I thought it best to take up an executive session. One is to discuss a little the Mexican situation and what the sub-committee of this committee has been up to and the second is to, the second item that I wish to discuss with the Board is Mr. Reuss's request for the minutes of reserve bank board meetings. Now let me say a little about the Mexican situation and then call on Mr. Wallich to talk to you about developments there and particular relation to those developments and perhaps in detail. As you may recall we have a swap facility on Mexico and Mexico can draw on us up to $360 million such a drawing was made earlier this year, and that amount was later repaid or repaid recently. The original loan to Mexico of $360 million was not made by us with due deliberation with due care. We acted I think a little mechanically, there was this arrangement they asked for the money and we asked a few questions, grumbled a little and just went along. The fact of the matter is that we are very poorly informed about Mexico's financial condition and I'm not proud of the way in which we have conducted ourselves. I'm not talking about the decisions, I'm talking about the amount of degree of knowledge, the amount of information we had at the time we made the decision. Now since then we have taken
strong steps to familiarize ourselves early with the situation in Mexico on our current basis but to keep up to date records as through as we can make them for each of the countries with which we have a swap arrangement, and we are far better organized today to deal with a request for a loan or a swap drawing than we were previously. Now there was a time when swap drawings were virtually automatic. The, our attitude has changed, mine certainly has, when Britain came in earlier this year the initial request was for 3 billion dollars. Without going through the details, I agreed with the British on the sum of $2 billion and indicated we would not go above that, and then I went to the Treasury, and asked the Treasury to become our partner. The reason being that Britain is no longer as creditworthy as it/was. And I'm afraid that is the kind of world we live in as far as borrowed borrowing from us much of it is concerned. We have not said anything about that publicly and I don't think we should. We would only pass to anxiety and uncertainty. But I no longer regard the swap facility as being quasi-automatic, I don't think it should be. Now I haven't found anyone who anticipated a depreciation of the Mexican peso of 50 per cent or over. The financial policies conducted by that country have been
scandalous, we were inadequately informed. Well we understand I think
now the situation in Mexico with reasonable thoroughness. The Mexicans
have now come in for a request for a new borrowing. The that request
was studied with the utmost care by your sub-committee. We had one
meeting after another on the issue, raised one question after another
one kind of conversation after another with the Mexicans, one conversatic
after another with the Treasury. In a short of it is that Mexico
may be very close to bankruptcy, I mean by that the enormous foreign
debts Mexico has contracted is by no means clear that Mexico will be
able to service these debts and the moratorium they need to be declared.
The debts
But that's being rescheduled. Now that would be a most unfortunate
development because our banks are heavily involved in lending to Mexico.
And of course it could set off moratoriums mostly around the world.
The taking things all and all, recognizing that Mexico is not a good
borrower, recognizing that any amount that we might loan to Mexico
may not be repaid for some time. The sub-committee still decided
unanimously to make a loan of $150 million and not go above that. That
is exactly that the Treasury has made available to the Mexicans, so
we're being partners just as we were on the British case.
Now you might wonder why would we make a loan in a case of a country
the prospects of which are so gloomy and the prospects of which in any
event are so highly uncertain. The fact that led me finally to conclu-
that it was desirable I believe that other members of the sub-committee
were persuaded by similar thoughts, was that if Mexico were to declare
a moratorium in the near future and receive no help at all from this
central bank, than we would inevitably share a certain responsibility for
that collapse and for the difficulties that would be caused to our Commer-
cial banks' demands. Now if you ask me am I at all sure that a loan of a $150 millio
by us would prevent such a default, the answer is, oh no by no means, its
really a drop in the bucket considering Mexico's enormous need to
borrow. But there is a new government will come into power and that
of course influenced our thinking to agree and if a reflow of capital
took place Mexico could straighten out its affairs, if a reflow doesn't
take place then I am afraid Mexico will go down the drain. Now I am going
to call on Mr. Wallich to add to my comments in any ways he see's fit.

Wallich: Mr. Chairman, there's a great deal I can't add to
what you say, accurately described the situation of Mexico.

