	5.77
April	13.91	11.30	13.11	5.50	5.48
May	13.91	11.30	13.11	5.50	5.88
June	13.91	11.30	13.11	5.50	6.18
July	13.91	11.30	13.11	5.50	5.86
Aug. (1Q)	n.a.	12.30	14.36	5.50	5.73

Source: Bank de Mexico, Indicadores Economicos.

Table 9

Mexico -- Increases in Minimum Wages, Mexico City, January 1966 - January 1976

	Percent Increases			Index	
	Nominal Wage	Real Wage	Real GDP 1/	Real Wage Jan 64 =100	Real GDP 1/ 1963= 100
January 1966	16.3	7.1	18.4	107.1	118.4
January 1968	13.0	8.3	13.7	115.9	134.6
January 1970	13.2	3.7	15.2	120.2	155.0
January 1972	19.7	7.5	10.6	129.2	171.4
January 1974 2/	34.4	1.7	15.4	131.4	197.8
October 1974	22.0	7.1	5.9	140.7	209.5
January 1976	24.0	5.4	4.0	148.3	217.8

1/ GPD changes are for intervals between wage changes except for October 1964 and January 1976, for which GDP changes for respectively all of 1974 and 1975 are shown because GDP data are available only for full years.

2/ Wages were raised by 18 percent in Octover 1973 and by 14 percent in January 1974. The increase shown for January 1974 includes the October 1973 change.

Table 10

Mexico - Balance of Payments
Since 1970
(in million dollars)

	Year 1970	Year 1971	Year 1972	Year 1973	Year 1974	Year 1975	1st half 1975	1st half 1976 p/
I. Balance on Current Account	-879.9	-676.4	-707.2	-1,109.8	-2,458.3	-3,529.0	n.a.	n.a.
II. Balance on goods and services	-945.9	-726.4	-761.5	-1,175.4	-2,558.1	-3,643.4	-1,614.3	-1,511
A. Exports of goods and services	2,933.1	3,167.1	3,800.6	4,828.4	6,342.5	6,303.3	3,100.7	3,529
1. Merchandise 1/	1,347.7	1,410.3	1,716.4	2,140.3	2,998.9	2,998.7	1,495.3	1,730.5
2. Tourism	415.0	461.0	562.6	724.6	842.0	800.8	399.5	443.6
3. Passenger Fares	39.3	47.3	59.5	63.4	78.1	88.7	42.1	2/
4. Border transactions	878.9	966.9	1,057.0	1,207.7	1,372.9	1,518.8	732.9	796.3
5. Value added by border indust. 3/	80.9	101.9	164.7	277.6	443.5	445.9	199.7	279.6
6. Other	171.3	179.7	240.4	415.2	607.1	450.3	231.1	284.9
B. Imports of goods and services	3,879.0	3,893.5	4,562.1	6,003.8	8,900.6	9,946.7	4,715.0	5,040.9
1. Merchandise 4/	2,326.8	2,254.0	2,717.9	3,813.4	6,056.7	6,580.2	3,088.3	3,090.2
2. Tourism	169.7	172.2	220.4	258.0	334.8	398.0	170.2	188.8
3. Passenger Fares	53.9	54.3	65.7	72.6	96.8	134.1	52.9	2/
4. Border transactions	585.0	612.5	649.3	695.0	819.2	933.6	444.3	522.2
5. Dividends, interests and other remitt, by foreign firms	357.5	383.0	451.5	528.4	633.7	699.0	344.6	403.4
6. Interest on official debt	229.2	236.8	261.8	378.5	588.5	778.8	415.6	489.3
i) Nacional Financiera & others	210.6	219.3	241.5	357.6	560.3	680.6	365.6	n.a.
ii) Government	18.6	17.5	20.3	20.9	28.2	98.2	50.0	n.a.
7. Other	156.9	180.7	195.5	257.9	370.9	423.0	199.0	367.0

Table 10 (continued)

	Year 1970	Year 1971	Year 1972	Year 1973	Year 1974	Year 1975	1st half 1975	1st half 1976p/
III. Errors and Omission in current and capital accounts (net)	498.7	217.7	233.5	-378.4	-135.8	-82.0	199.2	-751.6
IV. Long-term capital (net)	503.9	669.1	723.5	1,676.1	2,730.8	3,890.5	1,337.2	2,152.2
1. Direct foreign investment	200.7	196.1	189.8	286.9	362.2	362.3	205.1	n.a.
2. Purchase of foreign firms	--	--	-10.0	-22.2	-2.1	-25.8	-1.0	n.a.
3. Bonds and stocks	-7.2	52.0	6.2	-10.3	-59.8	136.8	81.8	n.a.
4. Loans from abroad (net)	342.2	450.6	546.0	1,370.7	1,999.2	2,952.3	679.3	n.a.
a. Public (net)5/	263.1	286.4	359.7	1,046.6	1,672.9	2,469.0	624.9	n.a.
i) Inflows	799.0	742.2	864.2	1,891.9	2,233.9	3,157.1	922.2	n.a.
ii) Amortization	-535.9	-455.8	-504.5	-845.3	-561.0	-688.1	-307.2	n.a.
b. Private (net)	61.1	164.2	186.3	345.1	326.3	483.3	64.4	n.a.
i) Firms with foreign investment (net)	41.7	168.0	179.4	196.4	196.5	348.7	--	n.a.
ii) Other firms (net)6/	19.4	-3.8	6.9	127.7	129.8	134.6	64.4	n.a.
5. Public debt (net)5/	-2.3	-28.9	37.8	69.9	470.9	460.0	357.3	n.a.
6. Loans granted abroad	11.5	-0.7	-16.3	-18.9	-39.5	4.9	14.8	n.a.
V. SDRs	45.4	39.6	39.2	--	--	--	--	--
VI. Change in Reserves of the Bank of Mexico (equals II + III + IV + V); (- = increase)	-102.1	-200.0	-264.7	122.3	-36.9	-165.1	-0.3	+174.8

1/ Exports of border industries are excluded.
2/ Included in "other."
3/ Value added plus domestic inputs of goods exported by border industries.
4/ Imports of border industries are excluded. Valued c.i.f.
5/ These categories were redefined in 1974.
6/ Includes loans guaranteed by the government.

p/ Preliminary.

Source: Bank of Mexico.

RESTRICTED

Table 11

Mexico -- Level and Composition of International Reserves
(millions of U.S. dollars, 1970-1976)

	Gold	Special Drawing Rights	Reserve Position in IMF	Silver and other Assets[a]	Foreign Exchange	TOTAL
December 31, 1970	176[b]	48	135	n.a.	385	744
December 31, 1971	200[c]	96	106	n.a.	550	952
December 31, 1972	188[c]	139	106	n.a.	731	1,164
December 31, 1973	195[d]	154	118	n.a.	888	1,355
December 31, 1974	154[d]	158	120	n.a.	960	1,392
December 31 1975	154[d]	101	114	n.a.	1,168	1,529
March 31, 1976	152[d]	100	113	n.a.	1,142	1,537
August 9, 1976	365[c]	98	113	20	537	1,133
August 31, 1976	337[f]	98	113	20	803	1,361
September 10, 1976	375[g]	98	113	20	964[est.]	1,570

Sources: IMF, International Financial Statistics and Bank of Mexico.

a. The IMF does not count silver as part of Mexico's reserves. The estimated figures on 1976 holdings consist mostly, if not entirely, of silver.
b. Valued at $35 per ounce.
c. Valued at $38 per ounce. d. Valued at $42.22 per counce.
e. 3.6 million ounces valued at 90 per cent of the price at the second gold fixing on August 9, $112.70 per ounce.
f. 3.6 million ounces valued at 90 per cent of the price at the second gold fixing on August 31, $104 per ounce.
g. 3.6 million ounces valued at 90 per cent of the price at the second gold fixing on September 10, $115.70 per ounce.

RESTRICTED

Table 12

MEXICO - Composition
of Merchandise Trade in 1975

	Value (in million dollars)	Share of Total (per cent)		Value (in million dollars)	Share of Total (per cent)
Exports			Imports		
Agriculture and Fishing	772	27.0	Consumer Goods	600	9.1
of which Cotton	(174)	(22.6)	of which Corn	(398)	(66.3)
Coffee	(184)	(23.8)	Other	(202)	(33.6)
Shrimp	(120)	(15.5)			
Other	(294)	(38.1)	Semi-Processed Materials	2,903	44.1
			of which Vegetable and Animal Oils	(207)	(7.1)
Extractive Industries	737	25.8	Fuels	(291)	(10.0)
of which Metals	(277)	(37.6)	Textiles	(28)	(1.0)
Petroleum	(460)	(62.4)	Paper Products	(158)	(5.4)
			Chemical Products	(773)	(26.6)
Manufactures	1,202	42.0	Unassembled Autos & Parts	(582)	(20.0)
of which Foods and Beverages	(214)	(17.8)	Steel Products	(536)	(18.5)
Textiles and Shoes	(141)	(11.7)	Other	(329)	(11.3)
Chemicals	(204)	(17.0)			
Steel Products	(38)	(3.2)	Investment Goods	2,391	36.3
Machinery and Transport Equipment	(270)	(22.5)	of which Machinery and Equipment	(1,924)	(80.5)
			Tools and Instruments	(204)	(8.5)
Other	(335)	(27.9)	Transport Equipment	(264)	(11.0)
Unclassified Products	148	5.2	Unclassified Products	686	10.4
Total	2,859 1/	100.0	Total	6,580 2/	100.0

1/ Excludes exports of silver and the operations of the border assembly plants.
2/ Excludes the operations of the border assembly plants.

Source: Bank of Mexico, Indicadores Economicos.

