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Mexico: Details & Critiques On Debt Reduction Agreement With Commercial Banks

by John Neagle
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On July 26, Notimex reported that according to unidentified members of the bank committee which negotiated debt reduction agreement announced late July 23 (see Chronicle, 07/25/89), commercial banks were likely to select options from the menu of three on a 20-60-20 basis. If the committee's estimate is accurate, the result would be a one-time reduction of debt principal of only $3.8 billion, and an annual interest payment reduction per year of only $1.5 billion. Under the first option, the loan principal is reduced by 35% and interest rates float at a rate equal to the Libor (London interbank offered rate) plus 13/16ths of one percent. The Libor is currently about 9%. The second option consists of reducing the interest rate for a fixed 6.25%, while loan face value is not changed. Unidentified analysts cited by the New York Times said this is the option most banks will select, because in the US it does not require a loss to be taken on the books. For both debt reduction options, a system of guarantees would ensure that the remaining payments on the loans are made. The guarantees will be financed with $7 billion in loans from the International Monetary Fund, the World Bank and Japan, on which Mexico is to pay interest. The loan monies would be used to buy $40 billion worth of 30-year zero coupon bonds. The rest will be used to guarantee interest on a rolling, 18-month basis. [Many Wall Street traders predicted that the guaranteed Mexican bonds would not be worth much more to buyers in the secondary market than the loans that have no guarantees. Unguaranteed Mexican loans are selling in the secondary market for about 44 cents on the dollar.] The third option consists of new loans over four years equal to 25% of a bank's current loan exposure in Mexico. This can be done by recycling interest paid to the bank on old loans. The interest rate on the new loans is also the London interbank rate plus 13/16ths of one percent. An unidentified senior banker who participated in the negotiations told the New York Times (07/27/89) that he thinks it is more likely that 30 to 35% of the banks will choose to make new loans rather than debt principal or interest rate reduction. Jeffrey Sachs, Harvard economics professor and adviser to Latin American governments, says that proportion could be 40% or higher. Peter Rona, chief executive of IBJ Schroder Bank & Trust Company, a Japanese owned bank in New York, said, "It is very much an option designed to accommodate the banks. The last thing these countries need is new debt." The agreement in principle states that banks would be permitted to retrieve some of the debt reduction if Mexico's oil revenues and proceeds hit agreed-upon levels after mid-1996. Mexican officials are not enthusiastic about seeing this provision implemented. Next, a provision in the tentative agreement is for Mexico to obtain $800 million in additional loans $400 million from a group of banks and $400 million from the IMF if the price of oil falls below $10 per barrel. Another provision in the agreement which Mexico has objected to in the past would permit banks to exchange existing loans for equity in state-run companies the government has already slated for privatization, and in some private projects yet to be determined. The specific details of these and other provisions remain to be finalized by Mexico and the 15-member bank advisory committee. This process may require several weeks. Individual banks' decisions on options will depend on several factors, from the size of the bank and its exposure in Mexico to tax and accounting rules that make a choice of debt reduction attractive for some but not for others. It will be months before
the banks' options are known. Shafiquel Islam, senior fellow at the Council of Foreign Relations, argued July 24 that the actual debt reduction would be much less than 35%. Under the breakdown bankers are using, he said, 80% of the $54 billion in existing loans from commercial banks would be subject to debt reduction. This would mean the net reduction would be 27%. In addition, said Islam, Mexico has $50 billion in loans from governments and short-term obligations that are not included, which means the net reduction over all is closer to 13%. "It is much less than Mexico needed," Islam said. MIT economics professor Rudiger Dornbusch said, "The Brady plan was initially 'Christmas for everybody' but that has now shrunk to very, very limited proportions." In the words of Albert Fishlow, economics professor at the University of California-Berkeley, and expert on the Latin American debt: "When you stop hitting your head against a wall, you're still bloodied. We have had five years in which countries have not invested enough, having given priority to increasing exports and paying interest, rather than to income distribution and fighting inflation. It's going to take several years of sustained recovery and growth before we can really pronounce this episode finished." Mexican officials had originally said they wanted a $7.5 billion annual reduction in resources transferred abroad, a total several billion dollars larger than the maximum possible under the tentative agreement. Mexican Sen. Ifigenia Martinez Hernandez is an economist and chief spokesperson on debt issues for the left-nationalist Democratic Revolutionary Party. According to the senator, "This is only a palliative, a chance for the government to catch its breath, and does not fundamentally solve the grave problem of Mexico's foreign debt. So long as the nation has not recovered economically, no more money should be paid." Leaders of the Mexican Labor Confederation (CTM), representing more than 3 million workers, and other labor groups have also criticized the agreement. Among other things, they said bank creditors had been offering their Mexican loans in secondary markets at a discount of 50% and argued that President Carlos Salinas de Gortari should not have settled for less. Samuel Ruiz Mora, head of the National Workers' Council, said that without a greater debt reduction, Mexico will not be able to leave economic crisis behind. According to Jorge Ortega Rivera, an economic adviser to the CTM, "The truth is that a renegotiation of this type is insufficient, because the country continues with its sacrifices to pay interest and sees its growth and development blocked." (Basic data from Notimex, 07/26/89; New York Times, 07/25/89, 07/27/89)