The original documents are located in Box B80, folder "Mexico 4/76 - 10/77 (8)" of the Arthur F. Burns Papers at the Gerald R. Ford Presidential Library.

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WITHDRAWAL SHEET (PRESIDENTIAL LIBRARIES)

FORM OF DOCUMENT	CORRESPONDENTS OR TITLE	DATE	RESTRICTION
	1. memo case, Solomon to Blumenthal, 2/8/77		
1a. memo	~~Under Secretary Designate Solomon to Sec. Blumenthal re meeting with Mexican financial officials (5 pp.)~~ DECLASSIFIED lt 5/94	2/8/77	A
1b. briefing paper	~~Current Economic Situation in Mexico (5 pp.)~~ DECLASSIFIED lt 5/96	2/8/77	A
1c. briefing paper	~~U.S./Mexican swap arrangements (2 pp.)~~ DECLASSIFIED lt 5/96	c. 2/77	A
1d. biography	Gustavo Romero Kolbeck, Director General Bank of Mexico (p. 1 only)	n. d.	A
1e. biography	Julio Rodolfo Moctezuma Cid, Secretary of Finance and Public Credit, Mexico (p. 1 only)	n. d.	A Exempted from Declass. 7/28/95
1f. biography	Miguel de la Madrid Hurtado, Under Secretary of Finance, Mexico (p. 1 only)	n. d.	A
	2. memo case, Truman & Maroni to Burns, 2/8/77		
~~2a. memo~~	~~Truman memo re topics likely to be raised by Mexican financial officials (3 pp.)~~ opened 4/22/96 KBH	~~2/8/77~~	~~C(A)~~
2b. memo	Yves Maroni to Mr. Reynolds re new Mexican financial officials (5 pp.) sanitized 4/22/96 KBH	2/8/77	~~C(A)~~ B
	3. memo case, Governor Coldwell to Burns, 2/8/77		
~~3a. paper~~	~~Impressions of February 1977 Mexican Situation (5 pp.)~~ opened 4/22/96 KBH	~~2/77~~	~~C(A)~~
4. memo of conversation	Visit of Mexican officials to Burns, 2/10/77 (9 pp.) sanitized 4/22/96 KBH	2/14/77	~~C(A)~~ B
5. memo	Ted Truman to Burns re meeting with Mexican financial officials, Feb. 10, 1977 (2 pp.) sanitized 4/22/96 KBH	2/22/77	~~C(A)~~ B

FILE LOCATION

Arthur Burns Papers
Federal Reserve Board Subject File, Box B80
Mexico, Feb. 8-28, 1977

SR
8/14/84

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Date: FEB 8 1977

MEMORANDUM FOR: SECRETARY BLUMENTHAL

From: Under Secretary Designate Solomon (s)

Subject: Briefing for Meeting with Mexican Finance Secretary Moctezuma Cid and Central Bank Director-General Romero Kolbeck

Date and Time: Wednesday, February 9, 1977, 4:00 pm

Place: Your Office

Persons Expected to Attend:

Mexico:
- Julio Rodolfo Moctezuma Cid, Finance Secretary
- Gustavo Romero Kolbeck, Director-General, Bank of Mexico
- Miguel de la Madrid, Deputy Finance Secretary
- Alfredo Phillips, Deputy Director for International Affairs, Bank of Mexico
- Gustavo Petriccioli, Chairman of the National Commission on Securities

Treasury:
- Secretary Blumenthal
- Under Secretary Designate Solomon
- Deputy Assistant Secretary Erb

State:
- Richard Cooper, Under Secretary Designate

Recommended to attend as recording officer:

L. Britt Swofford, International Economist, Office of Developing Nations (Mexico)

Finance Secretary Moctezuma and Director-General Romero request to meet with you to discuss the current economic situation in Mexico and to prepare for the February 14-15 visit

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	Initiator	Reviewer	Reviewer	Reviewer	Reviewer	Ex. Sec.
Surname	SWOFFORD	ERB				
Initials / Date	/	/	/	/	/	/

Form OS-3129
Department of Treasury

of President Lopez Portillo. While the Mexicans see this as an opportunity to establish personal contact, they will also wish to examine specific issues which might be discussed when Lopez Portillo meets with President Carter.

1. Issues which Mexicans are Expected to Raise:

(a) Establishment of a mechanism for dealing with bilateral economic issues.

The Mexicans have indicated a desire to establish some type of mechanism which would facilitate frequent meetings, at a technical level, to examine various bilateral economic issues and problems in depth. The mechanism would not necessarily need to be structured in a formal sense, e.g., "US-Mexican Joint Economic Commission," but in a way that would provide for a focal point for increased cooperation and coordination on issues of mutual concern.

(b) Given that the 1977 external financing requirement which may approach $3 billion in new funds, and the possible reluctance on the part of the private banking sector to increase lending to Mexico, the Mexicans may request the US Government to intervene on their behalf in urging U.S. banks to increase their exposure in Mexico.

Mexico, like many countries, has rapidly increased their external debt in recent years as excessive domestic demand went unchecked. Mexico's external public sector debt totalled $20 billion at end-1976. It is estimated that the gross external financing requirement in 1977 will be approximately $9 billion of which, $6 billion will be for debt rollover and restructuring and $3 billion represents new borrowing. There is growing concern on the part of some Mexican officials that the private banking sector, and in particular U.S. banks, will be unwilling to increase the amount of their outstanding loans to Mexican enterprises. Because of this growing concern, they may request U.S. Government assistance in obtaining private bank financing along two lines:

1) A request for a direct approach by high level U.S. Government officials to U.S. bankers, urging them to increase their lending to both public and private enterprises in Mexico.

2) Ask that during the course of U.S. bank examinations, examiners from the Comptroller of the Currency and Federal Reserve relax their requirements regarding classification of loans to Mexico.

In either case, the Mexicans would be seeking preferential treatment in order to assure continued access to U.S. capital markets.

(c) Discussion of U.S. Swap Arrangements

The U.S. provided $300 million of financial assistance in November 1976 (split evenly between the Treasury and the Federal Reserve) in accordance with the existing agreements. The Federal Reserve Swap is due for repayment on the 10th and 17th of February ($75 million on each date) and the Bank of Mexico has informed us that they intend to make repayment as scheduled. The $150 million Treasury Swap is due in November and we expect repayment on or before the due date.

In the fall of 1976 an additional $600 million in bridging finance was made available, contingent upon IMF drawing. $365 million was drawn and repaid, and $235 million remains available. (A record of the swap is attached at Tab 2) We also provided a $150 million one month swap on November 30, to help them meet their reserve requirement at the end of November. This was repaid at maturity on December 30.

(d) Renegotiation of the IMF Stabilization Agreement.

In September 1976, Mexico agreed to an economic stabilization program in cooperation with the IMF which provided for balance of payments financial assistance based on the attainment of mutually agreed upon economic performance targets. When the Lopez Portillo government came to power on December 1, there was much discussion about whether to reaffirm the program or to begin renegotiation discussions. It was decided that for reasons of maintaining confidence, the stabilization program would be implemented although many recognized that in all likelihood, renegotiation would be required later this year.

(e) Increases in the exploitation and exportation of Mexican petroleum products.

Recent nonpublic estimates indicate that Mexican petroleum reserves may be among the largest in the world. Rapid exploitation of these reserves, however, remains a politically sensitive issue in Mexico. Nonetheless, Lopez Portillo is expected to discuss privately the possibility of increasing petroleum production and ask for U.S. financial assistance. They claim that physical capacity constraints can only be overcome through external financing, and are anticipated to seek additional Export-Import Bank financing for PEMEX (the State owned petroleum company). They may also wish to explore other possible sources of U.S. financial assistance for the acquisition of capital goods for the petroleum sector.

(f) Increased access to U.S. markets for Mexican exports.

Given the need to increase their exports to the U.S., the Mexicans will be looking for assurances that our trade policies will not limit access to U.S. markets. They have special concerns about non-tariff barriers, such as marketing orders, and are interested in increasing coordination on trade matters.

Mexico is anticipating a large inflow of tourist receipts from the U.S., and would like to see the $100.00 duty free limit increased to $200.00. They are extremely concerned about adverse publicity regarding the safety of U.S. travellers in Mexico.

(g) There are other issues related to access to U.S. capital markets such as "Blue Sky Laws" which may arise but will require further consideration and consultation with other agencies such as the S.E.C.

2. <u>Issues you may wish to raise</u>:

(a) Given that one of the stated purposes of this visit was to prepare for the meetings with President Lopez Portillo, you may wish to ask if there are any specific financial or economic issues that will arise during the Presidential talks.

(b) Although there have been indications of a return of confidence since Lopez Portillo's inauguration on December 1, there still appears to be a "wait and see" attitude on the part of private bankers and investors. You may wish to ask what policies are being instituted to meet the economic performance targets in the IMF stabilization program.

(c) The 1977 budget calls for a 39 percent increase in public sector expenditure although this is described as only "modest increases" in real terms. You may wish to ask if there are plans for additional expenditure cuts or revenue measures during the year. The Finance Ministry has been urging for additional cuts in public spending combined with price increase by some public sector enterprises. However, the economic cabinet, chaired by the President, has not taken any actions of this nature.

ATTACHMENTS

1- Current Economic Situation

2- Record of US-Mexican Swap
   Agreements

3- Biographies

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Background on the Current Economic Situation in Mexico

The rate of growth of industrial activity began to slow in mid-1976 in response to the Bank of Mexico's tight credit policies. The industrial production index peaked in June, and has run at lower levels through October, the latest date for which it is available. The October index is 140.7(below levels prevailing in this month in two previous years). The average index numbers for the first six months of 1976 was 144.3, whereas it was 142.1 for the period July-October. Partial data for November is mixed but the index is unlikely to be higher than October.

Mexico's gross domestic output is estimated to have grown about 3 percent in real terms from 1975 to 1976. Most of this growth would have been in the first half of the year with total output holding steady or declining slightly from the first half to the second half. The price deflator for 1976 as a whole is estimated to have been about 20 percent.

Actual price data is now available for the year 1976. The average year on year increase, in the CPI was 15.88, while the December over December 1976 increase was 27.2 percent. The increase in the WPI was more marked, 22.3 percent on an average year on year basis and 45.9 percent December over December. The reason for this is that the WPI is heavily influenced by raw material prices, most of which trade at or close to world prices, and was heavily influenced by the devaluation in the last four months of 1976.

Lopez Portillo has publicly stated that the first six months of 1977 will be particularly difficult and that Mexico must find a new development strategy. While he admits that economic problems are the most pressing, there is no public evidence that the government has a coherent short-term economic strategy. GOM policymakers are working on various policy options, but have not yet come to any conclusions as far as we know. Lopez Portillo's first two priorities appear to have been a restoration of confidence, largely through words, and administrative reform. The latter has meant that in addition to filling positions to a fairly low level in the bureaucracy, new lines of command are being drawn with resultant confusion over responsibilities, information flow, etc. Administration is reportedly Lopez Portillo's strong point and first love

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judging from the priority he has given to administrative reform. The major loser in this reform at least with respect to control over spending and trade policy appears to have been Lopez Portillo's stepping stone to the Presidency, the Finance Ministry. The biggest gainers would appear to be the new Budget and Planning Ministry (ex-Presidency) and the Patrimony and Industrial Development Ministry. The significance of administrative reform in the overall context is the impact it might have on the economic policymaking process and on the level of government expenditure.

The economic policymaking process in the new government is not yet clearly defined. At the present time the Minister for Budget and Planning, Carols Tello, appears to be the preeminent, though not necessarily dominant advisor to the President. Tello's economic philosophy appears to favor acting against inflation on the supply side. Opposed to him are the financial officials from the Finance Ministry and Bank of Mexico who want to reduce inflation by cutting back demand. Key presidential advisor Rafael Izquierdo is said to be somewhere between these two schools of thought. The President seems to lean to the former school of thought perhaps because he fears the political consequences that a reduction in per capita consumption and employment might have. Even as Finance Minister at the time of the U.S. recession, Lopez Portillo stated privately that Mexico could not afford a recession because of the lack of social welfare programs to take care of the unemployed, a theme he continues to repeat.

The new administration's first internal policy debate is focusing on the budget. There is pressure on him from the Bank of Mexico and Finance Ministry to reduce expenditures as well as to increase revenues, particularly by higher public sector prices. It is possible that the delays caused by the administrative reform will impact on the level of expenditures. Whether this will result in permanent savings or merely a brief delay in making expenditures is unknown. The outcome of this debate will be the key in determining economic developments later in the year. There are reports that Lopez Portillo has ordered cuts in current spending by federal government agencies and has instructed public sector enterprises to increase revenues or cut expenditures. We have not yet been able to qualify these policies.

Apart from the question of public sector spending, the GOM is faced with the problem of financing a current account deficit which is being forecast at anywhere from $1.8 billion to $2.6 billion. In addition to this, the public sector's short-term debt of $4.2 billion has to be rolled over and public sector long-term debt amortization payments of $1.7 billion have to be refinanced.

Mexico's financial problem is twofold and inter-related. That is, the GOM not only has to finance a substantial budget deficit, the size of which will impact on the external accounts, but it also has to arrange, one way or another, for substantial gross foreign borrowing. The latter is the primary concern of the GOM.

While senior GOM officials often state that Mexico cannot afford a recession, the economy is in a recession according to the informal Mexican definition, i.e., a negative per capita growth rate. The recession may be worse than commonly believed. Industrial activity may be lower now than it was in last October. This judgment is based on the following factors. (1) The industrial work force is probably lower now than last summer. Various businessmen have told us that they are laying off workers. (2) Public sector spending is probably running below the budget level due to the reorganization of the entire public sector. We hear reports of major spending has been the underpinning of Mexico's economic growth since 1972. (3) Private investment was undoubtedly affected negatively by the events of last fall. The lack of ability to forecast economic developments with any certainty is affecting investment decisions. Many private businessmen say they are waiting to see specific economic measures rather than base investment decisions on moral suasion. (4) Foreign exchange transactions are reportingly declining. This may indicate a continued decline in imports that began last September and would in turn affect domestic economic activity. (5) Increased peso and dollar financing is not available to Mexico's private sector, nor has it been for some months. The impact of these, plus the delayed impact of the devaluation may be hitting domestic economic activity, particularly in the private sector, harder than is generally known.

The picture in the agriculture sector is more difficult to discern. Output of some crops may be up whereas output of other crops may be down. It is not possible to measure the impact of the land seizures in northwest Mexico, but these were certainly not conducive to increased private sector investment in agriculture and may have a negative impact on output in that region. (These judgments are extremely qualitative because of the lack of current data on which to base quanitative analysis.)

The GOM is undoubtedly aware of these developments and the prospect of continued stagnation or even further declines in economic activity may be one of the reasons Lopez Portillo could opt for a relatively high level of public sector spending even though this means more foreign financing than would otherwise be necessary.

The current economic slowdown is a mixed blessing. It should lead to a reduction in the current account deficit and, if there are actual budget savings, make attainment of IMF's EFF program targets somewhat more likely. On the other hand, Lopez Portillo is unlikely to be satisfied with a growth rate of 0-2 percent because of what he views as the political risks from reduced employment and per capita consumption.

Although a significant turnaround in economic activity could hardly have been expected within two months of taking office, we believe the suspected deterioration in the economic situation could have been mitigated by more positive action by the new government. In particular, while Lopez Portillo has stated that this will be a difficult period, neither he nor other GOM spokesmen have laid out in any detail what the Mexican business community and public might expect in 1977. This has never been done in Mexico, but it is important in the present context because the economic policy framework that predominated for over twenty years and provided a basis for forward planning disappeared with the devaluation.

Some areas where coherent policies have not yet been developed are the following:

A) Exchange rate policy (Fluctuations in rates generally attributed to changes in supply and demand. GOM has not said publicly that exchange rate might also be determined by such objectives as reducing the current account deficit and making manufactured exports competitive in worlk markets.)

B) Interest rate policy. (Higher interest rates on peso deposits will be necessary to retain existing peso financial savings and attract more pesos into banking system.)

C) Fiscal policy. (Ideally, some target figure for budget cuts could be announced along with a revenue increase target. The details need not be made public at this time. The intention to pursue a less inflationary policy would be reassuring to foreign bankers and to local businessmen who want financial stability.)

