

Mexico's current financial situation: new dangers and potential solutions

by David Goldman, Economics Editor

How severe the consequences of the present devaluation will be for Mexican private companies with large dollar-denominated debts is still not fully recognized; their prospects for the next six months are frankly grim. This principal weakness of the Mexican credit structure, the result of two years of "dollarization," rules out any possibility of economic stabilization in the short run, or even medium-term stabilization of a freely floating Mexican peso, unless certain rigorous measures are taken.

The issue now is not whether a private-sector shake-out will occur, or whether, indeed, Mexico will impose exchange controls during the course of the present year, but on whose terms they will occur. On any count the devaluation is a terrible blow to the economy: the extraordinary size of the devaluation (when so-called "purchasing parity" of the Mexican peso would argue for at most a 10-15 percent devaluation) was dictated by overt financial blackmail from the country's creditors' consortium. As the *Neue Zürcher Zeitung* announced Feb. 11, the view in banking circles vis-à-vis Mexico had shifted drastically, and the Mexican request for more than \$12 billion in new loans during 1982 had been turned down. Rather, the banks told Mexico to cut its currency to the point that Mexican assets were undervalued relative to international prices, to attract a flow of investment and tourism.

That foreign investors, particularly the Geneva, Zurich, and Paris private bankers, are eyeing Mexico with the delicacy of vultures was made public by the spectacular rise of the Mexican stock-market index on Feb. 19—by the precise amount of the previous day's 28 percent devaluation. (It nonetheless crashed on Feb. 25.) The perspective among European investors, who have always had a special channel into the Mexican market through the Franco-Swiss-owned Banamex commercial bank, is that the devaluation will roll the private sector up like a carpet, leaving them free to choose which of the shattered remnants of the Mexican economy they might wish to buy.

On the face of things, Banamex, whose origins in Mexico go back to the Hapsburg occupation of the

1860s, seems well-positioned to marshal exactly this sort of operation, to "dictate the value of the peso," as one of its Mexico City officers said. The private sector owes \$21 billion of Mexico's total foreign debt of about \$70 billion, most of it to American banks, the principal dollar lenders to the private sector. The annual interest charge on such debt is about \$3.7 billion, or roughly the same as the 1981 total non-oil exports of the entire country, which are a good approximation of the dollar earnings of the private sector. In other words, the private sector's interest cost alone is in excess of its dollar earnings, i.e., it is insolvent in dollar terms.

Last fall's near-bankruptcy of the giant Alfa group in Monterrey, requiring a \$600 million expenditure (secured by Alfa equity) on the part of the Mexican government, had been the first rock in an avalanche except for quick Mexican government action; but the government's lack of access to foreign financial resources makes it difficult to repeat. The *Wall Street Journal* Feb. 22 suggested that 36 private companies would probably not survive, but the list could be much larger.

This danger has been evident for some time. On June 30, 1981, I wrote, "If the country's economic planners fail to carry out the directive of President José López Portillo—to deal with inflation by enhancing output—there will be trouble not much later than the beginning of 1982," and "Under a worst-case scenario, Mexican inflation could double by the end of 1982." With the devaluation, inflation will certainly rise from the present 30 percent level to 50 percent or higher.

In memoranda to Mexican private clients, *EIR* had urged the adoption of foreign-exchange controls backed by a Gaullist policy of nationalization of private-sector financial institutions who failed to cooperate. Now every sophisticated observer concedes that a variant of this approach is inevitable. Since the private sector may only obtain foreign exchange by exporting, or by exchanging pesos for dollars, and since they now exchange at a 30 percent disadvantage, another wave of peso-selling against the dollar is built into the present, regrettable devaluation. At this point, as both the *Frankfurter*

Allgemeine Zeitung and the *Neue Zürcher Zeitung* made their readers aware Feb. 19, no Mexican government will have any choice but controls. Some prominent Mexican private-sector institutions expect this to coincide with a European movement toward exchange controls, fitting into an unsettled global context.