Going into a little more detail, they have moved into a period of un-
certainty about the exchange rate after many years which it was taken for granted with the exchange rate was stable. As a result, there developed in Mexico a great degree of ease of moving the going dollars and pesos, there is no exchange control, people can maintain dollar deposits in Mexican banks, they can take their dollars out of the country once. This system of stability has been abandoned, it comes very troublesome. The dollars deposited in Mexican banks can be sent abroad very easily or they can be withdrawn in currency, that's the reason why we have these heavy currency shipments to Mexico. Its a form of possible flight that is difficult to manage by means of interest rate policy, the straight policy affects the corporate borrower, but it is not on the whole the corporate borrower who is taking his money out of Mexico, its the individual who has dollar deposits or even has pesos savings and cashes those in and buys dollars. Now in the face of that, the bank of Mexico, in my opinion nevertheless, has tried far too long and far too hard to hold up the rate. The Fund told them XXXX at the beginning of the negotiations that led to the last agreement XXXX upon which besides 3 missions there this year. The Fund told them that they had concluded that a 50 per cent depreciation would be
needed. The initial depreciation was much less than that. They held the rate at this level that cost about a billion dollars as it resolves. Finally they had to let go, and went to what is in effect close to 50 per cent depreciation. The peso used to be 8¢ and now it is around 4.

Even then the Mexican central bank has tried to manage the rate trend and convey a sensation of upward trend in order to reduce the capital flight. They have invested less money in this effort than before, but they needed additional reserves, that is the one reason for the drawing.

The other reason for the drawing on Treasury and the Federal Reserve is that they need compensating balances, they typically keep 1.2 to 1.6 billion of compensating balances with their various banks because their exchange reserves. Now these are down into the low hundredths.

The Treasury examined the possibility of a swap that would give the Mexicans only compensating balances that they couldn't in effect draw out but it was abandoned because it would create legal problems and there were no particular strings attached to either the Treasury or our drawing. We had in the new drawing that was agreed a sharp cut back from the original level of the swap, that level remains as being a general authorization, but then this particular case instead...
said a limit of 150 this they were to take down into 2 tranches of 75 each. The second one to occur after they had secured a loan from the bank of America which is being negotiated 800 million and which according to reports from the Mexicans is being signed today. So that would create the conditions in which the second drawing could be made because the 1st drawing was made right after the agreement. We have a new wrinkle in this swap which gives us a little added protection, although I would caution not to overrate it. They had to agree to a maintenance of value clause if the peso which fluctuates in the market should go down during the period of the 90 day drawing then in the first place, but second if they're expected to repay, for instance it is by mutual agreement, agreed not to repay, to extend the swap.

Burns
You mean repay at the end of 3 months.

Wallich
3 months. But if we agree that it is to be rolled over and if the peso has depreciated at that time they have to put in additional pesos so the dollar value of collateral is maintained.

In the back of this phase the thought which I am sure is obvious to them although we have not made it overt that we could go into their market and sell these pesos for what they would bring. Now of course, could
be up by blocking this account and it is a thing that we would hardly do in accept in extremes but the fact that they would have to take further action to keep us from doing so I think will slightly weight the scales in their mind in favor of doing what they can can to meet their obligation. The Treasury tried to get the similar arrangement into their swap but they found again the legal problems defeated them so they go without this double added protection. Now as to the future, the Chairman has described the situation, and a new government is coming in and the President is a former finance minister. It is hoped that he will inspire confidence. His views are not 100 per cent known and there is some apprehension even with that they might lean in the direction of the agricultural reform of other things that would certainly not add to confidence. The fund thinks that the situation is manageable if they decide to do the right things, that is cut down government expenditures and keep wages from rising unreasonably. On both funds so far they have not performed very well. The government deficit looks as if it might be larger than expected and will have to be renegotiated with the fund to preserve the standby on wages the increases were larger than we seemingly agreed with the IMF. Other than that there is as yet no obvious impediment to continued ability
of Mexico. They claim that this $800 million loan negotiated after the 
devaluation was over subscribed, its being signed apparently on schedule 
to the date that they have said, although they're getting the money a 
little later than they have led us to believe. They have not yet 
negotiated for next year on the ground that when one is negotiating one 
big loan, one must not be negotiating something else. They do have to 

borrow something of the order of $250 million a month given that they 

will have something like at best a $2 billion current account deficit, 

and ought to restore their reserves by about a billion. That is not 
yet allowed for any refloows. If they get refloows their situation will 
be very materially improved. Total outflows just during this year were 

roughly guessed to have been at $2-1/2 billion. So very large Mexican 

amounts abroad could come back if there's confidence with great profit 
in pesos to the owners and it depends entirely on the attitude of the 

new government.