D) Wage Guidance. (The 10 percent minimum wage increase of January 1, is being intrepreted as a guideline for settlements of individual union contracts. It may not be possible for the GOM to do more than continue to urge restraint in wage negotiations.)

While Lopez Portillo has prepared the country for bad economic news, he has not provided any details. The economic situation is confused and the economic climate is radically different from what it was even a year ago. Confusion complicates planning and investment. It also delays the necessary structural changes in the economy. The public does not understand GOM objectives. Without guidance, stagnation is likely to last longer than would otherwise be necessary. Further, the foreign banking community is unlikely to be as supportive as it could be in the light of this uncertainty.

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US/MEXICAN SWAP ARRANGEMENTS

Record of Finance Arrangements
Between the United States and Mexico
During 1976

April 9 - Mexico drew $360 million from its swap arrangement with the Fed.

July 9 - Mexico rolled over its $360 million swap with the Fed.

October 7 - Mexico withdrew $365 million from its September 2 swap agreement with the Treasury.

October 8 - Mexico repaid $360 million to the Fed.

November 5 - Mexico repaid $365 million to the Treasury.

November 10 - Mexico withdrew $75 million from its regular swap arrangement with the Treasury.

November 10 - Mexico withdrew $75 million from the Fed.

November 17 - Mexico withdrew $75 million from its regular swap arrangement with the Treasury.

November 17 - Mexico withdrew $75 million from the Fed.

November 30* - Mexico drew $150 million from its swap arrangement with Treasury.

December 30 - Mexico repaid $150 million, 30-day swap to the Treasury.

*NOTE: This swap arrangement was for a 30-day period, due December 30, 1976 (although renewable by agreement). It is important to remember that this drawing was deposited in a U.S. Treasury account and could not be withdrawn. The drawing was for window dressing purposes and will not be announced by the Mexican Government.

AVAILABLE FINANCING REMAINING FROM U.S. GOVERNMENT:

Only $235 million remains unutilized under Mexico's current swap arrangement with the Treasury. The funds are available in installments contingent on drawings from the IMF's Extended Fund Facility (EFF). Any drawings under the current arrangement are to be liquidated within 90 days or 10 days after eligibility to draw an equivalent amount from the EFF, whichever occurs earlier. Under the EFF, Mexico

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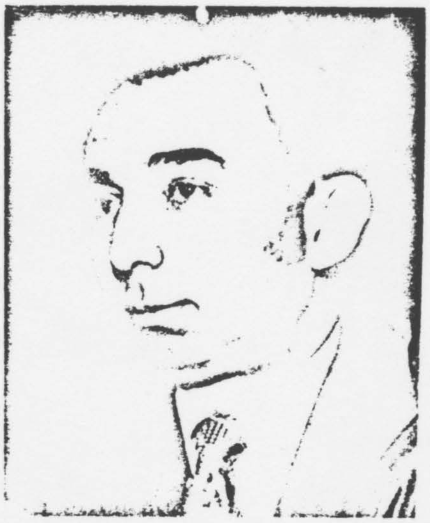
may draw in installments of $55 million, the cumulative total drawing is not to exceed $100 million on May 15, 1977; $150 million on August 15, 1977; and, $200 million, $318 million, and $518 million at end-1977, 1978, 1979 respectively.

Mexico's total swap arrangement with the Fed is $360 million of which $150 million has been drawn. It has been agreed that its drawdown from the Fed must be made on an equivalent basis as those from the Treasury. The unutilized portion of the Fed swap currently stands at $210 million.

Alfredo PHILLIPS Olmedo
(Phonetic: feeLEEPS)

MEXICO

Deputy Director for International Affairs, Bank of Mexico (since October 1975)



Addressed as:
Mr. Phillips

A competent banker, Alfredo Phillips is the youngest of the five deputy directors of the Bank of Mexico. In his current post, newly created at the time of his appointment, he is responsible for coordinating all the international operations that had previously been handled by the various departments of the bank. He served during 1970-75 as the manager of the bank's International Organization Division.

Phillips' banking career began in the 1960's, when he became an official in the Credit Directorate of the Secretariat of Finance and Public Credit. He joined the Bank of Mexico in 1970. As the Mexican Director of the International Monetary Fund in the 1960's, Phillips attended meetings of that organization and of the Inter-American Development Bank and the International Bank for Reconstruction and Development.

A graduate in economics of the National Autonomous University of Mexico, Phillips also studied economics at University College in London and at George Washington University and American University in Washington, D.C. Phillips, 41, is married to the former Maureen Greene, an Irish Catholic whom he met in London. The couple has two sons, Alfredo and Ricardo, and a daughter, Adriana. Phillips speaks English. His brother Carlos is married to the former Guadalupe Margaín, daughter of Hugo B. Margaín, current Ambassador to the United States.

CR M 77-10447
2 February 1977

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This form marks the file location of item number 1d - 1f as listed on the pink form (GSA Form 7122, Withdrawal Sheet) at the front of the folder.

February 8, 1977

To: Chairman Burns

From: Edwin M. Truman and Yves Maroni

We are attaching background material on Mexico.

(a) a note on the possible topics which the Mexican visitors may wish to raise.

(b) a paper assessing Mexico's external financing needs and prospects.

(c) a note on Mexico's borrowing.

(d) biographical sketches on Finance Minister Moctezuma and Bank of Mexico Director General Romero Kolbeck.

(e) a note containing some information on the background of Mexico's new economic leaders.

(f) a copy of the latest Board briefing on Mexico.

(g) a note on recent Mexican peso trading on the International Monetary Market.

(h) two tables on economic and financial indicators for Mexico.

(a)

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E.M. Truman
February 8, 1977

Topics Likely to be Raised by Messrs. Moctezuma & Romero Kolbeck

I. The stated purpose of this visit is to prepare for the visit of the Mexican President next week.

A. Messrs. Moctezuma and Romero, therefore, will want to discover possible topics that President Carter may want to raise with President Lopez Portillo.

B. These individuals, of course, have a general interest in economic policies in the United States and Mexico.

C. The Mexicans are also apparently interested in establishing a new mechanism of cooperation and consultation between the two countries. No one, including the Mexicans, apparently knows precisely what they have in mind. They do not want to appear to be creating a new symbol of dependence on the United States, but they would like to benefit from a special relationship. It is most likely that such a mechanism would deal with trade, migration, tourism and narcotics issues.

II. The Mexicans, according to my latest information, are planning to repay the Federal Reserve swap drawings due on February 10 and 17. But they will not repay the U.S. Treasury at that time. Messrs. Moctezuma and Romero presumably will want at least to review Mexico's eligibility for drawing again -- perhaps, in the near future -- on the Federal Reserve swap line and the procedures that would be followed.

III. We understand that the Mexicans are concerned about the heavy volume of borrowing that they will have to accomplish in 1977. Under the IMF

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MR 95-1, #29
KBH 4/12/96

program, they are allowed to make net new borrowings of up to $3 billion in 1977, $3/4 to $1 billion of which must be added to net reserves. In addition, it is estimated that they will have to roll over $6 billion in maturing debt, $4 billion in short-term debt and $2 billion in maturing long-term debt. In this connection, Messrs. Moctezuma and Romero may raise the following points.

A. They may request better treatment from Federal Reserve and the Comptroller of the Currency's examiners; some Mexican officials have recently complained that the examiners on "on their backs."

B. It is possible that they may even request the Federal Reserve and the Treasury to take positive steps to encourage U.S. bank lending to Mexico.

IV. Messrs. Moctezuma and Romero may request U.S. support in connection with renogotiation of the terms of the Extended Fund Facility agreement with the IMF. (It is generally accepted that some adjustments will be needed, but it is also thought that they should come later in the year, as necessary, for reasons of confidence in the Mexican program and for reasons of ensuring a higher level of over-all compliance.) Two issues in particular might be raised.

A. The Mexicans are unlikely to be able to meet their target for reducing their public sector deficit in 1977. The target is a deficit of 90 billion pesos. This is unlikely to be met. The only question is whether Mexico will at least hit the target of a deficit no larger than 6 per cent of 1977 GDP*/, which would imply a deficit of about 100 billion pesos, or whether it will miss this target as well. (We have heard estimates of budget deficits in 1977 up to 127 billion pesos.)

B. The Mexicans are also, we understand, concerned about the tightness of the IMF conditions with respect to monetary policy. Essentially they are required to operate in 1977 under gold-standard rules of the game. The Bank of Mexico can only increase the monetary base (currency plus other net liabilities to the private and public sector) by as much as Mexico's net international reserves increase.

V. The Mexicans are also expected, while in Washington, to discuss a number of trade issues with administration officials. These pertain mainly to supposed non-tariff barriers, e.g., against Mexican tomatoes, and textiles. They have not yet focused, we understand, on the fact that if the President or Congress accepts the International Trade Commission's recommendation to impose a tariff-quota on U.S. imports of non-rubber footware, Mexico will be adversely affected. (U.S. imports of such products from Mexico in 1976 were 10 times U.S. imports in 1974, which would be the base level for the quotas, and amounted to about $30 million.)

VI. The Mexicans are scheduled to discuss with the Export-Import Bank a proposal that the Bank open up a special line of credit for Pemex, the government-owned oil company, in return for a Mexican agreement to increase its oil exports. The Export-Import Bank's board has, we understand, given its tentative approval to this concept.

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*/ The deficit is estimated at 8.2 per cent of GDP for 1976.

(b)

Mexico

External Debt

Mexico's external debt at the end of 1976 is estimated at about $25 billion, 6-1/4 times as large as the estimated value of 1976 merchandise exports. Of this amount, some $19 billion is owed or guaranteed by the public sector. The public sector debt consists of over $15 billion with a maturity of one year or more and nearly $4 billion maturing in less than one year. The debt has been rising rapidly in recent years. As recently as the end of 1970, the total external public debt was only about $4 billion.

A substantial portion of the external debt is owed to banks in the industrial countries. At the end of September 1976, total bank claims on Mexico reported to the BIS were $16.8 billion, of which $12.1 billion were the claims of U.S. banks and their foreign branches.

Included in the debt is $478 million drawn on the International Monetary Fund, consisting of the gold tranche ($107 million), the first credit tranche ($158 million), and a compensatory financing drawing ($213 million). Since the end of 1976, another $115 million has been drawn, against the Extended Fund Facility.

The burden of servicing the debt is rising rapidly. The interest payments alone were approximately $2.0 billion in 1976, close to 28 per cent of the gross earnings from goods and services last year.

Current Economic and Financial Situation

The growth of the external debt of Mexico reflects the deterioration of the country's external balance, partly because of developments in the world economy, but mainly because of internally generated inflationary pressures. Internal inflation was stimulated by an expansion in the size of the public sector and of the public sector deficit. The deficit rose to 9.3 per cent of GDP in 1975. There was also an increase in the size and in the frequency of administratively determined increases in the minimum wage (which sets the standard for many wage settlements).

The Bank of Mexico sharply increased reserve requirements of the commercial banks and other financial institutions in 1974, in an attempt to channel an increased amount of financial resources from the private sector to the public sector, but the financing needs of the public sector exceeded what could be mobilized in this fashion and the Bank's own holdings of government securities rose markedly. Interest rates were not permitted to rise in line with interest rates in world markets in 1973-74, and this discouraged the inflow of funds into the Mexican financial institutions in this period, further aggravating the problem of financing the public sector deficit. Money supply, which rose at an average annual rate of less than 8 per cent in the period 1965-71, increased by more than 20 per cent in each of the next five years.

These developments were reflected in a more rapid increase in prices, from rates ranging up to 6 per cent and averaging substantially less in the 15 years 1958-72, to more than 20 per cent in 1973 and 1974 and 13 per cent in 1975. Industrial production rose more than 7 per cent in 1974, but only 4 per cent in 1975 and less than 3 per cent in 1976. Private investment, already discouraged by a distrust of the policies of the Echeverria Administration, stagnated.

The internal inflationay pressures stimulated imports after 1972 and slowed exports, especially those of in-bond assembly plants located on the Mexican side of the border with the United States. The value of imports was also swollen by the worldwide inflation of 1973-74. The ensuing recession further slowed the rise of exports and brought about a drop in tourist earnings. Interest payments on the rising external debt grew more rapidly.

For these reasons, the deficit on goods, services and private transfers increased from about $800 million in 1972 to over $4 billion in 1975, and was only moderately smaller last year. This deterioration is not attributable to the sharp increase in petroleum prices in 1973 and 1974 since Mexico was only a small net importer of petroleum in 1973 and has more recently become a net exporter of the product.

External borrowings were stepped up to cover the growing current account deficit and a moderate outflow of short-term capital, while allowing international reserves to continue rising. International reserves increased until March 1976. But, early in 1976, the outflow of short-term capital intensified as doubts spread that the disequilibrium could be corrected without a devaluation of the peso. This necessitated a further increase in external borrowings. At the end of August 1976, the Government opted to devalue the peso, effective on September 1.

Devaluation came only three months before the President of Mexico was to turn his office over to his successor. In the transition period, considerable uncertainty prevailed, and a wide range of rumors gained circulation, stimulating renewed capital flight. This caused a substantial drain on the country's international reserves, led to a second devaluation at the end of October, and eventually forced the Bank of Mexico on November 22 to withdraw completely from the exchange market. New external borrowings had to be negotiated to replenish the reserves and provide means to maintain payments on outstanding debts.

To gain lasting advantages from the devaluation and to strengthen their ability to obtain new borrowings, the Mexican authorities undertook to take measures to correct the disequilibrium. They formulated a stabilization program which received the approval of the International Monetary Fund. In October, the Fund authorized an Extended Fund Facility arrangement for Mexico, calling for disbursements over a three-year period, subject to the fulfillment of specific commitments regarding various aspects of economic and financial policy. This paved the way for Mexico to obtain a large new loan from a group of private banks in the latter part of November.

Assessment

The Mexican program approved by the Fund is a very comprehensive one covering all facets of economic and financial policy. If the Mexican authorities adhere to it, this program should restore a sustainable degree of external balance and relative internal financial stability to the Mexican economy. However, during the last four months of 1976, when there were no policy understandings between Mexico and the Fund, there was some erosion of the advantages expected from the September 1 devaluation. Specifically, wages were increased across the board by 23 per cent at the end of September. This raise was in addition to the wage bargains recently agreed upon and in process of being negotiated by individual employers and unions and the result was to bring the total wage increases for the year to about 35 per cent for most workers.

The 1977 budget calls for a deficit well in excess of the level specified in the Fund agreement. It is expected that the rates charged by public enterprises will be increased, so as to reduce the deficit to about 10 per cent above the level specified in the Fund agreement. But this has not yet happened. Moreover, the new Mexican President and some of his ministers have said publicly that the way to curb inflation is to increase production, that there is little room to reduce demand, and that an increase in output will require increased investment. These statements would seem to indicate an intention to pursue policies which would run counter to the austerity trends called for by the Fund agreement. It is possible that the shakedown process associated with the advent of the new administration will hold down the rise in public spending. But the extent of such a slowdown is very uncertain.

A further increase in the minimum wage, of 9-10 per cent, took effect on January 1, 1977, bringing the minimum wage about 35 per cent above the level of a year ago. For comparison, the consumer price index rose about 30 per cent during 1976. This does not seem consistent with the objective of reducing aggregate demand.

These developments do not help to promote the belief that Mexico will adhere to the targets specified in the Fund agreement. On the other hand, the Mexican authorities seem to be aware that they cannot afford to lose the confidence of the foreign banking community if they are to obtain the external financing they require. This should help to strengthen their resolve to adhere to their commitments to the Fund and to protect their eligibility to draw on the Fund, so that the banks will not be discouraged from continuing to lend to Mexico.

We estimate Mexico's balance of payments needs in 1977 at about $3 billion in new borrowings and about $6 billion to roll over existing debts,[1/] or an average of about $750 million a month for the two purposes combined. The current account deficit this year should be about $2-3/4 billion, some $650 million less than last year, with heavy interest payments preventing a greater decline. There should also be an inflow of direct private investment capital and some reflow of short-term private capital, altogether amounting to about $500 million. But net international reserves must rise by at least $750 million to comply with the Fund agreement. As of February 4, the Bank of Mexico's gross reserves appeared to be about $700 million above the minimum legally required as backing against its domestic liabilities.

