For more information, see Mexico and the IMF

Mexico, D.F., Mexico

June 15, 1999

Mr. Michel Camdessus
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Mr. Camdessus:

1. The attached policy memorandum describes the economic policies and objectives of the Government of Mexico and the Bank of Mexico for the period 1999-2000, in support of which Mexico requests from the Fund an amount equivalent to SDR 3,103 million (120 percent of quota) in the form of a Stand-By Arrangement for the period through end-November 2000. The economic program aims at consolidating the substantial reform efforts initiated during the 1980s and the gains made during 1996-98 following the 1995 financial crisis to set the economy on a higher, sustainable growth path in conditions of low inflation that will expand employment opportunities and foster higher living standards. The economic program will maintain tight financial policies, while promoting structural reforms that are key to increasing national savings, enhancing macroeconomic stability, and reducing external vulnerability.

2. The economic program of the Government of Mexico has been a subject of continuous and close dialogue with the Fund. Mexico considers it important to have a program with the Fund in light of possible uncertainty concerning external developments and to bolster confidence during the period of change in Administration.

3. The Government and the Bank of Mexico believe that the policies set forth in this letter are adequate to achieve the objectives of the program. Nevertheless, we stand ready to take further policy measures if needed. During the period of the arrangement, Mexico will consult with the Fund on the adoption of policy measures that may be appropriate in accordance with existing practices. Over the arrangement period, reviews of the program will be carried out with the Fund before end-December 1999, end-March 2000, and end-June 2000.

Sincerely yours,

/s/	/s/
José Angel Gurría Treviño	Guillermo Ortiz Martinez

Secretary of Finance and Public Credit of Mexico	Governor Bank of Mexico

Attachment: Memorandum of Economic Policies

Mexico-Memorandum on Economic Policies

I. Economic Stabilization and Recovery

1. Through the implementation of a comprehensive economic program, Mexico restored macroeconomic stability and resumed economic growth after the recession of 1995, increasing the resiliency of the Mexican economy to external shocks. This program was supported by sizable package of external financing, including SDR 12 billion from the Fund. Important efforts have been made toward restructuring the banking system and in the implementation of reforms to strengthen economic growth, fiscal, and balance of payments sustainability over the medium term. Furthermore, throughout this period, the Government has taken special care to alleviate the impact of the adjustment on the most vulnerable groups.

Economic developments in 1995-98

2. The Mexican economy has recovered markedly from the 1995 recession. Following real GDP growth averaging about 6 percent in 1996-97, real GDP per capita returned to its pre-crisis level. Inflation, which reached 52 percent during 1995, declined to under 16 percent during 1997. Rising employment and real wages prompted a recovery of private consumption beginning in 1997. Confidence was strengthened by a tight fiscal stance, with the primary surplus rising from 2 percent of GDP in 1994 to an average of 4 percent of GDP in 1995-97. The strong fiscal performance reflected an important decline in noninterest expenditure, some recovery in tax revenues and rising oil prices. In the context of a floating exchange rate regime, monetary policy was successful in reducing inflation and interest rates.

3. The economic recovery continued into the first half of 1998, but the subsequent uncertainty in international capital markets, combined with low oil prices, slowed substantially the pace of economic growth toward the end of the year with negative effects on Mexican financial markets. During 1998, short-term domestic interest rates increased by 1,300 basis points to 34 percent and the peso depreciated relative to the U.S. dollar by 22 percent. Most emerging markets, including Mexico, suffered a weakening of investor confidence, as reflected in the sharp rise in yield spreads on international bonds. International bond spreads and domestic interest rates declined in the fourth quarter of 1998, while the peso appreciated, amid easing international capital market conditions-but, subsequently those trends were reversed following the crisis in Brazil. Owing to Mexico's strong underlying fundamentals and policy response, the contagion from these crises has been limited; since mid-January 1999 the peso has appreciated and interest rates have resumed their downward movement.