Table 13

Mexico - Geographic Distribution

of Merchandise Trade in 1975p/

	Exports		Imports	
	Value (in million dollars)	Share of Total (Percent)	Value (in million dollars)	Share of Total (Percent)
Total	2,858 1/	100.0	6,580	100.0
United States	1,629	57.0	4,108	62.4
Canada	43	1.5	146	2.2
EEC Countries	258	9.0	1,091	16.6
United Kingdom	(28)	(1.0)	(193)	(2.9)
Germany	(87)	(3.0)	(480)	(7.3)
France	(21)	(0.7)	(184)	(2.8)
Other	(122)	(4.3)	(234)	(3.6)
Other Western Europe	61	2.1	250	3.8
Eastern Europe and USSR	13	0.5	36	0.5
Latin American and Caribbean Countries	482	16.9	514	7.8
Argentina	(36)	(1.3)	(211)	(3.2)
Brazil	(92)	(3.2)	(96)	(1.5)
Venezuela	(57)	(2.0)	(59)	(0.9)
Central America	(82)	(2.9)	(19)	(0.3)
Other	(215)	(7.5)	(129)	(2.0)
Japan	109	3.8	298	4.5
Other Asian Countries	97	3.4	36	0.5
Africa	1	negl.	21	0.3
Australia and New Zealand	4	0.1	22	0.3
Other Countries	18	0.6	56	0.9
Unallocated	143	5.0	--	--

p/ Preliminary

1/ Excludes both exports of silver, which are included in line II.A.1 of Table 10, and exports of border industries.

Source: Bank of Mexico, Indicadores Economicos.

RESTRICTED

Table 14

Mexico - Selected Data on External Debt
(in million dollars)

	Public and Publicly Guaranteed Debt Reported by Mexico[1/]			Claims on Mexico Reported by					
					Banks			Official Lending Institutions[5/]	Others
					Banks in Major Countries[3/]	United States Banks[4/]			
	Total[2/]	Long Term	Short Term	Total		Total	Head Offices		
1970	4,070	3,227	843	n.a.	n.a.	n.a.	1,276	n.a.	n.a.
1971	4,243	3,516	727	n.a.	n.a.	n.a.	1,306	n.a.	n.a.
1972	4,594	3,962	632	n.a.	n.a.	n.a.	1,591	n.a.	n.a.
1973	6,314	5,265	1,049	n.a.	n.a.	n.a.	1,836	n.a.	n.a.
1974	9,946	8,014	1,932	14,177	5,970[6/]	n.a.	2,673	2,003	6,204[6/]
1975	13,837	11,314	2,523	18,845	13,465	9,896	3,786	2,353	3,027
1976									
March	15,081	12,406	2,675	19,747	14,599	10,509	4,068	2,382	2,766
June	16,402	13,258	3,144[7/]	n.a.	n.a.	11,537	4,661	n.a.	n.a.

1/ Excludes unguaranteed private debt which is not systematically reported, but which was reliably estimated to amount to $6-8 billion at the end of 1975.
2/ Amounts disbursed.
3/ Refers to claims reported by banks in the United States, other G-10 countries, and US bank branches in the Bahamas, the Cayman Islands, Panama, Hong Kong, and Singapore.
4/ Includes claims reported by agencies and branches of foreign banks in the United States. To illustrate, these claims totalled about $650 million at the end of 1975.
5/ Refers to the IBRD, IDB, AID, and Eximbank. Data not readily available prior to 1974.
6/ For this date only, the claims of US bank branches in the Bahamas, the Cayman Islands, Panama, Hong Kong, and Singapore are included with the claims reported by Others. A year later, these claims totalled $5,366 million.
7/ Includes $360 million drawing on the Federal Reserve System under the swap arrangement.

Sources: World Bank, Bank for International Settlements, US Treasury Department, and Board of Governors of the Federal Reserve System.

RESTRICTED

Table 15

Wholesale Price Index
in Mexico and the United States[1/]
Since 1968

	Mexico		United States		Ratio of Mexican Index to U.S. Index (1970=100)
	Index (1970=100)	Change from Year Earlier (Percent)	Index (1970=100)	Change from Year Earlier (Percent)	
1968	92.0	+1.9	92.8	+2.4	99.1
1969	94.4	+2.6	96.5	+4.0	97.8
1970	100.0	+5.9	100.0	+3.6	100.0
1971	103.7	+3.7	103.3	+3.3	100.4
1972	106.7	+2.9	107.9	+4.5	98.9
1973	123.4	+15.7	122.0	+13.1	101.1
1974	151.2	+22.5	145.0	+18.9	104.3
1975	167.1	+10.5	158.4	+9.2	105.5
1974 - I	146.0	+29.0	135.1	+17.4	108.1
II	150.5	+26.3	139.9	+15.9	107.6
III	153.0	+20.6	149.8	+19.3	102.1
IV	154.5	+15.0	155.1	+22.4	99.6
1975 - I	158.6	+8.6	155.1	+14.8	102.3
II	165.0	+9.6	156.7	+12.0	105.3
III	170.4	+11.4	160.1	+6.9	106.4
IV	174.3	+12.8	161.8	+4.3	107.7
1976 - I	184.0	+16.0	162.5	+4.8	113.2
II	189.9p	+15.1	164.9	+5.2	115.2
1976					
Jan.	181.6	+15.5	162.4	+4.4	111.8
Feb.	183.9	+15.7	162.4	+4.6	113.2
Mar.	186.6	+16.8	162.7	+5.4	114.7
Apr.	187.5	+16.0	164.2	+5.3	114.2
May	190.4	+15.6	164.7	+5.0	115.6
June	192.0p	+13.9	165.9	+5.5	115.7
July	196.8p	+15.5	166.9p	+4.9	117.9

1/ Indices are averages for period shown.

Source: International Monetary Fund, International Financial Statistics.

Table 16

Mexico -- GDP/GNP Deflators in Mexico and the United States:
1968-75
(1968=100)

	Mexico (GDP) (1)	U.S.A. (GNP) (2)	Relative Prices (3) = (1) / (2) X 100
1968	100.0	100.0	100.0
1969	103.9	105.0	99.0
1970	108.6	110.6	98.2
1971	113.5	116.3	97.6
1972	119.8	121.1	98.9
1973	134.6	128.3	104.9
1974	166.7	140.7	118.5
1975	191.7	154.0	124.5

Source: Bank of Mexico, U.S. Department of Commerce.

RESTRICTED

[9-17-76]

RESTRICTED

HANDLE THE ATTACHED DOCUMENT IN ACCORDANCE WITH INTERNAL INFORMATION SECURITY PROCEDURES FOR RESTRICTED INFORMATION

RESTRICTED

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

September 17, 1976

TO: Chairman Burns

FROM: Ted Truman EMT

Attached is the complete version of the paper on the Mexican economic situation.

RESTRICTED

Summary of Analytical Aspects of the Mexican Economic Situation

This paper is in two parts. Part I analyzes the macro-economic setting of the Mexican economy in light of the recent sharp (37 per cent) depreciation of the Mexican peso. Part II analyzes several aspects of the peso depreciation itself.

Part I argues that prior to the September 1 depreciation of the peso the Mexican economy was in a situation of excess demand accompanied by very high inflation rates. This situation was largely stimulated by an expansion in the size of the public sector and the public-sector deficit. The expansion in the public sector led to a growing current-account deficit. At the same time private investment was stagnating. Consequently, the crucial objective of any Mexican economic stabilization program to complement the peso's depreciation must be to shift resources into the external sector. Part I analyzes, in turn, Mexican budget policy, monetary policy, investment, and wages and prices. It concludes that domestic aggregate demand should be restrained through a reduction in the size of the public-sector deficit. This will allow a tightening of monetary policy that would both support aggregate-demand policy and encourage a net inflow of capital. Finally, real wages should be restrained, if not reduced, to curb private consumption. The crucial issue in this last area is not how large the direct price effects of the peso's depreciation will be but rather how much will be passed through into increases in nominal wages. To date, we have little specific information that the Mexican authorities are willing or able to take the necessary policy actions in these areas.

Part II first traces the cause of the peso's depreciation on September 1 to a steady deterioration of the country's external trade and financial position. The proximate cause was the low level of Mexico's foreign exchange reserves. The size of the peso's depreciation is next discussed. This section reaches the conclusion that the 37 per cent depreciation of the peso that has occurred does not seem out of line with what might reasonably be expected, although it is on the high side of that range. The following section discusses the outlook for the Mexican Current Account under the assumption that the Mexican authorities will adopt an adequate economic stabilization program. It concludes that over the shorter term of a year or so some improvement might be expected in three specific areas: tourism, net earnings of border assembly plants, and net earnings from border transactions. The outlook for the Mexican capital account is also discussed briefly. Finally, a review of Mexico's reserves and its prospects for borrowing from the U.S. Treasury or the International Monetary Fund is presented.

RESTRICTED

Analytical Aspects of the Mexican Economic Situation

CONTENTS

RESTRICTED

CONTENTS (Cont.)

Analytical Aspects of the Mexican Economic Situation

I. Analysis of The Macro-Economic Setting

The principal malady of the Mexican economy over the past 3-1/2 years has been excess demand originating in the public sector. Real GDP increased at a historically high average rate of about 7-1/2 per cent per year in 1972-73, but slackened off somewhat to 5.9 and 4.0 per cent in 1974 and 1975 respectively. (See Table 1.) A sharp rise in the relative size of the public sector beginning in 1972 was incompletely offset by a rise in public-sector revenues. Although a substantial proportion of the consequent increase in the public-sector deficit was financed externally, this added to the external debt, and the excess demand and accompanying inflation added to the current-account deficit. Private and particularly public consumption expanded rapidly. Public investment increased, while private investment declined as a per cent of GDP. (See Table 2.) In large part because of the reduced rates of private investment the Mexican economy, at least in the short run, has by all reports, only limited unutilized capacity available. Consequently, the crucial objective in any Mexican economic stabilization program to complement the recent depreciation of the peso is to shift resources into the external sector and away from other uses. To accomplish this shift two adjustments will probably be required: reduction in the size of the public-sector deficit as a percentage of GDP and maintenance of a restored international competitive position. Both adjustments will tend to reduce the real income of the Mexican population.