Should the Mexican government wait for a second major crisis before taking such action after the fact, Mexico will revert to a status it shook off a century ago, with the fiduciary descendants of the Hapsburgs whom Benito Juárez ejected firmly in command. Since this element has never been eliminated from powerful positions inside Mexico, as President López Portillo warned elliptically in a Feb. 19 speech, the blackmail of the foreign creditors was supplemented by what López Portillo called "forces from inside as well as outside." This helps to explain why a full 90 percent of all new deposits in the Mexican banking system during January came in as dollars.

However, although great damage has been done, the situation may yet be recouped through bold, de Gaulle-like action. The attrition of the private sector, which grew as a ramshackle import-substitution producer of second-rate consumer goods, need not be a bad thing. One way or another the Mexican government will be left with a great deal of equity on its hands; if it uses this power to transform the private sector toward a technology-based capital-goods producer, Mexico may actually gain from the private sector's misery. In this regard Mexico's developing relations with Japan, which has the world's best record in aiding developing nations to build profitable and efficient heavy industry, may be the crucial factor.

As I argued in the cited June 30 commentary, the basic solution to Mexico's credit problem is so accessible as to make its avoidance a subject of great frustration. To much too great an extent, investment among leading Mexican private sector concerns has been oriented towards credit-based acquisitions of existing industrial capacity, rather than construction of new.

While the steel, petrochemical, and oil-producing sectors have, with substantial government subsidies, shown rates of growth of over 30 percent per year since 1978, the balance of the economy, especially agricultural production and food processing, has lagged well under the average 8 percent growth rate—leading to a shortage of basic items. Reorganization of the private sector under crisis conditions is not the best course, but one that could well ultimately solve these problems.

In this context a combination of exchange controls and import restrictions on luxury goods could easily save more than the private sector's present \$3.7 billion annual interest bill, which is to say that the Mexican government, with the right policies, could eliminate the present financial crisis almost overnight.

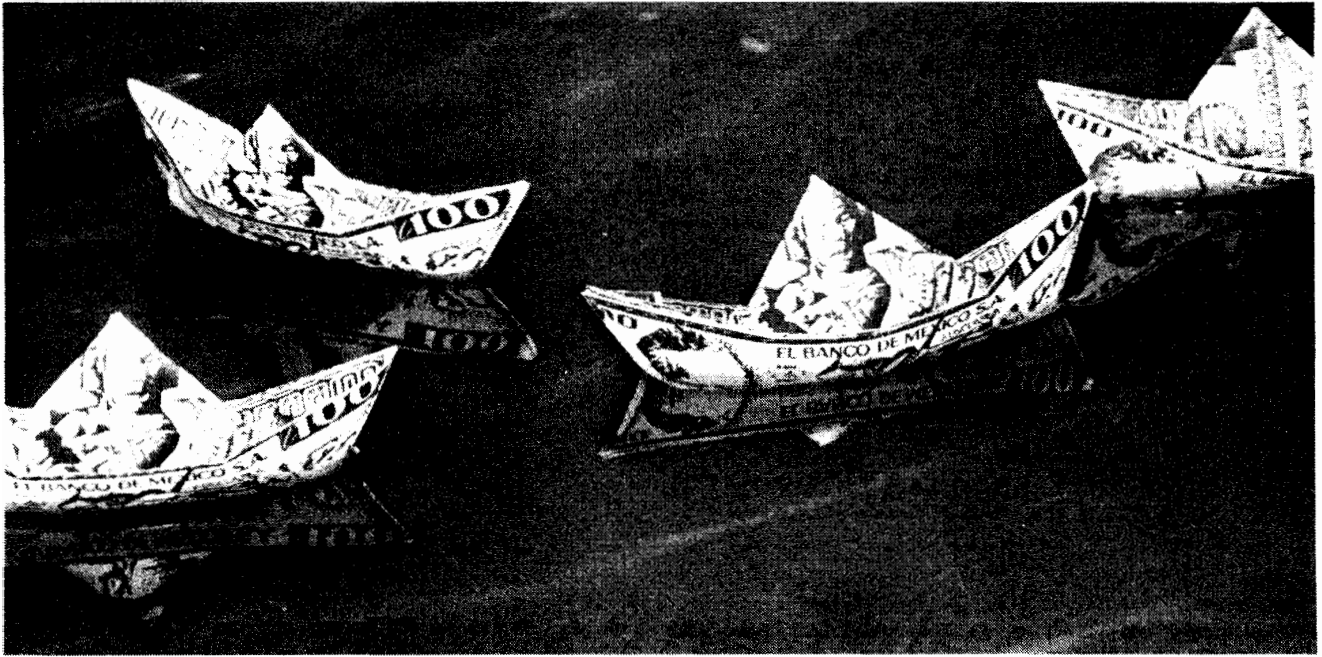
President López Portillo addresses army on peso

President José López Portillo made the following comments on the Mexican peso devaluation at a breakfast in honor of the Mexican Armed Forces Feb. 19, 1982. The presidential press office called attention to them as his only public statement on the topic.

