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Treasury Chambers, Parliament Street, SW1P 3AG
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ACM 090/1

PRIME MINISTER

MEXICO

I understand you received some briefing from the Bank on Mexico while you were abroad. But you may like to be brought up to date, particularly on UK participation in the BIS loan to Mexico.

2. The Mexican experience has been the classic one of over-rapid expansion leading to growing inflation and an external collapse. The Portillo administration, relying too heavily on Mexico's oil wealth, sought very fast growth and development. The budget deficit grew rapidly as a proportion of GNP (it has reached 14 per cent), inflation increased and external borrowing accelerated. As has happened with industrial as well as developing countries, the process has ended with depreciation, a flight of capital and inability to borrow further. Mexico now faces retrenchment and financial reconstruction with the help of the international community.

3. Action to deal with the Mexican financial crisis is proceeding by four main routes:-

(i) Direct help from the United States

This has provided Mexico with the most immediate assistance. We know of 4 forms of help totalling nearly \$3½ billion. The Mexican central bank exhausted a swap facility of \$700 million with the Fed more than a week ago. The United States are advancing \$1 billion to Mexico against future deliveries of Mexican oil for the US strategic



stockpile: and a further \$1 billion by way of credit to enable the Mexicans to buy US grain. In addition, the Fed is likely to provide a short term loan of another \$750 million in parallel with the BIS loan from other central banks.

(ii) The IMF application

After some hesitation on political grounds, the Mexicans have announced that they have applied to the IMF for facilities totalling nearly \$4 billion over 3 years. \$800 million is likely to be available quite quickly as a Compensatory Financing Facility related to the loss of export earnings from the fall in the price obtained for Mexican oil and other primary exports. The remainder will be a normal drawing related to Mexico's IMF quota and spread over 3 years. Provided a satisfactory adjustment programme can be speedily negotiated with the IMF, the announcement effect of this application on Mexico's credit standing is likely to be at least as valuable as the money itself.

(iii) Rescheduling of private debts

The Mexicans are asking the private banks to which \$60 billion is owed to defer requirements for capital repayments during the coming months. There will be practical difficulties in obtaining an agreement with the very large number of banks involved, some of them quite small, but it is in the interests of the banks to obtain a rescheduling which secures continued payment of interest, even at the cost of deferment of capital repayments for the present. The total exposure of US banks and their subsidiaries is about \$22 billion, of Japanese banks \$8 billion, of British banks \$6 billion and French banks \$4-5 billion. The figure of \$8 billion is sometimes quoted for UK



banking exposure, but this relates to banks registered in London, including American-owned subsidiaries. The \$6 billion figure relates to banks in British ownership or control, wherever registered.

- (iv) A BIS loan of \$ $\frac{1}{2}$ billion for 3 months renewable up to a maximum of one year. This will be linked with a direct loan by the Fed of the same amount to make a total loan from the central banks of 11 countries of \$1 $\frac{1}{2}$ billion. The Americans do not belong to the BIS.

4. The UK participation in the central bank short term loan operation will be a commitment by the Bank of England to provide \$140 million to the BIS if the BIS were to fail to obtain repayment. In a total short term loan of \$1 $\frac{1}{2}$ billion, of which half is carried by the United States, \$140 million is not an unreasonable UK share, given the extent of our banking exposure. Since the risk is too large for the Bank to carry it on its own resources, as it has done so far on a much smaller scale in the case of Hungary, we are giving the Bank a Treasury guarantee in respect of this commitment. This gives rise to no public expenditure problem unless and until it is called. The BIS will seek assurances of a "take out" from the proceeds of the Mexican application to the IMF, if necessary. There is no specific statutory authority under which the Treasury can extend this guarantee and in accordance with PAC requirements we shall therefore be laying a Minute before Parliament. There is a clear justification for the action we are taking in the urgency of the situation and the international character of the rescue in which we are participating.

5. We think it very possible that Mexico will seek a rescheduling of official as well as private banking debt. This would be likely, as a minimum, to produce deferment of capital



repayments to ECGD during the coming months, with a corresponding addition to the PSBR in the year of deferment. The amount involved could be of the order of £100 million or more. Total ECGD exposure to Mexico is about \$2 billion.

6. A striking feature has been the speed with which this international rescue operation has been set in motion. The American authorities have recognised the urgency of the requirement and the extent to which their own interests were at stake, both in the economic stability of their neighbour and in the exposure of their banking system. The IMF and BIS have also reacted very speedily. The Mexican authorities for their part have tackled the situation with urgency and determination once the actual extremity was upon them. The pace is bound to be slower now. Agreeing an IMF programme will take some time. So will the negotiations with the banks. But at least the international financial community has so far avoided an impression in the markets that the Mexican situation was going out of control. What is now needed as much or more than the plugging of a particular financial gap is a progressive restoration of confidence in Mexican credit.

7. Copies of this minute go to the Foreign and Commonwealth Secretary, the Secretary for Trade, the Governor of the Bank of England, and Sir Robert Armstrong.

A handwritten signature in dark ink, appearing to be 'G.H.' with a stylized flourish.

G.H.

24 August 1982