Burns: Thank you very much. If there is one additional word 

that I'd like to say before, it's in my view and Mr. Wallich and other 

members of the sub-committee to questioning, these conversations with 

Mexico were practically concluded by November 7, a Sunday, Sunday evening--
November 7. November 8, the morning of Nov. 8 we had a telephone
conference at which time we took up our longer range monetary targets—
The subject on which I had to testify on the 11th. Therefore it would
have been possible for me to take up this subject of the Mexican loan
on the morning of Nov. 8 with members of the Committee. Now I have
thought long and hard about that, that would have been certainly my
intention, my strong preference, but this is such a highly sensitive
subject and I'm told that our telephone hookup is not absolutely
secure. Therefore I decided that any leak could cause great convulsions
that would cause waves all around the world, and I decided therefore not
to do it. No your sub-committee met continuous with the exception of Mr. Volcker who was out of the country part of the time, so Mr.
Volcker was informed and the sub-committee was entirely unanimous, but
I did want you to know this technically could have come before the
Committee and my reason for bringing it up at the meeting on the
8th.

Baughman agreed. As verification a $150 million Federal Reserve and $150
at the Treasury?

Burns That's right.
Any magic in those numbers that they arrived at?

No, no hard bargaining, we started out being reluctant to do anything, but afterward you know our own discussions the attitude of the Treasury, taking into account repercussion on the world at large, on our own banks, the position that we would be in if we ignored the difficulty of another, ignored entirely difficulty of another central bank. The Treasury previously have reached this agreement other than 150, the Treasury indicated that they would be receptive in view of the possible consequences of increasing their loan.

We went along with a 150 and indicated to the Mexicans that we don't have any intention of going beyond that. Mr. MacLaury:

As I remember our last spot pick out, in fact it was the ESF -- the Exchange Stabilization Fund -- for a short time at least, we accept the change of the positions on it that took us out and we conveyed then funded by drawing on the IMF. Is that the sequence, that's in other words, the Mexicans hate us, it might have gone the other way.

But we didn't go that way, and at the moment what is the status of the Mexican ability to draw on the IMF, can we look to
that as a take out this time around or we on limb?

Burns

We have made no such condition this time.

Wallich

The effect of doing that is the Mexicans are going to get $235 a year for 3 years from the Fund. The first year 1977 the Treasury is going to prefinance in the finances of 3 pieces against not the next 2 years, so there is nothing for us to get our teeth into.

Winn/Mayo

Mr. Chairman, one of the extent of the exposure of the commercial marketing industry in this country and that's something you mentioned.

Burns

Well I don't have the figure in my $8 billion I think

Wallich

I think it's a little over, I think it's 9, close to 9.

Same as above

So this is merely a drop in the bucket

Burns

Well you have to see that borrowing needs as best we can judge is about 2 $250/2 1/2 months.

Partee

Do they remain in debt to the Treasury for that earlier, what was it $300

Wallich

That was repaid out of the IMF.

Partee

So that all the debt there is to be to the United States is $300 and we have indicated no more that
can't use any of the remaining part of the swap. Is that right?

Burns  Well they Henry and I had the initial conversations and Henry carried on a conversations later on. My understanding is that what's you communicate to the Mexicans. Would you answer that question precisely.

Wallich  They were told that we wouldn't go over $150 even though the swap remained at its reasonable level of 360 and its geared to be the same as to the Treasury that that's because the Treasury went to 150.

Coldwell  Henry who are the banks besides Burny such as that I don't mean by name, not any, not at all.

Wallich  All I can tell you is that the bank that usually had syndicates that could not do it and that's the advantage belonging to it.

Coldwell  You don't know how many other banks are involved?

Wallich  No. I don't. I was told by them that it was over subscribed which suggest that it was more than a very small number but I can't tell you.

Clewell  It's a goodly number. I think 10 or a closer

Coldwell  There is a number of regional banks waiting to lie in the wings to participate.
Burns

There are plenty of sheep in this country.

