Mexico's foreign debt bubble: growing, growing . . . gone

by Carlos Cota Meza and Dennis Small

When the international financial community and the government of the United States decided to try to salvage the speculative bubble which had exploded in Mexico in December 1994, it became evident that the political will did not exist, globally, to fundamentally change the financial system which was falling apart at the seams. By the same token, it became clear what the immediate fate of the Mexican economy would continue to be.

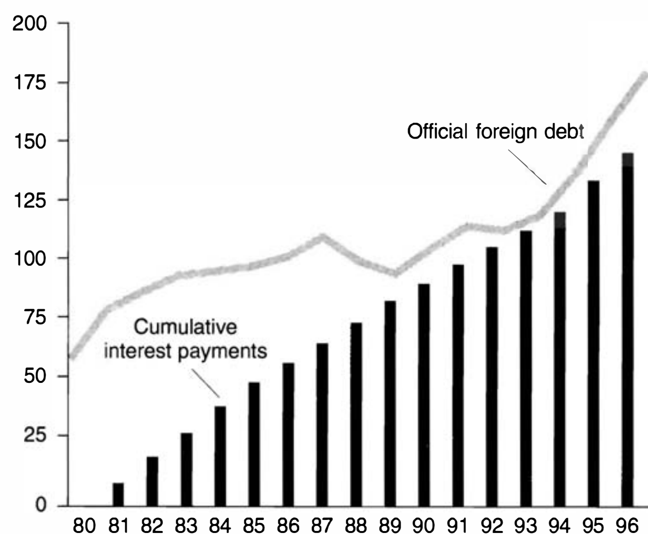
Under the government of Carlos Salinas de Gortari (1988-94), a gang of hoodlums, headed by U.S. President George Bush and run by the international banks, imposed the so-called Brady Plan to restructure the foreign debt, and the infamous North American Free Trade Agreement (NAFTA). The underlying idea of these plans was to try to breathe a few more years of life into the moribund world financial system, which had come close to collapse with the 1982 debt crisis. In exchange for cosmetic "debt relief," countries such as Mexico were forced to further contract their physical economies, and to tightly link their financial and banking systems to Wall Street. In this way, the idea was to impose on the increasingly bankrupt Mexican economy a new load of leveraged, short-term, dollar-linked debt.

In **Figure 1,** this process can be observed. After a brief hiatus in the late 1980s, from 1990 onwards the official foreign debt grew, to $180 billion in 1996, as compared to $57 billion in 1980. Over this 15-year period, Mexico has paid a staggering $150 billion in cumulative interest, almost three times the amount of the original debt in 1980. This is what has become known as "bankers' arithmetic": 57−150=180.

Another debt bomb in the making

It is highly revealing to look at this process in some detail over the last four years, as we do in **Table 1.** This table shows a calculation of what we define as Mexico's "real foreign debt," which is made up of the official foreign debt, but also includes a category of "de facto foreign debt"—such as foreign holdings in the stock market, and foreign-held internal government bonds. *EIR* first identified these new speculative

FIGURE 1
Foreign debt and interest payments
(billions of $)



Sources: World Bank, SHCP.

TABLE 1
Real foreign debt
(billions of $)

	1993	1994	1995	1996
1) Public foreign debt	84	89	118	112
2) Private foreign debt	35	47	41	68
—owed by banks	20	25	21	?
—owed by companies	15	22	20	?
Official foreign debt (1+2)	**119**	**136**	**159**	**180**
3) 'Internationalized' internal debt*	26	32	5	3
—foreign-held Cetes, etc.	25	4	3	3
—Tesobonos	1	28	1	0
4) Foreign holdings in the stock market	55	44*	25	31
De facto foreign debt (3+4)	**81**	**76**	**29**	**34**
Total (1+2+3+4)	**200**	**212**	**188**	**214**

*as of Dec. 15, 1995

Sources: World Bank, United Nations Economic Commission for Latin America and the Caribbean (ECLAC); Bank of Mexico (BdM); Ministry of Finance (SHCP); Ministry of Commerce and Industrial Development (Secofi).

