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BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

May 2, 1977

TO: Chairman Burns

FROM: Ted Truman

The attached cable from Mexico reports on an interview with President López Portillo in which he appears to endorse a solution to Mexico's problems through increase domestic production.

cc: Governor Wallich

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."



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EO 11652: N/A
TAGS: EINV, ETRD, MX
SUBJECT: PRESIDENT LOPEZ PORTILLO COMMENTS ON MEXICAN
ECONOMY

1. IN AN INTERVIEW WITH A CORRESPONDENT OF A SPANISH PERIODICAL ON APRIL 26, PRESIDENT LOPEZ PORTILLO COMMENTED ON THE MEXICAN ECONOMY. HE STATED THAT INFLATION COULD BE ATTACKED TWO WAYS, FROM THE SIDE OF DEMAND OR THAT OF SUPPLY. MONETARY MEASURES GENERALLY WORKED ON DEMAND. MEXICO HAD SO MANY UNSATISFIED NEEDS THAT MEASURES TO REDUCE DEMAND WOULD RISK INJUSTICE AND SOCIAL PROBLEMS. HENCE, MEXICO WOULD ACT UPON SUPPLY AND FOLLOW POLICIES TO AUGMENT PRODUCTION, GIVING AS AN EXAMPLE THE TEMPORARY MODERATION OF SALARY DEMANDS BY ORGANIZED LABOR.

2. JLP WENT ON TO POINT OUT THAT DURING ECHEVERRIA'S ADMINISTRATION LABOR HAD RECEIVED SUBSTANTIAL WAGE INCREASES, HENCE HOLDING DOWN WAGES NOW WAS NOT UNJUST. INFLATION ATTACKED THE POOREST HARDEST AND THEY DID NOT HAVE THE ADVANTAGE OF BEING ABLE TO ORGANIZE THEMSELVES.

3. WHEN ASKED IF THE PRIVATE SECTOR HAD NOT FULFILLED ITS PROMISES, JLP REPLIED, "YES, OF COURSE.", GIVING AS AN EXAMPLE THAT IMPORTANT BUSINESS GROUPS HAD ESTABLISHED PROGRAMS TO HELP SOLVE THE BIG PROBLEMS, INFLATION AND LACK OF JOBS.

4. JLP SAID THAT THE GREAT FOREIGN INDEBTEDNESS WAS DUE TO MEXICO'S DEFECTIVE SYSTEM OF FINANCING DEVELOPMENT WHICH HAD TO BE CORRECTED. THE DEBT WOULD BE REDUCED; MEXICO HAD THE ABILITY TO PAY IT. MEXICO WAS PREPARING A BETTER SCHEME FOR FINANCING DEVELOPMENT WHICH WOULD HAVE TO TAKE ACCOUNT OF REDISTRIBUTION OF INCOME, PRICE-SALARY RELATIONSHIPS, FISCAL MEASURES, PROFITS, AND THE PROFITABILITY OF STATE ENTERPRISES.
THOMPSON



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CONFIDENTIAL

May 16, 1977

TO: Chairman Burns

FROM: Ted Truman

Attached is a cable on recent economic developments in Mexico.

cc: Governor Wallich

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INCOMING TELEGRAM

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Mexico

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~~CONFIDENTIAL~~ SECTION 01 OF 03 MEXICO 07305

LIMDIS - PASS FEDERAL RESERVE

EO 11652: GDS
TAGS: EFIN MX
SUBJECT: RECENT ECONOMIC DEVELOPMENTS

1. SUMMARY: PARTIAL DATA PLUS PUBLIC AND PRIVATE COMMENTS BY COM OFFICIALS INDICATE THAT MEXICO IS MEETING THE FUND PROGRAM TARGETS. ECONOMY CONTINUES TO STAGNATE, CURRENT ACCOUNT DEFICIT DECLINES, PRICE INCREASES CONTINUE AT HIGH RATE. END SUMMARY.

BALANCE OF PAYMENTS.

2. CURRENT ACCOUNT. BANK OF MEXICO DIRECTOR GENERAL HAS PUBLICLY STATED THAT FIRST QUARTER TRADE DEFICIT WAS ABOUT \$100 MILLION AND CURRENT ACCOUNT DEFICIT WAS \$300 MILLION. THIS REPRESENTS A DRAMATIC IMPROVEMENT OVER FIRST QUARTER 1976, WHEN TRADE DEFICIT WAS \$672 MILLION AND CURRENT ACCOUNT DEFICIT WAS \$666 MILLION. ACCORDING TO PRELIMINARY AND UNPUBLISHED DATA OBTAINED ON A CONFIDENTIAL BASIS, EXPORTS WERE UP 33 PERCENT IN VALUE AND IMPORTS WERE DOWN 25 PERCENT. COFFEE ACCOUNTS FOR 30 PERCENT OF THE INCREASED EXPORT EARNINGS, PETROLEUM AND MANUFACTURES (MOSTLY AUTO PARTS) FOR 26 PERCENT EACH. THE DECLINE IN CAPITAL GOODS IMPORTS ACCOUNTED FOR OVER HALF OF THE DROP IN IMPORTS.

3. SERVICES, WHICH WERE ROUGHLY IN BALANCE IN FIRST QUARTER 1977, MUST HAVE REGISTERED A DEFICIT OF ABOUT \$200 MILLION IN FIRST QUARTER 1976. POSITIVE BALANCE ON FRONTIER TRANSACTIONS AND TOURISM WAS \$278.3 MILLION IN JANUARY-FEBRUARY 1977, \$22 MILLION BELOW YEAR EARLIER SURPLUS. HIGHER INTEREST PAYMENTS PROBABLY WERE MAIN FACTOR IN SERVICES DEFICIT.

4. CAPITAL ACCOUNT. DATA IS NOT YET AVAILABLE ON THE CAPITAL ACCOUNT, BUT WE WOULD ESTIMATE NET CAPITAL INFLOWS AT NO MORE THAN \$300 MILLION. PRESUMABLY NET PRIVATE SECTOR BORROWING HAS BEEN NIL, THOUGH AT LEAST ONE PRIVATE EXTERNAL BOND ISSUE HAS BEEN FLOATED. PUBLIC SECTOR NET BORROWING IN THE FIRST QUARTER COULD NOT HAVE BEEN VERY LARGE. WE ARE AWARE OF ONLY FOUR PUBLICIZED ISSUES FOR A TOTAL OF \$440 MILLION. THERE WERE, HOWEVER, NUMEROUS UNPUBLICIZED SHORT AND MEDIUM TERM CREDITS AS WELL. NET PUBLIC SECTOR BORROWING WAS PROBABLY NO MORE THAN \$250 MILLION IN FIRST QUARTER. PROCEEDS OF \$350 MILLION PEMEX ISSUE WERE NOT DRAWN DOWN UNTIL APRIL.

5. IT WOULD APPEAR THAT THE "ERRORS AND OMISSIONS" ENTRY WAS POSITIVE IN FIRST QUARTER. WHILE SOME CAPITAL FLIGHT CONTINUES, REFLows WERE GREATER, ACCORDING TO MOST REPORTS. AS BEST WE CAN DETERMINE, REFLows TOOK THE FORM OF SALES OF DOLLAR CURRENCY BEING HELD IN MEXICO RATHER THAN INTERBANK FLOWS. THERE IS NO SIGNIFICANT REPATRIATION OF CAPITAL HELD ABROAD, ACCORDING TO U.S. AND MEXICAN BANKERS. GROSS RESERVES INCREASED \$205 MILLION FROM END-DECEMBER TO MARCH 11.

6. RE PUBLIC SECTOR EXTERNAL BORROWING PROGRAM, WE UNDERSTAND THAT THE 150 MILLION EURO-DOLLAR CREDIT FOR BANOBRAS

(PUBLIC WORKS BANK) IS NOT FARING VERY WELL. BANKERS HAVE VOLUNTEERED DIFFERENT REASONS FOR THIS; ONE HAS SAID THAT COM PICKED A WEAK UNDERWRITING GROUP. ANOTHER SAID THE POOR RECEPTION IS DUE TO BANKS ALREADY HOLDING TOO MUCH BANOBRAS PAPER. A THIRD HAS SAID THAT THE POOR REACTION IS DUE TO CONCERNS RE MEXICAN PAPER. WE ALSO UNDERSTAND THAT A \$60 MILLION UNITED MEXICAN STATES BOND ISSUE FOR FIVE YEARS AT 9 PERCENT HAS JUST BEEN FLOATED IN NEW YORK. THIS ISSUE HAS BEEN IN THE WORKS SINCE BEFORE THE DEVALUATION. PEMEX IS REPORTEDLY NEGOTIATING A EURO-CURRENCY BOND ISSUE, AND THE RURAL BANK IS PLANNING A DM BOND ISSUE.

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7. RE BORROWING FROM COMMERCIAL BANKS, RECENT DISCUSSIONS WITH OFFICIALS OF THE THREE LARGEST U.S. BANKS INDICATE A RELUCTANCE TO INCREASE THEIR EXPOSURE IN MEXICO AS FAST AS IN THE LAST TWO YEARS. ONE OFFICIAL TOLD US HIS BANK DID NOT INTEND TO INCREASE EXPOSURE FASTER THAN ITS CAPITAL WOULD GROW; I.E., 10 PERCENT THIS YEAR. ANOTHER KEPT EXPRESSING THE VIEW THAT THE IFI'S SHOULD PLAY A LARGER ROLE IN FINANCING MEXICO'S CURRENT ACCOUNT DEFICIT. THESE VIEWS PROBABLY REFLECT THOSE OF SENIOR MANAGEMENT. WE HAVE NOT HEARD ANY BANKERS SAY THEY INTEND TO FURTHER REDUCE THEIR MEXICAN PORTFOLIO; SOME INDICATE THEY ARE WILLING TO INCREASE IT JUDICIOUSLY, OTHERS SAY THEY ONLY INTEND TO MAINTAIN THEIR END-76 EXPOSURE BY REPLACING MATURING DEBTS.

8. DOMESTIC ECONOMIC ACTIVITY. INDUSTRIAL OUTPUT REMAINS AT FOURTH QUARTER LEVELS AND IS BELOW YEAR EARLIER LEVELS.

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LIMDIS - PASS FEDERAL RESERVE

THERE HAS BEEN NO GENERAL REVIVAL OF PRIVATE INVESTMENT, AS BEST WE CAN DISCERN. WHILE THE PRIVATE BUSINESS COMMUNITY HAS WARM FEELINGS TOWARD LOPEZ-PORTILLO, THEY REMAIN RELUCTANT TO COMMIT FUNDS. THIS REFLECTS LINGERING DOUBTS OVER WHAT THE GOVERNMENT'S POLICIES WILL BE, A RELUCTANCE TO CONVERT DOLLARS INTO PESOS, GENERALLY TIGHT CREDIT, AND STAGNANT DOMESTIC DEMAND. THE LACK OF A CLEARLY STATED SHORT AND LONG-TERM ECONOMIC STRATEGY IS A COMMON COMPLAINT AMONG BUSINESSMEN AND BANKERS. THE JANUARY INDUSTRIAL PRODUCTION INDEX WAS 3.6 PERCENT BELOW THE YEAR-EARLIER FIGURE, AND ALSO SLIGHTLY BELOW DECEMBER INDEX, CONTRARY TO USUAL SEASONAL JUMP. A LARGE MEXICAN PRIVATE BANK ESTIMATES INDUSTRIAL PRODUCTION IN FIRST QUARTER 1977 WAS 4 PERCENT BELOW THAT OF ONE YEAR EARLIER.

9. MONEY SUPPLY IS GROWING ON A YEAR TO YEAR BASIS AT OVER 30 PERCENT. CURRENCY IN CIRCULATION OUTSIDE THE BANK OF MEXICO AS OF END-MARCH WAS 45 PERCENT ABOVE YEAR EARLIER FIGURE. AS OF END-FEBRUARY, TOTAL MONEY SUPPLY WAS 33 PERCENT ABOVE YEAR EARLIER FIGURE, AND 1.2 PERCENT ABOVE END-JANUARY FIGURE. CURRENCY IN CIRCULATION OUTSIDE THE BANK OF MEXICO WAS 70.3 BILLION PESOS AT END-MARCH, NINE BILLION BEPESOS BELOW THE END-1976 FIGURE. THUS, BANK IS WELL WITHIN FUND AGREEMENT PROVISION CALLING FOR THE CURRENCY ISSUE GROWTH NOT TO EXCEED THE CHANGE IN INTERNATIONAL RESERVES.

10. BANK OF MEXICO OFFICIAL TOLD US THAT NET CENTRAL BANK LENDING TO FEDERAL GOVERNMENT IN FIRST QUARTER WAS ABOUT 3 BILLION PESOS, SOMEWHAT BELOW YEAR EARLIER FIGURE. THERE IS NOT ANY DATA YET AVAILABLE FOR LENDING TO PUBLIC SECTOR, BUT THIS IS GENERALLY LESS THAN THE FEDERAL GOVERNMENT'S BORROWING. IT WOULD APPEAR THAT THE PUBLIC SECTOR DEFICIT IN FIRST QUARTER IS WELL WITHIN THAT CALLED FOR IN FUND AGREEMENT.

11. INSOFAR AS NON-MONETARY LIABILITIES OF PRIVATE BANKS INCREASED 20 BILLION PESOS IN FIRST QUARTER ACCORDING TO THE BANK'S DIRECTOR GENERAL, BANK OF MEXICO NET FINANCING TO FEDERAL GOVERNMENT SHOULD HAVE BEEN MANAGED WITHOUT ANY IMPACT ON MONEY SUPPLY. (RESERVE REQUIREMENTS WOULD HAVE CHanneled 10 BILLION OR MORE OF THIS INCREASE TO CENTRAL BANK.) BANK OFFICIALS HAVE CONFIRMED THIS IN PRIVATE CONVERSATIONS.

12. INTEREST RATE REFORM CONTINUES TO BE POSTPONED. APPARENTLY BECAUSE OF OPPOSITION FROM BANKERS AS GOVERNMENT OFFICIALS HAVE AGREED TO NEED FOR REFORM. REFORM, WHEN IT COMES, STILL PLANNED TO RESEMBLE PACKAGE OUTLINED IN MEXICO 3851.

13. THE PUBLIC SECTOR BUDGET REMAINS A MYSTERY IN PART BECAUSE THERE IS NO DATA FOR THE FIRST QUARTER AND IN PART BECAUSE OF CONTRADICTIONARY STATEMENTS. NUMEROUS GOM OFFICIALS HAVE COMPLAINED TO EMOFFS OF A LACK OF INVESTMENT FUNDS AND FROZEN OR REDUCED BUDGETS. PUBLICLY, BUDGET SECRETARY TELLO HAS MAINTAINED THAT SPENDING IS RUNNING AT BUDGETED LEVELS. OUR BEST GUESS IS THAT SOME INVEST-

MENT SPENDING WAS FROZEN PENDING A MORE THOROUGH REVIEW WHICH RECENTLY CONCLUDED WITH DECISION THAT 1977 SPENDING SHOULD NOT EXCEED ORIGINAL BUDGET.

14. THE AGREEMENT WITH THE FUND IS BEGINNING TO SURFACE AS A POLITICAL PROBLEM. A DEPUTY HAS SUGGESTED THAT THE CONGRESS SHOULD HAVE A LOOK AT AND DISCUSSION OF THE PROGRAM AS AGREED WITH THE FUND. THE GOM HAS RESPONDED, INDIRECTLY, THROUGH FINANCE MINISTER MOCTEZUMA WHO HAS DEFENDED THE FUND AGREEMENT AS A PROPER EXERCISE OF MEXICO'S SOVEREIGNTY AND, ACCORDING TO MEXICAN NEWSPAPERS, INSISTED IN THE IMF INTERIM COMMITTEE THAT THE FUND NOT VIOLATE THE "SOVEREIGNTY" OF ITS MEMBERS.

15. WHILE GOM OFFICIALS POINT OUT A REDUCTION IN THE RATE OF INFLATION SINCE THE LAST FOUR MONTHS OF 1976, INFLATIONARY PRESSURES REMAIN STRONG. THE WPI INCREASED 2.9 PERCENT IN APRIL AND THE NATIONAL CPI WAS UP 1.5 PERCENT LEAVING THESE INDICES 49.8 PERCENT AND 27.3 PERCENT ABOVE YEAR EARLIER LEVELS. THERE IS STILL CONSIDERABLE REPRESSIONED INFLATION. THIS CERTAINLY EXISTS IN THE PUBLIC SECTOR, BUT MANY PRIVATE BUSINESSMEN COMPLAIN ABOUT THE NEED TO RAISE PRICES OF GOODS SUBJECT TO PRICE CONTROLS. SEVERAL HAVE TOLD US THAT THEY HAVE CUT OFF PRODUCTION LINES RATHER THAN RUN THEM AT A LOSS. THE PRESUMPTION IS THAT ONCE THE 90 BASIC COMMODITIES PROGRAM IS EFFECTIVE, APPROVALS FOR PRICE INCREASES WILL BE GRANTED. (THIS PROGRAM IS PROGRESSING VERY SLOWLY. AGREEMENTS HAVE BEEN REACHED ON MORE THAN HALF THE PRODUCTS WHEREAS IT HAD BEEN HOPED AGREEMENTS ON ALL 90 WOULD BE SIGNED BY MAY 1.) IT IS ALSO WIDELY ASSUMED THAT CERTAIN PUBLIC SECTOR PRICES



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WILL BE RAISED. THUS, IT IS POSSIBLE THAT THE RATE OF INFLATION WILL SPURT IN JUNE. THE GOM MAY, HOWEVER, RESIST PRESSURES TO INCREASE CONTROLLED PRICES BECAUSE OF THE IMPACT THIS MIGHT HAVE ON THE EFFORT TO MAINTAIN A 10 PERCENT CEILING ON WAGE INCREASES.

