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TO PRIORITY FCO

TELEGRAM NUMBER 822 OF 28 SEPTEMBER

INFO TREASURY, DOT, ECGD, BANK OF ENGLAND, WASHINGTON, UKDEL IMF/IBRD

MY TELNO 800: MEXICAN ECONOMY

1. THE EFFECTS OF THE DECISION TO NATIONALISE THE PRIVATE MEXICAN BANKS AND IMPOSE FULL EXCHANGE CONTROLS CONTINUE TO REVERBERATE.
2. THROUGH EVERY MEANS AT ITS DISPOSAL (PRESS, RADIO, TELEVISION, PUBLIC HOARDINGS AND DEMONSTRATIONS), THE GOVERNMENT HAS PRESENTED THE NATIONALISATION OF THE BANKS AS A NEW AND ESSENTIAL PART OF MEXICO'S REVOLUTIONARY HERITAGE. BANKERS ARE DEPICTED AS RAPACIOUS AND UNPATRIOTIC, AND THERE ARE CONTINUING MENACES AGAINST THOSE WHO FAIL TO REPATRIATE THEIR DOLLARS BEFORE THE END OF THE MONTH. AMENDMENTS HAVE BEEN SUBMITTED TO THE CONSTITUTION BY THE RULING PARTY TO MAKE THE STATE THE SOLE LEGAL PROVIDER OF BANKING SERVICES. IN THESE CIRCUMSTANCES IT WAS COURAGEOUS OF THE 21 PRINCIPAL FORMER PRIVATE BANKS TO HAVE SOUGHT AN INJUNCTION FROM THE COURTS AGAINST EXPROPRIATION ON THE GROUNDS THAT IT WAS UNCONSTITUTIONAL AND REPRESENTED AN INFRINGEMENT OF FUNDAMENTAL RIGHTS. FEW EXPECT THIS LEGAL ACTION TO GET FAR.
3. IN FACT THE GOVERNMENT IS NOW SEEKING TO MAKE THE NATIONALISATION OF THE BANKS VIRTUALLY IRREVERSIBLE. PRESIDENT-ELECT MIGUEL DE LA MADRID, WHOSE INITIAL REACTION WAS AMBIGUOUS AND FELL WELL SHORT OF ENDORSEMENT, CAME OUT IN FAVOUR OF THE CONSTITUTIONAL AMENDMENT, ALBEIT WITH MINOR QUALIFICATIONS, ON 22 SEPTEMBER. HIS STATEMENT DAMPENED THE HOPES OF THOSE WHO HAD BELIEVED THAT HE WOULD WORK TO REVERSE THE PRESENT GOVERNMENT'S POLICIES WHEN HE TOOK OFFICE. BUT THIS WAS NEVER REALISTIC, AND THE CRUX OF THE PROBLEM REMAINS WHEN AND HOW THE SHAREHOLDINGS OF THE FORMER BANKS IN INDUSTRY AND COMMERCE ARE RETURNED TO THE PRIVATE SECTOR. SOME BELIEVE THAT DE LA MADRID'S STATEMENT COULD BE A QUID PRO QUO FOR PRESIDENT LOPEZ PORTILLO'S RENEWED COMMITMENT TO AN EARLY AGREEMENT WITH THE IMF.
4. IN THE MEANTIME THE DAILY FUNCTIONING OF THE BANKS SEEMS HARDLY TO HAVE CHANGED. STATE CONTROL WAS ALWAYS STRONG. ONLY THOSE AT THE TOP ARE NEW. IT IS TOO EARLY YET TO JUDGE WHAT THE PRACTICAL EFFECTS WILL BE, ALTHOUGH MOST MEXICANS USED TO NATIONALISED ENTERPRISES BELIEVE THAT EVEN THE FORMER LOW STANDARDS WILL NOT BE MAINTAINED.

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5. BY CONTRAST THE IMPOSITION OF EXCHANGE CONTROLS AND THE CONTINUING SHORTAGE OF FOREIGN EXCHANGE HAVE ALREADY HAD A SEVERE IMPACT ON THE ECONOMY. THE SLOWDOWN IN INDUSTRIAL PRODUCTION HAS BECOME ACCENTUATED. THERE ARE REPORTS OF INCREASING BANKRUPTCIES, ESPECIALLY AMONG SMALL COMPANIES. OTHER COMPANIES HAVE HAD TO REDUCE PRODUCTION DRASTICALLY IN RESPONSE TO FALLING DEMAND OR INABILITY TO OBTAIN DOLLARS FOR ESSENTIAL IMPORTS. THE GOVERNMENT HAS ESTABLISHED A FUND OF 25 BILLION PESOS TO HELP SMALL COMPANIES WHICH ARE IN DIFFICULTIES DUE TO THE FINANCIAL CRISIS.

6. INFLATION WAS 12% IN AUGUST (BRINGING THE RATE TO 54% SO FAR THIS YEAR), AND THE MONEY SUPPLY IS BELIEVED TO HAVE RISEN SHARPLY IN THE LAST TWO MONTHS. UNION LEADERS HAVE BEEN PRESSING FOR WAGE INCREASES TO MAINTAIN WORKERS' PURCHASING POWER, BUT THEIR STATEMENTS HAVE BEEN RELATIVELY MODERATE. DISSIDENT UNION PROTESTS HAVE BEEN MUCH STRONGER, AND YESTERDAY MEXICO CITY WAS DISRUPTED BY A PEACEFUL DEMONSTRATION OF AROUND 30,000. INCREASING ECONOMIC DIFFICULTIES HAVE PROBABLY CONTRIBUTED TO AN UPSURGE OF PETTY CRIME WHICH HAS BECOME EVIDENT IN THE LAST FEW WEEKS.

7. THE GOVERNMENT IS ANXIOUS TO CONVINCING THE WORLD THAT IT WANTS AN AGREEMENT WITH THE IMF, AND IS NEGOTIATING IN GOOD FAITH. THE GOVERNOR OF THE BANK OF MEXICO HAS SAID PUBLICLY THAT AN AGREEMENT WAS, HE SAID, NECESSARY TO ENABLE THE COUNTRY TO OBTAIN THE IMPORTS WHICH INDUSTRY NEEDED. BUT SOME SENIOR MEMBERS OF THE GOVERNMENT CONTINUE PRIVATELY TO EXPRESS DOUBTS ABOUT THE USEFULNESS OF AN IMF AGREEMENT. THERE ARE EVEN RUMOURS THAT IN HIS SPEECH TO THE UNITED NATIONS GENERAL ASSEMBLY ON 1 OCTOBER PRESIDENT LOPEZ PORTILLO MAY WISH TO CAP HIS ARGUMENTS FOR A NEW INTERNATIONAL ECONOMIC ORDER BY MAKING SOME GESTURE OF DEFIANCE TO THE INTERNATIONAL FINANCIAL COMMUNITY.

8. AS PRESIDENT LOPEZ PORTILLO REMARKED TO MR ONSLOW ON 24 SEPTEMBER, THE ECONOMY HAS SO FAR CONTINUED TO MOVE FORWARD UNDER ITS OWN INERTIA. BUT THAT INERTIA IS NOW SLOWING DOWN. THE EFFECTS OF AN IMF AGREEMENT HAVE STILL TO BE RECKONED WITH, AND YET MORE DIFFICULT, SOLD CONVINCINGLY TO THE MEXICAN PEOPLE. EVEN IF SUCH AN AGREEMENT HAS THE SUPPORT OF THE PRESIDENT-ELECT, THE EXISTING PRESIDENT FACES THE TWO MOST DIFFICULT MONTHS OF HIS SIX-YEAR TERM.

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