BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date November 5, 1976

To Chairman Burns

Subject: Mexican Swap

From Henry C. Wallich

I have promised Fernandez-Hurtado to call him today, Friday, November 5. It is my impression that he would rather be told "no" than to be kept waiting, because he must make immediate decisions about his rate.

I spoke to Yeo, who is holding $150 million available without requiring prior drawing upon the Federal Reserve, and I have informed Fernandez-Hurtado of that fact. It is surprising that he should have been under the misapprehension that prior drawing on the Federal Reserve was required since Yeo is in daily contact with him.

The information we have from Mexico does not indicate that they have unmanageable maturities before them, unless there are difficulties with rollovers. Thus there seems to be no clear and immediate threat to our banking system. There obviously is in the background a latent and very serious threat. In view of that contingency, I suggest the following approach:

(1) Allow the Mexicans to draw on the Federal Reserve <u>pari passu</u> with the Treasury up to $150 million.

(2) The total to be made available should be paid out in small amounts, say, $25 or $50 million at a time, providing an occasion to talk to the Mexicans each time to restrain their intervention.

(3) Because there is no take-out, the Mexicans should maintain the dollar value of the pesos they give us by increasing the amount of pesos if the peso declines. This provision has a precedent in the maintenance-of-value clause of the IMF. It could be implemented in an approximate fashion, by rewriting the swap every week or every month at the then prevailing exchange rate if that rate had declined. We would then have full collateral for our loan. While it is unlikely that we would ever try to collect our loan by selling the pesos in the market, and while the Bank of Mexico could prevent us from doing so by blocking the peso account, nevertheless our position in negotiations with the Bank of Mexico, and perhaps also in the eyes of possible critics of the operation, would clearly be stronger.

Scott Pardee has major misgivings about this approach. He argues that it would set a precedent for all other swaps and could also be applied to U.S. drawings under these other swaps. I see no necessary precedent or parallel, particularly since existing swaps contain some asymmetries, for instance, with regard to loss sharing. Also, we do not ordinarily offer a specific take-out in our own drawings.

(4) We might examine with Fernandez-Hurtado whether a swap of the sort which the Treasury holds available for a second $150 million would help Fernandez-Hurtado. This second $150 million that the Treasury could supply would be kept by the Treasury as collateral, so that the Mexicans do not effectively receive any funds and the Treasury runs no risk. My impression is that the Mexicans can use this deposit for

inclusion in their required minimum reserves, allowing them to draw down their own reserve funds by an equal amount. Fernandez-Hurtado told me that he was concerned about violating his required reserve limit. Conceivably an arrangement of this sort with the Federal Reserve, also to be used only pari passu with the Treasury, could help him.

Fernandez-Hurtado told me that he was trying to manage a trend in the rate with minimal use of resources. If he did not succeed, he would have to go out of the market in a few days. Yeo said that yesterday, Thursday, Fernandez-Hurtado made "a big push," presumably to set the rate on an upward trend, and failed. Yeo would be in accord with a policy of doling out funds piecemeal and, in general, going pari passu with the Federal Reserve.

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