In a foreign policy context, it should be noted that the new Mexican administration has adopted, as one of its goals, to seek an improvement in relations with the United States. Relations cooled somewhat during the last administration which often adopted "third world" positions. An improvement in relations would seem to require that new irritants be avoided as far as possible. A debt default would probably constitute a significant irritant, particularly if it were on a large scale and if it did not lead promptly to a settlement and to remedial action in the internal economic and financial field.

1/ This includes $4 billion in short-term debts and $2 billion in long-term debts maturing in 1977.

Therefore, the pursuit of improved relations may strengthen the Mexican resolve to continue servicing external debts on schedule.

The Mexican economy is highly dependent on that of the United States, where its principal markets and source of supply are located and from which over 90 per cent of its visiting tourists originate. The cyclical position of the United States economy heavily influences Mexican exports and tourist earnings.

On the other hand, Mexico stands to benefit from developments which adversely affect supply of some United States products. Specifically, barring import restrictions which might be applied by the United States at the instigation of interested U.S. farmers, the recent freeze in Florida could be a substantial windfall for Mexico, where there is a significant exportable surplus of tomatoes. It has also been reported that Mexico has some excess supply of natural gas and that it will begin to sell it to the United States to help in the current emergency.

Mexico's own agriculture is also vulnerable because of the social unrest associated with the land tenure problem, particularly in the northwest part of the country where expropriations and invasion of land by peasants have occurred in recent weeks. The turmoil is reported to have disrupted farm output in some highly productive areas, requiring some increase in certain imports and interfering with some exports.

The tourist business is quite sensitive to reports of occasional violence and harassment of foreigners, which have appeared in the press in recent months. If these reports should persist or multiply, there could be serious trouble for the tourist earnings on which Mexico counts heavily.

Yves Maroni
February 8, 1977

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Mexico's Borrowing Needs

We estimate Mexico's gross external financing needs in 1977 at about $3 billion in new borrowings and about $6 billion to roll over existing debts, or an average of about $750 million a month for the two purposes combined. The roll over obligations include about $4 billion in short-term debts and about $2 billion in long-term debts maturing in 1977.

The current account deficit this year should be about $2-3/4 billion, some $650 million less than last year, with heavy interest payments preventing a greater decline. There should also be an inflow of direct private investment capital and some reflow of short-term capital, altogether amounting to about $500 million. Net international reserves must also rise by at least $750 million to comply with the Fund agreement.

We understand that Finance Minister Moctezuma and Bank of Mexico Director General Romero Kolbeck will hold conversations with the Export-Import Bank of the United States concerning the possibility that Eximbank might establish a special line of credit for PEMEX, the Mexican State petroleum company, to help finance its import requirements. The establishment of the line of credit for PEMEX would be in return for PEMEX agreeing to increase petroleum exports to the United States. The Board of Directors of Eximbank has already discussed the matter and has given tentative approval to the concept.

The Wall Street Journal of February 4 reports that, according

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to a PEMEX spokesman, "Mexico has offered to sell the U.S. additional oil." The Journal adds that Mexico's exports of oil to the U.S. were expected to average 153,000 barrels a day this year, and that PEMEX could supply an average of up to 43,000 barrels a day in additional oil over a two-month period, the spokesman said.

According to the same story, the PEMEX spokesman announced that, in a few days, Mexico would begin sending up to 40 million cubic feet of natural gas a day to the U.S. and would continue these deliveries for 60 days. The gas will be sold to Texas Eastern Gas Transmission Corp. for distribution through its pipeline system to the U.S. East Coast.

We understand that PEMEX is going ahead with negotiations for a $300 million loan from a group of banks headed by Citibank. However, a previously reported negotiation for another $300 million loan for a Mexican copper company has been shelved for the time being so as not to crowd the market with Mexican paper. Bank of America is also reportedly organizing a $150 million loan in connection with the settlement of the default of a large Mexican steel firm.

Yves Maroni
February 8, 1977

ROMERO KOLBECK, Gustavo | MEXICO

Present Position:		Director General of the Bank of Mexico
Personal Data:		Born in 1923. Married. Three children.
Education:		Graduated in 1946 from the National Autonomous University of Mexico where he majored in economics. Received a master's degree in economics in 1948 from The George Washington University, Washington, D.C. Also studied economics at the University of Chicago.
Languages:		Speaks English fluently.
Career:	1949-54:	Chief of Economic Studies at the National Bank of Mexico (a commercial bank).
	1954-58:	Deputy Director of the Investment Commission in the Secretariat of the Presidency.
	1959-61:	Director of the Office of Investments in the Secretariat of the Presidency.
	1961-70:	Director of the Private Sector Economic Research Center.
	1971-73:	Mexican Ambassador to Japan and South Korea.
	1973-74:	Director of the National Sugar Finance Company.
	1974-76:	Director General of Nacional Financiera (the Government investment bank)
Other Activities:	1948-70:	Taught economics at the National Autonomous University of Mexico and at the Ibero-American University.
	1967-70:	Dean of the School of Economics at the University of Anáhuac.

MOCTEZUMA CID, Julio Rodolfo

MEXICO

Present Position:		Secretary of Finance and Public Credit
Personal Data:		Born in 1927. Married.
Education:		Graduated in 1947 from the National Autonomous University of Mexico where he majored in law and social sciences.
Languages:		Does not speak English
Career:	1947-59:	Practiced law and taught at the University.
	1959-63:	Private Secretary to the Under-Secretary in the Secretariat of the Presidency.
	1963-64:	Deputy Director of Planning in the Secretariat of the Presidency
	1964-70:	Director of Public Investment in the Secretariat of the Presidency
	1971-73:	President of Preinversion de Mexico, a private consulting firm.
	1974-75:	Chief Administrative Officer of the Secretariat of Finance and Public Credit.
	1975-76:	Director of the Institute of Political, Economic, and Social Studies (the research arm of the ruling political party) and Chief of Staff for Candidate (later President-elect) José Lopez Portillo.

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

(d) and (e)

Office Correspondence

Date December 13, 1976 1/

To Mr. Reynolds

Subject: New Mexican Financial Officials

From Yves Maroni YM

In response to Chairman Burns' question at the briefing on Friday, December 10, we have collected the following information regarding the new Mexican Secretary of Finance and Public Credit, Mr. Julio Rodolfo Moctezuma Cid, the new Director General of the Bank of Mexico, Mr. Gustavo Romero Kolbeck, and some of the other members of the new Mexican economic and financial team.

Mr. Romero Kolbeck, who is in his fifties, served in the Echeverría administration as Director General of Nacional Financiera, the Government development bank which is the principal conduit for external borrowings by the Mexican government. He has taught economics and previously was Director of the Private Sector Economic Research Center. While on a visit to Mexico in 1964, I was referred to him at the Research Center when I sought to get the views of the private business sector regarding the country's economic prospects at the time. As I recall my interview with him on that occasion, he was not very forthcoming in his comments, and I did not seek further appointments with him on subsequent visits to Mexico.

A recent telegram from the U.S. Embassy in Mexico City contains the following comments on Mr. Romero Kolbeck: "Romero is considered to be reasonably close to López Portillo through their common teaching experience, though in different fields. Romero is an economist,

1/ Revised February 8, 1977.

but not a Bank-of-Mexico-trained economist. He is pleasant, speaks English, ...
....
....
....
....

Mr. Moctezuma Cid, who is 49 years old, was one of the Under Secretaries of Finance in the Echeverría administration. He also has served in the Secretariat to the Presidency and as a Director of the ruling party's Institute for Political, Economic, and Social Studies. In this latter capacity, he is reported by the Journal of Commerce to have been "responsible for putting together what is expected to be López Portillo's government program." He has the reputation of being politically moderate. In a recent telegram, the U.S. Embassy in Mexico City reported that foreign bankers attending the presidential inauguration told the Embassy that he was not known to them. The Embassy commented that this "is probably a negative factor, at least until Moctezuma can prove himself." In the same telegram, the Embassy reported that Mr. Romero Kolbeck, as head of Nacional Financiera, was known to the foreign bankers, but not very well, as lower level officials handled most of Nacional Financiera's negotiations for external loans.

One U.S. banker told a Journal of Commerce reporter that he understood Mr. Moctezuma Cid "to be in favor of stimulating the economy very strongly, not with government spending but with higher productivity, especially in the government agencies." In another story, the Journal of Commerce said that "Mr. Moctezuma Cid is respected by local businessmen, although he is not well known to the foreign business community."

Two other members of the new Mexican economic team about whom we have information are Mr. José Andrés Oteyza, Secretary of National Patrimony,1/ and Mr. Fernando Solana Morales, Secretary of Industry and Commerce. Mr. Oteyza is 34 years old, has a master's degree in Economics from Cambridge University, and has served in lower level posts in the ministry which he now heads, as well as in the Bank of Mexico, and as a Director of the National Sugar Development Bank. ....

....

Mr. Solana is 42 years old and has served as Secretary General of the National University of Mexico and as Deputy Director of Planning and Finance of the agency responsible for supplying basic commodities at controlled prices.

The Journal of Commerce quotes one U.S. banker attending the presidential inauguration as praising the López Portillo appointments: "The cabinet proves Mr. López Portillo is going to be his own man. He picked his own people, he did not load the cabinet with leftists, and he kept most the technicians in the Finance Ministry, which is a good sign." In another story, the Journal of Commerce quotes the president of S. G. Rundt & Associates, a New York firm of

1/ This is the ministry which is responsible for policy on natural resources and other real national assets.

consultants on international business, as saying: "The ministers appointed by Mexican President José López Portillo add up to a very pro-business cabinet."

President López Portillo will also have a group of economic advisers reporting directly to him. This group will include Mr. Saúl Trejo, who holds a Ph.D. degree in Economics from Yale University, and Mr. Rafael Izquierdo, who has a degree in Economics from a Canadian University. Mr. Trejo has held a variety of posts in several ministries, most recently in the Ministry of National Patrimony. Mr. Izquierdo is a long-time employee of the Bank of Mexico. In recent years, he served as economic adviser to the Secretary of Finance and Public Credit.

In the Bank of Mexico and in the Ministry of Finance and Public Credit, the second level positions have been given to professional economists who have had considerable experience at the Bank of Mexico.

The principal Deputy Director General at the Bank of Mexico during the last five years, Mr. Miguel Mancera, is staying on. Two new Deputy Directors General have been named, and one of them, Mr. Leopoldo Solis, will deal with policy formulation. Mr. Solis did graduate work in Economics at Yale University and has held a number of positions at the Bank of Mexico in the late fifties and sixties, eventually becoming Director of Economic Research. When President Echeverría assumed office, at the end of 1970, Mr. Solís became an economic adviser to the President. However, he left this post over a year ago.

In the Ministry of Finance and Public Credit, the principal

Undersecretary is Mr. Miguel de la Madrid, who held the same job in the last year of the Echeverría administration. He formerly worked at the Bank of Mexico, and in lower level posts at the Ministry of Finance. I do not know where he received his economic training, but he has a good professional reputation. Under him, one of the key officials is Mr. Gilberto Escobedo, who has the title of Director General of Credit, and responsibility for the financing operations of the public sector. He was most recently working at the Bank of Mexico. I do not know where he received his economic training, but I know that he spent several months at the Federal Reserve Bank of St. Louis two or three years ago.

The outgoing Minister of Finance, Mr. Mario Ramón Beteta, has been appointed Director General of a government-owned financiera, or investment bank. The outgoing Director General of the Bank of Mexico, Mr. Ernesto Fernandez-Hurtado, has not been offered another official position.

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Board Briefing
Yves Maroni
January 24, 1977

It is the staff's best judgment that Mexico will implement sufficiently sound economic policies to ensure its continued access to foreign loans on a scale large enough to finance its balance of payments needs. This judgment rests on the belief that the Mexican authorities are aware that they cannot afford to lose the confidence of the foreign banking community if they are to obtain the external financing they require. They know that the foreign banks' confidence in Mexico is bolstered by the existence of the IMF Extended Fund Facility agreement, the Mexican stated commitment to comply with it, and the Fund surveillance which it entails. This should help to strengthen their resolve to adhere to their commitments to the Fund and to protect their eligibility to draw on the Fund, so that the banks will not be discouraged from continuing to lend to Mexico.

We estimate Mexico's balance of payments needs in 1977 at about \$3 billion in new borrowings and close to \$2 billion to roll over existing debts, or an average of about \$400 million a month for the two purposes combined. The current account deficit this year should be about \$2-3/4 billion, some \$650 million less than last year, with heavy interest payments preventing a greater decline. But net international reserves must rise by at least \$750 million to comply with the Fund agreement. As of January 20, the Bank of Mexico's gross reserves appeared to be about \$650 million above the minimum legally required as backing against its domestic liabilities.

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Mexican domestic policies are evolving slowly. The 1977 public sector deficit is forecast at about 100 billion pesos, 10 per cent above the amount specified in the Fund agreement. But the increases in rates charged by public sector enterprises, needed to validate this forecast, have not yet occurred. On the other hand, the shake down process accompanying the advent of the new administration is holding down public spending. Effective January 1, minimum wages were raised by 9-10 per cent and now are about 35 per cent higher than a year ago. For comparison, the consumer price index rose about 30 per cent during 1976. Some Mexican officials worry that the Fund agreement's targets will not be fully observed, but, by and large, guarded optimism prevails, especially in the private sector.

Some Mexican companies, faced with the increased peso cost of external debt servicing following devaluation, have been arranging a restructuring of their obligations, and creditors have reportedly agreed informally to give them a few months of grace on their payments. The biggest such case involves a large steel company, in which the Government has a minority interest. In this case, a Mexican official entity may provide funds to allow interest payments to resume as part of a settlement. The company's external debts total close to $400 million and it was reportedly not well managed. No other case with such heavy debts is expected.

BOARD OF GOVERNORS
OF THE
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Office Correspondence

Date February 8, 1977

To John E. Reynolds

From John E. Morton JEM

Subject: Recent Mexican Peso trading on the International Monetary Market (IMM).

The volume of trading in Mexican peso futures on the International Monetary Market (IMM) in recent weeks, shown in the attached table, does not indicate any sharp increase in speculative activity.

On January 18 and 19, the two days immediately preceeding the 14 per cent depreciation of the spot peso rate on the New York foreign exchange market, the table shows that trading volume in pesos on the IMM was unusually high, and the price of pesos for future delivery declined. The most active day of trading in pesos shown in the table was the following Monday, January 24, when the forward peso price recovered sharply. The average daily trading volume in the most recent week, January 31-February 4, was 54 contracts (about $2 million) per day. This was below the weekly average trading volume in the two preceeding weeks, 66 contracts per day (Jan. 17-21) and 106 contracts per day (Jan. 24-28). By comparison, the average daily trading volume in peso futures on the IMM in the week of December 6-10, 1976 -- a period of relatively quiet peso trading on foreign exchange markets in New York and Mexico -- was 87 contracts per day.

In the three week period covered by the table, the spot peso exchange rate in the New York foreign exchange market dropped from about 5 cents on January 17 to a current level of about 4.4 cents, a depreciation of 12 per cent. The current price on the IMM for pesos delivered in June is about 4.0 cents, indicating market expectations of a further 9 per cent decline in the spot peso rate during the first half of this year.