16. THE APRIL NATIONAL CPI WAS 8.9 PERCENT ABOVE THE DECEMBER LEVEL. ASSUMING ANOTHER 1.4 PERCENT INCREASE IN MAY, THE NATIONAL CPI WILL BE 10.4 PERCENT ABOVE THE DECEMBER LEVEL. THIS WILL MAKE THE GOVERNMENT'S 10 PERCENT CEILING ON WAGE INCREASES MUCH MORE DIFFICULT TO ENFORCE. WHILE THE SPIRIT OF THIS CEILING IS BEING MAINTAINED, SOME SETTLEMENTS ARE MORE COSTLY TO EMPLOYERS BECAUSE OF NEW OR ADDITIONAL FRINGE BENEFITS THAT RAISE THE ACTUAL INCREASE IN EMPLOYEE COSTS ABOVE 10 PERCENT. THOMPSON



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May 23, 1977

TO: Chairman Burns

FROM: Ted Truman

Attached is a report on economic trends in Mexico during 1976 and the first quarter of 1977. It does not contain any information that has not already been presented to the Board.

Attachment: Mexico A-71

cc: Governor Wallich



AIRGRAM

PT 77-072-0414

Mexico
FILE DESIGNATION

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E.O. 11652: N/A

TAGS: ECRP MX

FROM : AMEMBASSY MEXICO

DATE: 6 MAY 1977

SUBJECT : ECONOMIC TRENDS REPORT-MEXICO-CERP 0004

REF : STATE A-3476 of July 13, 1976.

The Embassy encloses herewith the Economic Trends Report for Mexico in accordance with the CERP reporting schedule. As Washington is aware, the Embassy did not submit an Economic Trends Report in October, 1976. We are proposing that the attached report be considered as both the October and April Report.

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Enclosure: Economic Trends Report, April 28, 1977.

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Classified by: FINATT:LPPascoe:cdm	Drafting Date: 5/2/77	Phone No.: 715	Contents and Classification Approved by: MIN:WAHayne <i>WAT</i>
References: ECON:Jozzello; POL:JHamilton; AGATT:RSWelton (all in draft)			E/C:NMBouton

FORM 10-64 DS-323

PREPARED
APRIL 28, 1977
FREQUENCY: SEMI-ANNUAL
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MEXICO
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SUMMARY

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MEXICO FLOATS THE PESO

CONFUSION AND RUMORS, SEPTEMBER-NOVEMBER

A NEW PRESIDENT ASSUMES OFFICE

NEW ADMINISTRATION WILL FACE MANY PROBLEMS

IMPLICATIONS FOR THE UNITED STATES



SUMMARY:

The Mexican economy is going through its most difficult period since 1945. A series of economic distortions developed over the past five years that will have to be eliminated before a high rate of economic growth can be renewed. Among these distortions were an over-valued currency, and excessively large deficits in the balance of payments on current account and the public sector budget. The decision to devalue and float the peso reflected the need to deal with these distortions. At the same time, it sparked confusion among the public. After years of assurances that the peso would not be devalued, the Mexican public was uncertain as to what to expect next. Unfounded rumors swept the country, causing several very serious runs on banks. Business was affected and the on-going economic slowdown was deepened.

José Lopez-Portillo assumed the Presidency on December 1. His inaugural address set the basis for a revival of confidence in the country's future. Relations between the government and the private sector improved dramatically. The capital flight now appears to have ceased and funds are gradually flowing back into the banks. The worse part of the economic and confidence crisis is hopefully over, but restoration of financial stability and resumption of Mexico's traditional high growth rate will take time. While 1977 will be another difficult year, the traumas of the last four months of 1976 should not be repeated. The first quarter deficit in the balance of payments on current account is estimated at one half or less of the year earlier figure. The rate of inflation is lower than in the last four months of 1976. The new administration is grappling with the problem of how to restore financial stability without unduly affecting the standards of living of lower income groups. Mexico's un- and under-employed were recently estimated to be 49 percent of the economically active population. At the same time it is trying to devise a new development strategy that will provide the basis for a high level of sustainable economic growth.

The Mexican economy is in a transition period with new policies evolving that are likely to have a significant impact on the patterns of economic activity. These cannot be predicted with any degree of certainty. One exception to this is oil. It is becoming increasingly likely that Mexico will exploit its petroleum resources at a more rapid rate and become a significant exporter of oil products over the next six years.



All values in Millions in
US\$ Unless Otherwise Stated.

Exchange Rate as of 04/22/76
US\$1 Equals Mex. 22.55 Pesos.

KEY ECONOMIC INDICATORS: MEXICO

Item	1974	1975	1976 ¹	%Change
<u>INCOME, PRODUCTION</u>				
GDP at current prices	65,032	79,016 (p)	78,606 (p)	22.9 ^{2/}
GDP at constant (1960) prices	30,008	31,272	25,816	2.0 ^{2/}
Per Capita GDP, at current prices.	1,123	1,319	1,267	18.8 ^{2/}
Industrial Production Index (1970 = 100)	132.8	139.0	142.3	2.4
<u>MONEY, PRICES</u>				
Money Supply (end-yr.)	7,798	9,455	7,768	30.9 ^{2/}
Interest Rates (commercial bank prime)	12-13%	12-13%	16-17	
National Consumer Price Index (1968=100)	166.8	191.8	222.1	15.8
Mexico City Wholesale Price Index (1954=100)	263.2	290.9	355.6	22.2
<u>BALANCE OF PAYMENTS</u>				
Current Account Receipts	6,342.5 (p)	6,303.3 (p)	6971.4 (p)	10.6
Exports	2,850.0	2,858.6	3297.8	15.4
U.S. Share (%)	56.7	60.0	62.0	-
Current Account Expenditures	8,900.6	10,071.9	9995.1	-0.8
Imports	6,056.7	6,580.2	6029.6	-8.4
U.S. Share (%)	62.2	62.4	62.4	-
Balance on Current Account	-2,558.1	-3,768.9	-3023.7	-19.8
Capital, Errors & Omissions	2,595.0	3,933.9	2690.5	-31.6
Change in Reserves	36.9	165.1	-333.1	-
Bank of Mexico Reserves ^{1/}	1,443.9	1,608.9	1411.7	-12.3

^{1/} Includes gold, SDRs, IMF gold tranche, foreign exchange and silver.

^{2/} Applies to changes in terms of pesos.

(p) Preliminary.

Source: Bank of Mexico.



CURRENT SITUATION AND ECONOMIC TRENDS.

Mexico Floats the Peso

1976 was probably the most difficult year for the Mexican economy in the post-war period. The economic growth rate dropped to an estimated 2 percent from 4.2 percent in 1975 and an average growth rate of 6-7 percent for the previous 20 years. After declining somewhat in the first eight months of the year, the rate of inflation picked up following the August 31 devaluation of the peso. The national consumer price index rose 27.2 percent from December 1975 to December 1976. The most dramatic development during the year was the government's decision to abandon the fixed parity of 12.5 pesos per dollar which had prevailed since 1954.

Mexico's economic problems which surfaced so dramatically in 1976 have their origins in earlier years. To some degree, the problems are due to short-comings in the economic development model that was followed for a number of years. The import-substitution policies hindered the development of competitive export industries. Also, the "Growth with Stability" policies, followed for at least fifteen years subsequent to the 1954 devaluation, had given way to a more vigorous government role in the economy. Following the economic slowdown in 1971, the government adopted more aggressive spending patterns. From 1972 to 1976, public sector spending more than tripled. Revenues did not increase as rapidly with the end result that the deficit quadrupled during this period. The bulk of this deficit was financed by domestic and external savings, but a significant portion was financed by the creation of new money. This resulted in inflation and a faster increase in domestic demand than domestic output of goods and services. As the Mexican rate of inflation exceeded that of the U.S., its major trading partner, Mexican imports rose faster than its exports, thereby increasing the current account deficit.

Another factor affecting the balance of payments was the attempt by the Mexican government to bypass the world recession of 1974-5. Rather than constrain domestic economic activity in order to align the Mexican economy with economies of the industrialized countries, growth-orientated policies were pursued. This resulted in continued increases in imports of goods and services that



were not compensated by increases in exports. Another factor that contributed to the deterioration in Mexico's external accounts was the relative stagnation in Mexico's agriculture sector. It became necessary to increase food imports to feed Mexico's growing population. While Mexico is now basically self-sufficient in petroleum products, the increases in world oil prices in late 1973 impacted the Mexican economy. The current account deficit increased from \$1.1 billion in 1973 to \$3.7 billion in 1975. This deficit declined to \$3.0 billion in 1976, but capital outflows increased, resulting in a substantially greater external financing requirement than in previous years. The fixed peso-dollar parity was terminated August 31, 1976, and the peso was effectively devalued 37 percent when Mexican banks resumed trading on September 2.

Confusion and Rumors, September - November.

The three months following the devaluation were a period of confusion and rumors. Confidence in the government's ability to restore financial and economic stability did not materialize. After twenty-two years of a fixed exchange rate and statements by government officials that the peso would never be devalued, the public seemed to be in a state of shock. The prospect of a change in government, with confidence in the outgoing administration dropping, also contributed to the confusion. In spite of the stated intention to let the peso float, the central bank controlled the rate closely and, at the President's instructions, "fixed" a rate of 19.7 (buying) and 19.9 (selling), effective September 13. Shortly thereafter, the government suggested guidelines for an emergency wage increase for organized labor. These guidelines called for increases of 23 percent. It was not clear whether these wage increases were to be additional to or inclusive of any increases that had been obtained in collective bargaining sessions earlier in the year. The 23 percent increases appears to have been viewed as additional for the most part. Minimum wages were also increased 23 percent, effective October 1. Simultaneously with the guidelines for wage increases, the government broadened the coverage of its price control program and issued a decree permitting a 10 percent increase in most prices subject to controls over prices prevailing on August 15.



The combination of wage and price increases led many to suspect that the country was entering a more vicious inflationary spiral than had prevailed and that further depreciation of the peso exchange rate was likely. In addition, and perhaps as a result of this, rumors began to circulate that bank accounts would be frozen, foreign exchange controls would be imposed, the government would nationalize the banks, and/or a military coup was imminent. These rumors circulated, died away and were revived until the December 1 change in government. There were sizeable transfers of capital into foreign exchange throughout this period. Part of these transfers remained on deposit with Mexican banks in the form of "Mex-dollars". Mexican banks pay higher interest rates on dollars than can be obtained elsewhere making local dollar time deposits attractive.

The transfers out of pesos reached critical levels at least twice. On October 26, the Bank of Mexico announced that it would no longer buy and sell foreign exchange at the 19.7/19.9 rates which had prevailed since September 13. The buy/sell rates on October 27 were 26.24 and 26.50, respectively. With banks operating at a one percent spread the peso gradually appreciated until the week of November 15, when the rates leveled off at about 24.1 buying and 24.3 selling. The rumors of military coups, foreign exchange controls, etc., reached a peak this week, causing very large withdrawals from banks. The central bank, the Bank of Mexico, then decided to withdraw completely from the foreign exchange market, and ordered other credit institutions to do likewise. Brokerage houses took over the foreign exchange market. While banks were technically excluded from the foreign exchange market, they continued to handle transactions which were technically registered on the books of brokerage houses. The foreign exchange market functioned every business day. Foreign exchange controls were not introduced, nor were bank accounts, in dollars or pesos, affected.

In late October, the Mexican Government and the International Monetary Fund agreed on a program under which Mexico could use Fund resources up to an amount of approximately \$965 million over a three year period.



The Fund's resources are to be used in support of an economic program for the short and medium term designed to restore an adequate rate of economic growth and the reduction of inflationary pressures. The Lopez-Portillo government subsequently indicated its approval of the agreement with the Fund.

In September, the U.S. Treasury and the Federal Reserve System established arrangements with the Government of Mexico whereby up to \$600 million would be available to the Bank of Mexico to counter disorderly exchange market conditions during a transitional period pending the receipt of drawings made on the International Monetary Fund.

Mexico's Gross Domestic Product (GDP) increased an estimated 2 percent in 1976, the lowest increase since 1953. The price deflator for 1976 was approximately 20 percent. The economic output appears to have grown by roughly 4 percent in the first half of the year whereas output was more or less flat in the second half of the year. Crop production declined in 1976 due to shortage of irrigation water in the Northwest and land tenure problems. Output in all industrial sectors with the exception of electrical energy grew less in 1976 than in 1975. Output of manufacturers which accounts for the bulk of the industrial sector, was up only 1.8 percent in 1976, compared to 3.9 percent in 1975. The output of petroleum and derivatives registered the largest growth, 9 percent, but this was two percentage points below the increase in 1975. While petroleum output reflects external demand, Mexico's manufacturing sector caters largely to domestic demand. This has been increasingly affected by the reduction in the purchasing power of large segments of the population, according to the Bank of Mexico's Annual Report. In other words, Mexico's inflation over recent years has seriously damaged the standard of living of Mexico's under-employed and workers who do not benefit from the minimum wage and/or are not covered by collective bargaining agreements. Production of consumer goods increased only 1.5 percent in 1976, compared to 4.1 percent in the previous year. Other factors affected output as well. Mexico was unable to take full advantage of the growth of the U.S. market in the first three-quarters of the year because the peso was overvalued. Another factor was the limited availability of credit, particularly in the second half of the year. Credit granted by private credit institutions increased only 14 percent from end-1975 to end-1976.



Mexico was able to reduce the current account deficit in 1976, to \$3.0 billion from \$3.7 billion in 1975. The improvement came largely on the trade account with the deficit declining from \$3.6 billion to \$2.6 billion. The improvement was split between an increase in exports (+\$439 million) largely due to higher prices for agricultural products, particularly coffee, and a reduction in imports (-\$550 million) which would seem to reflect the impact of the devaluation as the decline on a year-to-year basis occurred in the last four months of the year. The country's external financing requirement increased because of the large capital outflows. The "Errors and Omissions" entry in the balance of payments was - \$2,199.4 million, compared to - \$406 million in 1975. This figure may be indicative of the amount of capital that left the country. Medium and long-term capital inflows were \$4,889.9 net. Direct investment inflows were \$330.6 million, down from \$362 million in 1974 and 1975, due to a drop-off of these inflows in the fourth quarter of 1975. (1976?) Public sector net medium and long-term borrowing was \$3,890.6 million. Mexico's public sector external debt at end-1976 was \$19.6 billion compared to \$14.4 billion at end-1975. Private sector external debt at end-1976 is estimated at about \$6 billion. Reserves declined \$333.1 million during 1976, to total \$1411.7 million as of December 31. During the course of the year, the Bank of Mexico revalued its gold holdings at close to the market price.

A New President Assumes Office

On December 1, José Lopez-Portillo assumed the Presidency of the United Mexican States. The new President's address upon taking office was well received as being proper in tone and an effective first step toward restoring the badly shattered confidence of the Mexican people in their economy. On December 10, the President ratified ten agreements with private sector industrial groups whereby private industry and government undertook to make various investments in order to expand production and employment. On December 15, the new administration sent its proposed 1977 public sector budget to Congress. The budget is said to be expansionary, but not inflationary. Expenditures are to be 39 percent above estimated 1976 expenditures. Most of this increase is due to higher prices and larger debt servicing costs. On December 20, banks were once more permitted to deal in foreign exchange, but the Bank of Mexico indicated that it may continue to remain outside the market. The exchange rate remained



close to 20:1 until January 20, when the peso depreciated by about 10 percent. The rate has hovered around 22.5 pesos per dollar through April.

There is little doubt but that 1977 will be another difficult year for the economy. This is not to be unexpected as it will take several years to eliminate the distortions in the economy that developed over the past five years. The government does plan to reduce significantly the rate of inflation, the current account deficit and the public sector budget deficit in 1977. At the same time, the government wishes to avoid any unnecessary contraction of economic activity because of the impact this would have on Mexico's large numbers of un- and under-employed. The President has stated on several occasions that Mexico cannot deal with the inflation problem by reducing demand because the country does not enjoy a standard of living that permits greater sacrifices in consumption. He has emphasized the need for greater output and in this regard has instituted an "Alliance for Production" of which the agreements with the private sector referred to above form a part.

The statistical data available for the first quarter of 1977 combined with statements by government officials, indicate progress toward reducing the economic distortions. The Director-General of the Bank of Mexico recently said that the deficit on the current account of the balance of payments in the first quarter of 1977 should be about \$300 million, which is less than 50% of the deficit in the corresponding period of 1976. The trade deficit was approximately \$100 million in the first quarter of 1977, compared to a deficit of \$650 million in the first quarter of 1976. The capital flight that was so costly in 1976 appears to have stopped and there is capital reflow. Deposits in banks are growing, with the increase registered in the first quarter substantially above year earlier levels. Inflation as measured by the national consumer price index is declining. The month to month increases in the first quarter of 1977 fell from 3.2% in January, to 2.2 in February and 1.7% in March. Wage increases, which were an important source of inflationary pressures in 1976, have been held to 10% thus far this year. Economic output is probably running at year earlier levels, but there are no data on which a firm judgment can be made.