4. Economic activity remained robust during most of 1998, with real GDP growing by almost 5 percent during the year. The slowdown in 1998 occurred toward the end of the year, and can be attributed to a significant decline in investment and consumption growth associated with increased interest rates and the deterioration in the terms of trade. End-year inflation rate reached 18½ percent (compared with an original target of 12 percent); however, underlying inflation (excluding price changes of fruits and vegetables and of goods subject to official control) was stable at 16 percent.

5. In the face of pressures on the public finances during 1998 stemming from the sharp decline in international oil prices, the Government announced successive expenditure cuts totaling 0.8 percentage point of GDP, while protecting social expenditure. As a result, the originally targeted budget deficit of 1.25 percent of GDP was met. The Bank of Mexico responded to the financial crisis by tightening monetary policy on several occasions in order to maintain control over inflation; real interest rates reached 12 percent during the fourth quarter of 1998 compared with 6 percent during the corresponding period in 1997.

6. Based on relative consumer prices, in 1995 the peso depreciated by 50 percent in real effective terms (annual average basis, in local currency terms), but then appreciated by a cumulative 25 percent in the following years through end-1998 (based on the IMF's Information Notice System). In terms of unit labor costs, there was a considerable real effective depreciation in 1995, and only a marginal subsequent appreciation. The external current account deficit, which narrowed to under 1 percent of GDP in 1995-96 (from 7 percent in 1994) widened gradually in the following years, reaching 3.8 percent of GDP in 1998, partly reflecting the decline in the terms of trade.

II. The Medium-Term Economic Program (1999-2000)

7. The challenge facing Mexico in the medium term is to consolidate the gains made in 1995-98, and to set the economy on a higher, sustainable growth path that would substantially expand employment opportunities and improve living standards in the context of low inflation. Maintaining tight financial policies, while forging ahead with structural reforms, are key to increasing national savings, reducing external vulnerability, achieving macroeconomic stability, and promoting faster economic growth into the next millennium.

The medium-term macro framework

8. Consistent with these objectives, the Government's macroeconomic framework aims to achieve real GDP growth rising from 3 percent in 1999 to 5 percent in 2000; and to reduce inflation from 13 percent during 1999 to 10 percent in 2000. The external current account deficit is projected to decline to 2.2 percent of GDP in 1999 and, as access to international capital markets improves, to widen to 3.2 percent of GDP in 2000. It is expected that about two-thirds of external financing for the current account deficit would come from foreign direct investment, and the remainder from other long-term capital flows.

9. The main engine of growth in 1999 will be non-oil exports. Fixed investment is expected to slow down in the first part of 1999, reflecting the expected deceleration in growth and the lagged effect of the financial turmoil in 1998, but then should recover strongly, growing by about 11 percent in real terms in 2000. Private consumption is projected to increase at a rate below that of real GDP, but sufficient to allow a sustained increase in real consumption per capita. The Government would contribute to the increase in investment through its plans to expand basic infrastructure (including both joint ventures with the private sector and increased private sector participation in areas previously reserved for the state, such as electricity generation). In addition to physical capital, the Government is intensifying its focus on human capital development. Private savings are projected to increase gradually during the 1999-2000 period. This increase will be a direct result of the structural reforms being implemented, including the ongoing reform of the pension system, and the increasing confidence in the banking system.

The medium-term policy strategy

10. Our **medium-term strategy**, aimed at achieving the objectives listed above, emphasizes fiscal consolidation, macroeconomic stability in the context of a floating exchange rate regime, and structural reforms to help boost private savings and increase productive efficiency. It also relies on a continuity of economic and structural policies, to lay the basis for sustained economic growth.