Attachment

cc: Messrs. Morton, Smith, McCormick, Hooper and Truman

February 8, 1977

Recent Mexican Peso Trading on the International Monetary Market (IMM) of The Chicago Mercantile Exchange

Date	Trading Volume (# of 1 million peso contracts sold)	Closing Price (June delivery, in U.S. cents per peso)
January 17, 1977	42	4.25
" 18, "	138	4.19
" 19, "	100	4.11
" 20, "	34	4.00
" 21, "	15	3.85
" 24, "	233	4.14
" 25, "	85	4.08
" 26, "	81	4.14
" 27, "	63	4.14
" 28, "	66	4.18
" 31, "	60	4.15
February 1, "	89	4.14
" 2, "	51	4.03
" 3, "	37	3.95
" 4, "	31	4.01

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MEXICO: ECONOMIC INDICATORS

February 3, 1977

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	1973	1974	1975	1975 II	1975 III	1975 IV	1976 I	1976 II	1976 III	1976 MAY	1976 JUNE	1976 JULY	1976 AUG	1976 SEPT	1976 OCT	1976 NOV
REAL GDP, 1970=100	119.4	126.4	131.8	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
REAL GDP, PER CENT CHANGE (1)	7.6	5.9	4.2	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
INDUSTRIAL PRODUCTION 1970=100	123.8	132.8	139.0	143.2	139.7	140.8	144.0	144.6	142.6	145.9	147.4	145.1	143.7	138.9	N.A.	N.A.
INDUSTRIAL PRODUCTION PER CENT CHANGE (1)	10.1	7.3	4.7	8.2	-2.5	0.8	2.2	0.4	-1.4	3.8	1.0	-1.6	-1.0	-3.3	N.A.	N.A.
WHOLESALE PRICES PER CENT CHANGE (1)	15.7	22.4	10.5	4.0	3.3	2.3	5.6	3.2	5.6	1.5	0.9	2.5	-0.3	6.2	8.4	8.2
CONSUMER PRICES PER CENT CHANGE (1)	12.2	23.8	15.0	3.0	3.2	2.0	4.4	2.6	3.2	0.7	0.4	0.8	1.0	3.4	5.6	4.5
MONEY STOCK (M1) (SA) PER CENT CHANGE (1)	24.8	20.9	22.3	6.6	2.9	5.8	3.9	4.7	5.8	3.1	-0.4	3.0	-1.2	8.2	1.9	N.A.
PUBLIC SECTOR DEF.(-) AS PER CENT OF GDP	-5.7	-7.8	-9.3	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
CENTRAL GOVT. DEF.(-) AS PER CENT OF GDP	-4.4	-3.8	-4.3	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
EXPORTS (2) ($ BILLION)	2.4	3.4	3.5	0.9	0.8	0.9	0.9	1.1	0.9	0.3	0.3	0.2	0.2	0.2	0.2	N.A.
IMPORTS ($ BILLION)	3.8	6.1	6.6	1.7	1.6	1.9	1.4	1.7	1.5	0.5	0.6	0.6	0.6	0.4	0.4	N.A.
TRADE BALANCE (2) ($ BILLION)	-1.4	-2.6	-3.1	-0.8	-0.8	-1.0	-0.5	-0.6	-0.6	-0.2	-0.3	-0.3	-0.3	-0.1	-0.2	N.A.
BALANCE ON GOODS AND SERVICES ($ BILLION)	-1.3	-2.6	-3.8	-0.9	-1.0	-1.1	-0.7	-0.9	-0.9	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.

(1) PER CENT CHANGE FROM PREVIOUS PERIOD. QUARTERLY CHANGES AT QUARTERLY RATES; MONTHLY CHANGES AT MONTHLY RATES.
(2) MONTHLY DATA EXCLUDE EXPORTS OF BORDER ASSEMBLY PLANTS AND OF SILVER AND ARE NOT CONSISTENT WITH QUARTERLY OR ANNUAL DATA.

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FINANCIAL INDICATORS -- MEXICO

(dollar amounts in millions)	1975 YEAR	1976 QI	QII	QIII	QIV	NOV	DEC	1977 JAN	FEB 1-2	Week ended JAN 5	JAN 12	JAN 19	JAN 26	FEB 2
EXCHANGE RATE (CENTS PER PESO, END OF PERIOD)	8.00	8.00	8.00	8.00	4.98	4.40	4.98	4.55	4.40	5.00	5.00	4.98	4.55	4.40
SDR VALUE OF PESO	.06842	.06924	.06985	.04364	.04297	.03940	.04297	.03960	.03796	.04297	.04297	.04318	.03960	.03796
SHORT TERM INTEREST RATE (E.O.P.)	12.94	13.11	13.11	14.36	14.36	14.36	14.36	14.36	14.36	14.36	14.36	14.36	14.36	14.36
LONG TERM INTEREST RATE (E.O.P.)	13.02	12.86	14.17	15.09	14.29	15.25	14.29	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
RESERVES (IFS, E.O.P.)	1,533	1,501	1,585P	870P	1,261	1.417	1,261	1,512	1,473					
AVAILABLE IMF CREDIT TRANCHES (E.O.P.)	433	620	615	621	596	596	596	596	596*					
INTERVENTION, PURCHASES (+) OR SALES (-)														
OF DOLLARS						-558	91.1	24.3	-22.4	16.7	-2.7	-21.4	32.7	-63.3
(OF OTHER CURRENCIES; EQUIVALENT)														
SWAP ACTIVITY														
DRAWINGS (+), REPAYMENTS (-)	360 -360	--	360	--		150	--	--	--	--	--	--	--	--
SWAP LINE -- 360														

* Available under three-year Extended Fund Facility program starting January 1, 1977.

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February 3, 1977

Prepared by Financial Markets Section

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

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BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date February 8, 1977

To Chairman Burns

Subject:

From Governor Coldwell

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Attached for your information is a note concerning my recent trip to Mexico City and the impressions I gained on the Mexican economic and financial situation.

Attachment.

cc: Governor Wallich
Mr. Maroni
Mr. Truman

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MR 95-1, #31
KBH 4/12/96

IMPRESSIONS OF FEBRUARY 1977 MEXICAN SITUATION

Overall Evaluation

Mexico faces difficult times ahead. Its poor and lower middle class have been severely damaged by inflation but must be called upon to sacrifice more and give up their expectations of a better life for yet another period of time. The country's goal of social and economic improvement must be put off to accommodate the final realities of the moment.

The nation faces an immediate crisis of decisional management in the fiscal and monetary fields. The old procedures of policy determination have given way to a new more concentrated procedure which focuses the power in a person without demonstrated capacity in monetary policy and with heavy political orientation. The new procedures are not tried and could create significant delays and lack of programs in the immediate future. In fact, some knowledgeable observers in Mexico believe this is already developing. The process seems to work better for long-range goals than short-run solutions. If the new decision-making process is to be used, there is likely to be a very heavy political input--perhaps to the detriment of sound economic and financial policy.

The current thrust of policy rests most heavily on the proposition that debts will be extended, new borrowings will be available, the inflation rate will decline (especially for the 70 market basket items) and unions and management will maintain their moderate demands permitting time to re-stabilize the economy. How well this policy will work remains to be seen, but there are obvious hazards and pitfalls in the assumptions.

Mexican officials believe they can meet most of the IMF conditions, but are squeamish about the money supply and budget deficit relationship. They expect the peso-dollar rate to fluctuate considerably, but hope the range will be in the lower 20's. Others think the pattern will be upward perhaps to 30 by year-end. The odds at present seem against the official position, but with great luck and a dedicated populace, there is a chance of stability.

In summary, Mexico needs heavy continuous access to credit markets but has an economy faced with troubled times ahead. The nation will need all its administrative skill, economic and financial talent, a population and politicians willing to sacrifice and a large measure of luck to stabilize its economy and redevelop a program of growth.

It seems to me that from a U.S. viewpoint, the fundamental long-range elements are the close U.S.-Mexican ties in trade and border, the need for a sympathetic Mexican administration, the basic raw material wealth of the nation and, very practically, the heavy U.S. investment and creditor positions in Mexico. These auger for an accommodative, but not overly easy policy, which can maintain our ties, encourage appropriate Mexican policy, and retain a measure of caution for U.S. banks involved.

Following are some specific comments and interpretations I received in my visits with various people.

Discussions with representatives of U.S. banks in Mexico brought the following:

1. Many U.S. banks are near their own "country limits" for Mexico and a few are nervous about their current level of lending.

2. Most seemed resigned to debt renegotiation extending maturities.

3. Most were guardedly optimistic for Mexico's long-range future based on oil and other natural wealth, but somewhat pessimistic on population control and the implication thereof.

4. Most were willing to participate in specific project loans but somewhat concerned by potential diversion of funds loaned, from projects to BOP.

5. Bankers have the impression that government has not done enough nor given sufficient policy guidance in the present situation.

6. Banks expect Mexico to borrow $6 billion in 1977 with $3 billion for repayments due this year. They hope that the burden of borrowings will shift to international financing institutions and bilateral aid, thus reducing drawings on private banks.

7. Some bankers predict that the interruption of agricultural production, because of the peasant revolt may cause greater wheat and grain imports. (See Romero-Kolbeck response.) A few bankers ventured the opinion that Mexico has decided to export products from labor-intensive agriculture and import products of mechanized agriculture (i.e., tomatoes for wheat).

8. The bankers were obviously nervous about the peso-dollar exchange rate and cited the recent run up to 24 pesos to the dollar the day before. A few expected an exchange rate over 30 pesos to the dollar by year-end (see Romero-Kolbeck).

9. The primary short-run concerns are the handling of Fundidora, the steel company, and San Rafael, the paper company's debts. All expected long-run extensions (Romero-Kolbeck says EXIMBK has been the stumbling block).

10. The bankers believed that Mexican hotel and other tourist services have raised prices to nearly equal the benefits of devaluation (Romero-Kolbeck believes this has occurred only up to two-thirds of the change).

11. Bankers believe U.S. banks hold a dominant position on Mexican credits, but German, Swiss and U.K. banks are becoming a more important force.

12. Bankers believe they must have more information on any future loans, not only about government programs but the condition of the companies. They cite Fundidora as the prime example of lack of information on government involvement.

Discussion with Ernesto Fernandez-Hurtado, former Director-General of the Banco de Mexico, S.A., reflected the following:

1. Believes Mexico still headed downward and into greater trouble.

2. Says Banco de Mexico's substructure good but new Director does not have any say with President. Believes Finance Minister has too much influence without basic knowledge, but that the President has final say on policy.

3. Believes long-range plans are good but thinks short-range policies being slighted and will create major new problems.

4. Believes Banco de Mexico will lose its independent voice under the new administration.

Discussion with Romero-Kolbeck and Moctezuma Cid:

1. Romero-Kolbeck believes Mexico can meet the IMF conditions, except perhaps for money supply growth, which he ties to the budget deficit. Budget based on 18 percent inflation while non-government sources expect 25-30 percent. Key differential is effectiveness of labor-wage and business-profit limits agreed to by unions and companies.

2. Romero-Kolbeck says Banco de Mexico and Finance (Treasury) see eye-to-eye and have 98 percent of cabinet behind them.

3. Believes agricultural output interruption may cause some additional wheat imports but these may be partially offset by sales of citrus and tomatoes to make up for loss in U.S. freeze.

4. Says Mexico will borrow net of repayments $3 billion with structure of type of borrowings, same as in the past--largely private. Implied that Mexico will use IMF as back-up or security.

5. Believes exchange rate will fluctuate in low 20's but gave impression of some upward move, but specifically not as high as 30 pesos per dollar.

6. Expects money supply growth of 18-25 percent for 1977. Thinks IMF condition of peso creation tied to dollar liabilities is unreasonable if budget deficit enlarges.

7. Moctuzuma Cid said budget faced a 27.5 billion peso deficit, of which, 5.5 billion was covered by new taxes, 9.0 billion by petroleum, utility, and transport price increases already accomplished and remaining 13.0 billion, hopefully by same and other price increases (Metro) and by tax inflation. Recognized price inflation on expenditures too.

8. Moctuzuma Cid believes budget will be balanced.

9. Romero-Kolbeck and others say attitude of cooperation, optimism, and sacrifice, provide environment for improvement. Says the President implicitly agreed to two years of no growth to correct problems, but as a politician will head for new growth then.

10. Expectations of overall improvement rest crucially upon the interaction of limited wage increases, limited profits, reduced money supply and government spending, and reduced inflation, tied to continued development growth by foreign borrowing. If any of these links are broken, then unfavorable results are expected. Union willingness to limit wages is tied to a 70 item market basket of relatively stable prices and thus no big inflation.

11. Believes prices have only eaten up 30 percent of devaluation benefit for exports and reports significant gains in exports already.

12. Romero-Kolbeck says government has taken steps to help companies meet major dollar debt payments, both by loans and by prompt tax write-off.

13. Two loans are apparently under negotiation--a $300 million PEMEX loan from a Citibank group and a $150 million one from a Bank of America group to Fundidora. The latter is a trade-off to extend over $400 million in loans to 6-8 years maturity, while the proceeds of the $150 million will pay the interest and principal due now.

14. Moctuzuma Cid said reorganization of the Executive has created an economic-monetary policy group of the heads of the public banks (Agriculture, Public Works, etc.), plus, the Director General of the Banco de Mexico, to advise Moctuzuma Cid on foreign debt and exchange actions. He said the final decision is his alone--subject to the President's ratification.

16. Romero-Kolbeck says the Banco de Mexico has no independent status, but reports to Finance Minister Moctuzuma Cid, though in theory he (Romero-Kolbeck) can appeal directly to the President.

Visit of Mexican Officials to
Chairman Burns
February 10, 1977

The visitors were the Minister of Finance and Public Credit, Mr. Julio Moctezuma, and the Director General of the Bank of Mexico, Mr. Gustavo Romero Kolbeck. They were accompanied by Messrs. Miguel de la Madrid, Undersecretary of Finance, Leopoldo Solis and Alfredo Phillips, Deputy Director General and Deputy Director, respectively, of the Bank of Mexico. Also attending were Governor Wallich, Mr. Truman, and Mr. Maroni.

Chairman Burns welcomed the visitors and indicated his concern over the serious Mexican situation. He said that last year, there had been a lack of information about Mexico and about the policies being followed. He cited the repeated assurances that there would be no devaluation, which tended to hide the true situation. He noted that there had begun to develop an improved flow of accurate information and he expressed the hope that this would increase.

.... said that an improved flow of accurate information was very important and he indicated that this might well be one of the results to be derived from an informal bilateral commission which President Lopez Portillo would propose to President Carter during his visit here.

.... said that he was not aware that there had been a lack of information about Mexico. He noted the frequent visits to Washington by Mr. Phillips and, the day-to-day contacts with the U.S. Treasury through Mr. Britt Swofford, and he emphasized that he wanted no information held back so that there would be no surprises.

Chairman Burns asked for details on the proposal to establish an informal bilateral commission. .... replied that the idea was to set up a commission consisting of representatives of the two countries' Treasury Departments, Central Banks, and Foreign Affairs Departments. The principals might meet once a year and there might be more frequent meetings of deputies or working level officials. He said that at least two working groups were envisaged, one to deal with trade matters, the other with financial matters. He thought that this device might help improve the flow of accurate information.

Chairman Burns expressed sympathy for the idea. He went on to ask what were the prospects that Mexico would fulfill its agreement with the IMF.

.... replied that there had been a return of confidence since December 1. He noted that President Lopez Portillo attached great importance to the agreement and had taken careful steps to show his support of it, and to make this support effective. An economic cabinet has been set up to coordinate the main decisions in implementing the policies that will be needed to fulfill the agreement. This group has formally approved the agreement.

....
.... added that the measures taken so far would help in implementing the agreement. He noted that the budget was anti-inflationary and was within the IMF limits. He said that fiscal reform, which was being pushed, would have an anti-inflationary impact. As regards wages, he noted that the previous administration had put into effect a raise of more than 23 per cent last September--a raise that exceeded that of the cost of living, Chairman Burns commented--that this raise was the cause of the confidence crisis and the second devaluation, and that the new 10 per cent increase, which took effect on January 1, was small when viewed against the fact that the controlled prices of basic commodities were raised a few days before.

.... went on to say that the Government had concluded ten sectoral agreements with the private sector regarding investment plans and that this had helped to restore the Government's negotiating capacity vis-à-vis the private sector. He added that a return of funds to the banks had gotten under way on December 1, and that prices had risen more slowly in December and January than before December.

Governor Wallich asked about the prospects for the budget.
....
.... replied that he hoped the deficit would be about 105 billion pesos. He thought that this would be consistent with the IMF agreement which specifies that it should not exceed 6 per cent of GDP. He pointed out that the absolute amount would be higher than called for

under the Fund agreement, but he said that the agreement had been formulated before the 23 per cent wage increase and before the second devaluation. He thought that the figure of 105 billion pesos would be an accurate reflection of the Fund agreement target after taking account of the intervening price effects. He noted that the budget, as approved, called for a deficit of about 130 billion pesos, but that this would be cut by a tax bill, which would yield 5.5 billion pesos.

