10-11-1995

Mexico Announces Early Repayment on Part of Loan to U.S.

LADB Staff

LADB Article Id: 55910
ISSN: 1054-8890

Mexico Announces Early Repayment on Part of Loan to U.S.

by LADB Staff
Category/Department: Mexico
Published: 1995-10-11

On Oct. 5, Finance Secretary Guillermo Ortiz announced that Mexico had repaid US$700 million of a US$2 billion debt to the US that was due to expire at the end of October. The US$2 billion is part of the US$20 billion in loan guarantees provided by US President Bill Clinton's administration to Mexico this year to help the Mexican government weather the economic crisis that resulted from the peso devaluation in late 1994. Of the US$20 billion, Mexico has only used US$12.5 billion. In recent weeks, Ortiz and other officials have said that Mexico does not anticipate a need to use the remaining US$7.5 billion. The US$20 billion, which the Clinton administration provided via a special US Treasury fund, is part of a multilateral package of US$50 billion in credit guarantees. Others contributing to the loans are the International Monetary Fund (IMF) and the European-based Bank of International Settlements (BIS).

The Mexican government's decision to repay the US$700 million in loans to the US three weeks ahead of schedule was widely seen as a symbolic gesture designed to calm the financial markets, which had been battered by a loss of confidence in the Mexican economy. Indeed, both the Mexican peso and the Mexican Stock Exchange (BMV) reported heavy losses during the second week of September, but recovered strongly after the repayment was announced. The losses in late September had been attributed to a lack of concrete signs that Mexico's economy would recover to any significant extent in the near future (see SourceMex, 10/04/95). During the first half of 1995, Mexico suffered a GDP decline of 5.8% and an accumulated inflation rate of 35%.

Earlier this year, the Zedillo administration had forecast a GDP decline of 2% for 1995, but a more recent unofficial forecast projected a drop in GDP of about 5%. Inflation is widely expected to approach 50%, compared with the administration's earlier forecasts of a 42% rate. "The early repayment is symbolic," said economic analyst Sergio Sarmiento, who writes a column in the daily newspaper Reforma. "When you consider that the whole package is for US$50 billion you are talking about a very small amount." On the other hand, Sarmiento noted that confidence- building was a game of perceptions, and that the move represented a strong effort by the Zedillo administration to restore good will among investors. In fact, despite having paid the US$700 million, Mexico was still faced with having to renegotiate a rollover or extension of the repayment period for another US$1.3 billion still owed to the US.

In its Oct. 9-15 issue, El Financiero International weekly business newspaper suggested that Mexico's foreign reserves totalling US$16 billion were large enough for the total US$2 billion payment to be made by the end of October. "Not wishing to risk a depletion of its foreign reserves so as to protect against a future run on the peso, Mexican authorities pay a little less than one third and ask that the remainder be rolled over," said the newspaper. According to other financial and economic analysts, however, the Mexican government's repayment of the loan ahead of schedule also had some political implications. For example, Finance Secretary Ortiz's announcement of the early repayment came less than a week before President Zedillo's meeting with President Clinton

LADB Article Id: 55910
ISSN: 1054-8890

in Washington on Oct. 10. Analysts said the repayment not only demonstrates to US opponents of assistance to Mexico that the country has overcome the risk of becoming insolvent, but it also fosters a climate of goodwill between President Clinton and President Zedillo during the latter's visit to the US. Indeed, during the visit, Clinton and Zedillo used their meeting to publicly highlight areas where Mexico and the US have cooperated over the past two years, including the North American Free Trade Agreement (NAFTA).

There was some concern initially that the repayment of money to the US did not actually represent a reduction in Mexico's overall debt. To raise the funds to repay the US, Mexico incurred new debt on another front by issuing bonds in Germany totaling about 1 billion German marks (about US $700 million). The five-year bonds were issued at an interest rate of 9.375%. "What we're doing is substituting long-term debt for short-term debt," Ortiz told reporters. According to Ortiz, Mexico had actually offered bonds totaling 750,000 marks (US$525 million), but increased the amount offered because of strong demand among German investors. In fact, the strong demand for the Mexican bonds in Germany led Ortiz to issue a positive assessment about the Mexican economy. "Without a doubt, this offering constitutes a demonstration of the interest and confidence of international investors in the Mexican economy over the medium and long term," Ortiz said.

Ortiz claims that a total of US$41.4 billion in debt is scheduled to be paid back in 1995, including US$29 billion in short-term dollar-linked bonds called Tesobonos. According to some estimates, Mexico's short-term debt at the end of the year is expected to decline to US$87.4 billion, compared with US$106.1 billion in December 1994. The early repayment of the loan to the US, however, failed to appease critics in both the US and Mexico. In the US, opponents again took the opportunity to criticize the Clinton administration for using taxpayer money to guarantee the loan. "The Clinton administration never should have sent US$12.5 billion to Mexico without congressional approval," said Sen. Alfonse D'Amato (R-NY), in response to Ortiz's announcement of the early repayment. "I think American taxpayers have a right to expect the entire US$12.5 billion to be repaid right away."

Clinton administration officials have countered that, in addition to helping the Mexican economy regain stability, the economic assistance package provided by the administration has brought in US$470 million in interest payments by Mexico to the US Treasury. In Mexico, business leaders cautiously expressed their support for the Zedillo administration's early repayment of the US loan, but also took the opportunity to renew their call for the government to take decisive steps to reactivate the economy and provide more reassurance to financial markets. "We cannot fall again into the error that our economy is back in good shape, because it's not true," said Hector Larios Santillan, president of the business coordinating council (Consejo Coordinador Empresarial, CCE).

In the Chamber of Deputies, members of the two main opposition parties, the National Action Party (PAN) and the Democratic Revolution Party (PRD), also criticized the administration for taking an overly optimistic view on Mexico's economy. For example, PRD Deputy Ifigenia Martinez, who is also an economist, said the Zedillo administration, rather than engage in symbolic gestures, should heed the calls from political parties, business organizations, and civic and professional organizations to make profound changes in its economic policies. She said the administration's early repayment was merely an effort by President Zedillo to improve his standing before his visit to Washington on Oct. 10. "Zedillo was attempting to appease US public opinion to create a climate of good will

LADB Article Id: 55910
ISSN: 1054-8890

before his visit," said Martinez. (Sources: Associated Press, 10/05/95, 10/06/95; Excelsior, 10/06/95, La Jornada, 10/06/95; Reforma, 10/06/95; El Financiero International, 10/09/95; Agence France-Presse, 10/05/95, 10/10/95; New York Times, 10/06/95, 10/11/95)

-- End --