11. **Fiscal policy** will contribute to the attainment of macroeconomic stability and to the increase in savings and investment. The overall deficit of the nonfinancial public sector will decline from 1.25 percent of GDP in 1999 to 1.0 percent of GDP in 2000. This fiscal profile is consistent with an increase in public savings from 2.5 percent of GDP in 1999 to 2.8 percent of GDP in 2000 and a reduction in public debt from 27.6 percent of GDP in 1999 to 27.0 percent of GDP in 2000, excluding the debt of the recently established Bank Savings Protection Institute (IPAB). This fiscal scenario represents minimum targets. In this connection and to reduce the budgetary dependency on oil revenue, the 1999 budget law contains provisions that give priority to the utilization of those revenues in excess of the budgeted amounts for the purpose of amortizing public debt, and that require revenue shortfalls to be matched by expenditure reductions. The Government intends to introduce similar provisions in subsequent budgets, and will consider strengthening annual fiscal targets on the basis of the previous year's outturn and economic prospects. In addition, budgetary transfers for bank restructuring and support operations will aim to cover the full real component of interest accrued on IPAB liabilities starting in 2000, so as to at least not increase these liabilities in real terms.

12. **The tax system** is structurally weak due to its dependence on oil-related revenues, leaving the fiscal accounts vulnerable to variations in the international price of oil. The Government is committed to reduce such dependency. Recently, the Government took important steps to reduce the number of special regimes under the corporate income tax law with the intention to generate additional revenues, reduce economic distortions, and limit the scope for tax evasion. In particular, the immediate depreciation scheme was eliminated and the consolidation of the losses of related firms have been tightened. In an effort to further reduce tax evasion, the Government has introduced measures to enhance taxpayer registration programs, raise penalties for noncompliance, and increase the legal audit and confiscatory powers of the tax authority. More specifically, these measures include the implementation of a program to cross-check social security contributions and income tax data, and the criminalization of tax evasion. Public pricing policy will continue to support an improvement in the fiscal accounts and reduce economic distortions.

13. With a view to achieving its fiscal objectives, the Government will continue to exercise strict **control over noninterest expenditures,** which in 1999 are projected to reach their lowest level, relative to GDP, in the last two decades. The share of social expenditure (i.e., on health, education and training) in total expenditures will continue to increase; moreover, its efficiency will continue to improve due to the important efforts that have been made to phase out generalized subsidies in favor of better targeted arrangements. To make way for expenditure reallocation, nonpriority expenditure will continue to be reduced, and public entities restructured and privatized (including railways, ports, and airports).

14. A review of **revenue sharing and expenditure responsibilities between local and federal levels** will continue to be carried out in 1999-2000 with a view to identifying measures to ensure horizontal and vertical equity, while preserving the ability of the federal Government to determine the overall stance of fiscal policy. Between 1996-98, the Government introduced new schemes to transfer spending responsibilities to the state and local governments, while implementing a series of annual agreements with state governments aimed at improving their long term financial strength. As a result, the stock of subnational public sector debt has fallen dramatically from 4.4 percent of GDP in 1994 to about 1.4 percent of GDP in 1998. Over the coming years, the Government will seek to improve the administrative capacity of local treasuries and improve the links between spending and financing decisions at the state and local levels. In addition, the Government will promote the establishment of common budgeting and accounting rules to facilitate the analysis of the finances of subnational governments.

15. The Government is in the process of **reforming treasury operations and management** with technical assistance from the Fund. The fiscal authorities have worked to design, develop, and build the Federal Financial and Administrative Integrated System (SIAFF), which aims at strengthening substantially expenditure control at the federal level. The system will allow the treasury to improve the management of short-term debt and will

reduce the scope for misappropriation of resources. The Government intends to hold an international public bidding contest by mid-June 1999 with the view to install the SIAFF in the Treasury by July 2000. The system will be tested and then extended to other federal entities for full completion by end-2001. The federal government will promote similar initiatives among the state government treasuries to improve the monitoring and control of general government expenditures. In addition, a new budget management system is being put in place, allowing for a more efficient allocation of budgetary resources by assessing the budget not only in terms of inputs (money spent), but also outputs (classrooms constructed, children vaccinated, etc.). The first stage of the implementation of this system, covering ten ministries, will be implemented by end-1999, and the remaining nine ministries will be incorporated into the system by end-2000.