Implications for the U.S.

Mexico is going through a transition period. The end result of this for Mexico, as well as its implications for the United States are not yet clear and unlikely to be so for several years.

The need to reduce the current account deficit will undoubtedly impact on U.S.-Mexican trade patterns. Exports to Mexico in 1977 are likely to be lower than 1976 exports which were below 1975 levels. There will be changes in the composition of U.S. exports to Mexico. Some increase in exports of grains and oil seeds is likely. Exports of capital goods to Mexico's energy sector may also increase. Also, exports are likely to increase somewhat as the year progresses should the economy revive, as is hoped. Public sector investment spending has been held up according to some reports due to the delays in organizing the new government. It is possible that public sector investment spending will increase, resulting in a higher level of imports in the second half of the year.

U.S. exporters may find stiffer competition from Mexican products in third markets. The government has reinstated its rebates to exporters for indirect taxes (CEDIS) that it dropped at the time of the devaluation.

Trade in services are also being affected by the devaluation. U.S. border cities that developed a large trade with Mexican residents have been affected, and pre-devaluation sales levels are unlikely to be attained for a year or so. Tourism spending in the U.S. has also declined and is likely to run below year earlier levels in 1977. On the other hand, the number of U.S. tourists visiting Mexico is reportedly increasing.

The new administration has said that it welcomes foreign direct investment on the same terms as previously. Essentially this means that investments up to 49% of a firm's equity are welcome in most manufacturing activities. Exceptions can be made to the foreign minority ownership provision. No significant change in Mexican laws or regulations is anticipated. The government is going ahead with implementation of legislation passed under the previous administration such as the Patents and Trademarks Law.



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BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
May 31, 1977
1977 MAY 31 AM 10:22
RECEIVED
OFFICE OF THE CHAIRMAN

TO: Chairman Burns

FROM: Ted Truman *EMT*

Attached are three recent cables from Mexico.

The first cable (Mexico 8163) describes the recent reform of regulations governing interest rates that banks in Mexico can pay on peso-denominated deposits. This reform introduces some scope for market-determined interest rates.

The second cable (Mexico 8316) describes current borrowing activities by Mexico. It indicates that the external borrowing program is encountering some difficulties.

The third cable (Mexico 8332) reports on some remarks attributed to ambassador-designate Lucey on the U.S. Government's willingness to use its influence to encourage loans to Mexico for petroleum development.

Attachments

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."



✓ U.S.P., JK
✓ C.C.Y.M.

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INCOMING
TELEGRAM
Mexico

PAGE 01
ACTION EB-07

MEXICO 08163 241920Z

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INFO OCT-01 ARA-10 ISO-00 AID-05 CIAE-00 COME-00
FRB-01 INR-07 NSAE-00 USIA-15 XMB-04 OPIC-06
SP-02 EPG-02 OMB-01 ABF-01 /062 W
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EMT

R 241917Z MAY 77
FM AMEMBASSY MEXICO
TO SECSTATE WASHDC 2331
INFO TREASURY WASHDC

UNCLAS MEXICO 08163

EO 11652: N/A
TAGS: EFIN MX
SUBJECT: INTEREST RATE REFORM

1. SUMMARY: BANK OF MEXICO DIRECTOR GENERAL ROMERO KOLBECK ANNOUNCED OUTLINES OF LONG-AWAITED INTEREST RATE REFORM ON MAY 20. BANK OF MEXICO IS SETTING MAXIMUM RATES ON TIME DEPOSITS, WHILE PERMITTING BANKS TO PAY ANY RATES AT OR BELOW MAXIMUM. END SUMMARY.
2. BANKS WILL BE PERMITTED TO TAKE SHORT TERM DEPOSITS, THREE DAYS, ONE WEEK, AND ONE MONTH THAT WILL PAY ANNUAL INTEREST RATES OF NO MORE THAN 5.6 PERCENT, 5.8 PERCENT AND 8 PERCENT, RESPECTIVELY, NET OF TAXES. FINANCIAL BONDS, WHICH PAY 7.5 PERCENT NET OF TAXES AND ARE REDEEMABLE UPON DEMAND WILL BE PHASED OUT OVER A TWO AND ONE-HALF YEAR PERIOD.
3. MAXIMUM INTEREST ON THREE, SIX, TWELVE, 18 AND 24 MONTHS TIME DEPOSITS WILL BE 11 PERCENT, 13 PERCENT, 15 PERCENT, 15.5 AND 16 PERCENT, NET OF TAXES. THE PREVIOUS RATES FOR DEPOSITS IN EXCESS OF ONE MILLION PESOS RANGE FROM 8.5 PERCENT FOR THREE MONTHS, TO 10 PERCENT FOR SIX MONTHS AND 12.75 PERCENT FOR TWELVE MONTHS.
4. EACH INSTITUTION IS FREE TO SET ITS OWN RATES AS LONG AS THEY DO NOT EXCEED THE MAXIMUM. THE BANK OF MEXICO WILL ALTER THE MAXIMUM RATES AS "MARKET CONDITIONS AND ECONOMIC OBJECTIVES" REQUIRE. EXISTING DEPOSITS ARE NOT AFFECTED. THE MINIMUM AMOUNT FOR TIME DEPOSITS, NOW 100,000 PESOS, IS ABOLISHED.
5. THE BANK OF MEXICO IS MAKING AN UNEXPLAINED EFFORT TO MINIMIZE ANY INCREASE IN INTEREST RATES ON LOANS.
6. WHILE INCREASE IN ALLOWABLE RATES IS NOT DRAMATIC, MOVEMENT TOWARD MORE FLEXIBLE AND MARKET-ORIENTED RATES IS ENCOURAGING.
7. THESE INTEREST RATES APPLY TO PESO DEPOSITS. WASHINGTON WILL RECALL THAT INTEREST RATES ON "MEX-DOLLARS" WERE "REFORMED" IN EARLY APRIL. INTEREST RATES ON THESE DOLLAR-DENOMINATED TIME DEPOSITS ARE ONE PERCENTAGE POINT OVER THE RATE FOR THE CORRESPONDING LONDON EURO-DOLLAR DEPOSIT, PLUS AN AMOUNT EQUIVALENT TO THE MEXICAN 21 PERCENT WITHHOLDING TAX ON INTEREST. THOMPSON



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CLRG, HT, RHM
CL YM, SP, JK, USITS

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Department of State

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TELEGRAM
MEXICO

PAGE 01 MEXICO 08316 252346Z
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MEXICO 08316 252346Z

INFO OCT-01 ARA-06 ISO-00 AID-05 CIAE-00 COME-00
FRB-03 INR-07 NSAE-00 USIA-06 XMB-02 OPIC-03
SP-02 LAB-04 EPG-02 SIL-01 OMB-01 /050 W
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FM AMEMBASSY MEXICO
TO SECSTATE WASHDC 2385
INFO TREASURY WASHDC

~~CONFIDENTIAL~~ MEXICO 08316

EO 11652:GDS
TAGS: EFIN MX
SUBJECT: GOM BORROWING

6. RE INTEREST RATE REFORM ANNOUNCED MAY 20, AND REPORTED IN MEXICO 8163, MANY BANKS PUBLISHED ADS IN MAY 24 PAPERS OFFERING THE MAXIMUM RATES. THUS, IMMEDIATE IMPACT OF REFORM IS A SMALL UPWARD ADJUSTMENT IN RATES ON TERM DEPOSITS WITH NO COMPETITION BETWEEN BANKS. THIS IS UNLIKELY TO GENERATE CONVERSIONS FROM DOLLARS TO PESOS. IT REMAINS TO BE SEEN HOW OFTEN BANK OF MEXICO WILL ADJUST THE MAXIMUM RATES. CALDERHEAD

EMT

Please return to
International Information Center

1. SUMMARY: GOM EXTERNAL BORROWING EFFORTS CONTINUE TO MOVE SLOWLY AHEAD WITH \$150 MILLION BANOBRAS ISSUE TO BE SIGNED MAY 24 OR 25 IN LONDON AND \$150-200 MILLION NAFINSA CREDIT BEING PUT TOGETHER BY CITIBANK. ON THE DOMESTIC FRONT, PETROBONDS WERE REPORTEDLY A LIMITED SUCCESS AND BANKS REACT TO INTEREST RATE REFORM BY PAYING MAXIMUM ALLOWABLE INTEREST RATES. END SUMMARY.

2. \$150 MILLION BANOBRAS (GOM-OWNED PUBLIC WORKS BANK) EURODOLLAR FIVE YEAR CREDIT IS TO BE SIGNED IN LONDON ON MAY 24 OR 25. THIS HAS BEEN A VERY BADLY MANAGED ISSUE AND HAS PROBABLY HAD A NEGATIVE IMPACT ON GOM'S EXTERNAL BORROWING EFFORTS. MANDATE FOR LOAN ORIGINALLY GIVEN TO ORION BANK WHICH COULD NOT PUT TOGETHER AN UNDERWRITING GROUP. MEXICAN TREASURY THEN CALLED IN LLOYD'S BANK AND BANKERS TRUST TO ASSIST. UNDERWRITING GROUP HAS SOLD OFF ONLY \$20-30 MILLION. DIFFICULTIES FACED BY LOAN ATTRIBUTED IN PART TO BAD MANAGEMENT BY BANOBRAS AND MINISTRY OF FINANCE IN PART TO PRICING WHICH WAS SAME AS EARLIER AND SUCCESSFUL PEMEX \$350 MILLION EURODOLLAR CREDIT, AND IN PART TO MANY BANKS ALREADY HOLDING ALL THE BANOBRAS PAPER THEY CARE TO, OR CAN IN ACCORD WITH LEGAL LENDING LIMITS.

3. BANK OF AMERICA, CITIBANK AND LIBRA ARE PUTTING TOGETHER A TEN-YEAR EURODOLLAR ISSUE FOR NAFINSA (GOM-OWNED DEVELOPMENT BANK). THIS WILL BE A "BULLET" CREDIT WITH BANKS HAVING THE OPTION TO PULL OUT AFTER EVERY TWO YEARS AND A PREMIUM OVER LIBO THAT INCREASES IN EACH TWO-YEAR PERIOD. MARKET RECEPTION TO THIS ISSUE WILL BE WATCHED CLOSELY. MANY OF MEXICO'S LARGER U.S. BANKERS ARE REPORTED TO HOLD VIRTUALLY ALL OF THE NAFINSA, OR NAFINSA-GUARANTEED PAPER THAT THEY LEGALLY CAN. THEREFORE IT IS EXPECTED THAT CREDIT WILL HAVE TO BE SOLD LARGELY TO EUROPEAN AND SMALLER U.S. BANKS. AMOUNT OF LOAN IS NOT CLEAR. BANKERS HAVE SAID \$300 MILLION; TREASURY OFFICIAL SAID \$150 MILLION WITH HOPES IT WILL GO TO \$200 MILLION. THIS OFFICIAL ALSO SAYS CITIBANK WANTED ISSUE AND CAN ABSORB A REASONABLE AMOUNT OF NAFINSA PAPER.

4. SEVERAL BANKERS HAVE COMMENTED TO FINATT THAT NEXT LARGE PUBLIC SECTOR CREDIT SHOULD BE A UNITED MEXICAN STATES (FEDERAL GOVERNMENT) ISSUE AS THEIR BORROWINGS ARE NOT AS GREAT AS THOSE OF GOM-OWNED BANKS. AT END-76, FEDERAL GOVERNMENT DEBT OUTSTANDING WAS \$2.9 BILLION, AND GOM-OWNED BANKS DEBT WAS \$6.6 BILLION OUT OF \$20 BILLION TOTAL FOR PUBLIC SECTOR.

5. ON THE DOMESTIC SIDE, PETROBOND ISSUE (SEE MEXICO 4214) HAS REPORTEDLY NOT BEEN AS SUCCESSFUL AS HAD BEEN HOPED WITH SALES TO THE PUBLIC BEING SLOW. WHILE GOM OWNED BANKS ARE ACTIVELY SELLING THE BONDS, PRIVATE BANKS ARE NOT DOING SO APPARENTLY BECAUSE THEY PREFER TO HOLD THESE AS INVESTMENTS RATHER THAN SELL THEM TO THE PUBLIC IN COMPETITION WITH THEIR DEPOSITS. PAPERS HAVE REPORTED THE ISSUE AS SUCCESSFUL.

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E.O. 12958 SEC. 3.6

MR07-117 #30. Date Ver 2/22/08

BY del NARA DATE 3/10/05



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✓ U.S.P., JK
U.K.M., W.F., Y.M., M.T., U.S.I.T.S.

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INCOMING
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Mexico
2304

PAGE 01 MEXICO 08332 260015Z
ACTION ARA-10

INFO OCT-01 ISO-00 XMB-02 FEA-01 ERDA-05 AID-05 CEA-01
CIAE-00 COME-00 EPG-02 DODE-00 EB-07 FPC-01 H-01
INR-07 INT-05 L-03 NSAE-00 NSC-05 OMB-01 PM-04
USIA-06 OES-07 SP-02 SS-15 STR-04 TRSE-00 ACDA-07
PA-01 PRS-01 FRB-03 /107 W

EMT

R 260007Z MAY 77
FM AMEMBASSY MEXICO
TO SECSTATE WASHDC 2388

LIMITED OFFICIAL USE MEXICO 08332

Please return to
International Information Center

EO 11652: N/A
TAGS: EFIN, MX
SUBJECT: AMBASSADOR-DESIGNATE LUCEY'S REMARKS ON LOANS TO
MEXICO FOR PETROLEUM DEVELOPMENT

1. SUMMARY. MEXICO CITY NEWSPAPERS OF MAY 23 AND 24 GAVE PROMINENT COVERAGE TO STORY BY R. T. GARRETT OF DALLAS TIMES HERALD TO EFFECT THAT AMBASSADOR-DESIGNATE LUCEY SAID THAT USG WILL USE INFLUENCE WITH INTERNATIONAL BANKS TO HELP MEXICO OBTAIN CREDITS TO DEVELOP PETROLEUM RESOURCES AND BECOME A NEW SOURCE OF OIL FOR THE U. S. PAPERS OF MAY 26 CARRY NEGATIVE REPLY OF SECRETARY OF NATIONAL PATRIMONY AND DEVELOPMENT. END SUMMARY.
2. AMBASSADOR-DESIGNATE IS REPORTED AS HAVING SAID THAT THE CARTER ADMINISTRATION WILL PROPOSE ECONOMIC MEASURES TO ASSIST MEXICANS IN OBTAINING EQUIPMENT AND TECHNOLOGY TO SPEED UP THE RATE OF PETROLEUM EXPORTS AND THAT SOME INTERNATIONAL BANKS HAVE INDICATED A DESIRE TO EXTEND CREDITS BEYOND THE NORMAL LIMITS OF INDEBTEDNESS FOR EXPLOITATION OF MEXICO'S OIL RESERVES. GOV. LUCEY REPORTEDLY SAID THESE RESERVES WERE NO LESS THAN 50 MILLION BARRELS. STORY QUOTES LUCEY AS STATING "THERE ARE SOME IN MEXICO WHO FAVOR CONSERVING THE OIL FOR THE MEXICANS, BUT THIS POINT OF VIEW IS LOSING GROUND", ADDING, "IT SEEMS THE TENDENCY OF PRESIDENT LOPEZ-PORTILLO'S GOVERNMENT WILL BE TO PUSH FOR RAPID OIL EXPORTS".
3. QUESTIONED BY MEXICAN REPORTERS ABOUT THIS POLITICALLY SENSITIVE ISSUE, THE MEXICAN SECRETARY OF PATRIMONY AND INDUSTRIAL DEVELOPMENT, DE OTEYZA, TOLD REPORTERS THAT MEXICO IS NOT DISPOSED TO COMMIT ITSELF TO PROVIDE PETROLEUM TO THE U. S. IN EXCHANGE FOR INTERNATIONAL FINANCING OBTAINED AS RESULT OF FAVORABLE U. S. INFLUENCE. EXPANDING ON THIS POINT, DE OTEYZA SAID, "WE ARE DISPOSED TO CONTRACT CREDITS UNDER NORMAL CONDITIONS TO STIMULATE DEVELOPMENT OF THE COUNTRY BECAUSE OUR COUNTRY HAS GOOD INTERNATIONAL REPUTATION WITH RESPECT TO LOANS; WE HAVE MAINTAINED THIS STATUS AND WILL CONTINUE TO OBTAIN FINANCING BY VIRTUE OF OUR CONDUCT".
4. COMMENT: REPORTED "50 MILLION BARREL" FIGURE ABOVE PRESUMABLY INTENDED TO BE 50 BILLION. INTERESTING TO NOTE THAT GOV. LUCEY'S COMMENTS POSSIBLY CLOSER TO THE MARK THAN DE OTEYZA'S AS PEMEX DIRECTOR DIAZ SERRANO TOLD U. S. PRIVATE OIL EXECUTIVE MAY 23 THAT PEMEX NOW WILLING TO COMMIT SPECIFIC QUANTITIES OIL AND GAS TO U. S. IN EXCHANGE FOR FINANCING (SEE SEPTEL). IF POSSIBLE, EMBASSY WOULD APPRECIATE ANY FURTHER INFORMATION AVAILABLE TO THE DEPARTMENT CONCERNING AMBASSADOR-DESIGNATE LUCEY'S ALLEGED REMARKS. CALDERHEAD



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BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

CONFIDENTIAL

June 8, 1977

TO: Chairman Burns

FROM: Ted Truman

Attached is the memorandum that I mentioned I had been promised by Treasury on the IMF visitation to Mexico. It was apparently prepared two weeks ago in connection with Secretary Blumenthal's trip to the annual meeting of the Inter-American Development Bank. I am trying to obtain a more recent report if it is available.

cc: Governor Wallich

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June 8, 1977

CONFIDENTIAL

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Walter

BOARD OF GOVERNORS
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 1977 JUN -8 PM 11:38
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Leddy

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Briefing

Date: May 26, 1977

MEMORANDUM FOR: Assistant Secretary Bergsten

From: Sam Y. Cross *SL*

Subject: Supplementary Briefing on the Mexican IMF Program for
Your Discussions with the Mexicans in Guatamala

The Mexican Extended Fund Arrangement with the IMF contains a number of performance criteria which Mexico must meet in order to continue to be eligible to draw on its Fund credit. Apart from one technical point relating to measurement of certain external debts (see below), Mexico is at present meeting these performance criteria in full, according to IMF staff. In part, this result reflects genuine improvement in Mexico's situation -- inflation is much lower and trending down, wages have not been increased in recent months, the balance of payments is considerably improved, external borrowing has been restrained (but for the reason that the Mexican's can't raise the money). Mexico has also recently introduced interest and exchange rate policies that we and the IMF staff consider sound.

