SNIE 81-86

IMPLICATIONS OF MEXICAN FINANCIAL PROBLEMS

Information available as of 24 February 1986 was used in the preparation of this Estimate, approved by the National Foreign Intelligence Board on 20 February 1986.

PAGES 1 and 2 DENIED

DISCUSSION

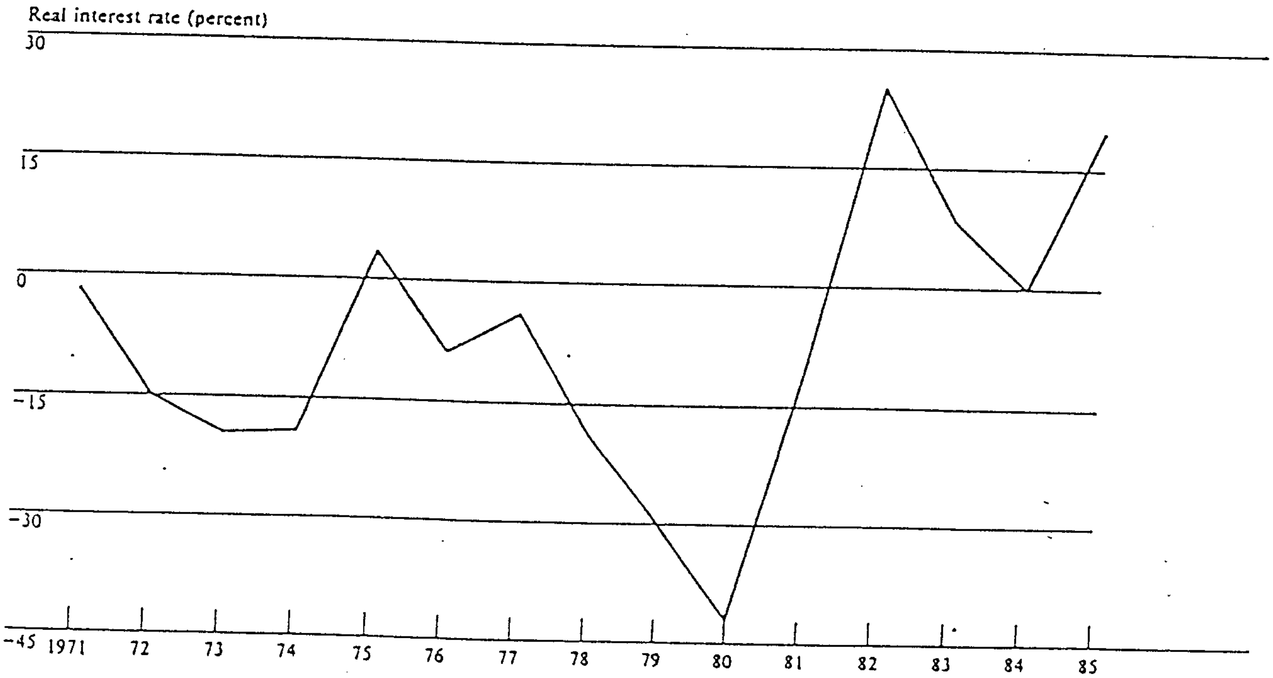
The Current Setting

1. [redacted]

2. Against this backdrop, the recent sharp fall in oil prices is acting as a catalyst both to increase the financial burden of Mexico's foreign debt and to stimulate demands for relief on foreign debt servicing charges, which will be roughly $13.5 billion in 1986, including $9.5 billion in interest. At Mexico's current average oil export price of about $15 per barrel, oil revenues will be roughly $5 billion less than initially estimated for 1986. Each additional $1 per barrel decline in the price would result in an additional net $375 million loss [1] in annual receipts at an export level

[1] This net figure includes a $500 million oil revenue loss and a $125 million savings in interest payments.

Figure 1
Mexico: Real Interest Rate on External Debt[a]



[a] Real interest rate is defined as the nominal interest rate paid on external debt minus the change in the US dollar export price index for Mexico.

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International Oil Price Outlook

The international oil market is in disarray following several months of high production and OPEC's December decision to defend market share instead of price. Spot oil prices for several key crudes have dropped to below $18 per barrel, down $8 per barrel and 30 percent since the beginning of January. Mexican crude prices have followed these prices downward—the state oil company has retroactively reduced prices several times since December. Mexican crude, which sold at a $1.25-per-barrel discount from average world prices during 1985, has lost ground. Competitive pressures and buyer dissatisfaction with the retroactive pricing scheme have forced the Mexicans to lower their average price to $15 per barrel, about $6 per barrel below the world average. According to press reports, early February export levels may have fallen to as low as 700,000 barrels per day compared with a target level of 1.5 million barrels per day.