16. The fundamental objective of **monetary policy** will continue to be the reduction of inflation, which is critical to achieving higher levels of domestic savings and investment, and a gradual decline in real interest rates. The Bank of Mexico's efforts against inflation are being reinforced through a more proactive monetary policy which will aim to counteract the effects of shocks to the domestic price level, while taking into consideration inflation trends over a medium-term horizon. The Bank of Mexico introduced measures in August 1998 and February 1999 to increase the effectiveness of policy implementation, including a reduction in daily overdraft facilities and a remunerated deposit requirement for commercial banks at the central bank. The implementation of monetary policy will be pursued within the context of the floating exchange rate regime.

17. **Minimum wages** will continue to be formulated in the context of negotiations between the various social partners-government, business, and labor. The strategy will provide for an increase in real minimum wages, based on the inflation objective and expected gains in productivity. The trend toward decentralized negotiated private sector wage increases tied to productivity gains should help to ensure Mexico's competitive edge.

18. Mexico has pursued its **trade liberalization** objectives through the conclusion of bilateral trade agreements as well as through participation in the Uruguay Round. In addition to the North American Free Trade Agreement (NAFTA), which accounts for 80 percent of Mexico's trade, Mexico has bilateral trade agreements with 8 Central and South American countries, and is in the process of negotiating agreements with 6 more countries in the region. Our government has already indicated its interest in participating in the process of trade liberalization within the Asia Pacific Economic Corporation (APEC), and expects to complete a free-trade agreement with the European Union before end-2000. After incorporating the impact of Mexico's existing free trade agreements, it is estimated that the trade-weighted average external tariff is 1.5 percent. With a view of reducing this average further, we intend to reverse the increase of import tariffs applied to non-free-trade-agreement countries by 2000, taking into consideration our ability to generate additional sources of revenue.

19. The Government intends to continue with the process of **structural reforms**, particularly in the areas of the **banking system** and **social security.** Also, actions will be taken to **enhance labor productivity**, **divest public enterprises**, and **increase private sector participation** in sectors that were previously primarily the domain of the state. These actions are critical to achieve the higher levels of growth and balance of payments sustainability envisaged in the medium-term program.

20. The Government accords high priority to the **strengthening and consolidation of the banking system** to put it on a more secure footing, play a pivotal role in the process of savings mobilization, and to be able to operate in a more volatile global environment. The Government has implemented a series of measures to improve the operational environment of the banking sector by strengthening bank regulation and supervision and adopting international accounting standards. In 1995, the Government, in collaboration with the World Bank and the Inter-American Development Bank, initiated a strategy to contain the impact of the economic crisis on the banking system. The range of actions taken included: the restructuring or intervention of troubled banks; the restructuring of nonperforming

loans; subsidy programs to assist specific categories of debtors; and, a Government portfolio purchase program contingent on new capital injections. To complement these measures, foreign investment restrictions in the financial sector were relaxed. In 1996, the range of subsidy programs for debtors was expanded, stricter capitalization rules were introduced incorporating market risk capital requirements in addition to the existing credit risk provisions, a process was started of upgrading accounting requirements to international standards, and bank supervision was tightened substantially. In 1997, regulation was issued in order to improve disclosure of bank information to the market. In March 1998, financial groups began to report information on a consolidated basis. These actions have helped to mitigate the negative effects of the 1995 financial crisis and have led to a substantial increase of foreign participation in the banking system.

21. **The banking legislation approved by Congress in December 1998** aims at increasing transparency in the restructuring of the banking system and improving market incentives, as well as allowing full participation of foreign investors in existing Mexican banks, including the largest ones. This legislation created the IPAB, which will assume the Bank Savings Protection Fund's (FOBAPROA) liabilities and claims. The law introduces (phased in over time) limited deposit insurance, new guidelines on bank support, intervention, and liquidation to foster market discipline. The legislation will also allow normalization of legal aspects of the bank restructuring process. The Government intends to move quickly to implement the financial legislation; IPAB's liabilities are expected to be negotiable and to pay no less than the real component of interest due on such debts from 2000 onwards. The IPAB intends to finalize the restructuring operations of banks currently identified in the law providing financial support to rehabilitate banks only if it is less costly than the payment of the deposit guarantee, there is a viable restructuring plan, and the existing shareholders have absorbed the losses. The IPAB will manage, and begin disposing of, assets acquired by FOBAPROA, and under normal conditions use the proceeds to reduce its liabilities. The IPAB, as required by law, will publish periodically its financial statements, and report its operations to Congress.