Chairman Burns wondered whether the Mexican authorities would seek to renegotiate the Fund agreement. ....replied that there would be no renegotiation of the fiscal targets, but that the ceiling on net foreign external debt was troublesome. He noted that the ceiling covered the current account deficit and the reserve increase associated with the need for domestic financing, but that it left out the needs of the financial intermediaries in Mexico. He insisted that this required a quantitative adjustment, not a qualitative one. He explained that Mexico would need $4 billion in net new money in 1977, $1 billion more than agreed with the Fund. Under questioning, he repeated that the additional $1 billion was for the capital account (to cover the needs of the financial intermediaries), not to help finance the current account. He pointed out that new borrowings would still be less than in 1976, when he estimated they reached $5 billion.

Chairman Burns commented that Mexico should take steps to reduce its borrowings even more, that the level was high and a cause for concern. .... replied that efforts were being made to reduce the external deficit and the need for new borrowings. He said that it was not certain that Mexico could reduce the borrowing need sufficiently, although there was a tendency toward a decline.

.... added that there was a problem with the lending limits of U.S. banks and with the regulations under which they operate. He thought that the additional $1 billion of new borrowings might be hard to negotiate.

Chairman Burns said that the interest burden on the Mexican balance of payments looked very high to him. He noted that he understood it to be about 28 per cent of the value of exports of goods and services. The visitors were skeptical of this estimate (which they felt sure must include amortization as well) and both sides agreed that their respective staffs should get together to bring their estimates closer to each other, and more generally to develop a common set of facts and figures on the Mexican situation.

.... explained that the outflow of funds from the banks had ended and that their liabilities were now increasing. He cited an 18 billion peso rise in December and a 6 billion peso rise in January when there usually is a large decline. He said that the Bank of Mexico had helped the banks by relaxing reserve requirements on a temporary basis when the banks found themselves with frozen loan portfolios (as borrowers became unable to pay back their debts following the devaluation). He said that the relaxation of reserve requirements amounted to 20 billion pesos in December and 1.6 billion more in January. He pointed out that the Treasury account was now in surplus, and that the Government deposit balance at the Central Bank was now about 12 billion pesos. He noted that, in the past, this balance never exceeded 2.5 billion pesos. He added that the implementation of the budget was moving slowly, especially as regards investment spending, which has not started. This was partly attributable to a reorganization which has shifted authority over spending to a new budget office. He commented that, if this continued, total spending for the year would be less than in 1976.

....
.... added that the exchange market was calm and that the peso was now floating normally. He said that the banks were back in the market, that the free convertibility and transferability that were traditional for Mexico were continuing, and that the gold market in Mexico was normal. He pointed out that price increases were moderating, and he cited monthly increases in the consumer price index of 2.6 per cent in December and 2.3 per cent in January, following three months of increases around 5 per cent. He concluded by saying that the Mexican authorities knew that they had a serious problem on their hands but that they were working to rectify the situation.

Chairman Burns commented that this report was very encouraging.

.... returned to the fiscal situation to explain that a special commission had been appointed to review and make recommendations on the tariffs and rates charged by public enterprises. He said that the commission had recommended increases totalling 8-9 billion pesos and that these were being put into effect. He noted that this would help to bring down the deficit from its initial estimate of 130 billion pesos. He added that the public enterprises were "well under control."

Chairman Burns drew attention to the possibility that it might be difficult for Mexico to borrow as much as $4 billion in new money. He wondered whether there were any contingency plans in case this could not be done.

................: replied that the situation would be difficult, that adjustments would be necessary, perhaps involving cuts in imports. But he said that the authorities preferred not to think about that. He said that there was a need to roll over maturing obligations of some $6 billion, but that this was not causing concern. The new borrowings were the problem. The $3 billion authorized under the IMF agreement might be hard to get, but it was important to continue importing.

....
.... agreed that the maintenance of import levels was very important. He pointed out that there was now a new public debt law, which required the Treasury to authorize all external debts. Even the Mexican Congress had to give its approval to overall levels of borrowings. This would help to ensure that all borrowings were strictly in accordance with plans. He emphasized that PEMEX was

an important part of the borrowing program, that its needs were related to exploration and drilling requirements, and that this was crucial for the country. He said that PEMEX was currently negotiating a $350 million loan with Citibank. (Our information is that the loan is for $300 million). He also mentioned that the Federal District (Greater Mexico City) was seeking a restructuring of its external debt with its French creditors,[1] and was hoping to stretch it to 15 years.

.... also said that the authorities had approached Bank of America and had asked them to study the possibility of setting up a $3 billion short-term line of credit, in cooperation with other banks in the United States, Europe, Canada, and Japan, to provide "parallel" financing to be used alongside with the drawings under the Extended Fund Facility. .... likened this to the recent United Kingdom loan organized by German banks.

.... said that there were no basic doubts about the future of the Mexican economy, but that the American press had spread inaccurate information. He mentioned stories suggesting that the new budget was inflationary. He said that he had explained to the representatives of the press that this was not true, and that,in reality, the new budget showed a tendency against inflation.

.... said that debt renewals were proceeding

1/ The Mexico City subway was built with French equipment.

normally up to now. In support of this statement, he cited the fact that Nacional Financiera had negotiated roll overs of obligations totalling $450 million since December 1.

.... asked whether Chairman Burns had any doubts or suggestions for President Lopez Portillo, whom he and ....
...... would see the next day.
......

Chairman Burns replied that, in all frankness, the foreign debt of Mexico looked very large and that he was not sure that the balance sheet position of the U.S. banks would permit them to come up with as much as Mexico is seeking in new borrowings. He added that he was encouraged to see a Mexican Government oriented toward sound policy lines.

Yves Maroni
February 14, 1977

February 11, 1977

TO: Chairman Burns

FROM: Ted Truman

Attached is the latest cable from Mexico.

Attachment: Mexico 1587

cc: Governor Wallich

Defense classification of this document is due to the inclusion of U.S. Government information officially classified under Executive Order 10501 which provides that "A document.... shall bear a classification at least as high as that of its highest classified component."

MEXICO

Department of State TELEGRAM

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PAGE 01 MEXICO 01587 100020Z
ACTION EB-08

INFO OCT-01 ARA-06 ISO-00 EUR-12 AID-05 CIAE-00 COME-00
FRB-03 INR-07 NSAE-00 USIA-06 XMB-02 OPIC-03 SP-02
CIEP-01 OMB-01 L-03 PA-01 PRS-01 /062 W
------------------1003447 117189 /72-62

R 092338Z FEB 77
FM AMEMBASSY MEXICO
TO SECSTATE WASHDC 221
INFO TREASURY WASHDC

LIMITED OFFICIAL USE MEXICO 1587

EO 11652 : N/A
TAGS : EFIN MX
SUBJ : RENEGOTIATION OF MEXICAN DEBT

1. SUMMARY : SEVERAL MEXICAN DAILIES OF FEBRUARY 9 CARRY STORY DATELINED AT WASHINGTON TO EFFECT THAT MEXICO WILL TRY TO OBTAIN $600 MILLION LOAN FROM IMF AND ORGANIZE A CLUB OF PARIS GROUP TO RENEGOTIATE MEXICO'S EXTERNAL DEBT. END SUMMARY

2. SEVERAL MEXICAN PAPERS CARRIED, MOSTLY ON INSIDE PAGES, A STORY STATING THAT JLP WILL TRY TO OBTAIN A $600 MILLION LOAN FROM THE IMF WHILE IN WASHINGTON; THAT MOCTEZUMA WILL ARRANGE FOR A FUND TEAM TO VISIT MEXICO TO STUDY THE MEASURES TO FIGHT INFLATION AND STABILIZE THE EXCHANGE RATE; AND THAT MOCTEZUMA MAY TRY TO HAVE THE FUND ORGANIZE A MEETING OF THE CLUB OF PARIS TO RENEGOTIATE MEXICO'S EXTERNAL DEBT. STORY IS ATTRIBUTED TO "FINANCIAL CIRCLES".

3. WHILE STORY SEEMS FAR-FETCHED AND SOMEWHAT CONFUSED, IT HAS ATTRACTED LOCAL INTEREST. SEVERAL EUROPEAN EMBASSIES CONTACTED FINATT RE STORY. HE SAID THAT IT HAD NO BASIS AS FAR AS HE KNEW. LOCAL BANKERS ARE ALSO LIKELY

FORM DS-1652

Department of State TELEGRAM

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PAGE 02 MEXICO 01587 100020Z

TO PICK UP STORY. WHILE BANKING COMMUNITY APPEARS WILLING TO RENEGOTIATE INDIVIDUAL CREDITS IF NECESSARY, SEVERAL HAVE EXPRESSED THEIR FEAR OF WHAT A CALL FOR GENERAL DEBT RENEGOTIATION MIGHT HAVE ON MEXICO'S ABILITY TO RAISE NEW FUNDS. THEY EVEN WORRY ABOUT WHAT IMPACT STORIES LIKE THIS, EVEN IF GROUNDLESS, MIGHT HAVE. JOVA

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FORM 8-66 DS-1652

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

February 11, 1977

TO: Chairman Burns
Governor Wallich
Governor Coldwell

FROM: Ted Truman

Attached is Part II of a New York Times article on Mexico's new regime. Part I, which was sent to you yesterday, is also attached for your convenience.

New York Times, 2/11/77

Mexico's New Regime: II

By John B. Oakes

MEXICO CITY — When the new President of Mexico meets the new President of the United States next week at the White House, they will discover many points in common, but there's one great difference that they probably won't discuss at all. That is, the way each achieved office; and it tells something about the difference between the political systems of Mexico and the United States.

For while Mr. Carter came up the hard way, Mr. Lopez Portillo was hand-picked by his predecessor, as were most of Mexico's presidents since the 1930's; and his election last July without opposition was in fact a mere formal ratification by the people of his appointment. Such is Mexican one-party "democracy" as practiced at the presidential level.

Under this system which, contrary to the Latin-American stereotype, has given Mexico a unique political stability for more than 40 years, each outgoing President has left office precisely at the end of his six-year term —without strings, but, usually, with something else: an enormous accretion of personal wealth.

"Mexico" goes the cynical remark, "is one of the world's richest countries; every six years it produces a new crop of multi-millionaires."

Perhaps Mr. Lopez Portillo will change this time-honored custom; but one thing he surely will not change, and that is the tight grip in which his "Institutional Revolutionary Party" (P.R.I.) holds the Mexican electorate. Thi party—*the* party—has managed for nearly a half-century to embrace the entire political spectrum from mid-left to mid-right. Tven its enemies marvel at its efficiency.

One of them, leader of a small left-wing group observed: "You've never seen anything so well-organized as P.R.I. They combine repression with concession| They've taken over practically all the union leaders. They don't represent the workers; they control them."

Mr. Lopez Portillo himself refuses, as does his party, to be classified "right" or "left." "We will not fall into this geometric trap," he says. "We want political philosophy, not geometry. The road that has been laid out by the Revolution is flexible..

The truth is that the party has managed not only to coöpt the labor leaders and major unions but also most of the rapidly growing middle class (of which an important segment is the huge governmental bureaucracy) and, for good measure, all but a handful of the country's immensely rich industrial, banking, and landed sectors.

The all-embracing umbrella of the P.R.I. operates, in fact, as a balancing device. It bears little resemblance to that revolutionary Communist image of Mexico, engraved indelibly on the American mind a generation ago by the stirring murals and frescoes of Rivera and Siqueiros, or with the ultra-radical impression left more recently by former President Echeverría's florid third-world rhetoric. For all its pretentions, Mexico is not a truly radical state; it's only surprising that it isn't more so.

In its mixed economy, the private sector (excluding such basics as steel, petroleum, electricity, etc.) plays the dominant part, contributing to enormous private fortunes, with politics accounting for a good deal of the remainder. For example, Miguel Aleman, whose mansion must be one of the largest in Mexico City, was during his Presidency a prime developer of Acapulco, he is a multi-millionaire.

Mexico may be nominally a democracy; but it is in fact—within the six-year time frame of each successive President—a semi-authoritarian "democracy" of a very special kind. Its theoretical freedom of ballot, speech and press has been severely limited at various times and in various ways in recent years. Among the latest instances was the governmentally-inspired ousting last year of the outspoken editor of Mexico's leading newspaper; another was the blatant stealing by P.R.I. last year of the mayoralty election in Monterrey from a small locally strong conservative party by methods that would have boggled the mind of the late Mayor Daley.

Any visitor to Mexico City will see at a glance that that great metropolis, with its overhanging curtain of polluted haze, its sophisticated uppercrust, its magnificent avenues, its impossible traffic, and its endless slums, is easily part of the "first world"; but much of the rest of Mexico still belongs to the third. And on every side, in its internal and external relations alike, Mexico seems to be afflicted with a kind of schizophrenia. Even today exery Mexican remembers that most of the American Southwest once belonged to his country. "Of course we have forgiven," said one of Mexico's leading bankers, unconvincingly. "But we can never forget."

Nor can Americans any longer afford to forget that for 2,000 miles along our southern border lies our fourth largest customer, a dynamic, sensitive, society whose population at the end of the century will be more than 100 million, and whose economic, social and political future is inexorably and increasingly linked to ours.

John B. Oakes is Senior Editor of The Times. This is the second article of a two-part series.

New York Times, 2/10/77 C

Mexico Under Portillo—I

By John B. Oakes

MEXICO CITY—The suave and successful businessman, speaking easily in the comfortable surroundings of his antique-encrusted living room, wryly observed to his American visitor: "This country can stand corruption in government as long as there's competence; but what it cannot stand is corruption with incompetence." Yet the hope of President José Lopez Portillo is to achieve what even the least cynical Mexican still believes can't happen here: a government both competent and incorruptible.

If the new President of Mexico attains that goal—he has referred to corruption as "the cancer of the country" — he will be the first in Mexico's long line of all-powerful Presidents to do so. But, given the critical state of his country's economy and the potential explosiveness of its restive society, he has no choice but to try.

If he fails, the prediction of the young radical, quietly sipping his coffee at a boulevard cafe, may conceivably turn out to be true: "With our one-party system, there's no channel for the masses to voice discontent. So one of these days there's going to be an explosion without anyone expecting it—or even leading it—because there's no other way."

Yet the remarkable thing about Mexico today is that despite the huge size of its depressed underclass, there seems little present likelihood of any such eruption in what is for all the revolutionary rhetoric, a not very revolutionary society. Even the peasant "invasion" and temporary expropriation of large landholdings in northwest Mexico last fall have been peacefully dissipated by reference to the courts—while the new President tries to negotiate the issue behind the scenes in his first crucial exercise of the conciliatory role that he seeks to play for the next six years.

In this as in other respects, Mr. Lopez Portillo will discover that politically and personally he has many points in common with President Carter when he visits the White House next week. Neither had a national constituency until after his Presidential nomination; both are supreme pragmatists; both stress—and claim—competence in administrative reform; both see as their most urgent goal the restoration and strengthening of a badly shaken public confidence in governmental institutions. And both project themselves to the public with studied informality.

While former President Echeverría did everything possible with his frenetic activity and third-world rhetoric to increase the traditional American distrust of our southern neighbor as a turbulent land of revolution, his successor has pointedly taken the opposite approach, which is indeed much closer to reality. The most revolutionary thing about Mexico now is constant oratorical reference to "the Revolution"—which broke up most of the large estates, cost a great many lives, didn't do much else—and took place some sixty years ago.

The terrorist violence that has received so much notoriety in recent months is in fact no more than a reflection of "the world climate," according to Mr. Lopez Portillo; and he may well be right. Even the leaders of the most left-wing groups disavow the use of violence, not necessarily on moral grounds but on the well-founded belief that it would be counterproductive. It would, as one of them privately admitted, "only separate us from the masses." His main present concern—as that of other radical splinter groups—is to get his party legally onto the ballot.

The "marginal" condition (the word is Mr. Lopez Portillo's) under which nearly a third of Mexico's 63 million people live is reflected less in violence or even in political activity than in the northward flow, in literally incalculable numbers, of the so-called "undocumented" immigrants into the United States. This is an out-migration that Mexico's President himself looks on as a "safety valve" for the country's rapidly increasing "surplus" population. It has—as one Mexican authority frankly put it—"poisoned" Mexican-United States relations for years; but it is a flow that obviously cannot or will not be stopped so long as life across the border, tough as it is, appears better than conditions at home to Mexico's urban and rural poor.

With wages rising this year by 10 percent against an inflation moving along at about 30 percent; half the work force unemployed or underemployed and half of these receiving less than the legal minimum of $5 per day; with Social Security severely limited and unemployment insurance unknown; with about a third of the population receiving no health services at all—how could it be otherwise?