Lily (?)

Is this 9 billion all government debt mean to the

Mexican government.

Burns

Oh no there total debt, total and long term indebtedness

is well over 20 billion. There is no indebtedness abroad.

Lily (?)

I'm thinking of the American banks

Wallich

To American banks and the lenders in part government,

part nationalized enterprises, and part private enterprises. In Mexico

the proportion of a private borrowers out of total Mexican form indebtedness is

particularly high because its that kind of country.

Burns

Let me call on Mr. Gardner, Mr. Garnder may want
to have to comment and then I know Volcker.

Gardner

Well my only comments gentlemen you have heard a complete story review of the conditions surrounding the request, I'll only attempt to again put it in a time and schedule structure. It's early November we know there is a negotiation going on for $800 million credit, we know also that Mexico must begin rolling over and arranging for rollovers for this enormous amount of credit they already have outstanding in our country and internationally. The rest of their government goes out of office on December 1. The IMF conditions which
were so carefully drawn do not go into effect until January 1. The
tourist season in Mexico begins on November 15. The U. S. foreign
policy position as expressed by the Treasury is one in which they very
clearly indicated that they would like us to consider whether or not
we could do something with them, move up to the administration for
foreign policy consideration. So we end up with a small carefully
days.

Partee: That's awfully important I think because of the
comparison with U. S. situations.

Burns: I must say I hope this interim, it has turned
out to be one of these loans that stretches out uncomfortably I would
not to be too surprised, unfortunately under the circumstances.

Gardner: I agree, I understand Governor's Partee's comment.

My point was probably poorly expressed. This amount of swap under our
regular and some special conditions is a very small part that has been
expressed, already been expressed here of the external indebtedness of
Mexico. It seems to me as a member of the sub-committee quite wise to
proceed in this small cautious way with the schedule that I have outlined
for you and the earnest hope that a new government headed by a formen...
finance minister, the IMF conditions and further drawings as Henry has described, and we as we all know now a further depreciation in the peso gives Mexico a fighting chance to manage this situation without an official moratorium. I think that persuaded me that it was important for us to be a part or a small part of this picture.

Coldwell: Was there a consideration that our participation might have as an official body, encouraged other people to

Burns: No, no, oh no, but well we thought long and hard about that and the last thing that we would have wanted to do or did do was to give Mexico a loan and have Mexico use that as a basis for borrowing from the commercial banks and therefore be indirectly responsible for drawing in the commercial banks. We did not fall into any such trap.

Now, we could have gotten for example also an agreement out of the Mexicans, I think this would have been easy under which getting 800 million or 800 million plus from the commercial banks now they would use some of that money to repay us, but we we think we well we talked about that but we didn't have to spend much time debating that. That would have put us in an impossible position you see. Here the other banks come in and we get our money back out of funds that they supplied
I don't think a central bank can ever put itself in that position. So we could have secured our loan but we decided not to. One other point I don't possibly you covered that Henry, I know I didn't. We have emphasized repeatedly to the Mexicans that they must use the funds supplied very sparingly and in the process of foreign exchange transactions and they must try to peg the peso that if they must husband their resources we have all kinds of assurances from the Mexicans they will do just that. These assurances were made initially voluntarily they have repeated those assurances as we raised the question but having said that I must go on to say that my confidence in these assurances being respected is very limited. and my confidence in the central bank operations are very limited. Mr.

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Mr. Chairman

Burns Yes

Where does this, what is our position in relationship to our own with the supervision of our domestic commercial banks if we feel such as you just have a substitute this expressed. Do we policy wise is this related anyway to our member banks in order to avoid a possible problem that they might have if there were a moratorium on the extended...
Burns