22. The Government is committed, based on a thorough **assessment of the condition of the banking system** following best international practices, to establish restructuring operations for banks under distress, and to develop plans for further strengthening and consolidating the banking sector. It is the Government's intention that the new debtor support program ("*punto final*") announced earlier this year will be the last program to support debtors. With the elimination of remaining restrictions on foreign ownership, it is expected that further foreign capital should help in recapitalizing the banking system. The timetable to introduce limited deposit insurance, in accordance with the IPAB law, was announced recently by the Board of IPAB with the objective of phasing out the full deposit guarantee by 2005.

23. The Government is committed to apply fully the **Basle Core Principles** for effective banking supervision. Loan classification and provisioning rules will be strengthened further and be consistent with a minimum general provision on standard loans. The definition of regulatory capital and connected lending will be revised, and minimum guidelines on banks' internal controls will be issued. The National Banking and Securities Commission (CNBV) will update banks' accounting principles, will strengthen monitoring of connected lending, banks' risk management practices, compliance with anti-money laundering laws, and will further improve disclosure of banks' information.

24. The Government has submitted a draft law to Congress (Federal Credit Guarantee Law) aimed at **strengthening creditor-debtor relations** and fostering financial intermediation. If approved, the law would enhance credit facilities through the creation of an optional collateral mechanism and improve the transparency of the legal framework for creditors and debtors.[1] In addition, the Government intends to modernize property and commercial registries to further improve market incentives and discipline and reform the judicial system.

25. The Government plans to improve further the operating efficiency of the **development banking sector**, following a sharp decline in recent years of lending by these institutions.

The Government will continue restructuring the largest development bank for small and medium sized firms (NAFIN) as well as the development bank for rural development (BANRURAL).

26. The Government is now in the final phase of its privatization program, which includes the divestment of infrastructural facilities previously in the domain of the state (ports, airports, railroads, satellites, and natural gas distribution). **The privatization/deregulation process** over the next few years is designed to increase competition through market forces in order to raise efficiency and thereby enhance sustained economic growth. The opening up of sectors provides opportunities for private investment to ease infrastructural bottlenecks. The planned structural reforms are expected to lead to a substantial reduction in production costs and contribute to an improvement in external competitiveness. A major initiative being undertaken by the Government is the proposed structural reform of the **electricity industry**. This industry requires massive investment over the next six years. Meeting these investment needs solely from state funds would impinge upon social spending. Thus, the Government has submitted a proposal to Congress that would allow for the introduction of competition in the electricity market. This would attract private investment in the electricity industry .

27. The Government is studying various options to strengthen further the recent reforms to the **social security and health care systems**. The Government plans to relax investment restrictions by: (I) allowing the private pension funds to invest more in private sector instruments; and (ii) allowing private pension fund managers to offer to participants more than one fund (with varying degrees of risk). Strengthening the financial fundamentals of the National Housing Fund for Workers (INFONAVIT) is fundamental to ensure the viability of the pension system. With regard to health care, the most immediate objective is to ensure the efficient operation of the public health care reform implemented in 1997-98.

28. The flexibility demonstrated by Mexican **labor markets** greatly facilitated economic adjustment in 1995-96. As noted above, employment in the formal sector has increased substantially since late 1995, and the medium-term growth targets are expected to be sufficient to absorb the supply of new entrants to the labor force. The Government, in collaboration with its social partners, intends to continue discussing ways of improving labor market flexibility. To foster the integration of the unskilled poor in the formal labor market, the Government has been putting greater emphasis on labor training schemes.