A. Budget Policy

In 1972, the size of the consolidated public sector began to increase from about 14 per cent of GDP before 1972 to above 20 per cent in 1975.*/ (See Table 3.) This was the result of a deliberate policy to expand the size of the public sector, which had been relatively small, and to increase rates of public investment. While the share of public-sector revenues in Mexican GDP also rose, the increase was not as large as the increase in the share of expenditures. Hence the size of the public-sector deficit rose from under 3 per cent of GDP before 1972 to almost 9 per cent in 1975.

Current data are available only for the revenues and expenditures of the Federal Government, and the latest data are only for May, 1976. (See Table 4.) These data suggest no substantial decline in the absolute size of the public sector deficit in the first five months of this year, through the rate of increase may have been arrested.

We see no evidence that the absolute size of the Mexican public-sector deficit is related to the slowdown in Mexican real growth. But the cyclical position of Mexico, or more accurately Mexico's relative cyclical position, has contributed to Mexico's balance-of-payments problem. Mexico was probably surprised and was certainly disadvantaged when it experienced positive real growth of 5.9 per cent and 4.0 per cent in 1974 and 1975 at the same time that its major trading partner -- the United

---

*/ As is the case for many countries, data on the size of the public sector and its deficit can be compiled under many different definitions. The definition used in the text includes the Federal Government, Federal District, Social Security, budgetary controlled Decentralized Agencies and Enterprises (the number of such units increased in 1973), and the deficit financing of the largest non-budgetary controlled public enterprises.

States -- was experiencing negative real growth. The adverse cyclical income effects on Mexico's balance of payments were substantial, on the order of $500 million over the two years combined. The lagged effects of sluggish external demand and, perhaps, high inflation rates on its domestic economic growth are continuing. (See Table 5 showing the sluggish growth of industrial production through May (the latest month available) except in the petroleum, petrochemical, and, more recently, the mining sectors.)

One problem that has reportedly contributed to the expansion of the public-sector deficit is a lack of adequate administrative controls on the expenditure side, particularly regarding the Decentralized Agencies and Enterprises. The consequences of this deficiency became particularly acute as the public sector was allowed to expand after 1971. The Mexican authorities apparently recognize the need for reform in this area. President Echeverria's new program as outlined by Mr. Fernandez Hurtado, refers to a planned reduction in the public sector deficit "through strict programming and surveillance of public expenditure to attain quantitative goals related to the adjustment process of the economy." But we do not know the specifics of what the Mexican authorities have in mind, and any results in this area will no doubt be slow in coming.

On the revenue side, roughly half of the Federal Government's current revenues are raised through income taxes. But observers have commented that the tax system is complex with important instances of inconsistent treatment of the same form of income. It is badly in need of reform and rationalization. These characteristics of the tax system have contributed to the Government's failure to achieve its revenue targets in recent years. The Echeverria program mentions the need for increasing public sector revenues but is not specific except in calling for (1) an export surtax, (2) a reduction of tax rebates for exports, (3) a reduction of import taxes, (4) an excess profits tax, and (5) special fiscal treatment of private enterprises seriously affected by the exchange-rate depreciation. The first three types of measures are designed primarily to offset, in part, the effects of the depreciation on the external sector and not for revenue purposes.

The only specifics on the fiscal program that have been revealed are (1) a reduction in average import tariffs from 20 per cent to 9 per cent, which will have a negligible effect on revenues since the peso price of imports on which duties are levied will increase pari passu with the 58 per cent depreciation; (2) a reduction in the import tariff to finance export promotion from 2 to 1 per cent; (3) a one-year 20 per cent export tax on fish and agricultural products, and a one-year 7.5 per cent export tax on manufactured goods, which together might increase revenues by 5,000 million pesos; and (4) a removal of subsidies on exports of manufactured goods, which amounted to 1,861 million pesos in 1975. The net fiscal effects of these actions might lower the public-sector deficit by about 7,000 million pesos or about 0.7 per cent of GDP in 1976.

We understand that prior to the depreciation of the peso, technicians at the Bank of Mexico were tentatively talking about lowering the public-sector deficit from 9 per cent of GDP in 1975 to 3.5 per cent in

1978. We do not know how firm these plans were, whether they have been changed, or how they might be implemented.

B. Monetary Policy

The Bank of Mexico is required to help finance the Government's deficit. Thus, it has little independent scope to exercise monetary restraint. As the public-sector deficit grew, its financing placed an increasingly heavy drain on the internal savings of the country. Table 3 shows that, in 1975, more than 50 billion pesos were raised from internal sources to help finance the deficit, nearly five times as much as in 1971. As a percentage of GDP, the internal financing of the deficit was over twice as large in 1975 as in 1971. The Bank of Mexico had long been forcing the banks to absorb large amounts of Government securities through the reserve requirements, but this became increasingly difficult to accomplish as the size of the fiscal deficit grew rapidly, and the Bank of Mexico found itself obliged to hold increasing amounts of these securities. As a result, the rate of growth of the money supply, which had been averaging about 11 per cent in the years 1966-71, jumped to over 20 per cent. This was accompanied by increasing tightness of credit to the private sector, as reserve requirements were raised drastically. Interest rates in Mexico are administered and the process of changing them is cumbersome, often involving the introduction of a new financial instrument. The principal tool of monetary control is a complex set of reserve requirements. Nevertheless, it is useful to look at what has been happening over the past several years to the course of monetary policy and the growth of the money supply.

Except for an explosion in the rate of growth of the Mexican money supply -- defined as coin and currency plus demand deposits -- in 1972, which probably contributed substantially to the subsequent imbalances that developed in the Mexican economy, the course of monetary policy -- judging by the behavior of the money supply -- has been at best neutral. (See Table 6.) In 1973 and 1974, the growth in the money supply was slightly more rapid than the rate of growth of consumer prices. (See Tables 6 and 7.) In 1975, the growth in the money supply became marginally more expansionary. Through May of this year, which is the last month for which data are available, the growth of the money supply (year over year) has edged down slightly from over 20 per cent to under 20 per cent,*/ while consumer prices were rising at year-over-year rates around 15 per cent.

We do not know what has happened to Mexico's money supply between May and August. The Echeverria program states that "a system of regulated credit growth will be established by the Bank of Mexico for use by the private and public sectors." We do not know what this new system involves, but as a practical matter, the Bank of Mexico cannot refuse credit to the Government. Thus, success in tightening monetary policy depends upon success in reducing the public-sector deficit and upon the amount of external financing for the deficit that is available.

Interest rates on deposits in Mexican financial institutions are administered by the Bank of Mexico. The fact that Mexican interest rates

---

*/ The Bank of Mexico releases money supply data on a seasonally-adjusted as well as a not-seasonally-adjusted basis. The seasonal factors are apparently large. On a seasonally-adjusted basis the money supply in May 1976, was 8.2 per cent above December, 1975. On a not-seasonally-adjusted basis, the money supply shows a <u>decline</u> of 4.3 per cent. On both bases the money supply in May was 19.7 per cent above the level a year earlier.

were not permitted to rise in line with interest rates on dollar-denominated assets in 1973-74 must have contributed to some net private capital outflow in these years. (See Table 8.) Banks were authorized to issue six and nine months certificates of deposits in early 1974. Initially, however, these instruments had relatively unattractive yields. In 1975 the interest-rate differential shifted more in favor of the large Mexican CDs as U.S. interest rates declined, and in August of this year the maximum interest rates payable on small CDs was raised by 1 percentage point while that on large CDs was raised 1.25 percentage points.

The Mexican government cannot afford for balance-of-payments or other reasons to lower interest rates. In fact, since real interest rates on short-term assets appear to be negative in Mexico, there may be room to raise them substantially. The only mention of interest-rate policy in the Government's new program which was announced on September 1 was the statement that "interest rates for small savers will be increased." At present we have no further information about what the Bank of Mexico plans to do with its interest-rate policy or monetary policy in general.

C. Investment

Between 1970 and 1975 real private investment increased only 12.5 per cent as real GDP rose 31 per cent. In 1975 real private investment is estimated to have been less than in 1974.*/ This stagnation in private investment is due to several factors. Two are most prominent. (1) Private entrepreneurs were distrustful of President Echeverria when he took office in December, 1970. His administration was committed to adjusting Mexico's

*/ Quarterly national income statistics are not available for Mexico.

severely skewed income distribution and, by implication, threatened the continuation of the previous administrations' extremely favorable environment for private investment. (2) It seems clear that there was some crowding out of private investment in 1975. Between 1970 and 1975 private consumption rose 27 per cent in real terms, real public consumption rose 77 per cent, and real public investment rose by more than 100 per cent.

Some of these public investment projects were related to social programs -- housing and rural development -- but many were designed to add directly to the capital stock -- petroleum, petrochemicals, steel, fertilizers.*/ Unfortunately, except in petroleum, the payoff to these large projects will not come until 1977 and later. In the meantime, these projects absorb resources and place strains on the domestic economy and the Mexican balance of payments.

The Government's new program announced on September 1 indicated that there would be no reduction in the rate of public investment in productive activities and social services. (Presumably, President Echeverria meant that there would be no reduction in the real rate of public investment.) Two implications can be drawn from this aspect of the Government's program: (1) These public investment projects will continue to contribute to an expansion of the nominal size of public sector expenditures and most of them are being undertaken by decentralized enterprises that are

---

*/ Data on the split between social and industrial investment do not appear to be available.

under only loose financial control by the Federal Government. (2) Until these public investment projects begin to yield positive returns, the productive capacity of the overall Mexican economy will be under strain. There appears to be little slack available to reduce the external deficit on current account (with the possible exception of the tourist industries and the border assembly plants); consequently, the reduction in the current-account deficit must occur through a reduction in real absorption rather than through an increase in real output.

D. Wages and Prices

Data on wage rates and earnings rates in Mexico are not readily available. The best proxy is the series for minimum wage rates in Mexico City. (See Table 9.) Increases in official minimum wages tend to set the standard for other wage settlements. Between January 1974 and January 1976, when the most recent adjustment in minimum wages occurred, real wages increased by almost 13 per cent, while real GDP increased by only 10 per cent.