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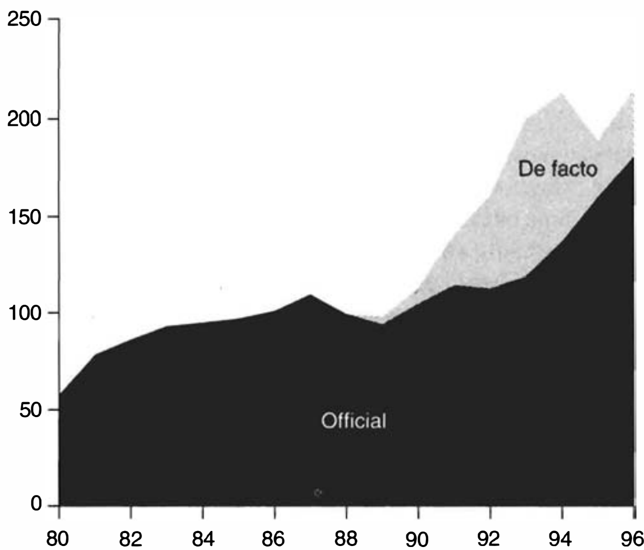
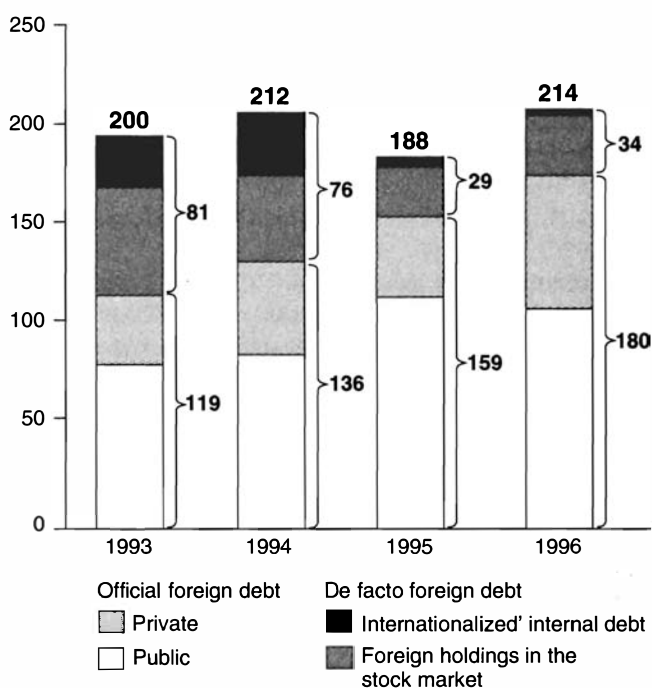
FIGURE 2
Real foreign debt
(billions of $)



Sources: World Bank, ECLAC, BdM, SHCP, Secofi.

FIGURE 3
Real foreign debt
(billions of $)



Sources: World Bank, ECLAC, BdM, SHCP, Secofi.

obligations back in November 1993 as de facto foreign debt, and warned that they were the most explosive component of Mexico's entire debt picture. Sure enough, that is the part that blew apart one year later.

Although the official foreign debt grew from $119 billion in 1993 to $136 billion in 1994, the de facto component added another $81 billion on top of that in 1993, and $76 billion in 1994—for a grand total real foreign debt of $200 billion and $212 billion, respectively. (These figures differ somewhat from earlier ones published by *EIR,* because more accurate data have recently become available.) After the debt bomb exploded in Mexico on Dec. 19-20, 1994, over the next year about $19 billion in foreign money fled the stock market (holdings dropped from $44 billion to $25 billion), and another $27 billion in the notorious Tesobonos and other foreign-held government bonds were cashed in (thus the drop in "'Internationalized' Internal Debt," from $32 billion to $5 billion).

The government of Ernesto Zedillo, which came into office on Dec. 1, 1994, decided from the outset to submit to the policy demands of the international financial oligarchy. It assumed all of the costs of the financial debacle, and committed itself to reestablish the speculative bubble that had been generated by the described leveraging procedures. And where did the Zedillo government get the money to pay off these de facto foreign obligations? By borrowing it, of course—from the International Monetary Fund (IMF) and the U.S. government, principally—in the now-famous "Clinton package." This meant that the Mexican government's official foreign debt leapt $29 billion in one year, from $89 billion to $118 billion—a 33% increase!

Some cite as a mitigating factor, the fact that the new obligations are at least somewhat longer term than the 90-day average of the Tesobonos. This might indeed be helpful, *if* the Mexican economy were now recovering, and *if* the game of speculative bubble-building were over. But, the opposite is the case, on both counts.

The net result of the 1995 measures was that the Mexican debt bubble was deflated over the course of the year, from $212 billion to $188 billion; but in so doing, it was also salvaged so that, like a cancer, it could turn around and start all over again in 1996. This is precisely what happened, as can be seen in **Figures 2** and **3.**

Although public foreign debt has dropped to $112 billion in 1996 through sizable amortization payments, Mexico's private sector turned with increased frenzy to international borrowing, and its total obligations grew by 66% in one year, from $41 billion to $68 billion.

It is not yet known how much of these new obligations were taken on by the Mexican banking sector, and how much by companies with access to foreign borrowing, although it is likely that the lion's share has been taken up by the companies. Most of the borrowing is being carried out by a relatively small number of Mexican companies that are completely insolvent, and are unable to borrow in Mexico because of the IMF-imposed credit contraction. They have instead been

forced to borrow abroad, even for operating capital. It is a speculative spiral that cannot last very long.