Despite the already steep slide in oil prices, there is still the potential for substantial price volatility and further price cuts in the months ahead. How fast and how far prices fall will depend, in large part, on the resolve that OPEC producers, particularly Saudi Arabia, show in maintaining their increased market share. Non-OPEC producers so far have not responded to the organization's call for increased cooperation and are unlikely to voluntarily cut output significantly. Problems in selling oil into a glutted market or in pricing oil competitively, however, could lead to production slowdowns in all producing countries.

We envision two possible price scenarios for 1986:

— *Price Erosion*. Under this most likely scenario, world oil prices average $20 per barrel for the year, with Mexican crude continuing to sell at a deep discount of at least $5 per barrel below this average. OPEC producers limit their market share target to about 18 million barrels per day (b/d)—about 1 million b/d more than the market needs—and winter oil requirements cause prices to firm in the second half of 1986. Mexico's financial problems give oil buyers additional leverage, and Mexico is forced to continue offering discounted oil to bring exports up to the target level of 1.5 million barrels per day.

— *Price Collapse*. Under a less likely, but still plausible scenario, world oil prices continue to spiral downward and average $15 per barrel for the year. Mexican crude prices tumble to $10 to 12 per barrel or below. In this case, Saudi Arabia and other OPEC countries aggressively stake out an increased market share and attempt to produce 19 million barrels per day for the year.

of 1.35 million barrels per day. Petroleum exports in 1985 accounted for about 70 percent of Mexico's export earnings and 45 percent of government revenue.

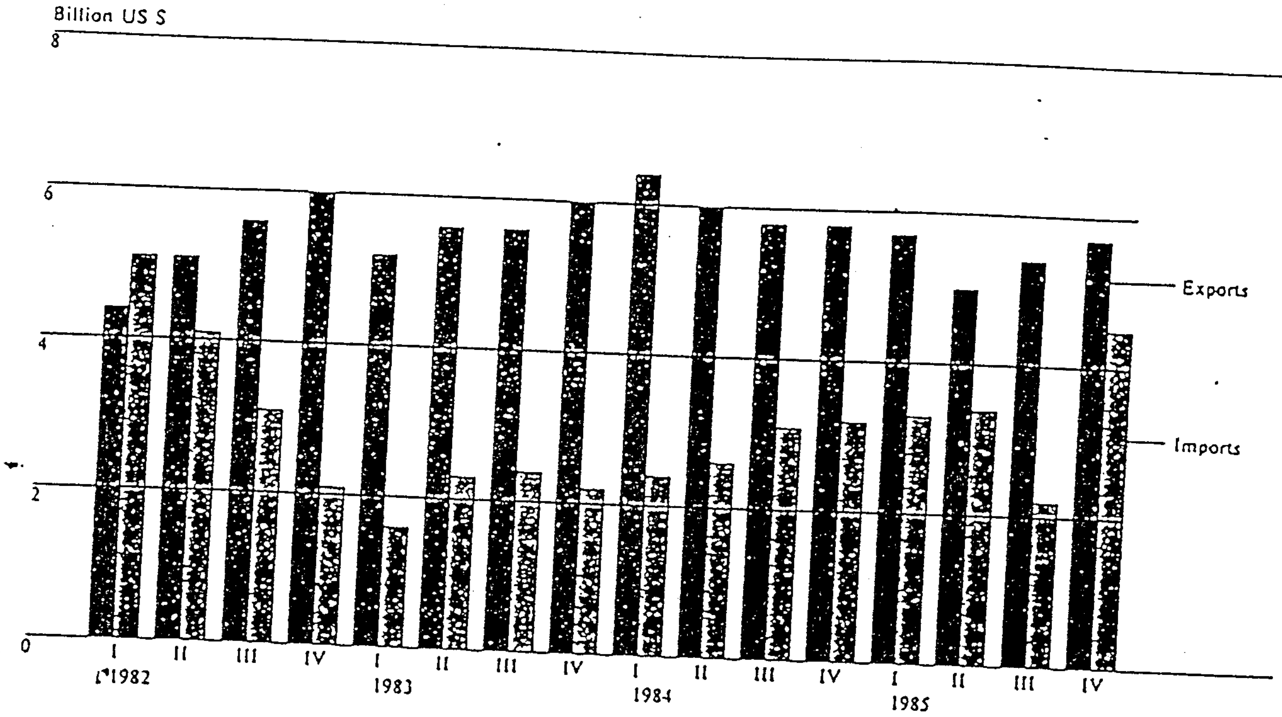
3. [redacted]

