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Since late December, President Ernesto Zedillo's administration has requested more than US $30 billion in loans from multilateral institutions and industrialized countries to shore up the crumbling peso. The total includes a formal loan package of US$18 billion pledged by the US, Canada, European countries, and several commercial banks offered in late December, plus an informal commitment which must yet receive final approval of US$14 billion from the International Monetary Fund (IMF). In addition, in early January, Japan pledged another US$1 billion to assist in the effort to stabilize the peso, while the Inter-American Development Bank (IDB) announced that organization may "soon" be able to provide US$2 billion for this purpose. As of Jan. 11, only the international loan package of US$18 billion was immediately available to the Zedillo administration for use to build up its reserves of foreign currency, which had dropped to US$5.5 billion by mid-December.

The US$18 billion increased Mexico's foreign reserves to about US$24 billion, which the Zedillo administration has started to use to intervene in the market (through purchase of pesos and sales of dollars) to shore up the value of the Mexican currency. In fact, on Jan. 9 the Banco de Mexico (central bank) confirmed that US$500 million from US monetary authorities and 83 million Canadian dollars from the Bank of Canada had already been used to support the peso. The intervention by the Banco de Mexico (central bank) in the market succeeded in shoring up the value of the peso to just under 5.40 per dollar on Jan. 9, from 5.80 per dollar on the previous trading day on Jan. 6. However, the value of the peso resumed its decline on Jan. 10, falling to about 5.70 per dollar by the middle of the trading session that day.

The decision to intervene in the market was accompanied by an increase in domestic interest rates, which the Zedillo administration described as a move to slow the flow of money out of Mexico. This decision to boost interest rates and tighten credit, in turn, led to rounds of heavy selling at the Mexican Stock Exchange (BMV) during Jan. 9 and Jan. 10 trading sessions. In fact, the selling created a near-crisis situation at midday during the Jan. 10 trading session, when the BMV's main index (Indice the Precios de Cotizacion, IPC) declined by more than 10% to 1,882 after several brokerage houses advised clients to sell regardless of the extent of the loss. Cumulative losses in the IPC for the Jan. 9 and Jan. 10 sessions approached 13%. The losses at the BMV have spilled over to the New York Stock Exchange, where the value of Mexican issues has fallen sharply. For example, the value of the Telefonos de Mexico (Telmex) stock had fallen to the equivalent of US$33.37 by the Jan. 10 trading session, compared with US$48.50 on Dec. 19, the day before the devaluation was originally announced. According to some estimates, the value of the peso has declined by almost 40% since Dec. 20, when the administration first announced plans to discontinue support for the peso because of a drain in foreign reserves.

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The government's use of part of the US$18 billion loan package to support the value of the peso was only a small step to address the problems facing Mexico in the short term. In the long run, Mexico will have to take a series of significant steps to address a number of serious structural problems that existed before the devaluation, as well as new problems that surfaced as a result of the steps taken to address the economic crisis. One of the most significant problems President Zedillo will have to begin to address is a huge growth in Mexico's foreign debt, which is due to reach an estimated US$164 billion. This total which does not yet include the possible loan of US$14 billion from the IMF represents both the largest debt in Mexican history and the highest debt in Latin America. According to some estimates, the total debt of which the public sector is expected to incur US$108 billion also represents about 50% of Mexico's GDP for 1995. In addition to payments of principal and interest on the international loans, the government has also been forced to raise interest for short-term securities even beyond their previously high rates in order to keep these instruments attractive for private investors, especially foreigners.

On Jan. 4, the government in its weekly Wednesday auction was offering 28-day Treasury Certificates (Cetes) at rates of 33%, compared with a rate of 16% the previous Wednesday. The high interest rates offered on Cetes are in part an incentive to US investors, who lost an estimated US$10 billion in December because of the devaluation. According to US brokerage houses, US investors have totally lost confidence in the Mexican government, angered because they were not told by then-Finance Secretary Jaime Serra Puche about a pending devaluation. The mishandling of the devaluation caused Serra Puche his job (see other article in this issue of SourceMex for more details). In addition to the lack of confidence in the Mexican government, potential investors remain wary about the continuing political instability in Mexico, which is compounded by the lack of resolution to the conflict in Chiapas with the Zapatista National Liberation Army (Ejercito Zapatista de Liberacion Nacional, EZLN) and the lack of resolution to the political assassinations of former presidential candidate Luis Donaldo Colosio and former governing party official Jose Francisco Ruiz Massieu. Many financial analysts expect that investor decisions on whether to roll over or withdraw maturing government bonds in the next several weeks will provide an important reflection on the prevailing attitude of the foreign business community toward Mexico. A total of US$685 million was due to mature during the week of Jan. 9-13, another US$942 million during the week of Jan. 16-20, and finally US$1.3 billion in the last full week of January.

