



BANCO DE MÉXICO

Measures implemented by the Federal Government and Banco de México to preserve the financial stability ¹

To deal with the instability of financial markets in our country, the Federal Government and Banco de México have implemented a series of measures aimed at restoring the proper functioning of markets and preserving financial stability.

In particular, the measures that have been implemented by Banco de México are described below:

1. Interventions in the foreign exchange market

The Foreign Exchange Commission, composed of officials from the Ministry of Finance and Banco de México, decided to intervene in the foreign exchange market for the first time since September 1998. The presence of Banco de México has been carried out through extensive and repeated US dollars offers, channeled to the market mainly through auction mechanisms. The measures taken by the Foreign Exchange Commission have not been implemented to protect a determined level of exchange rate, but to provide the necessary liquidity to meet an extraordinary demand arisen as a result of the movement of the exchange rate itself.

The actions carried out by Banco de México, instructed by the Foreign Exchange Commission, are the following:

- (a) [US dollar sales through extraordinary auctions](#). These have had the purpose of providing the market with the necessary liquidity to meet the extraordinary currency demand mentioned above ([see results](#)).
- (b) [US dollar sales through daily auctions](#). On October 9, it was decided to put back into operation the [mechanism of sales that was in use from February 1997 to June 2001](#). This mechanism is designed to provide liquidity at a time when exchange rate movements are significant, this is determined when a peso depreciation greater than 2 percent occurs. In particular, Banco de México carries out three auctions every day for a cumulative amount of \$400 million, with a minimum price equivalent to the result of multiplying the prior day's FIX exchange rate by 1.02. On March 9, 2009, the cumulative amount was changed to \$300 million and on May 29, 2009 the Foreign Exchange Commission decided to readjust the amount to be auctioned to \$250 million starting June 9, 2009. Whenever an allocation occurs in these type of auctions, the minimum price for the following business day will be the result of multiplying the average exchange rate of the auction by 1.02 ([see results](#)). On April 9, 2010, the Foreign Exchange Commission

¹ Part of the text below can be found in Banco de México's July-September 2008 Inflation Report.

announced that this mechanism would be suspended starting April 12, 2010.

- (c) [Direct US dollar sales](#). Banco de México carried out direct sales of US dollars in the market on February [4](#), [5](#), [6](#), [20](#), [23](#) and [27](#). The amount of the sales totaled USD1.835 billion. The results of the sales were reflected in the weekly balances of Banco de México, published on [February 10](#) and [24](#), and on [March 3](#).

Paired with the change in the cumulative amount, new US dollar [auctions without a minimum price](#) were initiated ([see results](#)). The initial amount for these actions was set to be \$100 million. On May 29 2009, the amount was readjusted to \$50 million effective June 9, 2009. Later, on September 1, 2009, the Foreign Exchange Commission announced that these daily auctions were going to be carried out until September 30, 2009 and would be suspended starting October 1, 2009.

2. New liquidity facility

Banco de México established an additional liquidity facility that complements the operating facility. The purpose of the new facility is to allow those institutions that do not have the eligible collateral securities in the existing facility to access liquidity using a broader range of eligible assets. Given that the purpose of the new facility is to deal with problems of liquidity, the interest rate applicable to the new facility will be lower than that of the existing operating facility.

Access to the new facility is subject to the sending of a written communication to Banco de México signed by their General Director, where they expose the liquidity problem they are facing and also that the institutions must have a signed contract with Banco de México. In operational terms, the conditions for the credit through the liquidity facilities are the following:

- (a) Maturity: one business day, with automatic renewal until the institution decision to stop it, or Banco de México decides to cancel it.
- (b) Interest rate: the one resulting from multiplying the factor 1.1 times the current target for the Overnight Interest Rate, determined by Banco de México' Board of Governors.
- (c) Collateral: either monetary regulation deposits, or US dollar deposits, that the banking institution keeps at Banco de Mexico (in this case the funding is documented as a credit) or eligible debt titles, for which a repo transaction is carried out. The list of eligible securities includes:
 - a. Government securities, BPAs and BREMS.
 - b. Foreign-currency denominated securities issued by the Federal Government.
 - c. Debt instruments of credit institutions that were issued by October 10, 2008.

- d. Peso-denominated debt instruments issued by Mexican development banks deposited at INDEVAL whose remaining maturity is greater than or equal to seven calendar days.
 - e. Peso-denominated securities with at least AA rating and that are issued by: state-owned enterprises, state and municipal governments, non-financial companies with residence in Mexico or financial firms and trusts that securitize mortgage portfolios.
- (d) Valuation: The eligible titles are valued according to the price and discount factors determined by Banco de México.

