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MR LITTLE 157

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MR BARTON n/ENGLAND

FM OTTAWA 052100Z AUG 82

TO IMMEDIATE FCO

MR GIBBS A.U.S.S.

TELEGRAM NUMBER 422 OF 5 SEPTEMBER

AND TO ROUTINE MEXICO

mt

V

FOLLOWING FROM UKDEL TO IMF/IBRD ANNUAL MEETING TORONTO

1. FINCH GAVE ANSON AN ACCOUNT TODAY OF THE REPORT BY THE IMF MISSION WHICH RETURNED FROM MEXICO CITY LATE YESTERDAY. HE HAS GIVEN A SIMILAR ACCOUNT TO THE AMERICANS BUT NOT YET TO OTHERS.

2. FINCH DESCRIBED THE MEXICAN SITUATION AS VERY UNSTABLE. THE MINISTER CLAIMED THAT HE WANTED TO GO AHEAD AND NEGOTIATE AN ECONOMIC PROGRAMME WITH THE IMF AS QUICKLY AS POSSIBLE. THE NEW CENTRAL BANK GOVERNOR APPEARED HOWEVER TO WANT TO PROCEED IN THE OPPOSITE DIRECTION. THERE WERE SIGNS OF FRICTION BETWEEN THE INCOMING AND OUTGOING PRESIDENTS. IT WAS PROBABLE THAT THE IMF WOULD NOT BE ABLE TO CLARIFY THE SITUATION, DESPITE THEIR BEST EFFORTS TILL THE NEW PRESIDENT TOOK OFFICE. THE FUND MIGHT BE DESCRIBING THE SITUATION IN RATHER MORE OPTIMISTIC TERMS, BUT BECAUSE THEY DID NOT WANT TO GIVE THE OUTGOING PRESIDENT AN OPPORTUNITY FOR SAYING THAT THE IMF WERE IMPOSING UNREASONABLE CONDITIONS AND HENCE AN EXCUSE FOR REPUDIATING LOANS. FOR THE SAME REASON THE FUND MISSION WOULD RETURN TO MEXICO AS SOON AS THE MEXICANS ASKED FOR IT. BUT AT PRESENT, CONDITIONS APPEARED TOO DISORDERLY FOR AGREEMENT TO BE ACHIEVABLE.

3. FINCH SAID THAT THE AMERICANS WERE EXTREMELY JITTERY AND HAD PRESSED THE FUND TO SETTLE BY THE END OF THE MONTH IN ORDER TO AVERT A COLLAPSE OF THE SYSTEM. THE AMERICANS WERE PARTICULARLY CONCERNED ABOUT THE EXPOSURE OF MAJOR US BANKS, FOR SOME OF WHOM THE MEXICAN EXPOSURE AMOUNTED TO A LARGE PROPORTION OF THEIR CAPITAL AND RESERVES. THE FUND HOWEVER DID NOT PROPOSE TO MOVE UNTIL THEY COULD GET A SATISFACTORY PROGRAMME. THEY FELT THE AMERICAN PRESSURE SHOULD BE DIRECTED TO THE MEXICANS, SINCE THE PROBLEMS WERE ON THE SIDE. THEY HAD ALSO ASKED THE AMERICANS TO CONSIDER GIVING MEDIUM TERM OFFICIAL ASSISTANCE, SINCE ALL THEY HAD DONE SO FAR WOULD ONLY INCREASE THE LIKELY PROBLEMS IN 1983. THE BIS ATTACHMENT OF MEXICAN OIL WOULD ALSO TEND TO ENCOURAGE BANKS TO WITHDRAW SUPPORT FROM MEXICO: ONE MAJOR US BANK HAD ALREADY BEEN INQUIRING ABOUT THE TERMS OF THE BIS SUPPORT.

4. ON THE ECONOMIC SITUATION, FINCH SAID THAT THE FISCAL DEFICIT THIS YEAR WOULD BE AROUND 15 PER CENT OF GDP -- ABOUT THE SAME FIGURE AS LAST YEAR. THE EXTERNAL FINANCING POSITION WOULD POINT TO REDUCING THIS TO 6 PER CENT, BUT IT MIGHT NOT BE PRACTICABLE IN THE FIRST YEAR TO GET IT LOWER THAN 8 PER CENT. THE MEASURES TO ACHIEVE THIS FIGURE WERE NOT YET IN SIGHT, AND AS THEY MUST INCLUDE ~~A~~ BIG REDUCTION IN SUBSIDIES IT WAS QUESTIONABLE WHETHER THEY COULD BE IMPLEMENTED WITHOUT SERIOUS SOCIAL UNREST. THE PROSPECT WAS THAT SOME OF THE INTEREST DUE TO THE COMMERCIAL BANKS COULD NOT BE PAID AND THAT THEY WOULD HAVE TO NEGOTIATE A SETTLEMENT ON THE LINES OF THAT AGREED WITH POLAND.

5. ON THE POINTS IN YOUR TELNO. 171, FINCH SAID THAT THE MOST IMPORTANT STRUCTURAL ADJUSTMENT WAS TO GET INCENTIVES RIGHT. THIS WENT TOGETHER WITH GETTING THE BUDGET RIGHT, GIVEN THAT SUBSIDIES WOULD NEED TO BE REDUCED DRASTICALLY. REDUCTION OF SUBSIDIES SHOULD ALSO HAVE A BENEFICIAL EFFECT ON THE PARASTATAL SECTOR. THE EXCHANGE RATE HAD ALREADY MOVED A CONSIDERABLE WAY AND GIVEN THE WEAKNESS OF THE CONTROL SYSTEMS THE MEXICANS WOULD PROBABLY HAVE AN OVER-DEPRECIATED RATE FOR SOME TIME. HE DID NOT THINK IT WOULD BE PRACTICABLE TO REMOVE TRADE AND EXCHANGE RESTRICTIONS IN THE EARLY PART OF THE PERIOD, BUT THIS COULD BE PART OF A PROGRAMME OVER 3 YEARS. THE PUBLIC EXPENDITURE CUTS WOULD NEED TO INVOLVE A CUT IN REAL WAGES. HE EMPHASISED AGAIN THAT THE FUND DID NOT WANT TO PUT MONEY INTO MEXICO UNTIL THEY WERE SATISFIED THAT ADEQUATE ADJUSTMENT WOULD BE ACHIEVED.

6. FCO PLEASE GIVE LIMITED DISTRIBUTION TO NO. 10, LITTLER (TREASURY), SALFOUR (BANK) AND EVANS (FCO).