In a country such as ours, it is vital that we make up our minds once and for all and prove to ourselves that we are capable of providing work to all Mexicans. And this has been, is, and will be the primary effort of our administration. Thus, of course, the distance between inflation in the U.S. and ours has grown, the Mexican rate surpassing the North American; it necessarily affects our currency. I declare to you that, under my total and exclusive responsibility, we made every effort to reduce that distance. We raised tariffs and revived licenses. To promote exports we stimulated them with subsidies and fostered them to a maximum through credit facilities. Everything we could do, we did. But because of the characteristics of our country, because of the fundamental freedoms under which we live and because of our geographic situation, we could not and should not control exchange rates. . . .

From Guadalajara I issued an appeal to our sense of patriotism and national responsibility. The policy of protection that we had formulated, was not understood; it did not have time to function fully for many reasons, some legitimate . . . some due to personal ambitions, and others which perhaps suffered from persecution delusions. This week the Bank of Mexico suffered real assaults against its reserves.

And, gentlemen, when I warned that our reserves ran the risk of running out in just a few days, I made the painful decision in the solitude of my office at Los Pinos to take the Bank of Mexico off the monetary market so that we would not again undergo what happened in 1976, a year in which we were forced to take a similar measure but without reserves in the bank; when we were forced, in order to survive in the international financial community, to resort to agreements with the International Monetary Fund and its intervention in our economic decision-making.



Carlos de Hoyos/NSIPS

Mexico's Economic Adjustment Program

On Friday, Feb. 19, a day and a half after the peso was cut loose from support by the Bank of Mexico, Finance Minister David Ibarra and Planning and Budget Minister Ramón Aguirre called a press conference to announce an eight-point "Action Program" of adjustments in all areas of Mexican economic policy.

Ibarra termed the packet "drastic, painful measures," a "program of the strictest financial and budgetary austerity." The official growth target for 1982 was reset at 4.5 to 5.0 percent, down from the 7.0 percent announced by the government in November 1981. Job-creation goals were similarly scaled down from 5 percent to 3-4 percent.

The eight points are:

1) **Exchange rate:** The peso will be allowed to find its "objective" level. Free exchange of the peso is inviolable. "Let us not echo rumors of exchange controls or freezing of dollar accounts."

2) **Federal budget:** A three percent cut in previously mandated 1982 levels, a reduction of roughly \$3 billion. According to some glosses, Ibarra stated the funds thus freed up will go into debt service.

3) **Financial policy:** a) "competitively" high interest rates will remain in effect; b) those companies,

both public and private, which contracted dollar debt in "good faith" and now face repayment problems, "will get help" from the government, including provisions for tax write-offs on 1982 returns; c) a seventh "petrobond" issue will go on sale March 1; d) a new form of bond will be issued, with a 6 percent guaranteed return over the consumer price index.

4) **Wages:** No emergency wage compensation, but adjustments "as soon as possible" as the effects of the devaluation are felt.

5) **Foreign trade:** Further tightening of restrictions on luxury-goods imports. Easing of some import curbs on items deemed basic for consumption. For exporters: a "flexible system of slippage" of the peso to keep exports competitive, plus "guarantees against any differential which may arise between external and internal inflation." (It is not clear if this implies maintaining the kind of export subsidy system under attack in U.S. countervailing duties cases.)

6) **Prices:** Some extension of price controls on basic items. No major new programs.

7) **International financial policy:** Continued full participation in international financial institutions; Mexico will meet all obligations to international creditors, public and private.

8) **Border action:** A program to move more Mexican-produced consumer goods into the northern border region which, because of inadequate Mexican production and transport, has become dependent on U.S. supply.