However, another factor is that the new government hasn't gotten organized to spend money as fast as planned -- and the budget deficit so far this year is low and within the first quarter's IMF target.

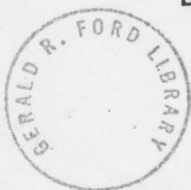
The budget deficit is potentially a very serious problem, and the IMF staff thinks it will determine Mexico's success or failure in stabilization of the economy. The IMF program calls for holding this year's deficit to 90 billion pesos (or 6 percent of GNP) -- in the first quarter it was only 15 billion pesos. The IMF staff say the planned budget expenditures will yield a deficit of 130 billion pesos -- and they are very confident of this figure although the Mexicans dispute it. In the view of the IMF staff, if the deficit can be held to near the 90 billion peso figure, the Mexicans stand

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E.O. 12958 Sec. 3.6

NR 95-2, #34, Treasury Hq. 3/7/96

By let NARA, Date 5/3/96



	Initiator	Reviewer	Reviewer	Reviewer	Reviewer	Ex. Sec.
Surname	CROSS/ <i>LEDDY</i>					
Initials / Date	<i>SL</i>					

a good chance of getting the inflation rate down to manageable levels -- one percent a month by mid-1977. But with a deficit of 130 billion pesos, there will be more inflation, possibly leading to currency speculation and a recurrence of last year's problems.

The Mexican Government is divided between those who agree with the IMF and emphasize stabilization vs. those who argue that Mexico should spend its way out of its difficulties and emphasize production. Fortunately, the "stabilization" group appears to be strengthening its position at the present time. The U.S. view will be important.

We would suggest that the U.S. take the following position in discussions with Mexican officials:

1. On the matter of the technical non-fulfillment of the performance criteria resulting from the technique of valuation of certain debt (the peso value of certain external debts has risen as the peso depreciated), we agree that this should not render Mexico ineligible and will support that view in the IMF Board if necessary. (Even though a technical change, this must be approved by the Board. The IMF staff plans to present it on a "lapse-of-time" basis, without Board discussion.)
2. On the broader issue, we think Mexico's overriding short-term priority must be stabilization. The budget deficit appears to be critical, and we are concerned that there is a possibility of a major break in the IMF target of 90 billion pesos. We think it is in Mexico's interest to meet that target -- or at least have no more than a very modest overage -- even if it means postponing some expenditures for a while. The slow pace of expenditures so far this year gives a real opportunity for meeting the budget deficit target, breaking the back of the inflation, and providing the basis for real growth in the future.
3. We recognize Mexico's interest in oil development, and hope they will make every effort to arrange this within the framework of the IMF program. The Administration has offered Eximbank help to finance oil development.

CC: Under Secretary Solomon
Deputy Assistant Secretary Nachmanoff
Deputy Assistant Secretary Widman
Mr. Sweeney
Mr. Swofford



CLASSIFIED BY Thomas Leddy
SUBJECT TO GENERAL DECLASSIFICATION
SCHEDULE OF EXECUTIVE ORDER 11652
AUTOMATICALLY DOWNGRADED AT TWO
YEAR INTERVALS AND DECLASSIFIED
ON DEC. 31 1983

CONFIDENTIAL

June 9, 1977

TO: Chairman Burns

FROM: Ted Truman

Attached is the latest cable from Mexico describing the general economic and political situation.

Attachment: Mexico 8935

cc: Governor Wallich

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✓ CCYM
✓ LLJK,SP

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10
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MEXICO

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ACTION ARA-10

MEXICO 08935 01 OF 03 040057Z POSS DUPE

INFO OCT-01 ISO-00 CIAE-00 DODE-00 PM-04 H-01 INR-07
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/106 W

(WHICH INCREASED 10 PERCENT FROM JAN 1 THROUGH APRIL) AND PROBABLY WILL BE HIKING UP FUTURE WAGE DEMANDS. WE EXPECT INCREASED TENSIONS BETWEEN LABOR AND MANAGEMENT AND LABOR AND GOVERNMENT (WHICH IS ALSO A MANAGER) DURING THE COMING MONTHS. WITH SO LITTLE VISIBLE PROGRESS HOLDING INFLATION IN CHECK, JLP WILL HAVE DIFFICULTY GETTING LABOR'S CONTINUED COOPERATION.

EMT

R 040052Z JUN 77
FM AMEMBASSY MEXICO
TO SECSTATE WASHDC 2564
ALL USCONS MEXICO BY POUCH

See 273atd.

CONFIDENTIAL SECTION 01 OF 03 MEXICO 08935

Please return to
International Information Center

E. O. 11652: GDS
TAGS: PINT, PFOR, EGEN, MX
SUBJECT: MONTHLY HIGHLIGHTS - APRIL-MAY 1977

REF: MEXICO 4702

SUMMARY: DOMESTIC POLITICAL ACTIVITY PICKED UP DURING APRIL AND MAY, RESPONDING TO THREE DYNAMICS:

- THE LACK OF DEMONSTRABLE PROGRESS TOWARDS A RESUMPTION OF ECONOMIC GROWTH WITHOUT INFLATION;
- A PERCEPTION SHARED BY BOTH LEFT AND RIGHT THAT THE LOPEZ PORTILLO GOVERNMENT REPRESENTED A TURN TOWARDS THE RIGHT, BOTH POLITICALLY AND ECONOMICALLY;
- CONCERN OVER ALLEGED ACTIVITIES OF FORMER PRESIDENT ECHEVERRIA AND THE PRESENCE IN THE LOPEZ PORTILLO GOVERNMENT OF ECHEVERRIA'S LOYALISTS.

IN FOREIGN AFFAIRS, MEXICO TURNED ITS ATTENTION TO ECONOMIC RELATIONS WITH A FEW KEY COUNTRIES. END SUMMARY.

2. MEXICAN ECONOMY STILL STAGNATES.

THE MEXICAN ECONOMY CONTINUES WEAK IN THE INDUSTRIAL SECTOR, PARTICULARLY IN STEEL, AUTOS, AND CONSTRUCTION, ALL RELATIVELY LABOR INTENSIVE. GRAIN AND MEAT PRODUCTION LIKEWISE SHOW NO SIGNS OF EXPANSION. BOTH PUBLIC AND PRIVATE INVESTMENT ARE STAGNATING, THE FORMER BECAUSE OF CREDIT LIMITATIONS OWING TO MEXICO'S HUGE FOREIGN INDEBTEDNESS; THE LATTER TO UNCERTAINTY AND LOW CAPITALIZATION OF PRIVATE ENTERPRISE AFTER DEVALUATION. WE THINK UNEMPLOYMENT MUST BE GROWING, ALTHOUGH STATISTICS ARE LACKING.
ONE OF THE FEW BRIGHT SPOTS IN THE EXTERNAL SECTOR, WHICH IN THE FIRST FOUR MONTHS HAD A NEGATIVE MERCHANDISE BALANCE OF ONLY \$176 MILLION, COMPARED TO THE \$982 MILLION JANUARY-APRIL 1976. THE DEVALUATION, STRICTER IMPORT CONTROLS, AND HIGH WORLD PRICES FOR COFFEE AND OIL ARE LARGELY ACCOUNTING FOR THIS IMPROVEMENT. ANOTHER BRIGHT SPOT IS THE CONTINUED EXPANSION OF INVESTMENT, PRODUCTION, AND SALES OF PEMEX, THE GOM PETROLEUM MONOPOLY. UNFORTUNATELY, THIS IS NOT HAVING ANY EFFECT ON THE EMPLOYMENT SITUATION.

3. 10 PERCENT WAGE RESTRAINT POLICY INTACT, BUT ... THE MOST IMMEDIATE POLITICAL CONSEQUENCE OF THE ECONOMIC SITUATION IS BEING FELT IN THE LABOR SECTOR. ORGANIZED LABOR CONTINUED TO HONOR ITS PLEDGE TO HOLD COLLECTIVE CONTRACTUAL WAGE SETTLEMENTS TO NO MORE THAN 10 PERCENT, BUT LABOR'S HEAD MAN VELAZQUEZ AND OTHER MAJOR LEADERS HAVE PUBLICLY REMINDED THE PRESIDENT THAT AS OF JUNE 1 THEY WILL BE TAKING A CLOSE LOOK AT CONSUMER PRICE LEVELS

4. GOM FIGHTS RIGHTIST LABEL

ACCUSATIONS FROM WITHIN THE POLITICAL ESTABLISHMENT THAT THE LOPEZ PORTILLO GOVERNMENT REPRESENTED A "TURN TO THE RIGHT" (WHICH SURFACED PARTICULARLY AFTER NOMINATION OF DIAZ ORDAZ AS AMBASSADOR TO SPAIN) BROUGHT DENIALS FROM BOTH CABINET MINISTERS AND THE PRESIDENT IN APRIL AND MAY. INDEED, THE GOM'S UNEASINESS WITH A RIGHTIST LABEL MAY HAVE INFLUENCED AT LEAST THE TIMING OF ITS DECISION TO DROP CHARGES AGAINST 400 POLITICAL PRISONERS AND TO PROCEED WITH THE POLITICAL REFORM ANNOUNCED APRIL 1. MORE IMPORTANTLY (ALTHOUGH THIS IS PURELY CONJECTURAL) THIS FACTOR MAY HAVE INFLUENCED THE GOM NOT TO REVERSE, EVEN PARTIALLY, PRESIDENT ECHEVERRIA'S LAND EXPROPRIATION IN SONORA LAST NOVEMBER.

5. LOPEZ PORTILLO UPHOLDS ECHEVERRIA LAND EXPROPRIATION AFTER AGRARIAN REFORM OFFICIALS HAD WORKED SEVERAL MONTHS ON A "POLITICAL SOLUTION" TO THE SONORA LAND EXPROPRIATION WHICH WOULD HAVE RETURNED AT LEAST SOME OF THE LANDS TO THEIR FORMER OWNERS, PRESIDENT LOPEZ PORTILLO ANNOUNCED IN AN EARLY MAY VISIT TO SONORA THAT NONE OF THE LANDS WOULD BE RETURNED, BUT THAT THE GOM WOULD PAY INDEMNIFICATION. ALTHOUGH RETURNING SOME LANDS WOULD HAVE PRESENTED TECHNICAL LEGAL PROBLEMS, WE SUSPECT THE GOM WAS INFLUENCED MORE BY THE POLITICAL CONSIDERATION NOT TO REINFORCE THE VIEW OF THE MEXICAN LEFT (ECHEVERRIA LOYALISTS, CAMPESINO GROUPS, UNREGISTERED OPPOSITION



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FM AMEMBASSY MEXICO
TO SECSTATE WASHDC 2565
INFO ALL USCONS MEXICO BY POUCH

~~CONFIDENTIAL~~ SECTION 02 OF 03 MEXICO 08935

GROUPS, ACADEMIC COMMUNITY) THAT THIS GOVERNMENT HAS
TURNED TO THE RIGHT.

6. POLITICAL REFORM: WILL COMMUNISTS BE REGISTERED?

GOM THROUGHOUT MAY HAS CONDUCTED PUBLIC HEARINGS ON THE
POLITICAL REFORM ANNOUNCED APRIL 1 BY INTERIOR SECRETARY
REYES HERODES. LEFTIST GROUPS WANT REGISTRATION REQUIRE-
MENTS FOR NEW PARTIES VIRTUALLY ELIMINATED; AN ELECTORAL
BOARD INDEPENDENT OF THE GOM/PRI; A SYSTEM OF PROPORTIONAL
REPRESENTATION; AND A DOUBLING OF THE NUMBER OF FEDERAL
DEPUTIES.

MOST INTEREST CONCERNS WHETHER REGISTRATION REQUIREMENTS
WILL BE EASED SUFFICIENTLY TO LET THE MEXICAN COMMUNIST
PARTY (PCM) REGISTER UNDER ITS OWN NAME. THE PCM AND
SEVERAL OTHER LEFTIST GROUPS ARE DISCUSSING A JOINT
REGISTRATION EFFORT, BUT APPARENTLY ARE HAVING PREDICTABLE
DISAGREEMENT CONCERNING WHICH PARTY WOULD BENEFIT FROM
THE JOINT EFFORT.

THE PCM HELD A NATIONAL ASSEMBLY IN THE WEEK OF MAY 23
WHICH IT OPENED TO THE PUBLIC TO GAIN RESPECTABILITY AND
TO ATTRACT PRESS ATTENTION. PCM STRENGTH IS
TOTALLY CENTERED ON UNIVERSITY CAMPUSES, AN AREA WHERE IT
IS CAUSING STATE AND FEDERAL GOVERNMENT SOME CONCERN (SEE
FOLLOWING ITEM).

THE GOVERNMENT'S OBJECTIVE IS TO BRING MEXICO'S POLITICAL
DISSIDENCE WITHIN THE SYSTEM, WHERE IT CAN BE CONTROLLED
MORE EASILY, TO PROVIDE A NON-VIOLENT, HARMLESS OUTLET
FOR POLITICAL OPPOSITION, AND, BY HOLDING OUT THE PROSPECT
OF REGISTRATION, TO GAIN LEVERAGE OVER THE PCM AND OTHER
LEFTIST GROUPS.

7. UNIVERSITY UNIONS CAUSING HEADACHES

MEXICAN COMMUNIST PARTY AND OTHER LEFTIST SUPPORTED EFFORTS
TO UNIONIZE ACADEMIC AND ADMINISTRATIVE PERSONNEL ARE HAV-
ING SUCCESS IN SEVERAL OF THE NATION'S UNIVERSITIES. AT
MEXICO CITY'S MAMMOTH NATIONAL UNIVERSITY (260,000
STUDENTS) TWO UNIONS HAVE MERGED TO DEMAND A SINGLE COL-
LECTIVE CONTRACT. STRIKE DEADLINE IS JUNE 20. AT
PROVINCIAL UNIVERSITIES IN OAXACA, ZACATECAS, AND NAYARIT,
SIMILAR MOVEMENTS HAVE FORCED REFERENDUMS OVER UNIVERSITY
RECTORSHIPS, EACH OF WHICH HAS BEEN WON BY THE RECTOR WITH
UNION BACKING. A SIMILAR CONFLICT IS NOW COMING TO A
HEAD IN GUANAJUATO.

8. ECHEVERRIA NAMED THIRD WORLD AMBASSADOR - CABINET
SHAKEUP RUMORED

GOM ON MAY 16 APPOINTED FORMER PRESIDENT ECHEVERRIA AS
"SPECIAL AMBASSADOR TO DEVELOPING NATIONS.", AN ASSIGNMENT
ON WHICH ECHEVERRIA DEPARTED IMMEDIATELY AND

WHICH PRESUMABLY WILL KEEP HIM OUT OF MEXICO FOR EXTENDED
PERIODS. THE APPOINTMENT FOLLOWED REPORTS OF PRESIDENTIAL
ANNOYANCE OVER ECHEVERRIA CONTINUING TO SEE OLD POLITICAL
FRIENDS AND CONTACTS. ANTI-ECHEVERRIA ELEMENTS, PERHAPS
SEEKING TO OPEN WIDER THE SMALL BREACH IN PRESIDENT LOPEZ
PORTILLO'S POLICY OF PROHIBITING PURGES AGAINST MEMBERS OF
THE PREVIOUS ADMINISTRATION, ARE MOUNTING CAMPAIGNS
AGAINST EDUCATION SECRETARY PORFIRIO MUNOZ LEDO IN
PARTICULAR, AND ALSO AGAINST PROGRAMMING AND BUDGET
SECRETARY CARLOS TELLO, WHO WHILE CLOSE AND LOYAL TO
LOPEZ PORTILLO, ALSO BEARS THE TAIN OF A CLOSE ASSOCIATION
WITH ECHEVERRIA. THESE ATTACKS HAVE GROWN FROM ONE LINE
SEMI-SLANDEROUS COMMENTS IN POLITICAL COLUMNS TO RUMORS
OF A SIZEABLE CABINET SHAKEUP.