An adjustment in wages for government workers is due on September 30. This, in turn, is likely to lead to an increase in minimum wages. President Echeverria has promised that this adjustment would be designed to compensate for the purchasing power lost since January. Mr. Fernandez Hurtado has indicated privately that the Government does not feel it can afford politically to enforce a reduction in real wages. In fact, union leaders have threatened a general strike unless nominal wages are increased by 65 per cent. If this is the case, then it will prove difficult to restrain the growth of private consumption to the extent necessary to permit an expansion in private investment and a reduction in the current account deficit. A successful depreciation leading to an improvement in the country's current account requires a reduction in real absorption in the case where an economy has little or no excess capacity.

On the price side, the situation is even more precarious. From April through July, the month-to-month increase in the Mexican consumer price index declined to under 1 per cent -- compared with month-to-month increases of over 1 per cent in late 1975 and early 1976 -- and the year-over-year increase declined to about 13 per cent from the early pattern of over 15 per cent. (See Table 7.) Generalized price increases accompanying the recent substantial depreciation of the peso will add to these inflationary pressures.

The Mexican government has indicated its intention to hold down the rate of inflation and mop up excess profits resulting from the depreciation. It remains to be seen how successful it will be in this effort. The crucial issue is probably not how large the direct price effects of depreciation are but rather how much will be passed through into increases in nominal wages. One step the Government can take and has indicated it will take is in the area of prices of services supplied by the public sector. Prices in this sector have tended to lag behind increases in the general price level and increases in costs. Ceteris paribus, any tendency to hold down these prices further would only add to the size of the public-sector deficit and produce further distortions in the economy.

II. Analysis of the Peso Depreciation

The Mexican current account position deteriorated rapidly after 1972. (See Table 10.) Moreover, in 1973 the Mexican inflation rate began to diverge substantially from that of the United States, to whose currency the peso had been pegged at an unchanged rate since 1954. This cumulative divergence continued through mid-1976. Thus, it became increasingly clear to many observers that the peso would have to be devalued or allowed to depreciate; the only question was when. Mexico's gross reserves of foreign exchange declined from $1,142 million on March 31, 1976, to an estimated $537 million on August 9 -- despite a drawing of the full $360 million Federal Reserve swap line on April 9, 1976 and drawings on Euro-credits. (See Table 11.) Mexico was apparently able to rebuild its foreign exchange reserves by over $250 million between August 9 and August 31 through heavy official borrowing on the private market. But the prospects of a significant underlying improvement in Mexico's reserves over the following several months were dim.

Consequently, Mexico's Secretary of Finance and Public Credit, Mr. Mario Ramon Beteta, announced late on August 31, that the fixed peso-dollar exchange rate was being abandoned and that the peso would be allowed to float subject to central bank intervention to prevent speculative and erratic fluctuations. The peso quickly depreciated about 40 per cent to a price of over 20 pesos per U.S. dollar compared with 12.50 per dollar at the old parity. On September 13, the peso was appreciated about 3 per cent and stabilized at 12.70/12.90 per dollar, equal to a

58 per cent increase in the peso price of the U.S. dollar or to a 37 decline in the dollar value of the peso.

The analysis in Part I above indicated that if the depreciation of the peso is to be successful in restoring a sustainable pattern to the structure of Mexico's international transactions, it must be accompanied by a strong domestic economic stabilization program. Domestic aggregate demand should be restrained through a reduction in the size of the public sector deficit. Monetary policy should be tightened in support of aggregate-demand policy and to encourage a net inflow of domestic and foreign capital. Finally, real wages should be restrained, if not reduced, to curb private consumption.

On the assumption that Mexico adopts an adequate domestic economic stabilization policy in support of its new exchange-rate policy, we can analyze how an improvement in Mexico's external accounts will come about and over what time period. In the short run any improvement in the current account should be the result of an increase in tourist earnings and earnings on net border transactions and from border assembly plants. In the longer run of a couple of years we can expect some pick up in merchandise exports and reduction in merchandise imports.

A. The Balance of Payments Situation Prior to the Peso's Depreciation

The decision to let the Mexican peso depreciate was the culmination of a steady deterioration in the country's external trade and financial position, caused partly by internally generated inflationary pressures and partly by economic and financial developments in the rest of the world. The Mexican deficit on current account rose from an average of about $750 million in 1970-72, to $1.1 billion in 1973, and over $3.6 billion in 1975. (See Table 10.) The Mexican current account deficit was not directly affected by the increase in petroleum prices since Mexico, in 1973, was a only small net importer of petroleum and has since become a net oil exporter. The value of merchandise imports rose sharply partly because of the world-wide inflation and partly because of excess demand in the Mexican economy. The value of exports also rose, but less rapidly. The growth of Mexican exports was slowed in the last part of 1974 and in 1975 by the world recession, which also contributed to a 5 per cent decline in the country's important tourist earnings, and by the deterioration of its competitive position. (See Table 12 for data on the composition of Mexican exports and imports and Table 13 for data on the geographic distribution of its trade.) The deterioration of Mexico's competitive position and the influence of the U.S. recession was also reflected in the reduced net contribution of border assembly plants to the Mexican balance of payments and the reduction in the rate of increase of the net surplus on so-called border transactions.

To cover this growing current account deficit and net errors and omissions, which turned negative in 1973 -- presumably, reflecting capital flight -- a substantial increase in external borrowings was required. (See Table 14.) At the end of 1975, the external debt was estimated at $20-22 billion, consisting of about $14 billion in debts of the public sector (of which $11.3 billion carried an original maturity of one year or more) and private sector debts of $6-8 billion. Mexico's total external debt may well have climbed by at least another $2.5 billion since the end of 1975. Claims on Mexico by U.S. banks amounted to $11,537 million at the end of June, 1976, up $3,388 million from the end of September, 1975, when comprehensive data were first collected.

Two features of the growing Mexican external debt are (1) the growing concentration of the debt in accounts of the public sector and (2) the deterioration of the quality of the debt as a result of its shorter average maturity. The debt service on public debt of maturity of more than one year was 25 per cent of exports in 1975, having reached a peak ratio of almost 30 per cent in 1968; it was 18 per cent in 1974. For what the concept is worth, this ratio will definitely increase over the next several years.

B. The Size of the Peso's Depreciation

The Mexican peso has been allowed to appreciate slightly after its initial depreciation and has been effectively pegged at a rate vis-à-vis the U.S. dollar at which the dollar is 58 per cent more expensive in terms of pesos than it was from April 1954 through August 31, 1976. The question arises of how large a depreciation of the peso is appropriate.*/

One approach is to argue that the peso's value should be determined primarily by market forces of supply and demand. However, the Mexican authorities are unlikely to permit the peso to float freely for an

*/ We have been told that the IMF has calculated that the peso should depreciate by 40-50 per cent, but we do not know the basis of this calculation.

extended period of time. They argue that the peso market is not extensive enough to operate without a substantial central bank presence in the market. In fact, they have announced a new target rate (19.70-19.90 per dollar) for the peso without as yet declaring a new parity.

A second possible line of analysis is to apply (admittedly crude) relative purchasing-power-parity concepts to the question. From 1960 to about 1972, the rate of increase of consumer prices and the GNP deflator in the United States was roughly equal to the rate of increase in these price measures in Mexico. On the other hand, the rate of increase in wholesale prices was much more rapid in Mexico over this period.

In 1975, however, using 1970 as a base, the Mexican wholesale price index had increased 4 per cent more than the U.S. WPI (See Table 15.); over the same period, the Mexican consumer price index and GDP deflator increased about 27 per cent more than the similar U.S. price measures. (See Tables 7 and 16.) Moreover, by July 1976, the Mexican WPI had increased 18 per cent more than the U.S. WPI on a 1970 base, and the Mexican CPI had increased 36 per cent more on the same base.

Two conclusions can be drawn from these data. First, the 58 per cent rise in the peso price of the dollar has more than offset the price differential with the United States that had opened up on any price measure at the time of the depreciation. Second, the Mexican-U.S. price differential was widening and could reasonably be expected to widen further in the months ahead even without the depreciation.

A third possible line of analysis is to apply the price elasticities approach to estimate how large a devaluation of the peso would be necessary to achieve a given improvement in the Mexican current account over the same time period. However, estimates of the relevant price elasticities are not available for Mexico, and, given the rapid rate of inflation in Mexico, it would be necessary in any application of this technique to calculate how much of a particular depreciation of the peso would be eroded by subsequent price inflation.

The Treasury staff has made a crude calculation based on estimates of price elasticities of the demand for exports and imports of other countries and the assumption that the objective is to generate a $2.1 billion improvement in the Mexican current-account balance by 1978. In this calculation it is estimated that a 40-50 per cent increase in the peso price of dollars would be needed. This appears to be a realistic estimate based upon this approach.

A more eclectic approach can also be considered. Under this approach explicit recognition can be given to several important factors. First, the underlying rate of Mexican inflation is likely to be at least double that in the United States for at least the next two years. This is because of the build up of inflationary pressures in Mexico, on the one hand, and, on the other hand, the depreciation itself. Thus, under the most optimistic scenario, the Mexican price level is likely to increase 10-12 per cent more over the next two years than the U.S. price level. If the peso is to be fixed more or less permanently to the dollar again, then this amount must be added to the estimate of the needed depreciation.

Second, it should be recognized that the Mexican authorities have said that they would reduce some import restrictions and remove their export subsidies following the depreciation of the peso. These actions are desirable in their own right and are a normal accompaniment to devaluations by developing countries. They serve, however, to reduce the size of the effective devaluation.

Third, given that the Mexican authorities have indicated their intention to fix eventually a new parity with the U.S. dollar (for the moment a rate of 19.70/19.90 per dollar has been chosen), given the fact that their reserves have been severely depleted, and given the fact that Mexico has built up a substantial external debt burden, it would be prudent for the Mexican authorities to err on the side of too large rather than too small a devaluation.

Finally, on a related point, the Mexican authorities have apparently indicated an interest in seeing a substantial initial depreciation of the peso that might be followed by a subsequent small appreciation. The rationale of this strategy might be to encourage a net capital inflow, since the expected appreciation would add to the expected return on peso-denominated assets. Similarly, the actual small appreciation of the peso subsequent to the initial depreciation may have servedto increase confidence in the currency.