As for the Mexican banking system, it is thoroughly bankrupt and in the process of being bought out by foreign banks—and is therefore probably not taking on large amounts of new foreign debt. The levels of non-performing debt in the banking system have reached 49%, according to the U.S. firm Security Auction Capital, despite the fact that the Mexican government over the past two years has bailed out the banks to the tune of about $29 billion, which amounts to about 8.4% of the country's entire Gross National Product in 1996.

Regarding the de facto portion, it's "off to the races again" there, too. Although foreign purchases of Mexican government bonds are at a low level, because the interest rates offered are deemed "insufficiently high" to attract foreign investment, foreign holdings in the Mexican stock market have resumed a "Salinas-style" trend, closing out 1996 with about $31 billion in holdings (about a 25% growth rate).

In sum, Mexico's real foreign debt as of Dec. 31, 1996 (two years after the debt bomb exploded) was $214 billion, an amount not seen even in the worst moments of speculative lunacy under the Salinas administration. And, the bankers' forecast for 1997 is for even more speculative insanity. Why? The answer can be given in a single word:

Oil exports

What has ensured Mexico's "debt servicing capacity" to date, is the impressive contraction of the government budget and the disappearance of entire sectors of the country's physical economy, as we have documented, along with the billions of dollars the country makes through oil exports.

Since January 1995, Mexico has been treated simply as if it were a financially troubled private corporation with a given source, "X" (the oil), of income, whose creditors are providing it with emergency loans backstopped by the cash flow expected from income source "X" (the oil). These emergency loans, or swaps, have in turn acquired speculative market valuations much higher than what the source "X" of income can in reality support.

At the point when the whole mountain of speculative paper comes crashing down, it is that income source "X" (Mexico's oil) which will have to answer for the totality of the nominal debts.

According to the official financial program for 1997, the government expects to pay about $15 billion in interest payments, and also intends to amortize $9 billion in principal coming due. In detailing the "sources of financing" to cover these 1997 amortization payments, the report asserts that about $5 billion will be lent to Mexico by the Inter-American Development Bank and the World Bank, while the remaining $4 billion will be covered by floating new bonds on the international markets.

But that is not all. The government report asserts that the $9 billion amortization figure does not include the refinancing, or rolling over, of short-term obligations, nor pre-payments on Mexico's foreign debt—in other words, the government plans to pay even more. These pre-payments and the refinancing of short-term debt will also be covered by new bond issues (mainly the so-called Global Bonds).

If we assume that Mexico's creditors are rational bankers, one has to ask: Why are they interested in all of these financial shenanigans, which clearly point toward a sudden and complete default, sooner rather than later?

It turns out that the Mexican government pays its bondholders not only a handsome spread over the interest rate paid by U.S. Treasury bonds, but also has built in the following bonus. If the international price of oil rises, the Mexican government is committed to increase the return on the bonds by an amount not to exceed 30% of the additional income coming from oil exports. This is why one often hears that Mexico's foreign oil sales are already 29% pre-committed to the country's creditors.

The base price of oil that is used to calculate this increase is not yet publicly known, but the government budget for 1996 gives some interesting leads. That budget's calculations were based on an expected international price for oil of $13.25 per barrel, but the actual average for the year turned out to be $18.05 per barrel. Thus, there was a $4.80 per barrel increase relative to the forecast price.

If we apply a 29% "oil bonus" to this difference, and multiply by 1.2 million barrels per day of oil exports, we find that Mexican bondholders are being handed a bonus of $1.7 million daily, on top of all their other returns. That explains what government officials really mean when they assert that "the international markets are eager to buy Mexican paper," and that foreign investors "are betting on Mexico."

But only a fool or an imbecile, of which there are both in the Mexican government, would think that, just because they have gone on for the last two years, these operations can be prolonged indefinitely, or that the bankers don't have an ulterior motive. Some government sources assert that in 1998, about $15 billion will be amortized using these same methods, and that the amount will rise to $17 billion in 1999—and that the only real problem Mexico faces is how to pay the annual interest due on the skyrocketing debt!

True enough: The only real problem with this entire scheme is how to maintain the real cash flow on which the leveraging is premised. Contrary to those Mexican government officials who believe that the country is already a new Arcadia, the creditors have made it clear that they want Mexico to hand over the source itself of income flow "X," i.e., the state oil company Pemex.

Great Britain's Chancellor of the Exchequer Kenneth Clarke was emphatic on this point during an early January 1997 visit to Mexico. "The Mexican government must take on the privatization of state-sector companies as a lifestyle," he said.