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Mexican Government, Creditor Bank Committee Reach Tentative Agreement

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After several weeks of laborious negotiations, the Mexican government has tentatively accepted a comprehensive financing package with creditor commercial banks, involving some US$77.75 billion. Reagan administration officials have announced that the agreement is essential for the success of the US program for alleviating the negative consequences of Third World nations' large debt burdens, known as the Baker Plan.

Major elements of the new financing package contained in statements released to the press late September 30 by the Mexican government, and the bank advisory group consisting of Mexico's 13 largest commercial creditors, are summarized below.

Mexico will receive US$6 billion in new loans from commercial banks. Of this amount, US$1 billion will be co-financed with the World Bank, with US$500 million backed by World Bank guarantees. The guarantees are subject to final approval by the World Bank board. The US$6 billion in new monies will be repaid over 12 years with a five-year grace period on debt principal payments.

The interest rate on the new loan will be 0.8125 percentage point over the LIBOR (London Interbank Offered Rate). (2) Repayment of US$43.7 billion in previously restructured debt contracted before 1983 will be stretched out further, i.e., to 20 years. The interest rate on this amount will also be 0.8125 percentage point over the LIBOR.

The banks reportedly also agreed to provide an additional US$1.2 billion in a contingency "investment support facility" to support public and private sector investment.

The banks will provide another US$500 million if Mexico cannot reach its growth rate target of 3% to 4% next year. Half of this amount would be guaranteed by the World Bank, also subject to final approval by the Bank's board.

The International Monetary Fund will also provide some US$600 million to compensate Mexico for any loss of income from further decreases in the price of oil. (6) For US$8.6 billion in new money contracts obtained in 1983 and 1984, maturities will remain the same, i.e., 12-year repayment period, and five-year grace period. However, the interest rate on these loan contracts will also be reduced to 0.8125 percentage point over the LIBOR.

According to Mexican sources, an US$11.2 billion exchange rate risk facility will also be subject to an interest rate of 0.8125 percentage point over the LIBOR. (8) Mexican officials said that a facility providing for US$6 billion in interbank borrowing, or short-term lending, will be maintained. The Mexican government said that the interest rate reductions resulting from the substitution of the

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New York prime rate with the LIBOR, would save Mexico some US$6 billion over the next two decades.

Moreover, government officials highlighted the fact that debt principal payments will not be forthcoming for the lion's share of the foreign debt during the next seven years. In brief, Mexican debt payment obligations will consist almost exclusively of interest payments.

Mexican opposition party members told reporters in Mexico City that government officials and citizens should be mindful of the fact that after interest rate reductions and other changes in debt payment schedules, the country will continue to pay about US$9 billion in interest annually. Thus far in 1986, Mexico has paid between US$600 and US$700 million per month in interest. As a result of the US$6 billion in new loans, overall interest payments will increase.

Moreover, aggregate foreign debt will increase to more than US$115 billion. Mexican media sources on Sept. 30 and Oct. 1 indicated that both sides reached a compromise of sorts. Mexico requested a grace period of 10 years on "old debt," and received seven. Next, Mexican negotiators demanded the elimination of the bankers' "spread" over the interest rate, or a substantial reduction. The spread was reduced from 1.25 to 0.8125 percentage points over the interest rate. Mexican negotiators also requested a grace period on interest payments pertaining to a large portion of the debt. Apparently, the banks were unwilling to concede on this point.

Finally, Mexico demanded that a portion of the debt be converted to shares in Mexican firms holding debt contracts. This arrangement was not included in the tentative agreement. According to the Mexican daily business newspaper EL FINANCIERO (9/30/86), the extension of repayment periods and shifting variable interest rates to the LIBOR are rather insignificant concessions. The newspaper emphasized that Mexico remains committed to enormous interest payments which will limit any real economic development possibilities.

Meanwhile, Reagan administration officials were quick to point out that the Mexican case should not be perceived as a trend setter for debt negotiations between commercial banks and other large debtor nations. Argentina and Brazil are currently engaged in negotiations on sizeable portions of their foreign debts. At present, accumulated foreign debt for these two nations is approximately US $50 billion, and US$105 billion, respectively. At the 1985 joint annual meetings of the World Bank and the IMF, US Treasury Secretary James Baker presented a global debt strategy that included net new financing by multilateral development banks and commercial banks, contingent on the implementation of certain structural reforms by debtor nations.

According to the US government sources, over the past year most major debtor nations have implemented suggested reforms, and the World Bank and IMF have provided new credits. Prior to the Mexican agreement, however, no substantial financing by commercial banks had occurred.

On Oct. 1, in remarks before the joint annual meetings of the IMF and the World Bank in Washington, Baker said the willingness of the banks to provide a major new financing package to Mexico "is an important, concrete example of the banks' willingness to support the strengthened debt strategy." Administration officials attending the joint meetings indicated that duplication of

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the Mexican case is not possible, since each the situation of each country will be reviewed on its own merits. The Mexican situation is considered a very special one due to the precipitous drop in oil prices, producing a 50% decline in oil revenues this year relative to 1985.

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