In summary, the depreciation of the peso that has occurred does not seem out of line with what might reasonably be expected, although it is on the high side of that range. This judgment is based, however, on the premise that an appropriate domestic economic stabilization program will be adopted in order to ensure that the effects of the depreciation on the Mexican balance of payments will not be eroded.

C. The Outlook for the Current Account

Under this heading it is reasonable to ask, first, what would be a realistic target for the Mexican current account. As a developing country it would be abnormal to expect Mexico to run a current-account surplus. On the other hand, the country cannot expect to add to its external debt at the rate it has over the past four years (1973-1976). Given the increase in nominal magnitudes since Mexico last appeared to be in balance-of-payments equilibrium in the early 1970s, one might take as a starting point a target for the Mexican current account of, say a deficit of $1-$1.5 billion, compared with the annual deficits in the earlier period of about $750 million.

One might ask next where this improvement might come from. Over the longer term of two to three years, one might expect it to come generally from an increase in current account receipts, including those from expanded oil exports, relative to current account payments. But, as we have already stressed, this will require a domestic economic stabilization program designed to restrain the growth of domestic demand and hold down, if not reduce, the level of real wages and incomes.

Over the shorter term of a year, one might expect some improvement in three specific areas aside from favorable cyclical effects as a result of higher U.S. growth and, perhaps, lower Mexican growth. The first area is tourism, where receipts declined by five per cent in 1975 and increased by only 16 per cent in 1974, compared with increases of 22 and 29 per cent in 1972 and 1973. (See Table 10.) On the payments side, Mexican tourist payments rose by 30 per cent in 1974 and 19 per cent in 1975, compared with 17 per cent in 1973. It is reported that the tourist industry is one sector where there definitely is excess capacity in Mexico. It can be expected that the income and price effects of the peso's depreciation will combine to produce a substantial increase in Mexican tourist receipts and at least a decline in the rate of increase in tourist payments.

The second area of possible immediate improvement is receipts from border assembly plants. Receipts from these installations increased by an average of over 50 per cent per year in 1972-74, but they stagnated in 1975. With the dramatic change in relative costs as a result of the peso's depreciation, it might be expected that there will be a revival in this area. But a crucial factor will be what happens to nominal wages in Mexico following the depreciation of the peso. If U.S. entrepreneurs are not convinced that the rate of increase in nominal wages will be held substantially below the increase in the peso price of the U.S. dollar, then one can expect no substantial gain in this area.

The third area of possible immediate improvement is net receipts from so-called border transactions. (There are the large volume of transactions that occur as border residents cross over to make purchases or work.) These net receipts had been increasing at around a 20 per cent annual rate from 1971 to 1973, but the rate of increase declined to 8 per cent in 1974 and under 6 per cent in 1975. As in the case of tourism, this is an area where income and price effects can have a relatively dramatic impact over a short period.

Over the longer term of a couple of years, one might expect a pick up in regular merchandise exports and a reduction in imports compared with what they otherwise might have been. Because many categories of imports are now subject to quantitative restrictions (leading to Mexican prices of imported goods -- prior to the depreciation -- that were as much as 25 per cent above the world price), the price effect of the devaluation on imports might be less than that on exports. On the other hand, the demand for Mexican exports other than manufactures may be relatively price inelastic; moreover, the value of imports is larger. On balance, we would look for about an equal impact on both types of trade.

D. The Outlook for the Capital Account

The first item to notice with respect to capital account transactions is that the Mexican authorities have wisely and pointedly declined to institute capital controls. They said explicitly that the country's tradition of free capital movements would be maintained and that Mexican financial institutions would receive adequate liquidity to assure that their commitments (to foreigners) would be met. This latter action might lead to an unwanted expansion or the prevention of a reduction in domestic liquidity, but it is the price that must be paid over the short run to maintain stability and guard against attempted capital flight.

In addition to relying, as was mentioned earlier, on a possible further small appreciation of the peso to add to the attractiveness of peso-denominated assets, the Mexican authorities might also consider tightening up on monetary policy and raising interest rates not only to dampen domestic demand but also to encourage a net capital inflow.

Finally, the primary objective of Mexican policy should be to reduce the rate of public-sector borrowing abroad and to replace it if possible by private-sector borrowing for investment. But progress in this area will depend on progress in reducing the current account deficit, which, in turn will depend on the adoption of an adequate domestic economic stabilization policy.

E. The Outlook for Mexico's Reserves and Borrowing from Official Institutions

As is indicated in Table 11, Mexico has experienced in 1976 a substantial decline in its foreign exchange reserves amounting to an estimated $365 million from December 31, 1975, to August 31, 1976. In addition it has acquired a $360 million short-term official debt under the Federal Reserve swap network. Although at one point in August the Mexican authorities were apparently concerned that they lacked adequate international reserves to meet their reserve requirements against notes in circulation, this constraint has been relaxed through the subsequent depreciation of the peso which raised the peso value of Mexican reserves pari passu. Nevertheless, Mexico has a clear need to build up its foreign exchange reserves. This may be one reason why the Mexican authorities are unconcerned about a possible excessive depreciation of the peso.

If, nevertheless, the Mexican authorities need additional foreign exchange reserves to intervene in the exchange market or to repay the Federal Reserve swap drawing, they might turn to the U.S. Treasury or the International Monetary Fund.

The Mexican stabilization agreement with the U.S. Treasury is for $300 million. The first $50 million can be drawn immediately. Another $100 million can be drawn upon certification by the IMF management that the Mexican authorities have adopted a stabilization program that would make Mexico eligible, in the IMF staff's view, for a drawing from the upper IMF credit tranches. A final $150 million can be activated but must remain on deposit with the Exchange Stabilization Fund. A final provision in the Treasury's stabilization agreement with Mexico is that Mexico must first have drawn on the Federal Reserve swap line. It is not clear whether this means that a drawing on the ESF cannot be outstanding when the Federal Reserve swap is repaid. It apparently is clear that Mexico cannot draw on the ESF and immediately use the proceeds to repay the Federal Reserve System.

Turning to the IMF, with which the Mexican authorities are reportedly currently negotiating, Mexico could draw up to $730 million under the IMF's regular credit facilities -- that is, not including the Compensatory Financing Facility or the Extended Fund Facility. Mexico could, first, draw $113 million (SDR 98 million at $1.15 per SDR) equal to its reserve position in the IMF. To do this it would merely have to declare that it has a "balance of payments need." Mexico could, next, draw its first credit tranche of $154 million (one fourth -- SDR 92.5 million -- of its IMF quota of SDR 370 million enlarged by 45 per cent according to the Jamaica agreement to SDR 134 million and valued at $1.15 per SDR). To do this Mexico would have to outline for the IMF its intentions to follow corrective domestic and balance-of-payments adjustment measures. Finally, Mexico could enter into a stand-by agreement involving possible drawings on its three higher expanded IMF credit tranches totaling $462 million. Under this stand-by agreement the IMF would have to agree that Mexico had adopted an adequate balance-of-payments adjustment program. The agreement would normally involve conditions placed on Mexico's domestic economic policies. Any drawings under this agreement would normally be spread out over as much as 12 months. Any of Mexico's IMF drawings would have to be repaid in 3-5 years.

Prepared by Yves Maroni and Edwin M. Truman
Division of International Finance
September 15, 1976

Table 1

Mexico - Gross Domestic Product

1965 - 75

	GDP - Current Prices		GDP - Constant Prices	
	Billions of Pesos	Annual Change (%)	Billions of 1960 Pesos	Annual Change (%)
1965	252.0	-	212.3	-
1966	280.1	+11.2	227.0	+6.9
1967	306.3	+ 9.4	241.3	+6.3
1968	339.1	+10.7	260.9	+8.1
1969	374.9	+10.6	277.4	+6.3
1970	418.7	+11.7	296.6	+6.9
1971	452.4	+ 8.1	306.8	+3.4
1972	512.3	+13.2	329.1	+7.3
1973	619.6	+20.9	354.1	+7.6
1974	812.9	+31.2	375.1	+5.9
1975p/	972.2	+19.6	390.1	+4.0

p/ Preliminary.

Source: Bank of Mexico.

Table 2

Mexico - Expenditure on

Gross Domestic Product

1965-75

A - Billions of Pesos Current Prices	1965	1966	1967	1968	1969	1970	1971	1972	1973	1974	1975p/
GDP	252.0	280.1	306.3	339.1	374.9	418.7	452.4	512.3	619.6	812.9	972.2
Consumption	210.1	231.1	251.0	278.3	305.4	344.9	375.2	416.2	496.5	660.4	798.3
Public	14.2	16.4	17.6	20.2	22.5	25.7	29.8	35.3	42.6	58.4	80.4
Private	195.9	214.7	233.4	258.1	282.9	319.2	345.4	380.9	453.9	602.0	717.9
Investment	44.1	50.4	59.4	65.8	72.7	82.2	82.2	101.2	131.0	173.7	205.8
Public	16.6	15.6	17.2	23.5	24.8	23.2	24.1	34.2	51.6	64.8	86.4
Private	27.5	34.8	42.2	42.3	47.0	59.0	58.1	67.0	79.4	108.9	119.4
Net Foreign Balance 1/	-2.2	-1.4	-4.1	-5.0	-3.2	-8.4	-5.0	-5.1	-7.9	-21.2	-31.9
Imports	26.0	27.4	29.9	34.3	38.5	42.7	42.7	50.2	65.4	97.0	106.5
Exports	23.8	26.0	25.8	29.3	35.3	34.3	37.4	45.1	57.5	75.8	74.6
B - As % of GDP											
Consumption	83.4	82.5	81.9	82.1	81.4	82.4	82.9	81.2	80.2	81.2	82.1
Public	5.6	5.9	5.8	6.0	6.1	6.6	6.9	7.2	8.3	7.2	8.3
Private	77.7	76.7	76.1	76.1	75.4	76.3	76.3	74.3	73.3	74.0	73.8
Investment	17.5	18.0	19.4	19.4	19.4	19.6	18.2	19.8	21.1	21.4	21.2
Public	6.6	5.6	5.6	6.9	6.6	5.5	5.3	6.7	8.3	8.0	8.9
Private	10.9	12.4	13.8	12.5	12.8	14.1	12.9	13.1	12.8	13.4	12.3
Net Foreign Balance 1/	-0.9	-0.5	-1.3	-1.5	-0.8	-2.0	-1.1	-1.0	-1.0	-2.6	-3.3

p/ Preliminary.
1/ National income accounts definition.