29. The Government's strategy to **alleviate poverty and provide social safety nets** includes special programs in the areas of primary education, preventive health care and nutrition for the poor, agricultural support programs, and subsidies for various basic products. A key element of the new strategy is to move away from the use of generalized subsidies, which are inefficient, toward the use of targeted subsidies. Already, the Government has eliminated the generalized subsidies for tortillas and gas, resulting in an annual savings equivalent to almost ½ percent of GDP. A majority of the savings arising from the elimination of generalized subsidies can be directed to the most vulnerable groups of society through the expansion of more targeted programs, such as the Program for Education, Health, and Nutrition (PROGRESA), which links income transfers to compliance with preventive health care check-ups, a vaccination schedule, and primary school attendance.

30. Notwithstanding the recent deterioration in the terms of access to global financing confronting emerging markets, it is expected that the Mexican private and public sectors will be able to increase slightly their external indebtedness in 1999 and to raise further their access to international capital markets in 2000. The authorities intend to contribute actively to the realization of these expectations, through the continued readiness to adjust policies in the event of adverse external shocks and to make efforts to convince foreign investors of Mexico's relative attractiveness based on the strength of the macroeconomic and structural reform policy stance. These efforts have already been reflected in the agreement recently concluded with a syndicate of foreign banks to convert about US$2 billion of a short-term facility falling due in early 2000 into instruments of up to five years maturity.

31. The Government's **debt management strategy** will continue to aim at lowering the financing costs of Mexico's public debt and achieving a smooth, lengthened maturity profile, thereby reducing the vulnerability to external shocks. Mexico has established a diversified debt profile providing benchmark instruments in the main international capital markets. To keep the external indebtedness of the public sector within sustainable levels, the Government intends to establish annual ceilings for net external borrowing consistent with the objectives of the medium-term program. The Government also intends to caution other public entities against the dangers of accumulating large stocks of collateralized, and therefore inflexible, debt instruments. We are working, in collaboration with the staff of the IMF, to strengthen our **external debt monitoring system** with regard to private sector external liabilities and its composition by type of instrument.

III. Summary of the 1999 Program

32. **The 1999 program** is formulated on the basis of a projected real GDP growth of 3 percent and targets a reduction in inflation to 13 percent over the 12 months ending in December.

33. **The 1999 budget** is based on a crude oil export price assumption of US$9.25 per barrel and aims at a primary surplus of 2.8 percent of GDP and an overall fiscal deficit of 1.25 percent of GDP. The 1999 budget includes the following **revenue measures**: (I) an increase in the domestic prices of gasoline and diesel; (ii) a change in the corporate profit tax rules concerning depreciation allowances, the consolidation of losses across related enterprises, and the reduction in the corporate income tax rate; (iii) an increase in the maximum marginal tax rate on personal income from 35 percent to 40 percent (accompanied by the introduction of a withholding tax on dividends of 5 percent) and an increase in the tax on interest earnings in order to maintain tax neutrality; (iv) an increase in the custom duties on imports originating in countries without a free trade agreement with Mexico; (v) a requirement that large value added tax (VAT) filers pay directly to the tax authority taxes due on purchases from small suppliers; (vi) an elimination of the VAT zero-rating for indirect exports; and (vii) a strengthening of tax compliance through the penalization of tax fraud with jail sentence, the enhancement of tax authority power to register economic agents and confiscate illegal merchandise, and the change in excise tax rules on alcoholic beverages to reduce evasion. **Programmable expenditures** will be reduced by 0.7 percent of GDP in 1999 to their lowest level this decade through the containment of the administrative expenditures (including the wage bill), and a cut in nonessential investment, making room for increasing transfers to the financial system without affecting social expenditure, which will increase to almost 60 percent of programmable spending.

