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Mexico Accumulates Strong International Reserves; Spending Debate Ensues

by LADB Staff

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In August, Mexican international reserves were estimated at $15 to $17 billion, result of unexpectedly high export sales, the return of $3 billion to $5 billion in flight capital and the first installments of nearly $8 billion in new foreign loans. The government has hesitated to spend the sudden influx of cash for several reasons, including fears of fueling inflation. Already at 133% in the last 12 months, inflation could escalate if even a small part of the reserves were pumped into the still weak economy. To introduce the reserves into the domestic economy, they would be converted into pesos, and probably by printing new ones. This would add to the already explosive growth of Mexico's basic money supply, which doubled between July 31, 1986, and July 31 of this year.

Some cabinet officials support the idea of using up to half the reserves to buy back some of Mexico's $105 billion in foreign debt. Mexican debt now sells for about 55 cents on the dollar on a recently created secondary market. By spending $8 billion, Mexico could buy back and cancel nearly $15 billion of its debt, reducing annual interest payments by about 15%. Opposition to this idea is strong. Leftists have criticized the idea because they don't support the idea of paying the debt in the first place.

The National College of Economists (Colegio Nacional de Economistas) has warned that it may be too soon to buy back any debt, because the secondary market value of all Latin American debt has been steadily declining. Colegio president Gustavo Varela explained his reservations in a recent interview with EXCELSIOR. He said "advance debt payments" are not advisable since such activity would effectively revalue the debt. For Varela, it makes more sense for debtor nations to first acquire more bargaining power which could be translated into longer payment terms and lower interest rates.

Next, Varela declared that despite the recent influx of cash, under current conditions the debt remains unpayable. Consequently, he said, Mexican debt paper in secondary markets may yet reach 30% of its face value. The economist then stated that the country had managed to attain financial "success" at the cost of social development. Part of the record reserves, he said, must be dedicated to economic recovery by means of productive investments. These resources should be used by the government to promote housing and infrastructure projects, which combined with private sector investment, leads to rapid growth in new jobs. Varela insisted that if the positive financial results obtained by the government are not converted into improved living standards for the majority, all its effort "makes little sense."

In another segment of the interview, the economist said that government spending of some of the export revenues in the domestic economy would tend to reduce interest rates on savings accounts, thereby having a positive effect on curbing inflation. A portion of these savings, he said, would then be channeled to the stock exchange, but on the condition of generating new investment,
including risk capital support. Varela declared that unless domestic savings are employed in productive investment, they are used in speculative activities, i.e., the purchase of existing stocks and government bonds. He said that recent years have seen very little productive investment. Most monies not going into productive activities ends up on the stock exchange, said Varela, is hardly beneficial to the masses of un- and underemployed. In support of his thesis that the reserves should not be used for pre-payment of the debt, but rather to promote employment growth and higher salaries,

Varela summarized the present state of affairs: "Four million Mexicans that should have entered the labor market last year did not find work; inflation in the first six months of 1987 totaled 67.5%, while the July-July total was 133%; purchasing power of the minimum wage is now 43.9% of its 1982 level; open unemployment now accounts for 15% of a 24 million strong labor force, in addition to large numbers of underemployed workers."

Additional hurdles to overcome in debt buy backs at less than face value are that Mexico would have to obtain permission from its foreign creditors under the terms of a 1982 loan renegotiation agreement. Most money-center banks, such as Citibank, which hold the majority of the Mexican debt, have made it clear they think their loans will eventually return more than 55 cents on the dollar. (Basic data from Knight-Ridder Newspapers, 08/30/87, EXCELSIOR, 08/12/87)

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