Mexico's New Debt Squeeze

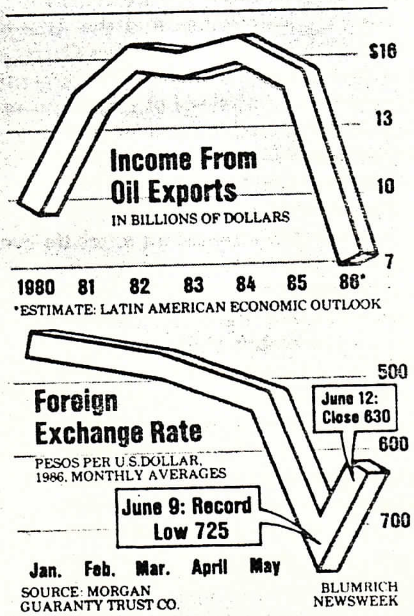
Would another bailout make much difference?

Even as the World Cup soccer tournament in Mexico moved toward the playoffs, the real contact sport was taking place on the sidelines. Last week officials in Washington and Mexico City bumped heads over a $6 billion package to bail Mexico out of financial disaster. The immediate task was familiar: to help Mexico make an estimated $1.5 billion in payments falling due shortly on its $98 billion debt. But the ultimate goal was to keep what Mexicans are calling *la crisis* from turning into a prolonged economic and political nightmare.

Whether officials would succeed was far from certain, for the Mexican standoff is steadily growing worse: The steep drop in oil prices has provoked an economic cataclysm: this year Mexico has lost $7.5 billion in oil-export revenues, a staggering 6 percent of its gross domestic product (chart). With the economy in recession, sharp cuts in government spending are sparking strikes and political unrest that threaten to disrupt the government of Mexican President Miguel de la Madrid Hurtado. Mexico's creditors are pressing for policy reforms before they pump in more money—but their demands may feed dissent and further damage the country's sagging economy. And in the end, a new loan package will do little more than meet Mexico's near-term financial needs, leaving more bargains to be struck in the years ahead.

Double Trouble

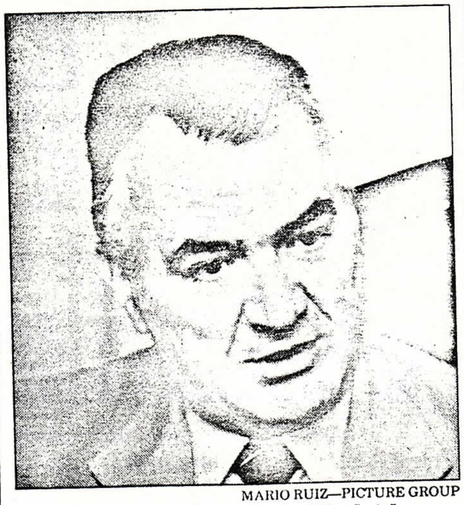
As falling world oil prices reduced petroleum export income, the peso began a sharp decline.



Amid ongoing disputes over drug smuggling and U.S. intervention in Central America, moreover, relations between the United States and its southern neighbor seem more strained than ever. "Our fortunes are linked on many fronts," President Reagan told a news conference last week, explaining why Federal Reserve Board chairman Paul Volcker had paid a one-day emergency visit to Mexico City. "We want to be of as much help as we can." But the help may not come on terms that Mexico can accept. For months Mexico and its key private creditors—American, European and Japanese banks—have been discussing provisions of the estimated $6 billion in loans it needs to get through the year. The package has been held up by Mexico's failure to secure the requisite seal of approval—an accord with the International Monetary Fund over harsh budget cuts and other economic reforms to be undertaken in exchange for a $1 billion IMF loan. But a break in the impasse may be at hand: the IMF and Mexico could reach an agreement in a matter of days—and the IMF may even be forced to agree to less austerity than it originally sought. As their part of the deal, meanwhile, the banks may be compelled to stretch out Mexico's debt payments, make other concessions or even do the once unthinkable—start writing off some loans.

'Breathing room': The shape of a Mexican bailout package was outlined in testimony before a Senate Foreign Relations subcommittee hearing last week called by North Carolina Sen. Jesse Helms. According to David Mulford, assistant treasury secretary for international affairs, the IMF and World Bank would each kick in $1 billion; commercial banks would contribute $2.5 billion to $2.7 billion. Major industrial countries, including the United States, would lend $600 million to $900 million through the so-called Paris Club, and an unspecified amount of trade credits would come from Japan, which hopes to encourage Mexican purchases of Japanese goods. All told, reaching agreement on such a package soon would ensure that Mexico could make interest payments falling due this month and next and still maintain its desired level of at least $5 billion in foreign-currency reserves. Moreover, the loans would "give Mexico breathing room until the end of the year to see if oil prices turn around," says Pedro-Pablo Kuczynski, a managing director of First Boston Corp.

But few bankers or officials are under any illusion that the loans will make much of a lasting difference. Although falling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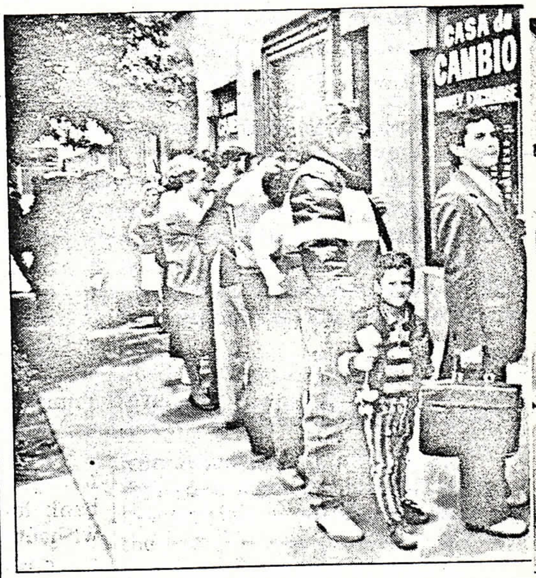
Under fire: *President de la Madrid*



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