Finally, if the institution does not have the securities or US dollar deposits, they can access the liquidity facility by making use of credits against states and municipalities whose ultimate source of payment is guaranteed with shared revenues and federal contributions.

3. Additional Measures

Banco de México, the Federal Reserve, Banco Central do Brasil, the Bank of Korea, and the Monetary Authority of Singapore announced on October 29, 2008 ([see announcement](#)) the establishment of temporary reciprocal currency arrangements (swap lines). These facilities are designed to help improve liquidity conditions in global financial markets and to mitigate the spread of difficulties in obtaining US dollar funding in fundamentally sound and well-managed economies. These reciprocal currency arrangements were initially authorized to run until April 30, 2009; however, on February 3, 2009, their term was extended to October 30, 2009 ([see announcement](#)) and on April 3, 2009, Banco de México announced that it was going to draw on its swap line with the Federal Reserve ([see announcement](#)). The first auction ([see auction announcement](#)) took place on April 21, 2009 ([see rules](#)) and the results suggest that the USD funding pressures faced by the private sector in Mexico had eased in the weeks before the auction (see [statement](#) and [results](#)). On June 25, 2009, the term of the arrangements was extended again to February 1, 2010 ([see announcement](#)) and on January 27, 2010, the end of such SWAP line was announced ([see announcement, available only in Spanish](#)).

As an additional measure to ameliorate the liquidity problems faced by banks, effective October 22, 2009 Banco de México started to remunerate US Dollar deposits that banks deposit at the central bank. The interest paid is calculated as the average interest rate that Banco de México receives from its US-Dollar overnight deposit investments in the international markets minus 1/8 of a percentage point.

Furthermore, the Foreign Exchange Commission announced on April 1, 2009, that it had decided to request access to the Flexible Credit Line from the International Monetary Fund with duration of one year, for approximately USD47 billion. This credit line is available to countries with a solid policy framework and solid fundamentals such as those of Mexico. The line is contingent, and once it is

approved, it is not subject to any conditionality. The terms on which the access to this credit line was obtained are very favorable, given that the cost is lower than that of alternatives to increase international reserves.

Previous to this, Banco de México and the Ministry of Finance jointly announced on October 27 and December 7 further measures aimed at improving the proper functioning of national financial markets. In particular, these measures are part of a coordinated strategy, which aims at restoring as quickly as possible the orderly functioning of the domestic financial markets. The measures announced were:

I. Changes in the auction schedule of Government securities for the fourth quarter of 2008

The Ministry of Finance reduced the programmed amounts of long-term securities in either pesos or UDIs and increased those of programmed short-term bills (Cetes). This was done in such a way that the amount of net domestic financing remained virtually unchanged. These adjustments were aimed at meeting the demand for short-term government securities and also ameliorating the negative impact of lack of demand in the market for long term securities.

II. Changes in the auction schedule of IPAB securities for the fourth quarter of 2008

IPAB reduced the amount of BPAS (savings protection bonds) to be auctioned from a total nominal value of 3850 billion pesos a week, to 1850 million weekly for the rest of 2008. IPAB would offset the smaller issue size by obtaining bank financing ([see general auction results](#)).

III. BPAS Repurchase Auctions

Starting November 4, Banco de México implemented a series of repurchases of securities issued by IPAB for an amount up to 150 billion pesos. These auctions were established mainly to deal with the liquidity problem affecting mutual funds ([see results](#)).

IV. Interest Rate SWAP

Starting November 14, Banco de México implemented an interest rate swap auction program for up to 50 billion pesos for domestic financial institutions. This measure was aimed at reducing the sensitivity of the institutions' portfolios so that they themselves are in a better position to meet the liquidity needs of their customers ([see results](#)).

V. Government Securities Repurchase Auctions

Starting December 3, the Federal Government implemented a repurchasing program for medium and long-term securities Bonos and Udibonos (10 to 30 years). Such repurchase included fixed-rate Bonos and Udibonos that are were not allocated on their primary issue, and which would be immediately cancelled. This repurchase was meant to contribute to increasing the relative

importance of those securities that were being issued and also enhance the liquidity of those issues ([see results](#)).

On the other hand, on December 1st, Banco de México announced that it was going to extend the assets that it accepts as collateral (to include US dollar deposits) when banks are allocated credits as part of Banco de México's daily open market operations, when banks need to overdraw their accounts at Banco de México and when banks bid for liquidity resources being auctioned at the Interbank equilibrium interest rate (TIIE).