And although the astronomical birth rate has been slowed, the fact is—as one of Mexico's leading experts on the subject says—"There's not much inducement to an impoverished farmer or worker to curb the size of his family as long as every new child is viewed as a prospective income producer."

Only economic improvement, especially in the rural areas, is likely to stem the immigrant tide (as well as the birth rate): and it is to this end—for example through special trade concessions for agriculture and industry—that the President of Mexico is likely to seek help next week from the President of the United States.

John B. Oakes, Senior Editor of The Times, has just returned from a trip to Mexico. This is the first of two articles.

February 15, 1977

TO: Chairman Burns

FROM: Edwin M. Truman

Attached are the latest cables from Mexico. The first cable (Mexico 1678) describes the problems of Dina, the fourth largest automotive manufacturer in Mexico. The second cable (Mexico 1740) describes President López Portillo's meeting with Business International. Note paragraph 9 where the inference is drawn that Mexico wants to renegotiate the terms of the IMF program; note also paragraph 11 where Mr. Romero Kolbeck is described as believing that Mexican inflation is caused by external forces.

Attachments: Mexico 1678
Mexico 1740

cc: Governor Wallich

Mexico

Department of State **TELEGRAM**

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PAGE 01 MEXICO 01740 01 OF 02 120015Z
ACTION ARA-10

INFO OCT-01 ISO-00 CIAE-00 DODE-00 PM-04 H-01 INR-07 L-03
NSAE-00 NSC-05 PA-01 PRS-01 SP-02 SS-15 AID-05 EB-08
CIEP-01 TRSE-00 STR-04 OMB-01 CEA-01 COME-00 FRB-03
XMB-02 OPIC-03 LAB-04 SIL-01 NSCE-00 SSO-00 USIE-00
INRE-00 /083 W
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INFO TREASURY WASHDC IMMEDIATE

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See 2 attached

LIMITED OFFICIAL USE SECTION 1 OF 2 MEXICO 1740

EO 11652: NA
TAGS: EFIN,MX
SUBJECT: PRESIDENTIAL VISIT: JLP COMMENTS TO BUSINESS INTERNATIONAL

REF MEXICO 1384

1. SUMMARY: LOPEZ PORTILLO TOLD BUSINESS INTERNATIONAL THAT MEXICO WELCOMED FOREIGN INVESTMENT ACCORDING TO ITS WELL-KNOWN RULES AND THAT THE SOLUTION TO MEXICO'S INFLATION PROBLEM WAS THROUGH INCREASED PRODUCTION FOR WHICH HE NEEDS FINANCING. END SUMMARY.

2. BUSINESS INTERNATIONAL GROUP HEADED BY ORVILLE FREEMAN MET WITH LOPEZ PORTILLO ON FEB. 10. MEETINGS OF THIS GROUP ARE TRADITIONALLY OFF-THE-RECORD AND PRIVATE. GROUP WAS TAKEN ABACK BY PRESENCE OF PRESS AND FREEMAN REPORTEDLY HAD TO TONE DOWN HIS REMARKS. JLP'S OPENING MEETNG TO PRESS ATTENDANCE MAY MEAN HE WANTED HIS REMARKS TO REACH WASHINGTON AND MEXICAN PUBLIC. MEETING GIVEN WIDE PUBLICITY IN FEB. 11 PRESS.

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3. FREEMAN OPENED MEETING BY SAYING HE HAD RECENTLY MET WITH PRESIDENT CARTER WHO WAS LOOKING FORWARD TO JLP'S TRIP. HE THEN QUERIED HOW GOM WOULD DEAL WITH INFLATION AND THE GOM ATTITUDE TOWARD FOREIGN INVESTMENT.

4. JLP CONCENTRATED ON THE FORMER. HE SPOKE EXTEMPORANEOUSLY. FOLLOWING ARE HIS MOST PERTIENT REMARKS AS CARRIED IN EXCELSIOR TEXT. "FOR SOME TIME, RECOGNIZING THE VIRULENT INFLATIONARY PROCESS, WE HAVE ESTABLISHED CERTAIN POLICIES WITH WHICH SUPPORT WE ARE REALIZING A NATIONAL PLAN THAT SUPPORTS A FUNDAMENTAL IDEA. INFLATIONARY PRESSURES CAN BE ALLEVIATED IN TWO WAYS: BY REDUCING DEMAND OR IN INCREASING SUPPLY. SOMETIMES IT IS NECESSARY TO ACT IN BOTH WAYS, BUT IN A COUNTRY WITH PERENNIAL NEEDS SUCH AS OURS, IN WHICH THE DEMAND IS OCCASIONALLY AT MINIMUM SUBSISTENCE LEVELS, THE SOLUTION TO THE INFLATIONARY PROBLEM, IF WE WANT TO BE DEFINITIVE, MUST BE ORIENTATED TOWARD PRODUCTION BEFORE REDUCING DEMAND WHICH WOULD VERY OFTEN LEAD TO SOCIAL PROBLEMS; BUT IT IS NATURAL THAT IN ORDER TO MAKE USE OF OUR RESOURCES, WE HAVE FINANCING PROBLEMS. THEREFORE IN THE LIGHT AGAINST THE INFLATIONARY PROCESS, WE ARE ATTEMPTING AS THE FUNDAMENTAL ISSUE TO RESOLVE THE PROBLEM THAT WHICH I HAVE CALLED THE 'FINANCIAL TRAP".

5. REGARDING PETROLEUM, JLP SAID THAT THIS COULD SOLVE MANY OF MEXICO'S EXPORTING PROBLEMS, BUT THAT "TO INCREASE EXPORTS, WE NEED TO IMPORT EQUIPMENT AND FOR THIS WE NEED FINANCIAL RESOURCES." AS PEMEX IS A GOVERNMENT ENTITY, ITS BORROWING IMPACTS ON THE PUBLIC SECTOR DEFICIT AND ITS SPENDING INCREASES INFLATIONARY PRESSURES, WITH THE RIGHT THAT, HE SAID, "WE HAVE AN ABSURD VICIOUS CIRCLE THAT IS TRULY A TRAP FROM WHICH WE ARE TRYING TO ESCAPE WITH A SERIES OF MEASURES, BOTH ECONOMIC AND SOCIAL."

6. NOTING THE NEED IN THIS CONTEXT, JLP MOVED TO THE SUBJECT OF FOREIGN DIRECT INVESTMENT, WHICH HE SAID MEXICO NEEDED TO MAKE USE OF TECHNOLOGY, MARKETS AND FOREIGN FINANCING. HE SAID MEXICO HAD SEEN AN EPOCH WHERE FOREIGN DIRECT INVESTMENT TOOK MORE FROM THE COUNTRY THAN IT GAVE, CALLING THIS "BAD BUSINESS".

7. JLP SAID THE FOREIGN INVESTMENT LAW WAS NOT ALWAYS UNDERSTOOD, BUT CLEARLY SPELLS OUT THE RULES OF THE GAME. "THE CARDS ARE ON THE TABLE", HE SAID. HE ALSO SAID THE FOREIGN INVESTMENT COMMISSION COULD MAKE SOME MUTUALLY ADVANTAGEOUS ADJUSTMENTS WITH THE BASIC PRINCIPLES BEING: "RESPECT FOR THE LAW, LOOK FOR EQUILIBRIUM, DO GOOD BUSINESS FOR ALL, RUN RUSKS, UNDERSTAND THINGS WITHOUT LOOKING FOR INCONVENIENT ADVANTAGES THAT ARE NOT FOR EVERYBODY". HE WENT ON TO DESCRIBE EQUILIBRIUM AS THE SECRET OF PEACE AND GOOD BUSINESS, WHICH IS TO THINK FOR THE LONG TERM.

8. COMMENT: JLP SEEMS TO BE SENDING A MESSAGE THAT HE DOES NOT WANT TO LIVE WITHIN THE CONFINES OF THE PROGRAM AGREED UPON WITH THE IMF, AND THAT OBTAINING ADDITIONAL FINANCIAL RESOURCES TO PERMIT HIM TO PURSUE EXPANSIONARY POLICIES WILL HAVE SOME PRIORITY IN HIS U.S. DISCUSSIONS.

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ACTION ARA-10

INFO OCT-01 ISO-00 CIAE-00 DODE-00 PM-04 H-01 INR-07 L-03
NSAE-00 NSC-05 PA-01 PRS-01 SP-02 SS-15 AID-05 EB-08
CIEP-01 TRSE-00 STR-04 OMB-01 CEA-01 COME-00 FRB-03
XMB-02 OPIC-03 LAB-04 SIL-01 NSCE-00 SSO-00 USIE-00
INRE-00 /083 W
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FM AMEMBASSY MEXICO
TO SECSTATE WASHDC IMMEDIATE 0291
INFO TREASURY WASHDC IMMEDIATE

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9. WE BELIEVE THAT JLP ENVISAGES NO CHANGES IN THE FOREIGN INVESTMENT LAW OR THE RECENT LAW GOVERNING PATENTS AND TRADEMARKS, AND THAT THESE WERE THE "RULES" BY WHICH BUSINESS WOULD HAVE TO BE CONDUCTED IN MEXICO. HOWEVER, HE SOFTENED THE IMPRESSION BY REFERRING TO THE OPERATIONS OF "A COMMISION (PRESUMABLY THE INVESTMENT COMMISSION) WHICH COULD MAKE "ADJUSTMENTS TO MUTUAL ADVANTAGES". WE DOUBT THAT THIS IS GOING TO BE SATISFACTORY IN ACCELERATING FOREIGN INVESTMENT COMING AS IT WOULD FROM COUNTRIES WHERE THE LAWS CANNOT BE SO READILY RE-INTERPRETED.

10. LOPEZ PORTILLO MAY ALSO HAVE BEEN USING THE OCCASION TO GET A MESSAGE ACROSS TO THE MEXICAN PEOPLE THAT SOME FOREIGN INVOLVEMENT IN THE MEXICAN PETROLEUM MIGHT BE NECESSARY, ALTHOUGH HIS REPORTED TEXT IS OBSCURE ON THIS POINT, PROBABLY DELIBERATELY.

11. AS REGARDS OTHER MEETINGS THAT BUSINESS INTERNATIONAL HAD WITH SENIOR GOM OFFICIALS, SEVERAL

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ATTENDEES HAVE EXPRESSED TO US THEIR DISAPPOINTMENT WITH THE LACK OF ANY SPECIFICS ON GOM POLICIES. KEY MINISTERS, TELLO AND DE OTEYZA, APPARENTLY GAVE THE SAME LINE AS THE PRESIDENT ON INFLATION. ROMERO KOLBECK DENIED PUBLICLY THAT INFLATION WAS A DOMESTIC PROBLEM, BLAMING IT INSTEAD ON EXTERNAL FORCES. HE DID SAY PRIVATELY TO A PARTICIPANT THAT HE HAD READ THE RECENT STATEMENT BY U.K. PRIME MINISTER DENOUNCING KEYNESIAN-INSPIRED POLICIES. DE OTEYZA REPORTEDLY ASKED THE AMERICAN CHAMBER HERE FOR THEIR VIEWS ON THE PATENTS AND TRADEMARKS LAW AS A NEW REGUATION WAS FORTHCOMING.
JOVA

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Mexico

Department of State TELEGRAM

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ACTION ARA-10

INFO OCT-01 ISO-00 AID-05 CIAE-00 COME-00 EB-08 FRB-03
INR-07 NSAE-00 USIA-06 TRSE-00 XMB-02 OPIC-03 SP-02
CIEP-01 LAB-04 SIL-01 OMB-01 NSC-05 SS-15 STR-04
CEA-01 /079 W
------------------1204547 011481 /13

R 111755Z FEB 77
FM AMEMBASSY MEXICO
TO SECSTATE WASHDC 264
INFO AMCONSUL MONTERREY POUCH
AMCONSUL GUADALAJARA POUCH

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PASS EXIM BANK

EO 11652 : N/A
TAGS : EFIN EIND MX
SUBJ : DINA CUT IN PRODUCTION

1. SUMMARY
DINA, FOURTH LARGEST AUTOMOTIVE MANUFACTURER IN MEXICO AND MAJOR PARASTATAL COMPANY IN CIUDAD SAHAGUN COMPLEX, HALTED PRODUCTION FOR TWO WEEKS AND FACES MAJOR ECONOMIC DIFFICULTIES WHICH MAY CAUSE PRESIDENTIAL CONCERN IN GOM. END SUMMARY.

2. DINA, ONE OF PARASTATAL COMPANIES IN CIUDAD SAHAGUN COMPLEX, SUSPENDED MOST ACTIVITIES FROM JANUARY 21 TO FEB 4. MANAGEMENT CONVINCED LABOR UNION TO TAKE MAY VACATION NOW. BEFORE VACATION, DINA PRODUCTION WAS VIRTUALLY HALTED DUE TO SCARCITY OF PARTS, BOTH DOMESTIC AND IMPORTED.

3. IN TELCON WITH EMBOFF, DINA'S SUBDIRECTOR OF FINANCING REFERRED TO VICIOUS CIRCLE: BANKS WON'T SUPPLY CREDIT, SUPPLIERS WON'T SHIP GOODS, LACK OF PARTS STALLS PRODUCTION,

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HENCE WORSENING FINANCIAL SITUATION OF COMPANY. SUBDIRECTOR JUST RETURNED FROM 2-WEEK VISIT TO U.S. SUPPLIERS AND BANKERS, WHO, SUBDIRECTOR SAID, HAVE "WAIT AND SEE" ATTITUDE TOWARDS MEXICAN ECONOMY. IMPLICATIONS ARE THAT DELAYS IN CREDITS AGGRAVATE CURRENT SITUATION.

4. NEW DIRECTOR-GENERAL OF SAHAGUN COMPLEX, FORMER SECRETARY OF NATIONAL PATRIMONY, FRANCISCO JAVIER ALEJO ALSO FACES STRIKE AND NEGOTIATIONS ON NEW WAGE CONTRACTS STARTING FEB 7. INDEPENDENT UNION ASKING FOR 37 PERCENT WAGE INCREASE BUT ALL AUTO UNIONS CUSTOMARILY MAKE HIGH DEMANDS. GM ALSO OUT ON STRIKE THIS WEEK OVER 24 PERCENT DEMAND. DINA UNION ALSO CONCERNED ON POSSIBLE LAY-OFFS. OTHER CO. SAHAGUN COMPANIES HAVE HAD RECURRENT LABOR PROBLEMS AND U.S. DIESEL MOTOR MANUFACTURER CUMMINS MAY BE CONSIDERING SEEKING ALTERNATIVES TO ITS ASSEMBLY CONTRACT WITH DINA.

5. DINA PRODUCED 23,692 RENAULT CARS, 13,190 TRUCKS, 384 MOTOR-TRUCKS AND 678 BUSES IN 1976, UP SLIGHTLY FROM THE 1975 LEVEL, BUT MONTHLY PRODUCTION DIPPED SUBSTANTIALLY IN THE LAST QUARTER.

6. OVER 8 BILLION PESOS INVESTED IN SAHAGUN COMPLEX, WHICH ALSO INCLUDES 10 OTHER COMPANIES MAKING RAILROAD AND SUBWAY CARS, AGRICULTURAL CONSTRUCTION TRACTORS, MOTORS, STEEL, AND MEDICAL EQUIPMENT. DINA RANKED THIRTEENTH IN MEXICAN VERSION OF FORTUNE 500 PUBLISHED BY EXPANSION AND RANKS SEVENTH IN SPENDING AMONG PARASTATAL COMPANIES. THREE PRINCIPAL COMPANIES IN SAHAGUN COMPLEX, DINA, CNCF (RAILROAD CARS) AND SIDENA (STEEL) EMPLOY OVER 14,000. CNCF AND SIDENA ARE REPORTED TO HAVE LAID-OFF MANY WORKERS IN RECENT WEEKS. SAHAGUN COMPLEX MOSTLY LOCATED IN TOWN OF THAT NAME NEAR MEXICO CITY, BUT PARTLY IN TOLUCA AND MONTERREY.