Sources: Bank of Mexico and World Bank.

Table 3
Mexico - Consolidated Public Sector Accounts
1965 - 75

A - Billions of Pesos	1965	1966	1967	1968	1969	1970	1971	1972	1973p/	1974p/	1975p/
Revenues	29.6	32.1	34.3	38.3	43.5	48.4	52.5	58.0	77.4	95.7	125.4
Expenditures	38.8	36.5	40.6	50.5	55.3	56.4	62.7	77.7	114.7	145.7	200.6
Budgetary Deficit(-)	-9.2	-4.4	-6.3	-12.2	-11.8	-8.0	-10.2	-19.7	-37.3	-50.0	-75.2
Other1/ Deficits (-) or Surpluses (+)	n.a.	n.a.	n.a.	n.a.	n.a.	-0.7	0.2	-3.0	-2.5	-4.0	-12.0
Overall Deficit	-9.2	-4.4	-6.3	-12.2	-11.8	-8.7	-10.0	-22.7	-39.8	-54.0	-87.2
Internally Financed	7.7	2.5	6.6	15.6	7.8	6.5	11.2	21.8	27.0	25.6	52.9
Externally Financed	1.5	1.9	-0.3	-3.4	4.0	2.2	-1.2	0.9	12.8	28.4	34.3
B - As % of GDP											
Revenues	11.7	11.5	11.2	11.3	11.6	11.5	11.6	11.4	12.5	11.8	13.0
Expenditures	15.4	13.1	13.2	14.9	14.7	13.4	13.8	15.2	18.5	19.0	20.7
Budgetary Deficit (-)	-3.7	-1.6	-2.0	-3.6	-3.1	-1.9	-2.2	-3.8	-6.0	-6.2	-7.7
Other1/ Deficits (-) or Surpluses (+)	n.a.	n.a.	n.a.	n.a.	n.a.	-0.2	negl.	-0.6	-0.4	-0.5	-1.2
Overall Deficit	-3.7	-1.6	-2.0	-3.6	-3.1	-2.1	-2.2	-4.4	-6.4	-6.7	-8.9
Internally Financed	3.1	0.9	2.1	4.6	2.1	1.6	2.5	4.2	4.3	3.2	5.4
Externally Financed	0.6	0.7	-0.1	-1.0	1.0	-0.5	0.3	0.2	2.1	3.5	3.5

p/ Preliminary.
1/ Refers to public enterprises not controlled through the budget.

NOTE: The number of budgetary controlled enterprises increased in 1973, so that the data for 1973-75 are not strictly comparable with 1965-72.

Source: World Bank.

Table 4

Mexico - Revenues and Expenditures of

the Federal Government

Since 1970

(Annual Rates)

	Revenues		Expenditures		Deficit	
	in billion pesos	as % of GDP	in billion pesos	as % of GDP	in billion pesos	as % of GDP
1970	33.9	8.1	40.2	9.6	-6.3	-1.5
1971	36.5	8.1	41.3	9.1	-4.8	-1.1
1972	42.3	8.3	59.1	11.5	-16.7	-3.3
1973	53.8	8.7	81.2	13.1	-27.4	-4.4
1974	72.9	9.0	104.1	12.8	-31.2	-3.8
1975	103.1	10.6	145.1	14.9	-42.0	-4.3
1974 - I	61.2		75.6		-14.4	
II	71.2		85.2		-14.0	
III	71.2		96.8		-25.6	
IV	87.6		158.8		-71.2	
1975 - I	91.2		125.6		-34.4	
II	105.2		133.2		-28.0	
III	100.0		138.4		-38.4	
IV	116.0		183.2		-67.2	
1976 - I	116.0		157.6		-41.6	
Jan.	121.2		111.6		+ 9.6	
Feb.	88.8		140.4		-51.6	
Mar.	138.0		220.8		-82.8	
Apr.	124.8		164.4		-39.6	
May	164.4		174.0		- 9.6	
Jan.-May	127.4		162.2		-34.8	

Source: Bank of Mexico

Table 5

Mexico - Index of Industrial Production
Since 1970
(1970 = 100)

	Total		Manufacturing		Petroleum		Mining	
	Index	Change From Year Earlier (Percent)	Index	Change From Year Earlier (Percent)	Index	Change From Year Earlier (Percent)	Index	Change From Year Earlier (Percent)
1970	100.0	+6.3	100.0	+5.2	100.0	+16.0	100.0	+2.7
1971	102.0	+2.0	102.8	+2.8	102.4	+ 2.4	96.7	-3.3
1972	112.5	+10.3	112.7	+9.6	108.6	+ 6.1	101.2	+4.7
1973	123.4	+ 9.7	123.0	+9.1	110.0	+ 1.3	107.7	+6.4
1974	132.3	+ 7.2	131.5	+6.9	127.6	+16.0	119.2	+10.7
1975	137.7	+ 4.1	136.4	+3.7	141.0	+10.5	109.7	- 8.0
1974 - I	132.3	+11.5	132.7	+9.9	118.5	+17.9	122.9	+17.9
II	132.8	+ 9.0	134.0	+9.9	116.8	+ 7.7	117.4	+14.4
III	130.3	+ 4.7	127.7	+4.6	138.4	+22.4	121.6	+ 6.0
IV	133.9	+ 4.0	131.8	+3.4	136.8	+15.7	114.8	+ 4.8
1975 - I	131.5	- 0.6	129.9	-2.1	132.5	+11.8	118.3	- 3.7
II	141.3	+ 6.4	142.2	+6.1	139.2	+19.2	103.5	-11.8
III	137.8	+ 5.8	135.9	+6.4	141.3	+ 2.1	113.6	- 6.6
IV	140.0	+ 4.6	137.4	+4.2	151.2	+10.5	103.4	- 9.9
1976 - I	142.5	+ 8.4	142.4	+9.6	142.2	+ 7.3	103.3	-12.7
Jan.	138.5	+ 1.6	137.4	+1.0	138.4	+ 3.4	103.1	-13.2
Feb.	139.0	+ 7.5	139.0	+7.8	141.2	+12.6	94.7	-17.9
Mar.	150.1	+16.5	150.9	+20.9	147.0	+ 6.2	112.2	- 7.1
Apr.	141.9	- 2.7	139.2	-6.1	153.7	+10.8	102.3	- 3.9
May	147.2	+ 4.7	141.0	-0.6	172.8	+23.3	119.7	+31.3

Source: Bank of Mexico.

Table 6

Mexico -- Money Supply (Coin and Currency plus Demand Deposits)
(1964 - May 1976)

	Amount outstanding 1/ (billions of pesos)	Percentage change from previous year
1964 - December	24,793.5	--
1965 - December	26,486.7	+6.8
1966 - December	29,395.8	+11.0
1967 - December	31,760.4	+8.0
1968 - December	35,892.8	+13.0
1969 - December	39,804.4	+11.2
1970 - December	43,999.9	+10.5
1971 - December	47,633.1	+8.3
1972 - December	57,736.5	+21.2
1973 - December	71,658.2	+23.8
1974 - December	87,412.3	+22.0
1975 - December	105,971.5	+21.2
1974 - Quarter I	73,901.0	+22.9
Quarter II	77,644.2	+21.7
Quarter III	81,048.4	+19.9
Quarter IV	85,069.2	+19.5
1975 - Quarter I	89,802.4	+21.5
Quarter II	95,620.0	+23.2
Quarter III	98,744.2	+21.8
Quarter IV	103,880.5	+22.1
1976 - Quarter I	108,313.5	+20.6
1976 - January	107,049.9	+22.1
February	108,621.1	+21.5
March	109,269.4	+18.4
April	111,263.5	+19.8
May	114,707.5	+19.7

1/ Seasonally adjusted.

Source: Banco de Mexico, Indicadores Economicos.

Table 7

Consumer Price Index in
Mexico and the United States 1/
Since 1968

	Mexico		United States		Ratio of Mexican Index to U.S. Index (1970=100)
	Index 2/ (1970=100)	Change from Year Earlier (Percent)	Index (1970=100)	Change from Year Earlier (Percent)	
1968	91.7		89.6		102.2
1969	95.1	+3.7	94.4	+5.4	100.7
1970	100.0	+5.2	100.0	+5.9	100.0
1971	105.7	+5.7	104.3	+4.3	101.3
1972	111.0	+5.0	107.7	+3.3	103.1
1973	123.6	+11.4	114.4	+6.2	108.0
1974	151.3	+22.4	127.0	+11.0	119.1
1975	176.8	+16.9	138.6	+9.1	127.6
1974 - I	142.4	+22.2	121.6	+9.8	117.1
II	146.8	+22.2	125.0	+10.5	117.4
III	153.1	+21.9	128.9	+11.5	118.8
IV	162.8	+23.2	132.6	+12.1	122.8
1975 - I	168.5	+18.3	135.0	+11.0	124.8
II	173.4	+18.1	137.1	+9.7	126.5
III	179.9	+17.5	140.1	+8.7	128.4
IV	185.5	+13.9	142.3	+7.3	130.4
1976 - I	193.7	+15.0	143.7	+6.4	134.8
II	198.9	+14.7	145.5	+6.1	136.7
1976					
Jan.	190.4	+13.3	143.3	+6.8	132.9
Feb.	194.1	+15.2	143.7	+6.3	135.1
Mar.	196.6	+16.3	144.0	+6.1	136.5
Apr.	197.7	+15.6	144.6	+6.0	136.7
May	199.2	+15.3	145.5	+6.2	136.9
June	199.7	+13.3	146.3	+5.9	136.5
July	200.5	+13.2	147.1	+5.4	136.3

1/ Indices are averages for periods shown.
2/ Refers to consumer prices in Mexico City.