9. FOREIGN AFFAIRS DEVELOPMENTS

A. THE LOVE-FEAST CONTINUES

THE MOVE TO IMPROVE US-MEXICAN RELATIONS BASED ON THE
SPIRIT OF "NEWNESS" OF BOTH NATIONS' GOVERNMENTS RECEIVED
TWO MORE POSITIVE IMPULSES DURING THIS REPORTING PERIOD
WITH THE US-MEXICAN INTERPARLIAMENTARY MEETING HELD IN
SONORA STATE MAY 26-30, AND THE VISIT TO WASHINGTON OF
FOREIGN SECRETARY SANTIAGO ROEL, MAY 26 TO BRING INTO
MOTION THE BILATERAL CONSULTATIVE MECHANISM AGREED UPON
LAST FEBRUARY.

IN SONORA, THE MEXICAN AND US LEGISLATORS DISCUSSED AT
LENGTH MAJOR BILATERAL, ISSUES INCLUDING ILLEGAL MIGRATION
AND ENERGY, IN DEBATES THAT THE MEXICAN PRESS CHARACTERIZED
AS FRANK BUT LACKING IN ACRIMONY. THE OPENNESS AND
CORDIALITY OF THE SESSIONS UNDOUBTEDLY DID MUCH TO REDUCE
THE ILL-FEELING GENERATED LAST YEAR WHEN 76 US CONGRESSMEN
SENT PRESIDENT FORD AN OPEN LETTER DECLARING THAT MEXICO
WAS "GOING COMMUNIST."



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Department of State

INCOMING
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ACTION ARA-10

MEXICO 08935 03. OF 03 070308Z

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FM AMEMBASSY MEXICO
TO SECSTATE WASHDC 2566

~~C O N F I D E N T I A L~~ SECTION 3 OF 3 MEXICO 8935

SIMULTANEOUSLY, MEXICAN-US RELATIONS WERE FURTHER CE-
MENTED BY FONSEC ROEL'S VISIT TO WASHINGTON ON MAY 26,
ACCOMPANIED BY CHIEF GOM ECONOMIC PEOPLE, AND BY THE SUB-
SEQUENT ESTABLISHMENT OF THREE HIGH LEVEL BILATERAL COM-
MITTEES-POLITICAL, ECONOMIC, SOCIAL- WHICH WILL STUDY IN
DEPTH, AND FOR THE FIRST TIME IN AN INTEGRATED FASHION,
THE MYRIAD BILATERAL PROBLEMS THE TWO NATIONS FACE.
PRESIDENT CARTER'S HISTORIC SIGNING OF PROTOCOL I OF THE
TREATY OF TLATELOLCO, DURING THE VISIT, WAS A GESTURE,
WHICH MEXICO, AS PRIME MOVER OF THE TREATY, OBVIOUSLY
APPRECIATED.

10. B. THEY'RE COURTING THE OTHERS, TOO.

NOW THAT THE NEW GOM BUREAUCRACY IS SETTling IN, PENDING
ARRANGEMENTS WITH OTHER FIRST, SECOND AND THIRD WORLD
NATIONS ARE GETTING THE ATTENTION THAT WAS SOMEWHAT
LACKING IN THE FIRST 100 DAYS OF JLP'S ADMINISTRATION WHEN
US-MEXICAN RELATIONS DOMINATED EVERYONE'S
THINKING.

BESIDES REFURBISHING ITS IMAGE WITH THE US, THE GOM HAS
ALSO MADE A MAJOR EFFORT TO GET ACROSS THE MESSAGE TO
EUROPEAN BUSINESSMEN THAT FOREIGN INVESTMENT IS ONCE
AGAIN WELCOME IN MEXICO. A THREE-DAY SESSION OF TALKS
WAS HELD IN MEXICO CITY IN MID-APRIL IN WHICH THE TOP GOM
ECONOMIC OFFICIALS MET WITH EMBASSY AND BUSINESS REPRE-
SENTATIVES FROM 12 WESTERN EUROPEAN NATIONS AND ISRAEL.
(MIXED REVIEWS - THE BUSINESSMEN LEFT STILL CAUTIOUS
ABOUT MEXICO'S NEAR-TERM ECONOMIC PROBLEMS, BUT FAVORABLY
IMPRESSED WITH JLP'S ECONOMIC TEAM).
GOM OFFICIALS HAVE ALSO MET MORE QUIETLY WITH OFFICIALS
FROM THE EEC TO IMPROVE MEXICO'S TRADING POSITION WITH
COMMON MARKET. SINCE THE OPENING OF MEXICAN-SPANISH
RELATIONS, BUSINESSMEN FROM BOTH NATIONS HAVE BEEN
TRAVELLING BACK AND FORTH SPEAKING WITH GREAT OPTIMISM
ABOUT THE SUITABILITY OF MEXICO FOR JOINT INVESTMENT
PROJECTS AND A GENERAL INCREASE OF SPANISH CAPITAL INTO
MEXICO.

THE GOM HAS ALSO RECENTLY REFOCUSSED SOME ATTENTION ON UN-
FINISHED AGREEMENTS WITH COMMUNIST NATIONS IN ITS SEARCH
FOR INVESTMENT CAPITAL. ALTHOUGH TRADE WITH THESE
NATIONS HAS DECREASED IN 1977, BOTH YUGOSLAVIA AND THE
GDR HAVE SIGNED JOINT INVESTMENT AGREEMENTS WITH MEXICO
IN THE PAST MONTH. IN CONTACTS WITH THE THIRD WORLD
NATIONS, THE GOM HAS PUSHED FOR LONG-OVERDUE MIXED-
COMMISSION MEETINGS WITH BRAZIL AND IRAN, INDICATING THAT
THIS GOM IS MORE CONCERNED WITH ECONOMIC ADVANTAGE IN ITS
BILATERAL RELATIONS THAN WITH IDEOLOGICAL CONGRUENCE.

THE GENERAL INCREASE IN MEXICO'S BILATERAL EXCHANGES IN
THE PAST TWO MONTHS SHOWS THAT JLP IS STILL PURSUING
THE FOREIGN CONTACTS SO AVIDLY SOUGHT BY HIS PREDECESSOR,
BUT SELECTIVELY AND PRAGMATICALLY. THOMPSON



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BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

1977 JUN 14 AM 10: 39

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June 14, 1977

RECEIVED
OFFICE OF THE CHAIRMAN

TO: Chairman Burns

FROM: Ted Truman

EMT

Attached are two recent cables on Mexico.

Mexico 9385 reports on the reduced Mexican current account deficit in the first quarter of 1977. It was \$245 million compared with \$686 million in the first quarter of 1976 and an average quarterly rate of \$750 million for all of 1976. Much of the improvement was in exports, especially increased export earnings on coffee, petroleum and tomatoes.

State 134376 reports on the U.S. participants in the working groups under the Mexican-U.S. "consultative mechanism."

Attachments

cc: Governor Wallich



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INCOMING
TELEGRAM
MEXICO

PAGE 01 MEXICO 09385 100004Z
ACTION ARA-14

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R 100008Z JUN 77
FM AMEMBASSY MEXICO
TO SECSTATE WASHDC 2740
INFO TREASURY WASHDC

UNCLAS MEXICO 09385

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STATE PASS FEDERAL RESERVE BOARD

E. O. 11652: N/A
TAGS: EGEN, ECRP, BEXP, MX
SUBJECT: MEXICO'S BALANCE OF PAYMENTS, FIRST QUARTER 1977

1. THIS CABLE REPORTS BALANCE OF PAYMENTS DATA FOR FIRST QUARTER 1977 AS IT APPEARS IN BANK OF MEXICO'S ECONOMIC INDICATORS FOR APRIL 1977. ALL FIGURES ARE IN MILLIONS OF DOLLARS; FIGURES IN PARENTHESES ARE FOR FIRST QUARTER 1976.
2. CURRENT ACCOUNT DEFICIT WAS 245.3 (665.8).
3. CURRENT ACCOUNT RECEIPTS TOTALED 1959.0 (1687.0) BROKEN DOWN AS FOLLOWS: EXPORTS OF GOODS, 1059.6 (781.2); SILVER, 38.8 (35.5); TOURISM 221.2 (237.6); FRONTIER TRANSACTIONS, 376.2 (377.7); IN-BOND ASSEMBLY PLANTS, 113.5 (121.5); OTHER, 149.7 (133.5).
4. CURRENT ACCOUNT EXPENDITURES TOTALED 2,204.4 (2,352.8), BROKEN DOWN AS FOLLOWS: IMPORTS OF GOODS, 1133.2 (1433.4); TOURISM, 56.6 (70.6); FRONTIER TRANSACTIONS, 251.4 (243.2); DIVIDENDS, INTEREST AND OTHER PAYMENTS BY COMPANIES WITH FOREIGN OWNERSHIP 237.5 (198.9); INTEREST ON PUBLIC SECTOR DEBTS 366.1 (254.7); OTHER, 159.5 (152.0).
5. ERRORS AND OMISSIONS WERE PLUS 60.6 (-238.2).
6. NET LONG-TERM CAPITAL INFLOWS WERE 352.2 (858.5); BROKEN DOWN AS FOLLOWS: FOREIGN DIRECT INVESTMENT 49.1 (85.2); FOREIGN CREDITS, NET, 323.9 (423.9), OF WHICH PUBLIC SECTOR NET WAS 330.5 (425.3). DISBURSEMENTS WERE 673.7 (702.4) AND AMORTIZATION PAYMENTS 343.2 (277.1). NET PRIVATE SECTOR CREDITS WERE -6.6 (-1.3); DATA ON THESE IS COLLECTED ON AN ANNUAL BASIS FOR THE MOST PART. OTHER GOVERNMENT DEBT, NET, WAS 2.8 (345.3), AND OTHER WAS -23.6 (4.1).
7. RESERVES INCREASED 167.5 (-45.4).
8. OF THE 278.4 MILLION INCREASE IN EXPORT EARNINGS FROM THE FIRST QUARTER OF 1976 TO THE FIRST QUARTER OF 1977, COFFEE ACCOUNTED FOR 100 MILLION ON REDUCED VOLUME; PETROLEUM FOR 60.; TOMATOES FOR 16 MILLION, SHRIMP FOR 19 MILLION; FROZEN STRAWBERRIES, UP 12 MILLION, CHEMICALS, UP 17 MILLION, IRON AND STEEL PRODUCTS UP 9 MILLION; MACHINERY AND TRANSPORT EQUIPMENT EXPORTS WERE DOWN 8 MILLION; OTHER MANUFACTURED EXPORTS WERE UP 4 MILLION. IN PERCENTAGE TERMS, AGRICULTURE AND FORESTRY EXPORTS INCREASED 39 PERCENT, LIVESTOCK, FISH EXPORTS WERE UP 66 PERCENT; EXPORTS OF EXTRACTIVE INDUSTRIES WERE UP 49 PERCENT, AND EXPORTS OF TRANSFORMATION INDUSTRIES WERE UP 20.1 PERCENT.
9. OF THE 300 MILLION DECLINE IN IMPORTS, CORN IMPORTS WERE OFF 52 MILLION; ENERGY IMPORTS DOWN 22 MILLION, AUTO PARTS DOWN 25 MILLION, IRON AND STEEL IMPORTS DOWN 37 MILLION; AND INVESTMENT GOODS DOWN 153 MILLION. THOMPSON



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MEXICO

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STATE 134376

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SCA-01 OIC-02 /120 R

CHAIRMAN: ANTHONY SOLOMON, UNDER SECRETARY OF TREASURY;
CHARLES MEISSNER, DEPUTY ASSISTANT SECRETARY OF STATE FOR
INTERNATIONAL FINANCE AND DEVELOPMENT. **EMT**

D. TOURISM SUBGROUP

CHAIRMAN: FABIAN CHAVEZ, ASSISTANT SECRETARY OF COMMERCE;
DANIEL TAHER, OFFICE OF REGIONAL ECONOMIC AFFAIRS (ARA)
DEPARTMENT OF STATE.

2. SOCIAL WORKING GROUP

COCHAIRMAN: MATTHEW NIMETZ, COUNSELOR OF THE DEPARTMENT OF
STATE; AND MICHAEL J. EGAN, ASSOCIATE ATTORNEY GENERAL,
DEPARTMENT OF JUSTICE;

CHARLES KNAPP, SPECIAL ASSISTANT TO THE SECRETARY OF LABOR;

LEONEL J. CASTILLO, COMMISSIONER, IMMIGRATION AND
NATURALIZATION SERVICE (INS);

FRANK A. WEIL, DEPARTMENT OF COMMERCE;

MORTON BACH, SPECIAL ASSISTANT TO THE UNDER SECRETARY
OF TREASURY.

3. ABOVE LIST SUBJECT TO ADDITIONS AND MODIFICATIONS
DEPENDING ON EXACT NATURE OF TOPICS CONSIDERED.

4. PLEASE ALSO INFORM ROEL THAT WE ARE DEVELOPING AGENDA
PROPOSALS FOR SUBMISSION TO GOM BY JUNE 17 AS AGREED IN
MAY 26 MEETING.

VANCE

DRAFTED BY ARA/MEX: M. YOHN: MRG
APPROVED BY ARA: W. H. LUERS
COMMERCE: R. ADES
EB: J. GERVERS
C: J. GORDON

P 101519 JUN 17
FM SECSTATE WASHDC
TO AMEMBASSY MEXICO PRIORITY

UNCLAS STATE 134376

E. O. 11652: N/A

TAGS: PGOV, HX

SUBJECT: CONSULTATIVE MECHANISM: U.S. PARTICIPATION

1. PLEASE CONVEY TO FOREIGN SECRETARY ROEL OR OTHER
APPROPRIATE OFFICIAL THE FOLLOWING LIST OF U.S. PARTICI-
PANTS IN THE CONSULTATIVE MECHANISM:

ECONOMIC WORKING GROUP

COCHAIRMAN: RICHARD COOPER, UNDERSECRETARY OF STATE FOR
ECONOMIC AFFAIRS; AND SIDNEY HARMAN, UNDERSECRETARY OF
COMMERCE.

A. TRADE SUBGROUP
CHAIRMAN, ALAN WOLFF, DEPUTY SPECIAL TRADE REPRESENTA-
TIVE;

HOWARD SAMUEL, DEPUTY UNDER SECRETARY OF LABOR;

JOHN RAY, DIRECTOR OF TRADE POLICY, TREASURY DEPARTMENT;

S. STANLEY KATZ, DEPUTY ASSISTANT SECRETARY OF COMMERCE

FOR INTERNATIONAL ECONOMIC POLICY AND RESEARCH;

HARRY WILHELM, DEPUTY ASSISTANT SECRETARY OF AGRICULTURE;

WILLIAM G. BARRACLOUGH, DEPUTY ASSISTANT SECRETARY OF
STATE FOR INTERNATIONAL TRADE POLICY;

B. ENERGY, MINERALS, INDUSTRY AND INVESTMENT SUBGROUP

COCHAIRMAN: STEPHEN BOSWORTH, DEPUTY ASSISTANT SECRETARY
OF STATE FOR INTERNATIONAL RESOURCES AND FOOD POLICY; AND
CECIL THOMPSON, DEPUTY ASSISTANT ADMINISTRATOR OF FEA FOR
INTERNATIONAL ENERGY AFFAIRS;

HOWARD SAMUEL, DEPARTMENT OF LABOR;

FRANK A. WEIL, ASSISTANT SECRETARY OF COMMERCE FOR
DOMESTIC AND INTERNATIONAL BUSINESS;

CHARLES SCHOTTA, DIRECTOR OF OFFICE OF ENERGY POLICY
ANALYSIS, DEPARTMENT OF TREASURY;

PATRICIA COUNTS, OVERSEAS PRIVATE INVESTMENT CORPORATION
(OPIC).

C. FINANCIAL SUBGROUP

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BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date June 23, 1977

To Chairman Burns

Subject: _____

From Ted Truman *EMT*

~~CONFIDENTIAL~~

Attached is the latest cable on financial developments
in Mexico.

Attachment: Mexico 10173

cc: Governor Wallich

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
1977 JUN 23 PM 2:08
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SIL-01 IGA-02 /085 W

R 210023Z JUN 77
FM AMEMBASSY MEXICO
TO SECSTATE WASHDC 2980
INFO TREASURY WASHDC

See 2 att.

~~CONFIDENTIAL~~ SECTION 01 OF 02 MEXICO 10173

EO 11652: GDS
TAGS: EFIN, EGEN, BEXP, MX
SUBJECT: RECENT FINANCIAL DEVELOPMENTS

REF: MEXICO 9398

1. SUMMARY. THE APRIL ISSUE OF THE BANK OF MEXICO'S ECONOMIC INDICATORS PERMITS SOME ANALYSIS OF INTERNAL ECONOMIC DEVELOPMENTS IN THE FIRST QUARTER. END SUMMARY.