7. COMMENT. MEXICAN AUTOMOTIVE INDUSTRY HARD HIT BY DEVALUATION AS SOME THIRTY TO FORTY PERCENT OF PARTS MUST STILL BE IMPORTED. DINA'S NATIONAL INTEGRATION IS 64 PERCENT FOR CARS AND 70 PERCENT FOR TRUCKS; IMPORTS OF PARTS: ESTIMATED AT 3.5 MILLION PESOS IN

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1976. STRUCTURE OF INDUSTRY WITH MULTIPLICITY OF MODELS PRODUCED PREVENTS ECONOMIES OF SCALE. MOST COMPANIES INCLUDING DINA WERE CONSIDERED INEFFICIENT EVEN BEFORE DEVALUATION, WHICH HAS WORSENED THEIR FINANCIAL POSITION. ALL AUTO MANUFACTURERS CUTTING 1977 PRODUCTION AS SALES FELL SHARPLY FOLLOWING INCREASES IN UNIT PRICES, AUTO TAXES, AND GASOLINE PRICE AND LACK OF CREDIT IN LATE 1976. LOPEZ PORTILLO'S GOVERNMENT HAS STATED POLICY OF ENFORCING MORE EFFICIENT MANAGEMENT IN UNPROFITABLE PARASTATALS. SINCE DINA IS MAJOR PARASTATAL AND DIRECTLY EMPLOYS SOME 7,500, PLUS SOME 3,000 THROUGH PRIVATE DISTRIBUTORS, GOM IS UNDER PRESSURE TO KEEP DINA AFLOAT, HENCE LIKELY TO BECOME ACTIVE IN HELPING COMPANY FIND NECESSARY SOURCES OF CREDIT, WHETHER DOMESTIC OR FOREIGN.
JOVA

February 15, 1977

To: Chairman Burns

From: Edwin M. Truman

Attached are four background notes on Mexico prepared by Mr. Maroni.

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date February 15, 1977

To Chairman Burns

Subject: Interest Payments on Mexico's External Debt

From Yves Maroni

In a recent memorandum on Mexico, I estimated that Mexico's interest payments on its external debt in 1976 amounted to about 28 per cent of the estimated gross earnings on goods and services. This percentage was based on interest payments estimated at about \$1.9 billion and gross earnings on goods and services estimated at about \$6.8 billion. The interest payments figure, in turn, was derived by applying an average interest rate of 8.5 per cent to the estimated total external debt at mid-1976, which I placed at about \$22.5 billion.

This method was used because the Mexican balance of payments statistics show interest payments in 1976 at something less than \$1.5 billion, an amount which implies an average interest rate of 6.66 per cent. Such a rate seemed unrealistically low, and led me to suspect that not all interest payments were recorded.

However, it now appears that my use of an 8.5 per cent average interest rate cannot be justified. While an exact rate would take time to estimate, analysis undertaken since I prepared my earlier memorandum leads me to believe that a rate of 7.5 per cent would be closer to the truth. With such a rate, total interest payments in 1976 would amount to about \$1,690 million, representing about 24.8 per cent of the estimated gross earnings on goods and services.1/

1/ I was unable to discuss this matter with the Mexican officials who accompanied Finance Minister Moctezuma and Bank of Mexico Director General Romero Kolbeck when they visited you last Thursday. They checked out of their hotel without contacting me and I have so far been unable to locate them elsewhere.

About two-thirds of Mexico's external debt is owed to banks and carries market rates of interest, which are often linked to the 3-month or the 6-month London Inter-Bank Offer rate. Using the 6-month rate and adding a spread representative of those agreed to by Mexico in the years since 1973, yields a total rate of about 7.5 per cent. The remainder of the debt includes debts to the international development lending institutions, some of which date back many years when their lending rates were lower than 7.5 per cent, while others were contracted more recently at rates in excess of 8 per cent. Debts to the U.S. Export-Import Bank were also mainly contracted at rates lower than 7.5 per cent although rates of 8 per cent and sometimes more have prevailed for about a year. There are also Mexican external bonds, which carry rates in excess of 7.5 per cent, as do credits from non-bank financial institutions. Credits from suppliers are often subsidized by official agencies in the exporting countries and may be at rates close to 7.5 per cent. Credits from other Governments, mainly the United States under aid programs, are often at concessional rates, but their total is not a large fraction of Mexico's total external debt. This evidence seems to me strong enough to warrant using the 7.5 per cent rate, which appears to be a realistic average rate for loans from banks, as the overall average rate for the entire debt.

The remainder of this memorandum explains the basis for my estimate of the total external debt of Mexico at mid-1976.

Mexico's total external debt may be estimated at $25 billion at the end of 1976. The Mexican authorities themselves admit to a public sector external debt of $20 billion on that date. The private sector debt is not available from Mexican sources, but may be partially estimated by adding to the public sector long-term debt the total claims on Mexico reported by banks in the industrial countries, and deducting from this sum the public sector's debt to banks so as to avoid double counting.

The necessary information is not yet available in sufficiently complete form to permit this calculation to be made for the end of 1976. But the data for 1975 may be used as a starting point. This yields a minimum external debt total for the end of 1975, as follows:

Public Sector Long-Term Debt as of 12/31/75:	$11,251 million
Total Claims of Banks in G-10 countries reporting to the BIS as of 12/31/75:	13,465 million
	24,716 million
Public Sector Long-Term Debt to Private Banks as of 12/31/75:	6,663 million
Minimum External Debt Total as of 12/31/75:	$18,053 million

It is not unreasonable to increase this total by about 10 per cent to include the unrecorded short-term debts to debtors other than banks and an amount shown as "unknown medium and long-term debts" in a recent IMF document on Mexico. When this is done, the estimated level of the total external debt of Mexico at the end of

1975 works out at about $19.8 billion.

We know that the total claims of the banks in the G-10 countries were $16,762 million at the end of September 1976 (the latest date for which this information is available). This represents an increase of $3.3 billion since the end of 1975. Conservatively, it may be estimated that these claims rose at least another $700 million in the fourth quarter. In addition, we know that Mexico drew $365 million from the IMF and $300 million under its swap agreements with the U.S. Treasury and Federal Reserve which were still outstanding at year end. There was also an increase in Mexico's debts to the international development lending institutions, the Export-Import Bank of the United States, suppliers, and others, including private holders of Mexican bonds. Partial information suggests that this amounted to about $500 million. With these additions, the total external debt may be estimated as follows:

Estimated total debt as of 12/31/75:	$19,800 million
Increase in bank claims through September 1976:	3,300 million
Estimated increase in bank claims, fourth quarter:	700 million
IMF drawings:	365 million
Treasury and Federal Reserve swap drawings:	300 million
Other:	500 million
Estimated Total External Debt as of 12/31/76:	$24,965 million

If Mexico's external debt rose evenly over the year, an appropriate mid-year figure would be $22.5 billion.

A Note on Mexican Oil and Natural Gas

Mexico has made important discoveries of oil and natural gas resources in recent years, and has become a net exporter of oil since the latter part of 1974. A reliable estimate of the magnitude of the new oil reserves is not available, and the official Mexican sources have tended to be cautious in their public statements on this point. But some knowledgeable observers have gone so far as to predict that Mexican reserves may rival those of Kuwait, i.e., about 60 billion barrels.

The new Director of PEMEX, the state petroleum company, has announced a six-year plan to bring production up to 2,242,000 barrels per day by 1982. The plan calls for spending $15.5 billion over the next six years. Half of this will be raised from external sources. He placed proven reserves at 11 billion barrels. He added that Mexico is exploiting only five of 180 known petroleum deposits. Of these, 90 are offshore, he said. He indicated that offshore drilling was expected to produce 118,500 barrels per day, or 45.1 million barrels yearly, by 1982.

The PEMEX Director said that two new oil refineries will be built and other facilities will be expanded so as to bring refining capacity to 865,000 barrels per day. In addition, 55 new petrochemical plants will be built by 1982, bringing the total to 115 plants. The PEMEX Director said that 24 per cent of petrochemical production will be sold abroad by 1982.

The attached table summarizes the available information on 1975 and 1976 production and exports, with official Mexican projections of volume for 1977 and 1982 and my own estimates of the corresponding export values based on the assumption that the dollar price of petroleum in 1982 will be 40 per cent higher than in 1976 (this implies that, following a 5 per cent increase in 1977, the price of petroleum will rise by 6 per cent each year until 1982). The table shows that, if the plans to develop production as indicated are carried out, by 1982, Mexican exports of petroleum may be close to $2.6 billion, nearly five times as large as in 1976.

In the short run, Mexico appears willing to increase its exports of oil to the United States as a quid pro quo for the establishment of a special line of credit by the U.S. Export Import Bank to help finance the import requirements of PEMEX. We understand that this matter is being discussed this week in conversations between the visiting Mexican officials and the top management of Eximbank. The Board of Directors of Eximbank has already given tentative approval to the concept.

The Wall Street Journal of February 4 reported that, according to a PEMEX spokesman, "Mexico has offered to sell the U.S. additional oil." The Journal added that Mexico's exports of oil to the U.S. were expected to average 153,000 barrels a day this year, and that PEMEX could supply an average of up to 43,000 barrels a day in additional oil over a two-month period, the spokesman said.

According to the same story, the PEMEX spokesman announced that, in a few days, Mexico would begin sending up to 40 million cubic feet of natural gas a day to the U.S. and would continue these deliveries for 60 days. The gas will be sold to Texas Eastern Gas Transmission Corp. for distribution through its pipeline system to the U.S. East Coast.

Yves Maroni
February 15, 1977

Mexico - Petroleum Production
and Exports in Selected Years

	Production (in thousands of barrels per day)	Exports		
		Volume		Value
		(in thousands of barrels per day)	(in millions of barrels per year)	(in millions of dollars)
1975	800	100	36.8	460
1976	960	131	47.8	550
1977p/	n.a.	147	53.7	680
⋮	⋮	⋮	⋮	⋮
1982p/	2,242	400	146.0	2,585

p/ projected

Latest Information from Mexico

The most recent statistics from Mexico are summarized in the attached tables. According to these statistics, the first signs that the monthly rate of price increases may be moderating have appeared and the trade deficit is remaining in the lower range to which it declined after the September devaluation. But the behavior of money supply continues to be erratic.

The consumer price index rose 2.5 per cent in December, about half the average rate of the previous two months. During their visit last week, Messrs. Moctezuma and Romero Kolbeck indicated that the January increase was 2.3 per cent. The wholesale price index rose by 5.3 per cent in December, compared to well over 8 per cent in each of the previous two months.

Imports in November were less than $400 million, barely above their monthly low for the year reached in September. For the three months September-November, imports averaged just under $400 million a month, compared to an average of about $530 million a month in the first eight months of the year. Even if imports in December exceeded the recent monthly average by as much as $100 million, total imports for the year would be $5.9 billion, or 10 per cent less than in 1975.

The preliminary export data for November (which do not include silver exports or exports by the border assembly plants) were less than $300 million, only slightly above the average monthly level of the first 10 months of 1976. The trade deficit in November (on this preliminary basis) was less than $100 million, for the first time since September 1971.

Data on tourism and border transactions indicate that Mexican spending under these headings has declined substantially since the September devaluation, but that the corresponding gross earnings have also declined. In the three months September-November 1976, Mexican tourists and vistors north of the border spend $52 million less than in the same months of 1975. But foreigners spend $42 million less in Mexico in the period September-November 1976 than in the corresponding months of 1975. The resulting improvement in the net earnings from these accounts is negligible.

The erratic behavior of money supply is shown in increases of over 8 per cent in September, less than 2 per cent in October, and over 7 per cent in November. At the end of November, money supply, seasonally adjusted, was about 33 per cent above the level of a year earlier.

In September and October, the peso liabilities of the banking institutions (excluding the Bank of Mexico) declined by about 20 billion pesos, or about 6 per cent. In the same period, their liabilities denominated in foreign currency rose by 171 billion pesos, or 115 per cent. The November breakdown is not yet available. It is against this background that Messrs. Moctezuma and Romero Kolbeck indicated during their visit that the outflow of funds from the banks had ended and that bank liabilities had increased by 18 billion in December and by another 6 billion pesos in January. They did not mention the latest figures on liabilities denominated in foreign currency.

In September and October, credit extended by the banking institutions (excluding the Bank of Mexico) increased by 24 per cent. In contrast, the increase in the first eight months of the year was only about 15 per cent

Yves Maroni
February 15, 1977

Attachment

C.9a MEXICO: ECONOMIC INDICATORS February 10, 1977

	1974	1975	1976	1975 III	1975 IV	1976 I	1976 II	1976 III	1976 IV	1976 JUNE	1976 JULY	1976 AUG	1976 SEPT	1976 OCT	1976 NOV	1976 DEC
REAL GDP, 1970=100	126.4	131.8	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
REAL GDP, PER CENT CHANGE (1)	5.9	4.2	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
INDUSTRIAL PRODUCTION 1970=100	132.8	139.0	N.A.	139.7	140.8	144.0	144.6	142.6	N.A.	147.4	145.1	143.7	138.9	140.7	N.A.	N.A.
INDUSTRIAL PRODUCTION PER CENT CHANGE (1)	7.3	4.7	N.A.	-2.5	0.8	2.2	0.4	-1.4	N.A.	1.0	-1.6	-1.0	-3.3	1.3	N.A.	N.A.
WHOLESALE PRICES PER CENT CHANGE (1)	22.4	10.5	22.3	3.3	2.3	5.6	3.2	5.6	21.0	0.9	2.5	-0.3	6.2	8.4	8.2	5.3
CONSUMER PRICES PER CENT CHANGE (1)	23.8	15.0	15.8	3.2	2.0	4.4	2.6	3.2	12.5	0.4	0.8	1.0	3.4	5.6	4.5	2.5
MONEY STOCK (M1) (SA) PER CENT CHANGE (1)	20.9	22.3	N.A.	2.9	5.8	3.9	4.7	5.8	N.A.	-0.4	3.0	-1.2	8.2	1.9	7.1	N.A.
PUBLIC SECTOR DEF.(-) AS PER CENT OF GDP	-7.8	-9.3	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
CENTRAL GOVT. DEF.(-) AS PER CENT OF GDP	-3.8	-4.3	-4.2	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
EXPORTS (2) ($ BILLION)	3.4	3.5	N.A.	0.8	0.9	0.9	1.1	0.9	N.A.	0.3	0.2	0.2	0.2	0.2	0.3	N.A.
IMPORTS ($ BILLION)	6.1	6.6	N.A.	1.6	1.9	1.4	1.7	1.5	N.A.	0.6	0.6	0.6	0.4	0.4	0.4	N.A.
TRADE BALANCE (2) ($ BILLION)	-2.6	-3.1	N.A.	-0.8	-1.0	-0.5	-0.6	-0.6	N.A.	-0.3	-0.3	-0.3	-0.1	-0.2	-0.1	N.A.
BALANCE ON GOODS AND SERVICES ($ BILLION)	-2.6	-3.8	N.A.	-1.0	-1.1	-0.7	-0.9	-0.9	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.

(1) PER CENT CHANGE FROM PREVIOUS PERIOD. QUARTERLY CHANGES AT QUARTERLY RATES; MONTHLY CHANGES AT MONTHLY RATES.

(2) MONTHLY DATA EXCLUDE EXPORTS OF BORDER ASSEMBLY PLANTS AND OF SILVER AND ARE NOT CONSISTENT WITH QUARTERLY OR ANNUAL DATA.

C.9b

FINANCIAL INDICATORS -- MEXICO

(dollar amounts in millions)

	1975	1976						1977		Week ended				
	YEAR	QI	QII	QIII	QIV	NOV	DEC	JAN	FEB 1-9	JAN 12	JAN 19	JAN 26	FEB 2	FEB 9
EXCHANGE RATE (CENTS PER PESO, END OF PERIOD)	8.00	8.00	8.00	8.00	4.98	4.40	4.98	4.55	4.41	5.00	4.98	4.55	4.40	4.41
SDR VALUE OF PESO	.06842	.06924	.06985	.04364	.04297	.03940	.04297	.03960	.03798	.04297	.04318	.03960	.03796	.03798
SHORT TERM INTEREST RATE (E.O.P.)	12.94	13.11	13.11	14.36	14.36	14.36	14.36	14.36	14.36	14.36	14.36	14.36	14.36	14.36
LONG TERM INTEREST RATE (E.O.P.)	13.02	12.86	14.17	15.09	14.29	15.25	14.29	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
RESERVES (IFS, E.O.P.)	1,533	1,501	1,585P	870P	1,261	1,417	1,261	1,512	1,634					
AVAILABLE IMF CREDIT TRANCHES (E.O.P.)	433	620	615	621	596	596	596	596	481*					
INTERVENTION, PURCHASES (+) OR SALES (-) OF DOLLARS (OF OTHER CURRENCIES; EQUIVALENT)						-558	91.1	24.3	104.2	-2.7	-21.4	32.7	-63.3	126.6
SWAP ACTIVITY DRAWINGS (+), REPAYMENTS (-)	360 -360	--	360	--		150	--	--	--	--	--	--	--	--
SWAP LINE -- 360														

* Available under three-year Extended Fund Facility program starting January 1, 1977.