Source: International Monetary Fund, International Financial Statistics.

Table 8
Mexico - Selected Interest Rates in Mexico
and the United States since 1970
(Gross Average Rates)

	Mexico			United States	
	Promissory Notes	Six Month Certificates of Deposit		Six Month Certificates of Deposit	
	One mil. pesos or more	Less than 1 mil.pesos	1 mil.pesos or more	Less than $100,000	More than $100,000
1970- I	12.22	--	--	5.00	6.75
II	12.22	--	--	5.00	6.75
III	12.22	--	--	5.00	6.75
IV	12.22	--	--	5.00	5.63
1971- I	11.48	--	--	5.00	4.19
II	11.11	--	--	5.00	4.91
III	11.11	--	--	5.00	5.52
IV	11.11	--	--	5.00	4.83
1972- I	10.60	--	--	5.00	4.10
II	10.60	--	--	5.00	4.82
III	10.60	--	--	5.00	5.08
IV	10.60	--	--	5.00	5.44
1973- I	10.60	--	--	5.00	6.27
II	10.88	--	--	5.00	7.38
III	12.70	--	--	5.50	9.22
IV	12.70	--	--	5.50	8.62
1974- I	12.78	10.94	11.94	5.50	8.10
II	13.74	11.21	12.48	5.50	10.08
III	14.20	11.44	12.94	5.50	10.80
IV	14.20	11.44	12.94	5.50	8.69
1975- I	14.20	11.44	12.94	5.50	6.60
II	14.20	11.44	12.94	5.50	6.73
III	14.20	11.44	12.94	5.50	7.19
IV	14.20	11.44	12.94	5.50	6.16
1976- I	13.91	11.30	13.11	5.50	5.58
II	13.91	11.30	13.11	5.50	5.85
January	13.91	11.30	13.11	5.50	5.44
February	13.91	11.30	13.11	5.50	5.54
March	13.91	11.30	13.11	5.50	5.77
April	13.91	11.30	13.11	5.50	5.48
May	13.91	11.30	13.11	5.50	5.88
June	13.91	11.30	13.11	5.50	6.18
July	13.91	11.30	13.11	5.50	5.86
Aug. (1Q)	n.a.	12.30	14.36	5.50	5.73

Source: Bank de Mexico, Indicadores Economicos.

Table 9

Mexico -- Increases in Minimum Wages, Mexico City, January 1966 - January 1976

	Percent Increases			Index	
	Nominal Wage	Real Wage	Real GDP 1/	Real Wage Jan 64 =100	Real GDP 1/ 1963= 100
January 1966	16.3	7.1	18.4	107.1	118.4
January 1968	13.0	8.3	13.7	115.9	134.6
January 1970	13.2	3.7	15.2	120.2	155.0
January 1972	19.7	7.5	10.6	129.2	171.4
January 1974 2/	34.4	1.7	15.4	131.4	197.8
October 1974	22.0	7.1	5.9	140.7	209.5
January 1976	24.0	5.4	4.0	148.3	217.8

1/ GPD changes are for intervals between wage changes except for October 1964 and January 1976, for which GDP changes for respectively all of 1974 and 1975 are shown because GDP data are available only for full years.

2/ Wages were raised by 18 percent in Octover 1973 and by 14 percent in January 1974. The increase shown for January 1974 includes the October 1973 change.

Table 10

Mexico - Balance of Payments
Since 1970
(in million dollars)

	Year 1970	Year 1971	Year 1972	Year 1973	Year 1974	Year 1975	1st half 1975	1st half 1976p/
I. Balance on Current Account	-879.9	-676.4	-707.2	-1,109.8	-2,458.3	-3,529.0	n.a.	n.a.
II. Balance on goods and services	-945.9	-726.4	-761.5	-1,175.4	-2,558.1	-3,643.4	-1,614.3	-1,511
A. Exports of goods and services	2,933.1	3,167.1	3,800.6	4,828.4	6,342.5	6,303.3	3,100.7	3,529
1. Merchandise 1/	1,347.7	1,410.3	1,716.4	2,140.3	2,998.9	2,998.7	1,495.3	1,730.5
2. Tourism	415.0	461.0	562.6	724.6	842.0	800.8	399.5	443.6
3. Passenger Fares	39.3	47.3	59.5	63.4	78.1	88.7	42.1	2/
4. Border transactions	878.9	966.9	1,057.0	1,207.7	1,372.9	1,518.8	732.9	796.3
5. Value added by border indust. 3/	80.9	101.9	164.7	277.6	443.5	445.9	199.7	279.6
6. Other	171.3	179.7	240.4	415.2	607.1	450.3	231.1	284.9
B. Imports of goods and services	3,879.0	3,893.5	4,562.1	6,003.8	8,900.6	9,946.7	4,715.0	5,040.9
1. Merchandise 4/	2,326.8	2,254.0	2,717.9	3,813.4	6,056.7	6,580.2	3,088.3	3,090.2
2. Tourism	169.7	172.2	220.4	258.0	334.8	398.0	170.2	188.8
3. Passenger Fares	53.9	54.3	65.7	72.6	96.8	134.1	52.9	2/
4. Border transactions	585.0	612.5	649.3	695.0	819.2	933.6	444.3	522.2
5. Dividends, interests and other remitt, by foreign firms	357.5	383.0	451.5	528.4	633.7	699.0	344.6	403.4
6. Interest on official debt	229.2	236.8	261.8	378.5	588.5	778.8	415.6	489.3
i) Nacional Financiera & others	210.6	219.3	241.5	357.6	560.3	680.6	365.6	n.a.
ii) Government	18.6	17.5	20.3	20.9	28.2	98.2	50.0	n.a.
7. Other	156.9	180.7	195.5	257.9	370.9	423.0	199.0	367.0

Table 10 (continued)

	Year 1970	Year 1971	Year 1972	Year 1973	Year 1974	Year 1975	1st half 1975	1st half 1976 p/
III. Errors and Omission in current and capital accounts (net)	498.7	217.7	233.5	-378.4	-135.8	-82.0	199.2	-751.6
IV. Long-term capital (net)	503.9	669.1	723.5	1,676.1	2,730.8	3,890.5	1,337.2	2,152.2
1. Direct foreign investment	200.7	196.1	189.8	286.9	362.2	362.3	205.1	n.a.
2. Purchase of foreign firms	--	--	-10.0	-22.2	-2.1	-25.8	-1.0	n.a.
3. Bonds and stocks	-7.2	52.0	6.2	-10.3	-59.8	136.8	81.8	n.a.
4. Loans from abroad (net)	342.2	450.6	546.0	1,370.7	1,999.2	2,952.3	679.3	n.a.
a. Public (net) 5/	263.1	286.4	359.7	1,046.6	1,672.9	2,469.0	624.9	n.a.
i) Inflows	799.0	742.2	864.2	1,891.9	2,233.9	3,157.1	922.2	n.a.
ii) Amortization	-535.9	-455.8	-504.5	-845.3	-561.0	-688.1	-307.2	n.a.
b. Private (net)	61.1	164.2	186.3	345.1	326.3	483.3	64.4	n.a.
i) Firms with foreign investment (net)	41.7	168.0	179.4	196.4	196.5	348.7	--	n.a.
ii) Other firms (net) 6/	19.4	-3.8	6.9	127.7	129.8	134.6	64.4	n.a.
5. Public debt (net) 5/	-2.3	-28.9	37.8	69.9	470.9	460.0	357.3	n.a.
6. Loans granted abroad	11.5	-0.7	-16.3	-18.9	-39.5	4.9	14.8	n.a.
V. SDRs	45.4	39.6	39.2	--	--	--	--	--
VI. Change in Reserves of the Bank of Mexico (equals II + III + IV + V); (- = increase)	-102.1	-200.0	-264.7	122.3	-36.9	-165.1	-0.3	+174.8

1/ Exports of border industries are excluded.
2/ Included in "other."
3/ Value added plus domestic inputs of goods exported by border industries.
4/ Imports of border industries are excluded. Valued c.i.f.
5/ These categories were redefined in 1974.
6/ Includes loans guaranteed by the government.

p/ Preliminary.

Source: Bank of Mexico.

RESTRICTED

Table 11

Mexico -- Level and Composition of International Reserves
(millions of U.S. dollars, 1970-1976)

	Gold	Special Drawing Rights	Reserve Position in IMF	Silver and other Assets[a]	Foreign Exchange	TOTAL
December 31, 1970	176[b]	48	135	n.a.	385	744
December 31, 1971	200[c]	96	106	n.a.	550	952
December 31, 1972	188[c]	139	106	n.a.	731	1,164
December 31, 1973	195[d]	154	118	n.a.	888	1,355
December 31, 1974	154[d]	158	120	n.a.	960	1,392
December 31 1975	154[d]	101	114	n.a.	1,168	1,529
March 31, 1976	152[d]	100	113	n.a.	1,142	1,537
August 9, 1976	365[c]	98	113	20	537	1,133
August 31, 1976	337[f]	98	113	20	803	1,361
September 10, 1976	375[g]	98	113	20	964[est.]	1,570

Sources: IMF, International Financial Statistics and Bank of Mexico.

a. The IMF does not count silver as part of Mexico's reserves. The estimated figures on 1976 holdings consist mostly, if not entirely, of silver.
b. Valued at $35 per ounce.
c. Valued at $38 per ounce. d. Valued at $42.22 per counce.
e. 3.6 million ounces valued at 90 per cent of the price at the second gold fixing on August 9, $112.70 per ounce.
f. 3.6 million ounces valued at 90 per cent of the price at the second gold fixing on August 31, $104 per ounce.
g. 3.6 million ounces valued at 90 per cent of the price at the second gold fixing on September 10, $115.70 per ounce.