2. MONETARY DEVELOPMENTS: THE END-MARCH MONEY SUPPLY WAS 31 PERCENT ABOVE THE YEAR-EARLIER FIGURE, COMPARED TO 32.8 PERCENT FOR FEBRUARY AND 31 PERCENT FOR JANUARY. THE RATIO OF CURRENCY TO MONEY SUPPLY REMAINS HIGH, 49 PERCENT, COMPARED TO 43 PERCENT IN THE TWO PREVIOUS YEARS; HOWEVER, THIS RATIO IS DECLINING FROM THE HIGH OF 53 PERCENT REACHED LAST NOVEMBER. THE SUBSTANTIAL CURRENCY ISSUE MADE NECESSARY BY THE RUN ON THE BANKS HAS INDIRECTLY HELPED THE BANK OF MEXICO MEET THE FUND AGREEMENT TARGETS IN THAT THE CURRENCY ISSUE AS OF END-1976 WAS HIGHER THAN IT WOULD OTHERWISE HAVE BEEN. THE BANK OF MEXICO'S CURRENCY ISSUE AS OF END-MAY WAS 68.2 BILLION PESOS, 11.2 BILLION BELOW THE END-1976 FIGURE, AND 18.6 BILLION OR 37.5 PERCENT ABOVE THE YEAR-EARLIER FIGURE.

3. PESO-DENOMINATED DEPOSIT LIABILITIES OF NATIONAL AND PRIVATE BANKS INCREASED 16 BILLION PESOS IN THE FIRST QUARTER, VIRTUALLY ALL OF THE INCREASE WAS IN THE FORM OF TIME DEPOSITS. ON A YEAR-TO-YEAR BASIS, THE COMPARABLE FIGURE IS 2.3 BILLION PESOS; EXCLUDING DEMAND DEPOSITS, PESO-DENOMINATED DEPOSITS AT END MARCH 1977 WERE 10 BILLION PESOS BELOW THE YEAR-EARLIER FIGURE. DOLLAR-DENOMINATED DEPOSITS INCREASED \$241.3 MILLION OR THE EQUIVALENT OF 5.3 BILLION PESOS IN THE FIRST QUARTER CONVERTED AT THE AVERAGE EXCHANGE RATE FOR THIS PERIOD. LIABILITIES TO FOREIGN BANKS INCREASED \$175.2 MILLION IN THE FIRST QUARTER. FOR THE 12-MONTH PERIOD, DOLLAR

DEPOSIT LIABILITIES WERE UP \$1,691.6 MILLION AND LIABILITIES TO FOREIGN BANKS WERE UP \$2,640.9 MILLION. THE SHIFT FROM PESOS TO FOREIGN EXCHANGE HAS SLOWED, BUT IT HAS NOT REVERSED.

4. BANK OF MEXICO DIRECTOR GENERAL ROMERO KOLBECK HAS STATED THAT THE INTEREST RATE REFORM HAS HAD A SIGNIFICANT IMPACT. HOWEVER, IN APRIL AND MAY PROCEEDS FROM MATURING TIME DEPOSITS WERE HELD IN MORE LIQUID FORMS SINCE HIGHER INTEREST RATES WERE WIDELY ANTICIPATED.

5. TOTAL CREDIT FLOWS IN THE FIRST QUARTER AMOUNTED TO 20.4 BILLION PESOS, OF WHICH 8.3 BILLION WENT TO NON-GOVERNMENT BORROWERS, BUT INCLUDING PARASTATAL ENTITIES. ADJUSTED FOR THE IMPACT OF DEVALUATION ON DOLLAR-DENOMINATED CREDIT, THE STOCK OF CREDIT TO NON-GOVERNMENT BORROWERS WAS 16 PERCENT ABOVE YEAR-EARLIER FIGURES WHICH WOULD BE A DECLINE IN REAL TERMS.

6. THE STOCK OF BANKING SYSTEM (EX-BANK OF MEXICO) CREDIT TO THE FEDERAL GOVERNMENT INCREASED 19.5 BILLION PESOS IN THE FIRST QUARTER. ADJUSTED FOR THE INCREASE IN THE STOCK OF DOLLAR-DENOMINATED DEBT IN TERMS OF PESOS RESULTING FROM THE DEPRECIATION OF THE PESO, THE CREDIT FLOWS FROM PRIVATE AND NATIONAL BANKS TO THE FEDERAL GOVERNMENT WERE 12.2 BILLION PESOS. THIS FIGURE EXCLUDES RECEIPTS FROM FOREIGN BORROWING AND CHANGES IN BANK OF MEXICO CREDIT. IT ALSO EXCLUDES BORROWING BY THE REST OF THE PUBLIC SECTOR.

7. IT IS DIFFICULT TO RECONCILE THE ABOVE DATA ON BANK LENDING TO THE FEDERAL GOVERNMENT WITH THE DATA ON CASH OUTLAYS AND RECEIPTS FOR THE FIRST TWO MONTHS WHICH SHOW A SURPLUS OF 0.4 BILLION PESOS. IT IS POSSIBLE THAT MARCH SHOWED A SIGNIFICANT DEFICIT AND/OR BANK OF MEXICO CREDIT TO FEDERAL GOVERNMENT DECLINED. FEDERAL GOVERNMENT EXTERNAL BORROWING WAS NEGLIGIBLE, WITH ONLY \$2.8 MILLION SHOWING UP IN THE BALANCE OF PAYMENTS ACCOUNTS. A PRIVATE BANK THAT IS USUALLY WELL-INFORMED, REPORTS THAT THE FEDERAL GOVERNMENT DEFICIT IN THE FIRST QUARTER WAS ABOUT 6 BILLION PESOS.

8. FEDERAL GOVERNMENT SPENDING IN THE FIRST TWO MONTHS WAS ABOUT 25 PERCENT ABOVE THE YEAR-EARLIER FIGURE. HOWEVER, CURRENT EXPENDITURES WERE 47 PERCENT ABOVE THE YEAR-EARLIER FIGURES AND CAPITAL EXPENDITURES WERE 60 PERCENT ABOVE THE YEAR-EARLIER FIGURE. A REDUCTION IN PAYMENTS OF ADEFAS (OBLIGATIONS INCURRED IN PREVIOUS



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dal 7/26/07

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Department of State

INCOMING
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INFO OCT-01 ISO-00 SP-02 USIA-06 AID-05 EB-07 NSC-05
EPG-02 TRSE-00 SS-15 STR-04 OMB-01 CEA-01 CIAE-00
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~~CONFIDENTIAL~~ SECTION 02 OF 02 MEXICO 10173

FISCAL YEARS) ACCOUNTS FOR THE RELATIVELY SLOW GROWTH IN TOTAL EXPENDITURES. ADEFAS IN 1977 WILL PRESUMABLY BE GREATER THAN IN 1976. ALTHOUGH IT MAY BE TOO EARLY TO EXTRAPOLATE, THESE FIGURES COULD INDICATE A HIGHER LEVEL OF SPENDING THAN IS CONTEMPLATED IN THE BUDGET, WHICH CALLS FOR A 35 PERCENT INCREASE IN FEDERAL GOVERNMENT OUTLAYS. IN THIS REGARD FINANCE SECRETARY MOCTEZUMA TOLD A GROUP FROM THE U.K. THAT THE TOTAL PUBLIC SECTOR DEFICIT WOULD NOT EXCEED 125 BILLION PESOS THIS YEAR. WHILE THIS NEED NOT CONTRADICT THE FUND PROGRAM, IT IS INTERESTING THAT HE WOULD NOT GO ON THE RECORD AS PREDICTING A DEFICIT CLOSER TO THAT CALLED FOR IN THE FUND AGREEMENT.

9. INDUSTRIAL PRODUCTION: WHILE THE INDUSTRIAL PRODUCTION INDEX SLIPPED 0.3 PERCENT FROM JANUARY TO FEBRUARY, THE SUBINDEX FOR MANUFACTURERS WAS UP 1.4 PERCENT. THERE IS SOME REASON TO BELIEVE THAT THE DECLINE IN INDUSTRIAL OUTPUT WHICH BEGAN LAST JUNE HAS NOW STOPPED. THE OVERALL INDEX DECLINED BECAUSE OF DECLINES IN FOUR OF THE OTHER FIVE SUBINDICES. ONLY MINING OUTPUT INCREASED. PETROLEUM OUTPUT IN FEBRUARY WAS AT THE YEAR-EARLIER FIGURE. THE PETROCHEMICAL INDEX DROPPED 20.3 PERCENT FROM JANUARY TO FEBRUARY. THIS IS IN PART SEASONAL; THE BALANCE MAY REFLECT THE DROP IN PETROLEUM OUTPUT. THE ELECTRICITY SUBINDEX DROPPED 6.7 PERCENT FROM JANUARY TO FEBRUARY WHEN IT WAS 5.2 PERCENT ABOVE THE YEAR-EARLIER FIGURE. THE FEBRUARY INDUSTRIAL PRODUCTION INDEX WAS 4.7 PERCENT BELOW THE YEAR-EARLIER FIGURE AND THE MANUFACTURERS' SUBINDEX WAS 3.3 PERCENT BELOW THE YEAR-EARLIER FIGURE.

10. THERE ARE 16 INDUSTRY SUBINDICES IN THE MANUFACTURERS' SUBINDEX. TENDING TO CONFIRM THE VIEW THAT THE BOTTOM HAS BEEN REACHED, 13 OF THE 15 INDICES FOR WHICH THERE IS MARCH DATA SHOWED MONTHLY INCREASES. ON A YEAR-TO-YEAR BASIS, 8 OF THE 15 SHOWED INCREASES.

11. MEXICO'S INDUSTRIAL OUTPUT IN THE FIRST QUARTER 1977 IS LIKELY TO BE ABOUT SIX PERCENT BELOW THE YEAR-EARLIER FIGURE. WHILE IT IS HOPED THAT THE BOTTOM HAS BEEN REACHED, NOBODY IS ANTICIPATING A QUICK OR STRONG RECOVERY. THE POSSIBILITY OF A SLIGHT YEAR-TO-YEAR DECLINE IN INDUSTRIAL OUTPUT SHOULD NOT BE RULED OUT. IF THIS OCCURS, IT IS UNLIKELY THAT GROWTH IN THE OTHER ROUGHLY TWO-THIRDS OF THE ECONOMY WILL BE MUCH GREATER THAN ZERO. THE LIKELIHOOD OF A ZERO GROWTH RATE FOR THE YEAR AS A WHOLE LOOMS LARGER AND LARGER. THOMPSON



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BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date August 17, 1977

To Chairman Burns

Subject: _____

From Edwin M. Truman

EMT
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The attached cable describes the progress made by Mexico in stabilizing its economy this year. It indicates that Mexico appears to have met all of the June 30 targets specified in its IMF program though all data are not yet available to confirm this (especially data on the public sector deficit). This information is consistent with the analysis contained in Yves Maroni's most recent note on Mexico, circulated to the Board on July 29. A copy of that note is also attached, together with the latest revisions of our tables on Mexican economic and financial indicators.

The cable also discusses the failure of private sector investment to revive, ascribing that failure to the slowdown in public sector infrastructure investment, uncertainty over industrial and trade policy, uncertainty over the future of the exchange rate, and doubts that the Mexican Government will be able to cope with the country's social and political pressures.

The cable also notes that the dollar component of the money supply continues to expand. Partial data indicate that the increase in peso interest rates, late in May, has not induced a shift from dollars to pesos.

cc: Governor Wallich

~~CONFIDENTIAL~~



Office Correspondence

Date August 17, 1977

To Chairman Burns

From Edwin M. Truman

Subject:

~~CONFIDENTIAL~~

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cc: Governor Wallach



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INCOMING
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MEXICO

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TO SECSTATE WASHDC 4172
INFO TREASURY WASHDC

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~~CONFIDENTIAL~~ SECTION 01 OF 02 MEXICO 13393

E.O. 11652: N/A
TAGS; EFIN, MX
SUBJECT: THE MEXICAN ECONOMY AT MID-YEAR

*Please return to
International Information Center*

REF: STATE 180067

1. SUMMARY: THE GOM HAS MADE CONSIDERABLE PROGRESS TOWARD STABILIZING ITS ECONOMY AFTER THE TUMULTUOUS EVENTS OF 1976. IT APPEARS TO HAVE MET ALL THE TARGETS FOR THE FIRST HALF AS CALLED FOR IN THE IMF PROGRAM. THERE IS INCREASING CONCERN OVER THE LACK OF PRIVATE INVESTMENT AND THE LACK OF ANY APPARENT STIMULUS TO ECONOMIC RECOVERY. THIS TELEGRAM PROVIDES PARTIAL RESPONSE TO REFTEL. FURTHER ANALYSIS WILL BE SENT SHORTLY. END SUMMARY.

2. THE GOM HAS RECEIVED A LETTER FROM IMF MANAGING DIRECTOR WITTEVEEN STATING THEY HAVE MET THE TARGETS IN THE FUND PROGRAM FOR THE FIRST QUARTER OF 1977. THEY PROBABLY MET THE TARGETS IN THE SECOND QUARTER, THOUGH ALL DATA ARE NOT AVAILABLE TO CONFIRM THIS. THE CURRENCY ISSUE OF THE BANK OF MEXICO WAS 68.6 BILLION PESOS AT END-JUNE; WELL WITHIN THE FUND PROGRAM CEILING. PUBLIC SECTOR EXTERNAL DEBT INCREASED \$641.4 MILLION IN THE FIRST QUARTER OF THE YEAR, TO \$20,241.6 MILLION AS OF MARCH 31. NET BORROWING (DRAWDOWNS) IN THE FIRST HALF WAS PROBABLY ABOUT \$1.2 TO \$1.4 BILLION. THE PUBLIC SECTOR DEFICIT IN THE FIRST QUARTER WAS SAID TO BE ABOUT 14 BILLION PESOS. THE SECOND QUARTER DEFICIT WILL BE GREATER, BUT SHOULD NOT EXCEED 25 BILLION PESOS, FOR A FIRST HALF DEFICIT OF ROUGHLY 40 BILLIONS PESOS.

3. THE GOM HAS ALSO MADE SIGNIFICANT PROGRESS IN REDUCING THE RATE OF INFLATION. THE NATIONAL CONSUMER PRICE INDEX INCREASED 0.9 IN MAY AND 1.2 IN JUNE. THE JULY INCREASE SHOULD BE NO MORE THAN 1. THE INCREASE FOR THE FIRST HALF OF THE YEAR WAS 11.2. THE WHOLESALE PRICE INDEX INCREASED 12.5 IN THE FIRST HALF OF 1977. THE GOM ALSO MANAGED TO KEEP ITS WAGE POLICY MORE LESS INTACT THROUGH JULY WITH FEW WAGE INCREASES PASSING THE 10 FIGURE.

4. THE DECLINE IN INDUSTRIAL OUTPUT THAT BEGAN LAST JULY MAY HAVE BOTTOMED OUT IN FEBRUARY. THE INDUSTRIAL PRODUCTION INDEX INCREASED 14 FROM FEBRUARY TO MARCH, BUT WAS 1.6 BELOW THE YEAR EARLIER FIGURE. ALL SIX SUB-INDICES SHOWED SHARP INCREASES, BUT WITH THE EXCEPTION OF THE PETROLEUM SUB-INDEX, ALL WERE AT OR BELOW YEAR EARLIER FIGURES. THE SUB-INDEX FOR MANUFACTURES ROSE 12.7 FROM FEBRUARY TO MARCH, BUT WAS 2.5 BELOW THE YEAR EARLIER FIGURE. THE AVERAGE INDEX FOR THE FIRST QUARTER 1977 WAS 3.4 BELOW THE YEAR EARLIER FIGURE.

5. IN APRIL, THE INDUSTRIAL PRODUCTION INDEX DECLINED 3.8 FROM THE PREVIOUS MONTH BUT IT REMAINED 0.8 ABOVE THE APRIL 1976 LEVEL. THE SUB-INDEX FOR MANUFACTURES IN APRIL WAS 5.3 BELOW THE MARCH FIGURE AND 0.5 ABOVE THE APRIL

1976 FIGURE. THE APRIL DECLINE IS DUE IN LARGE PART TO THE EASTER HOLIDAYS. THE YEAR TO YEAR INCREASES ARE ENCOURAGING. IT WOULD APPEAR THAT THE BOTTOM HAS BEEN REACHED. PARTIAL DATA FOR MAY INDICATES A CONTINUED RECOVERY, BUT VERY LIMITED GROWTH OF OUTPUT ON A YEAR TO YEAR BASIS.

*GBH
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6. THE APPARENT INCREASE IN INDUSTRIAL OUTPUT IS BEING DONE BY HIGHER UTILIZATION RATES. THERE ARE NO SIGNS OF A REVIVAL OF PRIVATE SECTOR INVESTMENT. THIS IS BECOMING AN ISSUE BETWEEN PUBLIC SECTOR OFFICIALS AND PRIVATE BUSINESSMEN, WITH SOME PUBLIC OFFICIALS CHARGING THAT THE PRIVATE SECTOR IS FAILING TO LIVE UP TO ITS PROMISES WITHIN THE ALLIANCE FOR PRODUCTION. HOWEVER, THESE CRITICISMS HAVE BEEN MUTED. THE PRESIDENT IS REPORTEDLY DEEPLY CONCERNED OVER THE LACK OF PRIVATE SECTOR INVESTMENT AND HAS ASKED U.S. BUSINESSMEN, AND PRESUMABLY MEXICAN BUSINESSMEN, FOR IDEAS AS TO HOW TO REVIVE PRIVATE INVESTMENT. THERE IS AN ACTIVE DIALOGUE BETWEEN THE PUBLIC AND PRIVATE SECTORS ON THIS MATTER IN A SPIRIT OF COOPERATION, THOUGH RESULTS THUSFAR SEEM VERY LIMITED.