February 10, 1977

Prepared by Financial Markets Section

M

February 16, 1977

TO: Chairman Burns

FROM: Ted Truman

Attached is the latest cable from Mexico.

Attachment: Mexico 1874

cc: Governor Wallich

bcc:

Defense classification of this document is due to the inclusion of U.S. Government information officially classified under Executive Order 10501 which provides that "A document.... shall bear a classification at least as high as that of its highest classified component."

EMT

Department of State TELEGRAM

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ACTION EB-08

INFO OCT-01 ARA-06 ISO-00 COME-00 CIAE-00 INR-07 NSAE-00
OPIC-03 FRB-03 OMB-01 /029 W
------------------152349Z 055286 /64

P 152326Z FEB 77 15
FM AMEMBASSY MEXICO
TO SECSTATE WASHDC PRIORITY 347
INFO TREAS WASHDC PRIORITY

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International Information Center

LIMITED OFFICIAL USE MEXICO 1874

EO 11652 : N/A
TAGS : EFIN BPRO MX
SUBJ : BUSINESS INTERNATIONAL DISAPPOINTED WITH MEXICO VISIT

REF : A) MEX 1384 B) MEX 1740

1. DURING COURSE OF FEB 13 DINNER CHARGE WAS TOLD BY SEVERAL PARTICIPANTS IN RECENT BUSINESS INTERNATIONAL (BI) DISCUSSIONS WITH GOM SENIOR OFFICIALS INCLUDING PRESIDENT, THAT MEETING GENERALLY CONSIDERED DISAPPOINTING.

BI PARTICIPANTS WERE MADE UNEASY BY WHAT THEY INTERPRETED AS REPEATED INDICATIONS FROM PRESIDENT AND CABINET MEMBERS THAT GOM WILL PURSUE EXPANSIONARY POLICIES AS IT TRIES TO SPEND ITS WAY OUT OF "STAGFLATION."

2. WE HAVE HAD OTHER REACTIONS FROM PARTICIPANTS INDICATING THAT, AMONG THOSE INTERVIEWED BY BI, JLP (SEE REFTEL B) SOUNDED ALMOST SOLE NOTE OF AUTHORITATIVE POLICY AS HE TOLD BI VISITORS THAT MEXICO WELCOMED INVESTORS ON ITS TERMS. OTHER CABINET OFFICERS GENERALLY OFFERED BLAND STATEMENTS WHICH SUGGESTED THAT BROAD COHERENT POLICIES IN MOST IMPORTANT PROBLEM AREAS HAVE YET TO BE ACHIEVED. THEY ALSO WERE UNANIMOUS IN ESPOUSING NEED FOR GREATER ACCESS TO NEW FINANCING.

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FORM

Department of State TELEGRAM

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3. BI PARTICIPANTS WENT AWAY WITH NEGATIVE FEELING THAT
E THER THEIR VISIT HAD BEEN PREMATURE, OR THAT GOM SO
I TENT ON JLP'S WASHINGTON TRIP, THEY REALLY HAD NO TIME
F R TYPE OF PRESENTATION WHICH WOULD HAVE IMPRESSED OR
NOTICED THESE POTENTIAL INVESTORS.
THOMPSON

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February 17, 1977

TO: Chairman Burns

FROM: Ted Truman EMT

SUBJECT: Additional Information on Mexican Oil Production in Relation to U.S. Imports

1. In 1976, the United States imported an average of 7.8 million barrels per day (b.p.d.) of petroleum and petroleum products. The rate of imports rose from 6.8 million b.p.d. in the first quarter to 8.3 million b.p.d. in the fourth quarter.

2. In 1976, it is estimated that Mexico exported an average of 131 thousand b.p.d. (See Mr. Maroni's table; a copy of his note is attached.) This figure represented 1.68 per cent of U.S. imports of petroleum and petroleum products in 1976. In fact, about 70 per cent of Mexican exports went to the United States; in other words, 1.19 per cent of U.S. imports in 1976 actually came from Mexico.

3. We estimate that in 1977 U.S. imports will average 8.3 million b.p.d. of oil -- about 45 per cent of domestic consumption needs. If Mexico were to increase its total oil exports in 1977 to 147 thousand b.p.d. as they have said publicably they would, this would only raise Mexican oil exports to 1.78 per cent of estimated U.S. import needs in 1977, compared with 1.68 per cent in 1976.

4. However, it might be reasonable to expect Mexico to raise its oil production by 200 thousand b.p.d. over the rate in 1976, since this is in line with the growth of production that they have forecast. It might also

be reasonable to expect also that Mexico would export all of this increase in production, i.e., raise average 1977 oil exports to 331 thousand b.p.d. (This would imply either a conservation effort in Mexico or a larger than now planned increase in domestic oil production.) Under these assumptions Mexican oil exports in 1977 would rise to 4.01 per cent of estimated U.S. oil imports.

5. It should be pointed out that the projected rate of increase in Mexican oil exports, rising only to 400 thousand b.p.d. in 1982, contained in Mr. Maroni's table is very low and might be called into question although it is based on published sources. We have also seen estimates of Mexican oil exports of 1 million b.p.d. by 1982. Therefore, it would seem reasonable to expect that Mexico could step up its production and oil exports much faster than they are now planning. If they were to do so, this would have the beneficial effect of bringing pressure to bear on the OPEC cartel and on the price of oil set by OPEC. (Of course, Mexico now exports, and would presumably continue to export, its oil at the world price set by OPEC.)

cc: Mr. Maroni

A Note on Mexican Oil and Natural Gas

Mexico has made important discoveries of oil and natural gas resources in recent years, and has become a net exporter of oil since the latter part of 1974. A reliable estimate of the magnitude of the new oil reserves is not available, and the official Mexican sources have tended to be cautious in their public statements on this point. But some knowledgeable observers have gone so far as to predict that Mexican reserves may rival those of Kuwait, i.e., about 60 billion barrels.

The new Director of PEMEX, the state petroleum company, has announced a six-year plan to bring production up to 2,242,000 barrels per day by 1982. The plan calls for spending $15.5 billion over the next six years. Half of this will be raised from external sources. He placed proven reserves at 11 billion barrels. He added that Mexico is exploiting only five of 180 known petroleum deposits. Of these, 90 are offshore, he said. He indicated that offshore drilling was expected to produce 118,500 barrels per day, or 45.1 million barrels yearly, by 1982.

The PEMEX Director said that two new oil refineries will be built and other facilities will be expanded so as to bring refining capacity to 865,000 barrels per day. In addition, 55 new petrochemical plants will be built by 1982, bringing the total to 115 plants. The PEMEX Director said that 24 per cent of petrochemical production will be sold abroad by 1982.

The attached table summarizes the available information on 1975 and 1976 production and exports, with official Mexican projections of volume for 1977 and 1982 and my own estimates of the corresponding export values based on the assumption that the dollar price of petroleum in 1982 will be 40 per cent higher than in 1976 (this implies that, following a 5 per cent increase in 1977, the price of petroleum will rise by 6 per cent each year until 1982). The table shows that, if the plans to develop production as indicated are carried out, by 1982, Mexican exports of petroleum may be close to $2.6 billion, nearly five times as large as in 1976.

In the short run, Mexico appears willing to increase its exports of oil to the United States as a quid pro quo for the establishment of a special line of credit by the U.S. Export Import Bank to help finance the import requirements of PEMEX. We understand that this matter is being discussed this week in conversations between the visiting Mexican officials and the top management of Eximbank. The Board of Directors of Eximbank has already given tentative approval to the concept.

The Wall Street Journal of February 4 reported that, according to a PEMEX spokesman, "Mexico has offered to sell the U.S. additional oil." The Journal added that Mexico's exports of oil to the U.S. were expected to average 153,000 barrels a day this year, and that PEMEX could supply an average of up to 43,000 barrels a day in additional oil over a two-month period, the spokesman said.

According to the same story, the PEMEX spokesman announced that, in a few days, Mexico would begin sending up to 40 million cubic feet of natural gas a day to the U.S. and would continue these deliveries for 60 days. The gas will be sold to Texas Eastern Gas Transmission Corp. for distribution through its pipeline system to the U.S. East Coast.

Yves Maroni
February 15, 1977

Mexico - Petroleum Production
and Exports in Selected Years

	Production (in thousands of barrels per day)	Exports		
		Volume		Value
		(in thousands of barrels per day)	(in millions of barrels per year)	(in millions of dollars)
1975	800	100	36.8	460
1976	960	131	47.8	550
1977p/	n.a.	147	53.7	680
⋮	⋮	⋮	⋮	⋮
1982p/	2,242	400	146.0	2,585

p/ projected

February 18, 1977

TO: Chairman Burns

FROM: Yves Maroni and Ted Truman

1. We contacted the Director of Research at the Bank of Mexico about Mexican money supply statistics. They have no information for January 1977. Data through the end of 1976 including preliminary estimates for December are presented in the attached table.

2. The table shows that between November and December the monthly rate of <u>increase</u> in M_1 declined from 7.1 per cent the previous month to 3.2 per cent. On a year over year basis the increase in M_1 in November 1976 was 32.9 per cent and that in December was 30.5 per cent.

3. The published figures for M_1 in Mexico do <u>not</u> include dollar-denominated deposits at banks, although in principle they could. Between November 1975 and November 1976 the peso value of dollar-denominated deposits (excluding time deposits) at Mexican banks increased by about 300 per cent, while the peso price of the dollar increased by about 80 per cent. Between the end of November 1976 and the end of December 1976 the peso value of dollar-denominated deposits at Mexican banks declined by 9.2 per cent, but the peso price of the dollar declined by 11.7 per cent as the peso appreciated after the inauguration of López Portillo.

Mexico
Changes in Money Supply 1976
(Seasonally Adjusted)

	Total		Currency and Coins		Checking Accounts	
	Change from previous month	change from 12 months earlier	change from previous month	change from 12 months earlier	change from previous month	change from 12 month earlier
July	+3.0	+20.9	+4.8	+26.7	+1.6	+16.5
August	-1.2	+17.1	-3.4	+18.7	+0.6	+18.8
September	+8.2	+27.1	+14.5	+38.4	+3.1	+18.5
October	+1.9	+26.9	+8.3	+44.5	-3.8	+13.2
November	+7.1	+32.9	+13.6	+60.6	-0.2	+10.2
December	+3.2	+30.5	-1.1	+52.8	+9.3	+13.7

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date February 22, 1977

To Chairman Burns

From Ted Truman EMT

Subject: Two Points on Mexico

RESTRICTED

When you met with Messrs. Julio Moctezuma and Gustavo Romero Kolbeck on February 10, two points that they raised without adequate explanation were (a) an addition of $1 billion to their IMF-authorized new external borrowing in 1977 and (b) a possible $3 billion short-term credit package involving the Bank of America. Mr. Maroni and I have consulted with our Treasury counterparts on these two points and have reached the following interpretation.

1. The Mexican's spoke of the need, as they saw it, to raise the IMF's limit on new external borrowing in 1977 from $3 billion to $4 billion. They indicated that this would not be used to finance a larger current account deficit. Our present understanding is that it would be used, however, to finance a larger government deficit. (Note that $1 billion equals about 23 billion pesos at the present exchange rate, which would "cover" a large part of the estimated excess over a public sector deficit equal to 6 per cent of 1977 GDP.) The argument that the Mexican's have used is that under present conditions domestic supply must be stimulated by public sector investment, which they would propose to finance from abroad. The central feature of this idea is that it would involve a substantial modification of the IMF's restrictions on (a) new external borrowing and (b) the public sector deficit. (It

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would also probably increase the current account deficit.)

2. The $3 billion, short-term line of credit that the Mexicans spoke of was apparently an idea put to them by the Bank of America. This apparently would be an official credit package. (Our information on this comes from the Treasury staff who contacted ... . of the Bank of America, who was also contacted for an explanation by Mr. Richard N. Cooper, Under Secretary of State Designate.) I suppose that it is understandable that the Mexicans did not know what they were talking about if this was the Bank of America's idea. The notion, we gather, is that the package would be similar to that put together for the British in June 1976 to tide the Mexicans (and the banks) over temporary borrowing difficulties.

cc: Governor Wallich

February 28, 1977

TO: Chairman Burns

FROM: Ted Truman

Attached is a cable on possible lending by the Overseas Private Investment Corporation to Mexico.

Attachment: Mexico 2241

cc: Governor Wallich

Defense classification of this document is due to the inclusion of U.S. Government information officially classified under Executive Order 10501 which provides that "A document.... shall bear a classification at least as high as that of its highest classified component."

EXIT

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ACTION OPIC-06

INFO OCT-01 ARA-06 ISO-00 EB-08 L-03 AID-05 CIAE-00 INR-07
NSAE-00 COME-00 FRB-03 OMB-01 SP-02 TRSE-00 XMB-02
USIA-06 /050 W
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R 241655Z FEB 77 24
FM AMEMBASSY MEXICO
TO SECSTATE WASHDC 0498

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E.O. 11652: N/A
TAGS: EFIN, MX
SUBJ: OPIC FINANCE PROGRAMS IN MEXICO

REF: STATE 040144.

1. WE BELIEVE THE POSSIBILITY OF USING OPIC FINANCE PROGRAMS IN MEXICO WOULD BE AN APPROPRIATE SUBJECT FOR DISCUSSION IN ONE OF THE WORKING GROUPS TO BE SET UP IN THE CONTEXT OF THE PRESIDENTIAL VISIT.

2. IT IS POSSIBLE THAT OPIC LOANS TO PRIVATE INDUSTRY WOULD PROVIDE AN EARLY AND POSITIVE REACTION ON THE PART OF THE USG TO MEXICO'S FINANCIAL PROBLEMS, EVEN THOUGH THE AMOUNTS INVOLVED MIGHT BE SMALL RELATIVE TO MEXICO'S TOTAL REQUIREMENTS.

3. MEXICO'S PRIVATE SECTOR CAN BORROW IN DOLLARS WITHOUT ANY RESTRICTIONS AND HAS BEEN DOING SO FOR MANY YEARS. FROM TIME TO TIME PUBLIC SECTOR ENTITIES SUCH AS NACIONAL FINANCIERA GUARANTEE THESE LOANS IF THE LENDER SO DEMANDS.

4. THERE IS A WITHHOLDING TAX LEVIED ON INTEREST PAYMENTS TO FOREIGN FINANCIAL INSTITUTIONS. THIS IS 10 PERCENT ON INTEREST PAYMENTS TO GOVERNMENT-OWNED FINANCIAL

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INSTITUTIONS SUCH AS EXIMBANK AND 21 PERCENT TO FINANCIAL INSTITUTIONS REGISTERED WITH THE MEXICAN TREASURY. OPIC WOULD PRESUMABLY BE CONSIDERED A GOVERNMENT-OWNED FINANCIAL INSTITUTION, BUT THIS WOULD HAVE TO BE CONFIRMED.

5. WE BELIEVE GOM WOULD BE RECEPTIVE TO OPIC'S MAKING LOANS TO MEXICAN COMPANIES THOUGH GOM IS LIKELY TO CONTINUE TO OPPOSE OPIC GUARANTEES FOR U.S. PRIVATE INVESTMENT IN MEXICO. BECAUSE OF THE PROSPECTIVE ESTABLISHMENT OF JOINT WORKING GROUPS, WE BELIEVE THAT OPIC DIRECT LENDING PROGRAMS WOULD BE MOST PROFITABLY DISCUSSED IN THIS FRAMEWORK.

6. IN LIGHT OF MEXICO'S PRESENT FINANCIAL PROBLEMS AND USG INTERESTS, WE ASSUME THAT ANY OPIC LENDING PROGRAM WOULD BE COORDINATED WITH THE INTERESTED U.S. AGENCIES.
THOMPSON