RESTRICTED

Table 12

MEXICO - Composition
of Merchandise Trade in 1975

	Value (in million dollars)	Share of Total (per cent)		Value (in million dollars)	Share of Total (per cent)
Exports			Imports		
Agriculture and Fishing	772	27.0	Consumer Goods	600	9.1
of which Cotton	(174)	(22.6)	of which Corn	(398)	(66.3)
Coffee	(184)	(23.8)	Other	(202)	(33.6)
Shrimp	(120)	(15.5)			
Other	(294)	(38.1)	Semi-Processed Materials	2,903	44.1
			of which Vegetable and Animal Oils	(207)	(7.1)
Extractive Industries	737	25.8	Fuels	(291)	(10.0)
of which Metals	(277)	(37.6)	Textiles	(28)	(1.0)
Petroleum	(460)	(62.4)	Paper Products	(158)	(5.4)
			Chemical Products	(773)	(26.6)
Manufactures	1,202	42.0	Unassembled Autos & Parts	(582)	(20.0)
of which Foods and Beverages	(214)	(17.8)	Steel Products	(536)	(18.5)
Textiles and Shoes	(141)	(11.7)	Other	(329)	(11.3)
Chemicals	(204)	(17.0)			
Steel Products	(38)	(3.2)	Investment Goods	2,391	36.3
Machinery and Transport Equipment	(270)	(22.5)	of which Machinery and Equipment	(1,924)	(80.5)
Other	(335)	(27.9)	Tools and Instruments	(204)	(8.5)
			Transport Equipment	(264)	(11.0)
Unclassified Products	148	5.2	Unclassified Products	686	10.4
Total	2,859 1/	100.0	Total	6,580 2/	100.0

1/ Excludes exports of silver and the operations of the border assembly plants.
2/ Excludes the operations of the border assembly plants.

Source: Bank of Mexico, Indicadores Economicos.

Table 13

Mexico - Geographic Distribution

of Merchandise Trade in 1975 p/

	Exports		Imports	
	Value (in million dollars)	Share of Total (Percent)	Value (in million dollars)	Share of Total (Percent)
Total	2,858 1/	100.0	6,580	100.0
United States	1,629	57.0	4,108	62.4
Canada	43	1.5	146	2.2
EEC Countries	258	9.0	1,091	16.6
United Kingdom	(28)	(1.0)	(193)	(2.9)
Germany	(87)	(3.0)	(480)	(7.3)
France	(21)	(0.7)	(184)	(2.8)
Other	(122)	(4.3)	(234)	(3.6)
Other Western Europe	61	2.1	250	3.8
Eastern Europe and USSR	13	0.5	36	0.5
Latin American and Caribbean Countries	482	16.9	514	7.8
Argentina	(36)	(1.3)	(211)	(3.2)
Brazil	(92)	(3.2)	(96)	(1.5)
Venezuela	(57)	(2.0)	(59)	(0.9)
Central America	(82)	(2.9)	(19)	(0.3)
Other	(215)	(7.5)	(129)	(2.0)
Japan	109	3.8	298	4.5
Other Asian Countries	97	3.4	36	0.5
Africa	1	negl.	21	0.3
Australia and New Zealand	4	0.1	22	0.3
Other Countries	18	0.6	56	0.9
Unallocated	143	5.0	--	--

p/ Preliminary

1/ Excludes both exports of silver, which are included in line II.A.1 of Table 10, and exports of border industries.

Source: Bank of Mexico, Indicadores Economicos.

Table 14

Mexico - Selected Data on External Debt
(in million dollars)

	Public and Publicly Guaranteed Debt Reported by Mexico[1]			Claims on Mexico Reported by					
					Banks			Official Lending Institutions[5]	Others
		Long	Short		Banks in Major	United States Banks[4]			
	Total[2]	Term	Term	Total	Countries[3]	Total	Head Offices		
1970	4,070	3,227	843	n.a.	n.a.	n.a.	1,276	n.a.	n.a.
1971	4,243	3,516	727	n.a.	n.a.	n.a.	1,306	n.a.	n.a.
1972	4,594	3,962	632	n.a.	n.a.	n.a.	1,591	n.a.	n.a.
1973	6,314	5,265	1,049	n.a.	n.a.	n.a.	1,836	n.a.	n.a.
1974	9,946	8,014	1,932	14,177	5,970[6]	n.a.	2,673	2,003	6,204[6]
1975	13,837	11,314	2,523	18,845	13,465	9,896	3,786	2,353	3,027
1976									
March	15,081	12,406	2,675	19,747	14,599	10,509	4,068	2,382	2,766
June	16,402	13,258	3,144[7]	n.a.	n.a.	11,537	4,661	n.a.	n.a.

1/ Excludes unguaranteed private debt which is not systematically reported, but which was reliably estimated to amount to $6-8 billion at the end of 1975.
2/ Amounts disbursed.
3/ Refers to claims reported by banks in the United States, other G-10 countries, and US bank branches in the Bahamas, the Cayman Islands, Panama, Hong Kong, and Singapore.
4/ Includes claims reported by agencies and branches of foreign banks in the United States. To illustrate, these claims totalled about $650 million at the end of 1975.
5/ Refers to the IBRD, IDB, AID, and Eximbank. Data not readily available prior to 1974.
6/ For this date only, the claims of US bank branches in the Bahamas, the Cayman Islands, Panama, Hong Kong, and Singapore are included with the claims reported by Others. A year later, these claims totalled $5,366 million.
7/ Includes $360 million drawing on the Federal Reserve System under the swap arrangement.

Sources: World Bank, Bank for International Settlements, US Treasury Department, and Board of Governors of the Federal Reserve System.

Table 15

Wholesale Price Index
in Mexico and the United States 1/
Since 1968

	Mexico		United States		Ratio of Mexican Index to U.S. Index (1970=100)
	Index (1970=100)	Change from Year Earlier (Percent)	Index (1970=100)	Change from Year Earlier (Percent)	
1968	92.0	+1.9	92.8	+2.4	99.1
1969	94.4	+2.6	96.5	+4.0	97.8
1970	100.0	+5.9	100.0	+3.6	100.0
1971	103.7	+3.7	103.3	+3.3	100.4
1972	106.7	+2.9	107.9	+4.5	98.9
1973	123.4	+15.7	122.0	+13.1	101.1
1974	151.2	+22.5	145.0	+18.9	104.3
1975	167.1	+10.5	158.4	+9.2	105.5
1974 - I	146.0	+29.0	135.1	+17.4	108.1
II	150.5	+26.3	139.9	+15.9	107.6
III	153.0	+20.6	149.8	+19.3	102.1
IV	154.5	+15.0	155.1	+22.4	99.6
1975 - I	158.6	+8.6	155.1	+14.8	102.3
II	165.0	+9.6	156.7	+12.0	105.3
III	170.4	+11.4	160.1	+6.9	106.4
IV	174.3	+12.8	161.8	+4.3	107.7
1976 - I	184.0	+16.0	162.5	+4.8	113.2
II	189.9p	+15.1	164.9	+5.2	115.2
1976					
Jan.	181.6	+15.5	162.4	+4.4	111.8
Feb.	183.9	+15.7	162.4	+4.6	113.2
Mar.	186.6	+16.8	162.7	+5.4	114.7
Apr.	187.5	+16.0	164.2	+5.3	114.2
May	190.4	+15.6	164.7	+5.0	115.6
June	192.0p	+13.9	165.9	+5.5	115.7
July	196.8p	+15.5	166.9p	+4.9	117.9

1/ Indices are averages for period shown.

Source: International Monetary Fund, International Financial Statistics.

Table 16

Mexico -- GDP/GNP Deflators in Mexico and the United States: 1968-75
(1968=100)

	Mexico (GDP) (1)	U.S.A. (GNP) (2)	Relative Prices (3) = (1) / (2) X 100
1968	100.0	100.0	100.0
1969	103.9	105.0	99.0
1970	108.6	110.6	98.2
1971	113.5	116.3	97.6
1972	119.8	121.1	98.9
1973	134.6	128.3	104.9
1974	166.7	140.7	118.5
1975	191.7	154.0	124.5

Source: Bank of Mexico, U.S. Department of Commerce.

Department of the TREASURY
WASHINGTON, D.C. 20220 TELEPHONE WO4-2041
NEWS

FOR RELEASE 11 A.M.
MONDAY, SEPTEMBER 20,1976

The Treasury Department and the Federal Reserve System today announced arrangements with the Government of Mexico whereby short-term drawings up to $600 million will be available to the Bank of Mexico to counter disorderly exchange market conditions during a transitional period pending the receipt of medium-term financing from the International Monetary Fund. Drawings under these arrangements will have maturities of up to 90 days.

Of this amount, and at the option of the Government of Mexico, the Federal Reserve System will make available amounts repaid in advance of maturity under the existing Federal Reserve System reciprocal currency arrangements up to $180 million.

The remaining amounts will be made available by the Treasury through the Exchange Stabilization Fund under swap arrangements.

# # #

WS-1089

September 20, 1976

MEXICO ISSUES STATEMENT ON
FINANCIAL ARRANGEMENTS WITH
UNITED STATES-IMF

The Mexican Secretary of Finance and the Bank of Mexico have agreed with the International Monetary Fund, the United States Treasury and the Federal Reserve System to obtain substantial resources in support of the program to adjust the balance of payments announced September 1 by President Luis Echeverria.

The Managing Director of the IMF, Mr. Johannes Witteveen, addressed a letter to the Secretary of Finance of Mexico, informing him that he finds adequate and correct the Mexican Government's economic program that was evaluated by an International Monetary Fund Mission in order to deal with the balance of payments problems on the basis of a realistic exchange rate and free convertibility and transferability of the Mexican peso. The Managing Director of the Fund will present and recommend to the Executive Directors of that institution the use of the Fund's resources by Mexico for the objectives above-mentioned for a sum that can reach approximately $1.2 billion.

On its part, the U.S. Treasury and the Federal Reserve System today signed with the Government of Mexico and the Bank of Mexico agreements for a total of $600 million to be repaid upon receipt of the IMF credit tranche drawings in order that the Bank of Mexico can deal with unforeseen and disorderly situations in the exchange market for the Mexican peso. These resources are additional to the Exchange Stabilization Fund swap agreement of $300 million, which is now in force between the above-mentioned institutions.

# # #