



BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

July 3, 1979

STRICTLY CONFIDENTIAL (FR)
CLASS I - FOMC

TO: Federal Open Market Committee

FROM: Murray Altmann *M.A.*

Attached is a memorandum from Messrs. Pardee and Truman, dated today, and entitled "The Mexican Swap Line."

It is contemplated that this memorandum will be discussed at the meeting of the Committee on July 11, under agenda item 7.

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TO: Federal Open Market Committee
FROM: Scott E. Pardee and Edwin M. Truman
SUBJECT: The Mexican Swap Line *SEP* *EMT*

On June 15, the Director General of the Bank of Mexico, Gustavo Romero Kolbeck, met with Chairman Miller. Mr. Romero raised the possibility of increasing the size of the System's swap arrangement with the Bank of Mexico. Chairman Miller said he would consult with his colleagues on the FOMC and let Mr. Romero know what the Committee's sentiment was after the July meeting.

Background

The System's swap line with the Bank of Mexico is now \$360 million. It was last increased (doubled) in August 1975. (See attachment.) Mr. Romero did not mention a figure for an increase in the swap line. However, he did refer to his impression that the size of many of the System's swap lines had been doubled in recent years.^{1/} We understand, based on informal conversations, that the Bank of Mexico would like to increase its swap line with the System to \$700 million. This would raise total Mexican swap facilities with U.S. authorities to \$1 billion, including the \$300 million swap line with the ESF.^{2/}

^{1/} In fact, the only swap lines that have been increased since August 1975 are those with the Bundesbank, Swiss National Bank, and Bank of Japan, which were more than doubled during 1978.

^{2/} The Bank of Mexico may approach the U.S. Treasury for an increase in its swap line with the ESF but has not done so.

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Mr. Romero presented two arguments in favor of increasing the swap line: First, it is desirable to prepare for possible contingencies in light of the general increase in nominal magnitudes of trade and financial flows in recent years. Second, and more important, there is considerable political interest in this subject in Mexico, and it would be desirable to contribute to an improvement in political relations between Mexico and the United States by demonstrating increased monetary cooperation between the two countries.

In the latter connection, the Bank of Mexico would like the announcement of any increase in the swap line to be made prior to or at the time of the next meeting between President Carter and President López Portillo -- around September 25.

Mexical real GDP is expected to increase rapidly in 1979, at about an 8 percent rate compared with 6.6 percent in 1978. Bank of Mexico officials have indicated that this rate of economic expansion is faster than is desirable. Consequently, the rate of increase in consumer prices is likely to be no better than the rate last year, 16 percent (December over December), compared with a 13 percent target; the consumer price index increased at an annual rate of more than 20 percent during the first five months of 1979. Mexico's current-account deficit is likely to increase somewhat in 1979 from its level of about \$2.5 billion in 1978. Although the Mexican peso is formally floating, it has been essentially stable against the U.S. dollar since early 1977. Recently, however, there have been rumors in financial markets that the peso would be "devalued" in late August -- the third anniversary of the 1976 devaluation.

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Bank of Mexico officials have indicated that they have no need to draw on the swap line and do not anticipate making a request to activate the swap line in the near future. They have argued that Mexico's financial condition is strong. Mexico's reserves stood at about \$2.5 billion at the end of June, including approximately \$500 million in gold valued at close to the market price. Mexican officials have also pointed out that the López Portillo government has acted to restore confidence in Mexico's economic and financial policies, for example, by meeting the conditions of the three-year Extended Fund Facility agreement of late 1976 with the IMF. Mexico also has considerable borrowing power in private markets because of its large petroleum and gas reserves.

Thus, in the Committee's consideration of the Bank of Mexico's request, a principal issue is whether the need for closer relations between the United States and Mexico merits an affirmative reply and a departure from the Committee's normal practice of approving increases in swap lines only when economic and financial conditions indicate the desirability of doing so.

ATTACHMENT
June, 1979

Bank of Mexico Swap Lines with the
Federal Reserve and Treasury
(all numbers in millions of dollars)

1) Federal Reserve Swap Lines

<u>Date</u>	<u>Increase</u>	<u>Total Amount</u>
May 17, 1967	(line established)	\$130
July 9, 1973	+\$50	180
August 19, 1975	+180	360

2) Treasury (ESF) Swap Line

<u>Date</u>	<u>Increase</u>	<u>Total Amount</u>
May 1967*	+\$25	\$100
December 31, 1973	+100	200
December 31, 1975	+100	300**

* The ESF swap line with the Bank of Mexico has been in effect since 1965; under the arrangement in effect between 1941 and 1965, the U.S. Treasury did not have the right to draw on the Bank of Mexico.

** Under terms of this swap arrangement any Mexican drawings of more than \$150 normally must be redeposited at the ESF. Therefore, the maximum amount available to Mexico for intervention purposes is \$150. Use of this swap line is conditional on roughly equivalent use of the System's swap line and on a declaration by the management of the IMF that Mexico is eligible to draw on the IMF under a conditional (upper credit tranche) credit arrangement.

3) Mexican Drawings and Repayments on Swap Lines

Date	Federal Reserve		Treasury (ESF)	
	Amount Drawn (+)/Repaid (-)	Amount Outstanding	Amount Drawn (+)/Repaid (-)	Amount Outstanding
1967-1973	0	0	0	0
1974				
August	+180	180	0	0
November	-180	0	0	0
1975				
September	+180	180	0	0
October	+180	360	0	0
December	-360	0	0	0
1976				
April	+360	360	0	0
October	-360	0	0*	0*
November	+150	150	+300*	300*
December	0	150	-150	150
1977				
February	-150	0	0	150
April	0	0	-150	0
1978-1979	0	0	0	0

* On September 20, 1976 the Treasury opened a temporary special swap facility with Mexico under which Mexico could draw up to \$600 million in anticipation of proceeds of IMF credits. Mexico drew \$365 million in October 1976 and repaid this drawing in November 1976.