7. THERE ARE A VARIETY OF REASONS FOR THE LACK OF A REVIVAL IN PRIVATE SECTOR INVESTMENT. ONE IS THAT PUBLIC SECTOR INVESTMENT IS DOWN, AND PRIVATE SECTOR INVESTMENT HAS TENDED TO FOLLOW AND COMPLEMENT PUBLIC SECTOR INFRASTRUCTURE INVESTMENT. ANOTHER IS UNCERTAINTY OVER GOM ECONOMIC POLICIES. WHILE GOM OFFICIALS TALK ABOUT A NEW INDUSTRIAL POLICY, THE DETAILS ARE VAGUE AND INADEQUATE TO GUIDE SOME INVESTORS WHO FOR THIRTY YEARS HAVE THOUGHT IN TERMS OF SUPPLYING THE DOMESTIC MARKET WITH GOODS PREVIOUSLY IMPORTED (AN IMPORT SUBSTITUTION ORIENTATION). A THIRD IS UNCERTAINTY OVER THE FUTURE EXCHANGE RATE FOR THE PESO THAT MAKES BUSINESSMEN RELUCTANT TO TAKE



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E.O. 12958, Sec. 3.5
State Dept. Guidelines

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By dal, NARA, Date 7/26/07

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INFO OCT-01 ISO-00 AID-05 CIAE-00 COME-00 EB-08 FRB-03
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~~C O N F I D E N T I A L~~ SECTION 02 OF 02 MEXICO 13393

ON DOLLAR DEBT. MOST OF THE INCREASE IN PESO CREDIT APPEARS TO HAVE BEEN USED TO PAY OFF DOLLAR DEBT. THE FOURTH IS A FEAR THAT THE LOPEZ-PORTILLO ADMINISTRATION WILL NOT BE ABLE TO COPE WITH MEXICO'S SOCIAL AND POLITICAL PRESSURES, THEREBY MAKING FOREIGN INVESTMENTS BY MEXICANS DESIRABLE.

8. MONETARY DEVELOPMENTS ARE REASONABLY ENCOURAGING, BUT ANALYSIS IS COMPLICATED BY THE USE OF TWO CURRENCIES AS WELL AS LIMITED STATISTICS. IN THE FIRST FIVE MONTHS OF THE YEAR, THE PESO COMPONENT OF THE MONEY SUPPLY DECLINED 9.4 BILLION PESOS. WHEREAS PESO-DENOMINATED CREDIT FROM THE BANKING SYSTEM INCREASED 11.8 BILLION PESOS, TIME DEPOSITS WERE UP 15 BILLION PESOS. THIS APPARENT SHIFT FROM CURRENCY AND DEMAND DEPOSITS IS SEASONAL, AND NOT OUT OF LINE WITH DEVELOPMENTS IN THE TWO PREVIOUS YEARS. THE YEAR TO YEAR INCREASE IN THE MONEY SUPPLY HAS DECLINED FROM 31 IN JANUARY TO 28.7 IN MAY.

9. THE DOLLAR COMPONENT OF THE MONETARY SYSTEM CONTINUES TO EXPAND. DOLLAR DEMAND DEPOSITS WERE UP \$69 MILLION IN THE FIRST FIVE MONTHS OF THE YEAR. DOLLAR DENOMINATED CREDIT INCREASED \$709.5 MILLION, WHEREAS DOLLAR LIABILITIES (EX-DEMAND ACCOUNTS) WERE UP 1,279 MILLION. OF THE LATTER AMOUNT EXTERNAL LOANS TO THE BANKING SYSTEM ACCOUNTED FOR \$575.4 MILLION. THE RESIDUAL IN THE DOLLAR EQUATION IS \$500.5 MILLION.

THIS PRESUMABLY WOULD SHOW UP IN OTHER ASSETS THAT ARE NOT INCLUDED IN THE DATA PUBLISHED BY THE BANK OF MEXICO. PARTIAL DATA ON BANK LIABILITIES THROUGH JUNE SHOW CONTINUED INCREASES IN BOTH PESO AND DOLLAR LIABILITIES WITH THE LATTER UP 11.9 FROM END-APRIL AND THE FORMER UP 1.6. THIS PARTIAL DATA WOULD INDICATE THAT THE INTEREST RATE REFORM OF LATE MAY DID NOT INDUCE A SHIFT FROM DOLLARS TO PESOS, NOR DOES IT APPEAR TO HAVE BROUGHT ABOUT A SHIFT FROM CURRENCY TO DEPOSITS. THE PRESIDENT REMAINS MOST CONCERNED WITH DOLLARIZATIONS AND IS INTRODUCING ADDITIONAL MEASURES TO COPE WITH THE PROBLEM. FINANCE SUB-GROUP WAS TOLD THAT THERE WAS A SHIFT FROM THE MORE LIQUID TIME DEPOSITS TO THE LONGER MATURITIES.

10. THE CURRENT ACCOUNT DEFICIT FOR THE FIRST QUARTER OF 1977 HAS BEEN REVISED DOWNWARD TO ABOUT \$190 MILLION, BUT NOT YET PUBLISHED AS SUCH. THE SECOND QUARTER CURRENT ACCOUNT DEFICIT IS LIKELY TO BE AROUND \$300 MILLION. "ERRORS AND OMISSIONS" IN THE FIRST QUARTER WERE \$215 MILLION. THIS WOULD INDICATE THAT THERE WERE NET PRIVATE CAPITAL OUTFLOWS IN THIS PERIOD. ACCOUNTING FOR THE PROCEEDS FROM THEIR FUND DRAWING IN JANUARY AND REPAYMENT OF THE \$150 MILLION FED SWAP IN FEBRUARY WOULD REDUCE THIS BY ABOUT \$30 MILLION. ASSUMING A CURRENT DEFICIT OF \$300 MILLION IN THE SECOND QUARTER, NET PUBLIC SECTOR BORROWING OF \$500 MILLION AND A RESERVE INCREASE OF \$15 MILLION, OR \$165 MILLION, TAKING INTO ACCOUNT REPAYMENT OF THE TREASURY SWAP, PRIVATE CAPITAL OUTFLOWS SLOWED IN THE SECOND QUARTER.

11. APPARENTLY THESE CAPITAL OUTFLOWS ARE TAKING THE FORM OF REPAYMENTS OF PRIVATE SECTOR EXTERNAL DEBT. IT APPEARS THAT THE INCREASE IN PESO CREDIT IN THE FIRST FIVE OR SIX MONTHS OF THE YEARS HAS BEEN USED TO REDUCE DOLLAR DEBT. THUS, IT IS POSSIBLE THAT SOME PRIVATE CAPITAL HELD ABROAD HAS BEEN REPATRIATED, BUT NOT IN AN AMOUNT ADEQUATE TO OFFSET THE RUN OFF OF PRIVATE DEBTS TO FOREIGN FINANCIAL INSTITUTIONS. LUCEY



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BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date July 29, 1977

To Board of Governors

Subject: Recent Economic Developments
in Mexico and Performance
under IMF Agreement

From Edwin M. Truman

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Attached for your information is a note by Yves Maroni providing an update on Mexico's economic and financial situation.

Attachment

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Yves Maroni
July 29, 1977

Recent Economic Developments in Mexico
and Performance under IMF Agreement

Preliminary indications are that Mexico remained in compliance with the terms of its IMF Extended Fund Facility agreement as of the end of the second quarter. However, it will be several more weeks before the data with which to make a definitive statistical verification become available. Moreover, uncertainty still exists concerning the prospects for compliance at the end of the year.

The IMF agreement requires Mexico to observe specified quarterly ceilings on (1) the public sector deficit, (2) the net external borrowings of the public sector, (3) the relationship between the growth of the net international reserves of the Bank of Mexico and the increase in the currency issue, and (4) the growth of the net domestic assets of the Bank of Mexico.

The IMF staff confirmed last month that Mexico met comfortably the March 31 targets. Beyond this, the Mexican officials taking part in a meeting of the U.S.-Mexican financial working group last week in Mexico City, gave the U.S. team provisional second quarter results for the public sector deficit and for the net external borrowings of the public sector, and these are within the June 30 limits specified in the Extended Fund Facility agreement.

We also have a report that the currency issue at the end of June was well below its end-of-December 1976 level, while gross

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E.O. 12958 Sec. 1.5 ()

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MR 95-1, # 35 Fed Res. Ltr. 2/13/96

By KBIT, NARA, Date 4/19/96

reserves of the Bank of Mexico were substantially higher than in December. This makes it likely that the June 30 targets relating to net international reserves and to net domestic assets of the Bank of Mexico also were met.

The increase in Mexico's gross international reserves, amounting to nearly \$200 million in the first half of 1977 (and an additional \$150 million in the July 1-28 period), was made possible in part by external borrowings. In the first half, Mexico arranged medium-term Euro-currency credits totalling \$1,045 million and issued Euro-bonds totalling \$290 million. Mexico also floated a \$50 million bond issue in the United States, and its medium-term borrowings from the head offices of U.S. banks increased by about \$40 million. The IMF agreement limits the permitted net increase in the public sector's external debt outstanding to \$3 billion this year (\$2.1 billion in the first half of the year).

The Bank of Mexico made net intervention sales of dollars totalling in the first half of 1977, most of this in May. Small additional net sales continued in July. The Bank allowed the peso to depreciate from 4.98 to 4.40 cents in the first quarter, and further to 4.34 cents in May-June. But there was a slight firming in July, to 4.37 cents on July 28. The forward discount on the peso narrowed significantly in July.

The satisfactory fiscal performance in the first half of



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1977 is largely the result of a slowdown in public investment spending attributable to the change in administration last December and to subsequent administrative reforms. However, there continues to be considerable skepticism, even among some Mexican officials, regarding the fiscal performance in the second half of 1977, as public investment spending is likely to pick up. For the year as a whole, the IMF staff's forecast of the public sector deficit remains distinctly more pessimistic than the official Mexican forecast, and the latter is not firm enough to justify a conviction that the year-end ceiling for the public sector deficit will be observed. During the meeting of the U.S.-Mexican financial working group last week, the Mexican team indicated that the authorities were making strong efforts to stay within the ceiling, but that it was not certain that they would succeed. One obstacle the Mexicans mentioned was the difficulty of raising public sector prices without undermining the wage policy.

The wage guideline adopted by the authorities at the beginning of the year was that wage increases negotiated during the year should not exceed 10 per cent.^{1/} The wage settlements reached during the first half of 1977 conformed to this guideline. But, at the end of June, the head of the Mexican Labor Confederation, Mr. Fidel Velasquez, was reported to have said that a recent meeting of

^{1/} This is not one of the performance criteria specified under the IMF Extended Fund Facility agreement.

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the Confederation's executive board did not specify any maximum for wage increases and gave each affiliated union freedom to negotiate and obtain raises related to the economic capacity of the enterprises concerned. While this appeared to signal the breakdown of the wage guideline, several subsequent wage settlements, including an important one in the steel industry, did not exceed 10 per cent.

On the other hand, we have received reports of a few settlements in the 12-13 per cent range. Many executives of American corporations and banks operating in Mexico are skeptical about the prospect of holding wage increases to 10 per cent for the rest of the year. The Mexican Ambassador to the United States has said recently that the 10 per cent guideline might be exceeded somewhat in coming months.

The test of the Government's determination to hold the line on wages is likely to come in September when public sector salaries are due to be increased. September is also the month when, in the past four years, the Government has granted a special across-the-board increase to all workers, and the possibility of another such increase at that time cannot be ignored. President Lopez Portillo is scheduled to deliver his first state of the nation address to the Mexican Congress on September 1 and he may announce his intentions at that time.

In the first half of this year, consumer and wholesale prices in Mexico rose by about 12 per cent (or about 25 per cent at annual rate). While the month-to-month rates of increase have been

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diminishing, union pressure to disregard the government wage guideline has mounted as the cumulative increase in prices for the year-to-date approached the 10 per cent barrier.

Mexican industrial production remains sluggish. In the first quarter, it was more than 3 per cent lower than in the same period of 1976. In April, it barely exceeded the year-earlier level.^{1/} The Mexican authorities anticipate an overall rate of real GDP growth for the year of not more than 2 per cent. This is less than the rate of increase in population, and implies a decline in real per capita GDP.

The IMF staff estimates that, if all of the targets specified in the Extended Fund Facility agreement are met, Mexico's deficit on goods and services account may be less than \$2 billion this year, in contrast to about \$3 billion last year. In the first quarter, the deficit was less than \$250 million, only about one third as high as the average of the quarterly deficits recorded in 1976. Exports expanded substantially because of the economic pick up in the United States, the restoration of Mexican international competitiveness as a consequence of the exchange rate adjustments undertaken since September 1, 1976, the surge in coffee prices, and the steady growth of Mexican crude oil production. Imports declined significantly, as economic activity in Mexico continued to stagnate and, in particular, industrial production fell and public investment slowed. Preliminary indications are that these conditions continued in the second quarter

^{1/} Data on industrial production in the attached table are not seasonally adjusted.



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when, according to provisional figures, the deficit on goods and services account was about \$350 million. An increase in public spending in the second half is likely to stimulate imports. At the same time, recent declines in coffee prices may hold down the growth of exports. These factors suggest that the deficit on goods and services is likely to be larger in the second half of this year than in the first half. However, the deficit for the year as a whole may well be less than the IMF staff has projected.

At the meeting of the U.S.-Mexican financial working group, the Mexicans made clear that the formulation of their strategy regarding the implementation and financing of the PEMEX oil and gas development plans has not yet been completed. Therefore, it is likely that the financial impact of this program in 1977 will not be very large. Even if implementation starts toward the end of the year, this should not pose an insurmountable problem in adhering to the specific ceilings of the Extended Fund Facility agreement. In particular, the external financing which is likely to be undertaken for this purpose in 1977 is likely to be small enough to be accommodated within the IMF external borrowing limit.

Under the IMF Extended Fund Facility agreement, new performance ceilings for 1978 will have to be negotiated during the fourth quarter of this year. By then, definitive information should be available on Mexico's compliance with the terms of the agreement, not only for June 30, but probably also for September 30.

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C9.a

MEXICO: ECONOMIC INDICATORS

August 11, 1977

	1974	1975	1976	1976 I	1976 II	1976 III	1976 IV	1977 I	1977 II	1976 DEC	1977 JAN	1977 FEB	1977 MAR	1977 APR	1977 MAY	1977 JUNE	Per cent change Latest month over year ago.
REAL GDP, 1970=100	126.4	131.8	134.4	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	2.0	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	139.1	142.8	144.0	145.8	143.8	137.6	139.1	N.A.	131.7	132.9	132.9	151.6	143.9	N.A.	N.A.	
INDUSTRIAL PRODUCTION PER CENT CHANGE (1)	7.3	4.7	2.6	2.3	1.3	-1.4	-4.3	1.1	N.A.	-4.6	0.9	0.0	14.1	-5.1	N.A.	N.A.	0.8
WHOLESALE PRICES PER CENT CHANGE (1)	22.4	10.5	22.3	5.6	3.2	5.6	21.0	10.5	6.7	5.3	2.3	1.7	1.9	2.9	2.2	0.9	50.9
CONSUMER PRICES PER CENT CHANGE (1)	23.8	15.0	15.8	4.4	2.6	3.2	12.5	8.6	4.6	2.5	3.2	2.2	1.7	1.6	0.9	1.2	32.7
MONEY STOCK (M1) (SA) PER CENT CHANGE (1)	20.9	22.3	22.9	3.9	4.7	5.8	13.1	5.2	N.A.	3.2	-0.4	2.0	-0.5	1.0	N.A.	N.A.	29.8
PUBLIC SECTOR DEF. (-) AS PER CENT OF GDP	-7.0	-9.0	-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	-3.8	-4.3	-4.7	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)	3.5	3.5	4.0	0.9	1.0	0.8	1.1	1.2	N.A.	0.4	0.3	0.3	0.4	0.4	N.A.	N.A.	
IMPORTS (\$ BILLION)	6.1	6.6	6.0	1.4	1.7	1.5	1.4	1.1	N.A.	0.6	0.4	0.4	0.4	0.4	N.A.	N.A.	
TRADE BALANCE (2) (\$ BILLION)	-2.6	-3.1	-2.1	-0.5	-0.6	-0.7	-0.3	0.1	N.A.	-0.2	-0.1	0.0	0.0	0.0	N.A.	N.A.	
BALANCE ON GOODS AND SERVICES (\$ BILLION)	-2.6	-3.8	-3.0	-0.7	-0.9	-1.0	-0.5	-0.2	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	QI	QII	JULY	AUG 1-10	JULY 13	JULY 20	JULY 27	AUG. 3
EXCHANGE RATE (CENTS PER PESO, END OF PERIOD)	8.00	8.00	8.00	5.03	4.98	4.40	4.34	4.3688	4.3663	4.35	4.36	4.36	4.3663	4.3663
SDR VALUE OF PESO	.06842	.06924	.06985	.04364	.04297	.03802	.03723	.03734	.03742	.03713	.03707	.03706	.03727	.03742
SHORT TERM INTEREST RATE (E.O.P.)	12.94	13.11	13.11	14.36	14.36	14.36	15.52	15.52	15.52	15.52	15.52	15.52	15.52	15.52
LONG TERM INTEREST RATE (E.O.P.)	13.97	13.80	15.40	16.41	15.56	17.75								
RESERVES (IFS, E.O.P.)	1,533	1,501	1,585	870	1,251	1,442	1,444	1,615						
AVAILABLE IMF CREDIT TRANCHES (E.O.P.)	433	620	615	621	596	481*	481*	481*						
INTERVENTION, PURCHASES (+) OR SALES (-)														
OF DOLLARS						-19.0	-261.9	26.4	33.6	-6.2	59.3	9.6	74.8	-24.5
(OFF OTHER CURRENCIES, EQUIVALENT)														
SWAP ACTIVITY (SWAP LINE -- 360)														
DRAWINGS	360	--	360	--	150	--	--	--	--	--	--	--	--	--
REPAYMENTS	-360				-360	-150								



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

RESTRICTED-CONTROLLED

August 12, 1977

Prepared by Financial Markets Section

MEXICO

External Debt

- Rising rapidly in recent years to a level of about \$25 billion at end 1976; about \$19 billion owed or guaranteed by public sector.
- U.S. banks hold about half this debt.
- Interest payments are now about \$2 billion per annum, about 28% of goods and services exports.