4. [redacted]

[redacted]

5. [redacted]

Figure 2
Mexican Trade



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[redacted]

6. [redacted]

7. [redacted]

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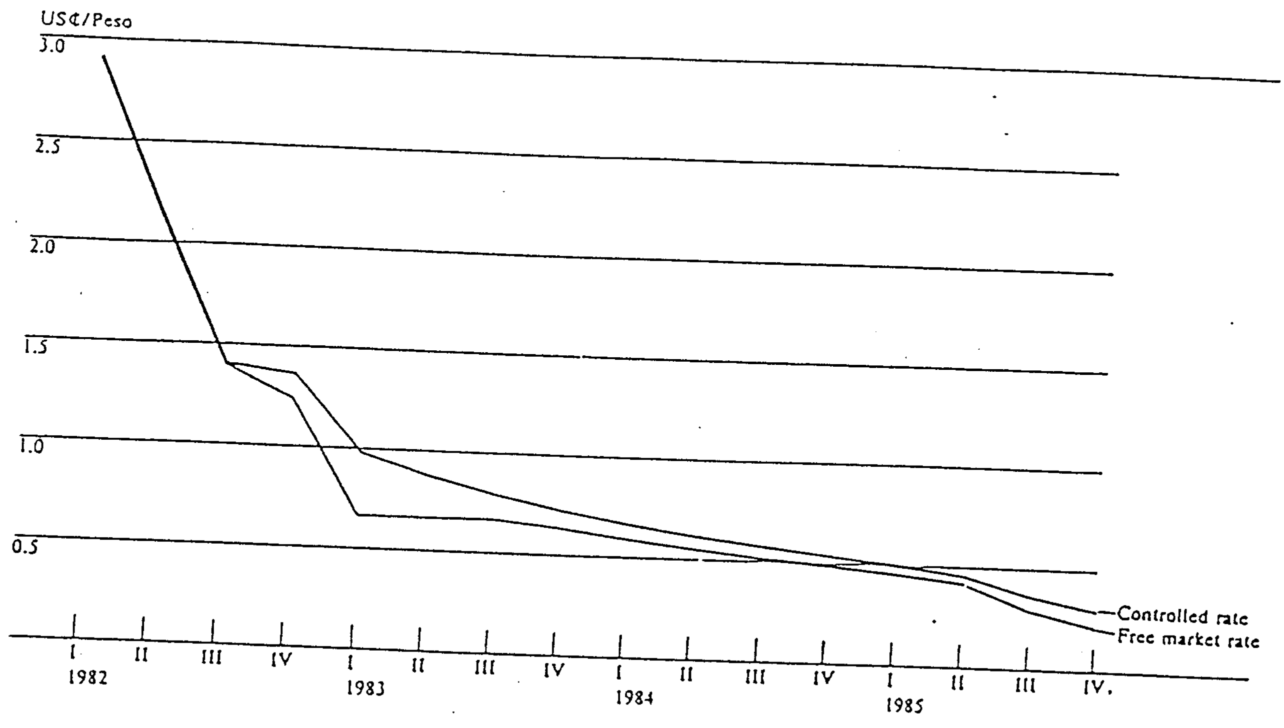
Figure 3
US Dollar/Peso Exchange Rates



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Position of the Banks

11. Mexico's 4 February announcement that this year's financing needs would be $9 billion as a result of falling oil prices surprised creditors, who believed the figure overstated true revenue losses, given oil prices that prevailed at that time. Previously, the Mexicans had requested $4-5 billion in net new financing for 1986 of which roughly $2.5 billion would come from commercial banks. [redacted]

12. [redacted]

[redacted]

13. [redacted]

Table 2
US Commercial Bank Exposure to Mexico [a]

Billion US $

Debt held by US banks	
Total	25.2
9 money center banks	14.2
15 other large banks	4.8
All other	6.2
Amount owed by borrowers	
Mexican banks	4.2
Mexican public borrowers	13.3
Mexican private nonbank	7.7
Maturity of distribution	
One year and under	8.2
Over one to five years	10.1
Over five years	6.9

[a] Data as of September 1985.

This table is Unclassified.

US/Mexican Ties

— Mexico is the United States' principal foreign supplier of petroleum and third-largest trading partner.

— US banks hold over 35 percent of Mexico's commercial debt, and investment in the country by US firms accounts for over 80 percent of total foreign investment.