34. The Government firmly believes that its **economic program is sound**. Nevertheless, as is normally the case for all forecasts, some key underlying assumptions may not turn out as expected. As was the policy for 1998, if needed due to the net effect of such deviation, the Government intends to take additional **fiscal measures** over the course of the year to ensure meeting the overall deficit target of 1.25 percent of GDP. The budget law approved by Congress includes provisions that require the Government to offset, with selective expenditure cuts, shortfalls in revenue larger than 1 percent of projected revenues. Also, revenue more than 1 percent greater than the revenue projection in the budget would be used to reduce public debt. In submitting the budget to Congress in coming years, the Government intends to continue to pursue this policy.

35. Nonfinancial **public sector debt** (excluding the liabilities of IPAB) is projected to fall from 27.9 percent of GDP in 1998 to 27.6 percent of GDP in 1999 (down significantly from 38.5 percent in 1995). In order to ensure a comprehensive public sector debt strategy that aims at a further reduction in overall public sector debt to sustainable levels, it is the Government's intention, in submitting to Congress the 2000 budget initiative, to include budgetary transfers sufficient to cover the real component of interest obligations on liabilities incurred for bank restructuring operations, comprising those arising from subsidy programs to debtors. The Government will closely monitor these payments.

36. **The monetary program for 1999** assumes an increase in the monetary base of 18.1 percent (in line with the increase in nominal GDP and a modest remonetization) together with a commitment of at least no change in net international reserves. To help achieve the inflation objective, the Bank of Mexico is prepared to maintain a bias toward monetary tightening. The Bank of Mexico will implement monetary policy in a more proactive manner to foster the gradual and sustained reduction in inflation.

37. **Net credit from development banks will continue to be closely monitored**, with the emphasis placed on lending through commercial banks (second tier lending) rather than direct lending. For the full year 1999, such net credit has been limited to 0.3 percent of GDP. A specific timetable for the reform agenda of the development banks will be set up during 1999.

38. **The external current account deficit is projected to narrow** to 2.2 percent of GDP in 1999, notwithstanding a further decline in the terms of trade (the adverse impact is estimated at 0.2 percentage point of GDP). Non-oil export volume growth would slow to about 7 percent in 1999, while import volume growth would slow to 1 percent. The current account deficit would be fully financed by capital inflows with both the public and private sectors increasing slightly their net external indebtedness, and with foreign direct investment of some US$8.5 billion in 1999 (compared with US$10.5 billion in 1998).

39. The Government has made important strides in the **monitoring of commercial banks' external credit lines**. The present system monitors changes in the terms and conditions of access by Mexican banks to foreign credit lines and rollover rates by groups of foreign creditor institutions. The Government intends to further improve the compilation of external debt statistics for the private sector, in particular through the establishment of one-year quarterly and five-year annual projections for the external debt service for commercial banks resident in Mexico, consolidated with their nonresident branches and agencies.

40. **The structural agenda for 1999** includes continued privatization of infrastructural facilities, financial sector reform (including strengthening its financial structure and improving prudential regulation and banking supervision), improvements in the quality and efficiency of social spending, and reforms to protect the environment.

41. **The program will include quarterly performance criteria** through end-December 1999 and indicative targets for end-2000 for the overall fiscal deficit, the primary fiscal balance, net official international reserves, and net domestic assets of the Bank of Mexico. Also, the program establishes limits on net external borrowing by the public sector, consistent with those approved by the Mexican Congress. The first review of the program will focus on the banking sector as well as on any required measures needed to meet program targets, and reestablish indicative targets for December 2000. The Government already has strengthened its external debt monitoring system, permitting a more thorough and timely assessment of external financing conditions, and will take further steps which will be discussed within the context of the first program review. The second program review will establish quarterly performance criteria for March, June, and September 2000. The third program review will focus on monitoring progress in the bank restructuring process and in tax policy and administration measures introduced with the 1999 budget.

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[1]Debtors will be able to pledge as collateral their property. However, the debtors will be entitled to continue to occupy the property provided they make appropriate payments. During payment, debtors will gradually recover their pledged assets. Upon default, creditors will be able to dispossess debtors through a new and brief judiciary process.