Balance of Payments and Reserves

- Current account deficit increased from about \$800 million in 1972 to over \$4 billion in 1975; \$3.4 billion in 1976.
- International reserves down \$275 billion in 1976 to \$1.3 billion; have since risen about \$350 million.
- Peso devalued 37%, effective September 1 and a further 24% on October 27. Support withdrawn on November 22; peso has since floated.

Domestic Economy

- Industrial production rose 7% in 1974, about 4% in 1975 and less than 3% in 1976.
- Consumer price inflation on order of 20% per annum in 1973 and 1974, 13% in 1975 and 27% in 1976.
- Public sector deficit was 9.3% of GDP in 1975 and 8.2% in 1976.
- Money supply rose more than 20% per annum in 1972-76.

Assessment

- Likely that not all elements of IMF program will be adhered to.
- Fiscal and wage restraint are key elements.
- Debt servicing capacity being strained. Gross borrowing requirements approximate \$750 million per month for 1977.
- State of world (and especially U.S.) economy critical to prospects.
- Problems could result if tourist earnings fail to rebound.



BRAZIL

External Debt

- Rose about 25% in 1976 to about \$28 billion, owed in roughly equal parts by public and private sectors.
- U.S. banks hold about \$12 billion of this total.
- Interest payments in 1976 are estimated at 20% of export receipts.

Balance of Payments and Reserves

- Adjustment needed: 1973 current account deficit of \$2 billion rose to \$7 billion in 1974; remained over \$6 billion in 1976.
- Because of heavy international borrowing, reserves rose from a low of \$3.4 billion in May 1976 to about \$6.4 billion at end of 1976.
- Currency is devalued frequently by small amounts.

Domestic Economy

- Real growth averaged more than 9% for the years 1968-1974; it fell to 4% in 1975, but was more than 8% in 1976.
- Price inflation was 35% in 1974, 30% in 1975 and perhaps 45% in 1976.
- Money supply has risen rapidly in each of past four years.
- Wage restraints in effect since mid-sixties were relaxed in 1975; wages almost doubled since then.

Assessment

- Real growth at unsustainably rapid rate in 1976 and rapid inflation continues.
- Record high level of reserves provides a cushion but current account deficit remains stubbornly high.
- Policy of restraint in 1977 has political backing.



KOREA

External Debt

- External debt rose about 50% in 1975 to level of \$7.5 billion.
- U.S. banks held about 1/3 of this total.
- End-1975 data indicate average maturity of 17 years and only 5% of debt with maturity less than three years.
- Debt service ratio declined from a high of 25% in 1971 to about 11% in 1976.

Balance of Payments and Reserves

- Some adjustment has occurred: current account deficit only \$200 million for first nine months of 1976 after having been near \$2 billion for 1974 and 1975.
- International reserves increased \$1 billion in 1976 to \$2.6 billion in October.
- Exchange rate has been stable since 18% devaluation against the dollar in December 1974.

Domestic Economy

- Real growth under 9% in 1974 and 1975; in excess of 15% in 1976.
- Inflation being curtailed: price inflation at 8% for 1976/75; had been 25% for 1975/74.
- Budget surplus in 1976, after three years of deficit averaging 2.2% of GNP.
- Money supply growth continues rapid (33% annual rate for October 1975/ October 1976).

Assessment

- Fiscal restraint expected to continue.
- High rate of growth of increasingly diversified exports expected.
- Little debt maturing in near term.
- Adjustment (domestic and international) has improved picture substantially.



SPAIN

External Debt

- Total external debt rose about 35% in 1976 to \$12 billion.
- U.S. banks hold about \$2.6 billion of Spain's external debt.
- Total external debt equals about 145% of exports.

Balance of Payments and Reserves

- Current account balance weakened by almost \$4 billion in 1974 to a deficit in excess of \$3 billion; the deficit was about \$3.5 billion in 1975 and 1976.
- International reserves declined almost \$1 billion in 1976 to \$5.3 billion.
- Peseta depreciated by about 13% in 1976 against the dollar.

Domestic Economy

- Real growth about 1% in 1975 and an estimated 2% in 1976.
- Consumer price inflation about 17-18% during past two years.
- Growth of money supply near 20% for past three years.
- Fiscal policy tightened in mid-1976. Budget deficit is 2% of GNP.

Assessment

- Reserves appear adequate to preclude problems with debt repayment over coming months.
- Unlikely that there will be any further economic reforms until after the June elections.
- If these elections do not return a strong government, fundamental reforms may be further delayed. Under such circumstances, external imbalance may be worsened and the possibility of difficulties in servicing external debt will increase.



TAIWAN

External Debt

- External debt rose \$1.5 billion to \$3.3 billion at end-1975.
- Indebtedness to U.S. banks probably rose about 35% in 1976, however, to a level in excess of \$2.3 billion.
- The debt-service ratio was 4.7% of exports in 1974, 6.9% in 1975, and 6.5% in 1976.

Balance of Payments and Reserves

- The current account moved from a \$1.1 billion deficit in 1974 to a surplus in 1976.
- International reserves rose by about 1/3 in 1976 to \$1.6 billion in October.
- The New Taiwan dollar has been stable against the U.S. dollar since 1973.

Domestic Economy

- Real output grew 2.8% in 1975 and almost 12% in 1976.
- Consumer price inflation, 48% in 1974, fell to 6% in 1975 and 3% last year.
- The budget consistently has been in surplus.
- Money supply is growing at about 15%, down from rates of approximately 20% in 1974 and 1975.

Assessment

- Taiwan's real growth and inflation prospects are bright.
- No economic problems seem likely in the foreseeable future.



SOUTH AFRICA

External Debt

- Bank reported debt rose from \$2.7 billion at end 1974 to \$4.8 billion at end 1975 and to \$6.5 billion by the third quarter of 1976.
- U.S. banks hold about 1/3 of this total.
- Most recent borrowings have been short-term.
- Total external debt equals about 130% of exports.

Balance of Payments and Reserves

- 1976 current account deficit of about \$1.7 billion down \$700 million from the 1975 deficit.
- International reserves down about \$200 million in 1976 to \$1.2 billion.
- Rand devalued 20% in September 1975; stable against the dollar since.

Domestic Economy

- Real growth during 1975 and 1976 was near 1% per year.
- Consumer price inflation was on order of 17% per annum during 1975 and 1976.
- Budget deficit as per cent of GNP was 7% in 1975 and 8% in 1976.
- Money supply growth slowed dramatically in second half of 1976.

Assessment

- Current account is likely to improve due to improved world primary commodity prices and demand.
- About 40% of exports are gold and will be sensitive to gold production and price developments.
- Policy has recently become quite restrictive.
- Major (and very substantial) uncertainties that could cause trouble include political factors.



THE PHILIPPINES

External Debt

- Increased from \$1.8 billion at end-1974 to \$3.0 billion at end-1975.
- U.S. banks held about 60% of Philippine external debt at the end of 1975.
- Almost 70% of total external debt has a maturity of more than 5 years.
- Total external debt equals about 30% of 1975 Philippine exports. Debt service in 1976 was 17% of exports.

Balance of Payments and Reserves

- Current account balance weakened from 1973 to 1975 as imports rose and exports weakened; deficit in 1975 of about \$1 billion; no improvement in 1976.
- International reserves increased some \$250 million in 1976 to about \$1.6 billion.
- Exchange rate at 7-1/2 pesos per dollar since July 1975.

Domestic Economy

- Real growth near 6% per annum for the past three years.
- Consumer price inflation on the order of 35% during 1974 but has slowed dramatically to 8% in 1975 and perhaps a bit lower than that in 1976.
- The budget deficit was about 0.8% of GNP in 1975 following surpluses in the prior two years.
- Growth in the money supply had slowed from more than 20% in 1973 and 1974 to less than 15% in 1975, but has accelerated a bit in 1976.

Assessment

- Philippine reserves and foreign borrowing resources seem adequate to finance 1977 current account deficit.
- Policies in line with restraints associated with drawing under IMF Extended Fund Facility.
- Situation stable barring sharp break in sugar prices.



ARGENTINA

External Debt

- \$8 billion at end-1975; perhaps \$8.5-\$9.0 billion at end-1976, owed in roughly equal amounts by public and private sectors.
- U.S. banks hold 20-25% of this total.
- External debt amounts to more than twice annual exports.

Balance of Payments and Reserves

- Current account deficit of \$1.3 billion in 1975 transformed to a surplus of \$550 million in 1976.
- International reserves rose sharply in 1976 to about \$2.2 billion.
- The peso is devalued frequently by small amounts.

Domestic Economy

- Inflation rates were around 500% per annum in the first part of 1976; toward the end of 1976, the annual rate of price inflation had fallen to about 100%.
- Real GDP estimated to have declined 3% in 1976.
- Real wages declined substantially in 1976.
- Central government deficit at 8% of GDP in 1976, down from over 12% in 1975.
- Money supply expansion remained very high in 1976 (344% for the year ending in September).

Assessment

- Government aiming at further reduction of fiscal deficit in 1977, to 3% of GDP, but this target is not likely to be reached.
- 1977 real wage policy to match only productivity increases.
- Labor is becoming increasingly restive.
- A new round of political turmoil in a year or two would be consistent with Argentine history.



INDONESIA

External Debt

- External debt has increased substantially in recent years, reaching almost \$9 billion at the end of 1975.
- U.S. banks hold about \$2.1 billion of this debt.
- The average maturity of the debt has declined substantially.
- Debt service is now about 10% of annual exports.

Balance of Payments and Reserves

- The current account deficit increased rapidly since 1974 to about \$1.8 billion in 1976.
- International reserves, however, roughly tripled in 1976 to a level of \$1.7 billion.
- The dollar exchange rate of the rupiah has been unchanged since 1971.

Domestic Economy

- Real growth was almost 10% in 1976.
- Consumer prices rose 40% in 1974 and about 20% in 1975 and 1976.
- The budget deficit has increased in recent years, reaching 2.9% of GNP in 1975.
- Money supply grew more than 30% in 1975 and 1976.

Assessment

- Large current account deficit likely to continue, despite oil exports.
- Continued large budget deficits and rapid monetary expansion expected.
- Oil exploration has been temporarily suspended.
- Current trends are not encouraging.



PERU

External Debt

- Estimated at \$4.5 billion at end-1976, up from \$3.7 billion a year earlier.
- U.S. banks hold about \$1.8 billion of this total.
- External debt is more than 3 times annual exports.
- Experienced difficulties in borrowing during 1976.

Balance of Payments and Reserves

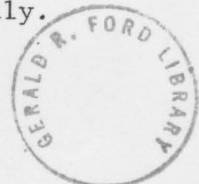
- The current account deficit rose to over \$1.5 billion in 1975. Incomplete data indicate a deficit of about \$1.3 billion in 1976.
- Having reached a low of \$300 million in June 1976, international reserves were confidentially reported just over \$350 million at the end of 1976.
- Sol depreciated 35% in 1976 against the dollar.

Domestic Economy

- Real growth was less than 4% in 1975 and less than 3% in 1976.
- Inflation has risen steadily since 1972, reaching 40% in the year ending September 1976.
- Since the June stabilization measures, the public sector deficit has declined from 9.5% of GDP in the first half of the year, to about 8% of GDP in the second half.
- Bank credit has been tightened and interest-rate ceilings increased.
- A moderate decline in real wages has occurred since June.

Assessment

- The June stabilization measures have a reasonable chance of success under present conditions.
- The labor situation is, however, potentially explosive.
- The external financial situation could also deteriorate quickly.



BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date October 3, 1977

To Chairman Burns

Subject: More Information on Mexico's

From Charles J. Siegman *CJS*

\$1.2 Billion Loan

The attached telegram from Mexico provides information concerning the banks participating in, and the terms of, the \$1.2 billion Euro-credit that the Mexican government recently negotiated. At least six U.S. banks, out of a total of about 34 banks, are participating as underwriters for this loan.

Attachment.

cc: Governor Wallich



uFD
uRG, HT, RHM
uGBH, EMT, EK, RFE
uYM, DD, MT, USITB

LIMITED OFFICIAL USE
Department of State

INCOMING
TELEGRAM
MEXICO
0375

PAGE 01 MEXICO 16193 280010Z
ACTION ARA-14

INFO OCT-01 ISO-00 EUR-12 AID-05 CIAE-00 COME-00 EB-08
FRB-03 INR-07 NSAE-00 USIA-06 TRSE-00 XMB-02
OPIC-03 SP-02 LAB-04 SIL-01 OMB-01 /069 W
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FM AMEMBASSY MEXICO
TO SECSTATE WASHDC 5283
INFO TREASURY WASHDC

LIMITED OFFICIAL USE MEXICO 16193

Please return to
International Information Center

EO 11652: N/A
TAGS: EFIN MX
SUBJECT: GOM EXTERNAL BORROWING
REF: MEXICO 14443

1. SUMMARY: \$1.2 BILLION EUROCREDIT REPORTED REFTEL IS BEING WELL RECEIVED WITH OVER 30 BANKS SIGNED UP AS PART OF UNDERWRITING SYNDICATE. MOST ARE EUROPEAN. END SUMMARY.
2. MEXICO'S LARGEST EURODOLLAR SYNDICATED BORROWING IS REPORTEDLY BEING WELL RECEIVED. ABOUT 34 BANKS HAVE JOINED THE UNDERWRITING GROUP, THEREBY ENABLING THE MINIMUM COMMITMENT TO BE LOWERED FROM \$50 MILLION TO AROUND \$35 MILLION PER BANK. GOM APPARENTLY PREFERS TO KEEP ISSUE AT \$1.2 BILLION RATHER THAN LETTING LOAN BE OVERSUBSCRIBED. SECONDARY DEMAND IS CONSIDERED TO BE RELATIVELY STRONG AND ONE BANK REPRESENTATIVE SAID THEY HOPED TO SELL DOWN TO \$25 MILLION.
3. THERE WILL BE ONLY SIX U. S. BANKS IN THE UNDERWRITING GROUP, BANK OF AMERICA AND FIVE LARGE NEW YORK CITY BANKS. THE BALANCE OF THE GROUP IS COMPOSED OF FOUR CANADIAN BANKS, THREE JAPANESE BANKS, TWO MIDDLE EASTERN BANKS AND NINETEEN EUROPEAN BANKS. LOW NUMBER OF U. S. PARTICIPANTS REPORTEDLY DUE TO CONCERN OVER LEGAL OR IN-HOUSE LENDING LIMITS. WHILE WE DO NOT HAVE COMPARATIVE DATA ON HOLDERS OF MEXICAN DEBT, OUR IMPRESSION IS THAT THIS YEAR A LARGER PORTION HAS BEEN PLACED WITH EUROPEAN BANKS THAN IN EARLIER YEARS. MEXICO HAS BEEN VERY SUCCESSFUL IN ENTERING EUROPEAN BOND MARKET THIS YEAR HAVING FLOATED THREE OR FOUR DM AND SWISS FRANCS BOND ISSUES.
4. FAVORABLE RECEPTION OF \$1.2 BILLION EUROCREDIT ATTRIBUTED TO YIELD, L.75 PERCENT OVER LIBO, AND THE ANTICIPATION OF A DECLINE IN YIELDS ON FUTURE ISSUES, PLUS THE VIEW THAT MEXICO/S MEDIUM-TERM PROSPECTS ARE FAVORABLE DUE TO ITS PETROLEUM. EUROPEAN BANKERS OCCASIONALLY COMMENT THAT THEY FEEL CONFIDENT LENDING TO MEXICO BECAUSE THEY BELIEVE THE USG WOULD NOT PERMIT OR PREVENT A MAJOR DEFAULT. THERE IS TO BE A MANAGERS' MEETING IN NEW YORK OCTOBER 3, TO BE ATTENDED BY FINANCE MINISTER MOCTEZUMA.
5. ABOVE INFORMATION OBTAINED FROM VARIOUS REPRESENTATIVES OF U. S. AND FOREIGN BANKS. SUBSEQUENT TO DRAFTING THIS, WE HEARD THAT THE NUMBER OF U. S. BANK PARTICIPANTS MAY BE GREATER THAN SIX. LUCEY