— The economies of dozens of cities on both sides of the border are increasingly interdependent and the well-being of their people intertwined.

— The border assembly program, dominated by US firms, is Mexico's fast-growing economic sector and already is the second-largest foreign exchange earner.

— Thousands of US citizens visit Mexico annually, helping make tourism the third-largest foreign exchange earner.

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[redacted]

14. [redacted]

15. [redacted]

16. [redacted]

[redacted]

17. [redacted]

18. [redacted]

[redacted]

19. [redacted]

20. Should the negotiations drag on, there are a series of moves the Mexican Government could take beyond selectively withholding interest payments but short of declaring a moratorium on all debt. These steps include:

- — Refusing to make payments to commercial banks on medium- and long-term credits but honoring other obligations, particularly short-term credits.
- — Announcing a scheme that links debt payment to export performance or some other criteria.
- — Declaring a moratorium until oil prices stabilize.

[redacted]

21. [redacted]

PAGES 11 and 12 DENIED

ANNEX

FINANCIAL PROBLEMS OF OTHER DEBTORS

Although most recent attention has focused on LDC oil exporters, most LDCs that rely heavily on commodity export earnings are in serious financial condition.

- — The price of tin, for example, has fallen by some 40 percent since late 1984, with nearly all of the decline coming since the collapse of the tin market late last year.
- — Zinc, lead, and phosphate prices have declined sharply over the last year.
- — Prices of important LDC agricultural exports, including rice, palm oil, and coconut oil also have dropped over the last 12 months.

Indeed, of some 22 key LDC primary commodity exports, only five have not experienced falling prices over the past year.

Collectively, these adverse price trends severely damaged the export performance and debt servicing prospects of debtors in Africa and Asia. Egypt, for example, has been hit not only by falling oil prices, but also by lower prices for cotton, second only to oil as an Egyptian export. Morocco also experienced falling export earnings due largely to the drop in the price of phosphate, which accounts for one-fourth of its exports. While lower oil prices will benefit oil importers like Morocco, the effect of the declines in prices of their export products have, in many cases, been greater.

The picture is similar in Asia, with the adverse effects of falling oil prices being accentuated by price trends for other primary commodities that account for the bulk of their nonoil imports. For Malaysia the collapse of the tin market not only means lower prices for its tin exports, but also perhaps having to put up funds to cover the International Tin Council's share of the cost of the collapse.

Table 3
Price Changes in Key LDC Commodity Exports *Percent*

	Change Since December 1984	Change Since 1980
Coconut oil	−59	−49
Palm oil	−42	−41
Tin	−40	−58
Hides	−36	102
Oil	−29	−35
Zinc	−27	−18
Phosphates	−23	28
Groundnut oil	−22	−17
Lead	−14	−60
Cotton	−14	−36
Silver	−11	−72
Corn	−11	−22
Soybeans	−11	−26
Beef	−9	−11
Rice	−8	−54
Wheat	−3	−17
Lumber	−2	−4
Rubber	1	−43
Cocoa	1	−15
Copper	1	−36
Sugar	15	−86
Coffee	32	−20

This table is Unclassified.

Table 4
Selected Debtors: Debt Servicing Capabilities

	Change in Merchandise Exports for 1985 [a] (percent)	Primary Commodities as Share of Total Merchandise Exports (percent)		Ratio of Reserves [d] to Imports (months)	Interest Payments as Share of Merchandise Exports in 1985 (percent)	Change in Value of Merchandise Imports, 1981 to 1985 (percent)
		Oil [b]	Nonoil [c]			
Argentina	1	4	76	1	63	−55
Brazil	−5	7	45	10	38	−23
Chile	−0	NEGL	65	4	39	−55
Colombia	15	NEGL	66	6	35	−27
Egypt	3	76	16	2	23	25
Indonesia	−9	77	17	4	14	−20
Ivory Coast	10	4	93	1	14	−42
Jamaica	−20	1	49	1	29	−20
Malaysia	−5	27	42	4	15	12
Mexico	−12	70	9	3	46	−67
Morocco	−10	2	59	NEGL	26	−15
Nigeria	3	96	3	1	12	−50
Pakistan	−7	1	18	1	18	7
Peru	−3	21	69	8	20	−46
Philippines	−15	3	48	2	49	−35
Thailand	−5	NEGL	59	3	26	−1
Venezuela	−11	86	6	17	22	−46
Zaire	−9	20	55	2	16	17

[a] Based on exports to OECD.
[b] Fuels.
[c] Foodstuffs plus raw materials.
[d] Total reserves minus gold.