

The Bank of Mexico Plans to Inject \$30 billion to Provide Liquidity

By Manuel Leon Hoyos

Original post [here](#).

On April 21, the Bank of Mexico ([Banxico](#)) unveiled a [series of liquidity measures totaling \\$30 billion](#) to “foster an orderly functioning of financial markets, strengthen the credit channels and provide liquidity for the sound development of the financial system.”

The market liquidity measures total [3.3% of last year’s GDP](#). So far, only the [government securities swaps](#) have been in operation; rules for additional facilities were published last week. In addition to these measures, Banxico [cut interest rates by 50 basis points](#), and again on May 14 [to 5.5%](#)—its lowest level [since December 2016](#). So far, Banxico has cut 175 basis points this year.

Mexico, the second largest Latin American economy, has been hit hard by the COVID-19 crisis. Since February, the Mexican peso has [depreciated by over 20%](#). The country has experienced shortages in foreign exchange liquidity and a sharp fall in commodity prices—particularly [crude oil prices](#). According to Banxico, the crisis has brought “the greatest contraction ever recorded of holdings of emerging economies’ assets, especially of fixed-income instruments.” Additionally, Mexico’s sovereign credit rating and Mexico’s national oil company Pemex have been downgraded. Mexico’s central bank expects the Mexican economy to contract [by 5% in the first half of 2020](#)—a forecast that might be revised in the next quarterly report at the end of May. The [IMF currently expects a 6.6% contraction in 2020](#).

The \$30 billion in liquidity includes programs financing SMEs and individuals, the corporate debt market, the government debt market, and other domestic debt markets. In addition, existing facilities have been expanded to provide greater liquidity and foreign exchange hedges. Banxico published rules for financial institutions on these measures in Mexico’s Official Journal [Circular 15/2020](#) on May 13 and Circulars [16/2020](#), [17/2020](#), and [18/2020](#) on May 19.

For SMEs funding:

- A [\\$10 billion financing facility directed to support micro, small-, and medium-sized enterprises, and individuals](#) will operate through commercial and development banks. Resources will come from Banxico’s Monetary Regulation Deposits (DRM) or, if necessary, the Banxico will provide financing at terms of 18-24 months, at the overnight interbank interest target rate. The DRMs are mandatory long-term deposits from national credit institutions in the Banxico and have an indefinite maturity date and generate yields equivalent to the interbank funding rate. They differ from the reserve requirement used by other central banks in that the DRM is not continually adjusted according to fluctuations in the benchmark liabilities of the banks. The DRM may be used as collateral in Banxico’s transactions with banking institutions such as in liquidity—providing auction. (see [here](#) on DRM). Securities eligible for the Ordinary Additional Liquidity Facility (FLAO) will be eligible for this facility. The FLAO has been available since 2008 and offers liquidity to commercial banks through collateralized credits or repos, at a reduced cost of 1.1 times the Bank of Mexico’s target overnight interbank interest rate.

- A [\\$4 billion temporary collateralized financing facility](#) is directed for commercial banks holding corporate loans of micro, small- and medium-size enterprises. The facility will provide financing at a term of 18-24 months, at the target overnight interbank interest rate. The financing will be guaranteed by the SME corporate loans held by the commercial banks, with credit ratings of at least “A” at local scale, by at least two rating agencies.

For the corporate debt market:

- A [\\$4 billion Corporate Securities Repurchase Facility \(FRTC\)](#) aims to support the corporate debt market by providing liquidity for short-term corporate securities and long-term corporate debt. Eligible securities include those issued by nonfinancial private companies that reside in Mexico and comply with FLAO criteria. The cost of the repos will be 1.1 times the average of the overnight interbank interest rate.

For the government debt market:

- A [\\$4 billion facility to repurchase government securities](#) at longer terms than in regular open market operations aims to facilitate intermediation of government securities. Financial institutions holding government debt will obtain liquidity without the need to dispose of their securities in stressed financial markets. The cost of repurchase agreements will be set at 1.02 times the average of the overnight interbank interest rate.
- A [\\$4 billion facility for auctions of government securities swaps](#) will trade long-term securities of at least 10 years in exchange for shorter maturities of up to 3 years to promote proper functioning of the government debt market. The terms for each swap will be determined in each auction. The first auctions occurred on [April 29](#).

For the general domestic debt market:

- A \$4 billion temporary debt securities swap facility is to promote an orderly behavior of Mexico’s debt market. The facility aims to provide liquidity for securities that have become illiquid in the secondary market. Eligible institutions can exchange debt securities exchange for government securities. FLAO criteria apply for Peso-denominated securities eligible for the facility.

Other extensions of existing facilities:

- The Bank of Mexico [widened the eligibility of debt securities](#) in FLAO repos and of collateral for foreign exchange hedges settled by differences in [US dollar credit auctions](#). Securities eligible in Mexican pesos must have credit ratings of at least “A” in the local scale or “BB+” in the global scale (for securities denominated in foreign currency), from at least two agencies.
- In order to foster a sound functioning of the money market, Baxico has preserved excess liquidity during trading hours. To foster the orderly operating conditions in the MXN/USD exchange market, particularly when markets in Asia and Europe operate, by instruction of the Mexican Foreign Exchange Commission, the Bank of Mexico will conduct [hedge transactions settled by differences in US dollars at hours when Mexican markets are closed](#).

- Banxico reduced the DRM [by \\$2 billion](#). The resources will improve the liquidity of these institutions and their capacity to grant credit.