Now let me talk about that just a little in the a more comprehensive or rather a more general way. The we could advise the banks to and we could advise them strongly to cut back on their foreign lending. If we did that we would reduce the risk, the very crisis in internation finance that we are seeking to prevent. I'm not talking about Mexico, I'm talking about all around because our banks have in my judgment been rather imprudent once again in lending abroad. That is my judgment, I may be wrong about that, but that's the way I feel. If we gave them strong advice to that effect we could bring on an international financial crisis. On the other hand, if they continued lending on the scale that we have doing then I think its only a matter of time before such a crisis will occur. Now what I have done really, don't let me go back. Mr. Woodervein issued a work of warning, and that was done after consultation with us. He issued his work of warning in Manilla, which you may have seen. Mr. Simon did the same and that was done after careful consultation with us. In some meetings with private bankers the I tried to deal with the question lightly and indicated this is an area interior that bankers must consider carefully. I thought about taking stronger measures but here is the difficulty. There are two difficulties
The one that I just mentioned, namely that they might take that advice to strictly and then bring down a crisis. But there is a second difficult if we start telling banks publicly just to whom to lend for what purpose to lend, we would be getting into the business of credit allocation. and you may recall the difficulties we had with the Congress in connection with the REITs East. We did a little of that and all hell broke loose on Capital Hill, the point being well now you were in the credit allocation business now, and what's wrong with the credit allocation bill that has been submitted. So we have been quite cautious. I don't if others #ot is -- it's as I don't know if I can make a good reply I can make to question. I would not want to say and I have never said to anyone to answer your question specifically that banks should not lend to Mexico I haven't singled out Mexico. I have talked generally about the abos and honestly in the world that we live in the category of all these sees badly needs redefine in my judgement, England or Great Britain and Italy in today's world belong in a category where the sees belong in every practical financial purpose. Yes Mr. Eastburn.

Eastburn I have heard some talk I heard some of the underground underwritten. Is this optimistic?
No, rather I think it is. But the way in which they have been handling their wage problems also makes me wonder how long that condition will continue.

Wallich I think that is an accurate assessment. The fund, surprisingly to me, concluded the beginning 50 per cent depreciation at least 40 was what they needed. They didn't believe it. They finally got it. The price impulses are somewhat stronger than was anticipated so the valuation is probably temporary.

Burns Any other questions?

Baughman Do we have an impression as to what the policy of the government of the central bank will be with respect to showing up private business firms that find the devaluation places them in an unfordable situation.

Burns I, I don't know the general.

Wallich Yes, this was one of the 12 or 13 points in the original program to take care of firms that were in that condition. If doing this they are not doing it on a very generous scale, because one of the strongest objections that are raised to further depreciation for instance one says why don't you let the rate go, let it find its
own level is the threat of bankruptcy to firms that owed dollars have been invested in pesos. How they got themselves into that position is the history of the last 12 years of stability in which it was cheap to borrow in dollars and had to borrow in pesos and they did not properly as individual firms manage their exchange rate exposure.

Burns

Mr. Volcker would you like to comment.

Volcker

I don't think I have anything to say except that the thing that adds specific to the message situation other than a summary comment that has already been made that Mexico is basically a country that could manage the situation and they are able to economically.

I do think what we're seeing should be a manageable situation. The thing to see here is the symptom of general strains and tensions of the world, but they are going to be difficult to manage. They will be difficult in this case, they think they are difficult in other cases, and I feel very strongly there is nothing we can walk away from, and we will be called upon from time to time for this kind of difficult operation in Mexico, in this case, maybe there won't be any others, but I suspect there could be. It seems to me to be a very modest time effort on our part, to rest with the risks are limited in view of the risks the situation may not be managed correctly. I think we need to exert a little effort here. A little help from us from time
to time and this a better situation we are in.

Burns I would second that comment situation we can’t walk away from. Now the I think you all know that the British have applied to the IMF but the British are putting on a very powerful political campaign to accomplish 2 things. First, no conditions of the IMF in effect have the IMF blessed British financial policy. Second, to work out some arrangement whereby the sterling balances which in the aggregate amount to about 10 billion dollars but of the sensitive part is the part that is held by central banks and that part amounts to $4 billion. Well the British would like to have those sterling balances somehow taken care of by other countries. Now this is a problem that has concerned me very deeply for some time., and the in response to a direct question from the bank of England and response to an emissary sent by other central bankers and response to Mr. Leaver who is here is a emissary of the British government Mr. Galagan and Mr. Leaver and the President today. I have taken a very hard position on that saying that we will not even that I for one will not even talk about the sterling balances until the IMF arrangement has been concluded.

But while I have taken this very tough position talking to the British and have in a similar position fortunately I think has been