In an effort to convince investors to keep their money in Mexico, President Zedillo's administration has proposed the creation of a series of longer-term, higher-yielding bonds. However, as of Jan. 9, the new bonds had not appeared on the market. In addition to the possible issue of longer-term bonds, the administration has taken great pains to reassure potential investors that the current economic crisis is temporary. "Halfway through 1995, it should be clear to all that the transitory uncertainty of last December in Mexico's financial markets was just that: transitory," said Finance Secretary Guillermo Ortiz Martinez in a meeting with 250 US and international bankers, brokers, and other financial representatives in New York on Jan. 5. Martinez also took time to explain the steps taken by the Zedillo administration to deal with the economic crisis, including a reduction in government expenditures, an effort to increase revenues by expediting planned privatizations, and an agreement with labor and business to limit increases in wages and consumer prices in order to contain inflation (see SourceMex, 01/05/95).
For his part, Foreign Minister Jose Angel Gurria Trevino brought the same message to Japanese investors during a trip to Tokyo on Jan. 9. "In the next few weeks I expect the pendulum to have swung back to the middle," Gurria told government officials, bankers, and business executives in Tokyo. He forecast that the peso would settle around 4.50 to the dollar by the middle of the year. Like Ortiz, Gurria also explained the measures taken by the administration to address Mexico's economic crisis. In response, Japanese bankers and representatives of the business community expressed cautious support for the steps taken by the government. "The new program has good substance," said Governor Hiroshi Yasuda of The Export-Import Bank of Japan. "But we want to watch how the new measures take effect for a while. Notwithstanding the attractive interest rates and the government's promises of a stable economy, US and other foreign investors are considering other factors in deciding whether to keep their money in Mexico. For example, on Jan. 6, the respected New York-based Moody's Investors Service lowered its ratings on some bonds and other Mexican securities, although the rating for longer-term debt instruments was left unchanged. Such investment rating changes could have a significant impact on investor decisions. Meantime, the high rates paid on Cetes and Treasury bonds (Tesobonos) have had the effect of further raising the already-high cost of obtaining loans for businesses and individuals in Mexico, which in turn is expected to place severe restrictions on business expansion.

On Jan. 4, the Mexican Banks Association (Asociacion de Banqueros de Mexico, ABM) issued a statement warning that because of high interest rates and economic adjustments made by Zedillo to address the crisis, the banking sector expected an increase in postponements or outright defaults on loans. ABM president Jose Madariaga Lomelin criticized Zedillo for adopting a policy of secrecy in not informing bankers about the pending devaluation in December. He said the move came as a "surprise" to bankers and investors. On the other hand, Madariaga directed the brunt of his criticism against former president Carlos Salinas de Gortari's administration for using "soft investments" to finance Mexico's trade and current account deficits, which reached US$28 billion during 1994. Indeed, commercial banks have cause for concern about an expected increase in non-payment of loans. For example, on Jan. 4, the agriculture movement El Barzon, which represents about 200,000 agricultural producers throughout Mexico, announced a "total suspension" of debt payments to commercial and government development banks, citing the hardships created by the Zedillo administration's emergency economic plan. El Barzon representatives did not say how long the suspension of payments would be in effect, but asked for a renegotiation of debt. Other agriculture groups, such as the Sonora state Regional Cattle Producers Union (Union Ganadera Regional de Sonora), have also warned that an increase in interest rates would create difficulties for most agricultural producers to pay back loans. Beyond an inability to pay loans on time or even pay them at all Mexicans in general will be facing other hardships resulting directly or indirectly from the devaluation. For example, the agreement by labor to limit wage increases to 7% will be insufficient to match the rate of inflation, which had been adjusted to 16% after the devaluation.

In the past, anti-inflation agreements between the government, business, and labor, generally held because raises and increases in consumer prices were generally tied to the rate of inflation. However, with inflation twice as high as the ceiling on salary increases, many labor unions are not expected to hold to the agreement reached with the Zedillo administration and will likely seek raises beyond 7%. This, in turn, is expected to create conditions for inflation to increase much beyond the forecast 16%. An additional problem is that business organizations may not be able to stick to their pledge to keep prices down, since many products manufactured in Mexico rely on imported parts,
which are now more expensive due to the devaluation. Already the state-run oil company PEMEX on Jan. 4 announced a schedule of monthly increases in the price of gasoline, heating oil, and other products in order to compensate for the effects of the devaluation.

In addition to adjusting inflation higher, the Zedillo administration has lowered expectations for GDP growth, which is now projected at 1.5%, compared with previous forecasts of close to 4%. Some analysts suggest that Mexico may face difficulties even reaching the 1.5% GDP growth rate. In fact, according to El Financiero daily business newspaper, several manufacturing sectors that in recent years had faced severe economic difficulties are expected to suffer even more. These sectors include textiles; shoes and leather; printing and editorial products; wood and lumber; basic metals; and petroleum derivatives such as plastics and artificial rubber. On the other hand, the newspaper said the devaluation and the government's economic adjustment programs are expected to have less impact on manufacturers of soft drinks, tobacco, and certain processed metals.

Other steps announced by the Zedillo administration to deal with the crisis include the implementation of strict austerity measures for government officials, plus plans to expedite privatization of petrochemical plants, port administrations, and support services for the state-run railroad Ferrocarriles Nacionales (Ferronales). Many economic analysts suggested, however, that most government properties with a potential to produce high revenues were already privatized by former president Salinas, so the impact of the latest privatizations on the budget is expected to be minimal. There was some concern that the Zedillo administration would include the Federal Electricity Commission (Comision Federal de Electricidad, CFE) and PEMEX among the government properties offered to the private sector. However, in a statement on Jan. 9, the Energy Secretariat (Secretaria de Energia, SE) said these agencies would remain fully in the hands of the government. In fact, the only PEMEX properties that are due to be sold to the private sector are petrochemical plants, which former president Salinas had already planned to privatize. The privatization of these properties was suspended because low global prices for petrochemical products had reduced the value of these plants. (Sources: El Financiero International, 01/02/95; Toronto Globe & Mail, 01/03/95; El Financiero, 01/04/95; Deutsche Press Agentur, El Universal, 01/05/95; Agence France-Presse, 01/04- 06/95; Reuter, 01/09/95; La Jornada, 12/27/95, 12/30/95, 01/05/95, 01/09/95, 01/10/95; Notimex, 01/03-05/95, 01/10/95; Associated Press, 01/04/95, 01/05/95, 01/09-11/95; New York Times, 01/09-11/95)