



XI Central Banking Operations Meeting

CEMLA and Banco de México

From the response to the COVID-19 crisis to the structural development of financial markets

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* The views expressed in this presentation are the ones of the author and do not necessarily reflect those of the Central Bank of Mexico.



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Introduction

- The COVID-19 pandemic inflicted an unprecedented shock to the global economy and worlds' financial markets. Emerging market economies suffered historically large capital outflows, and abrupt movements in financial asset prices in early 2020.
- The policy response was forceful, including massive monetary stimulus and large packages of fiscal measures to stimulate the economy. Banco de México addressed the pandemic working on four different dimensions: monetary policy, liquidity provision, credit channels and fostering an orderly behavior of financial markets.
- The extraordinary measures to address the crisis had a positive effect from the beginning, by providing liquidity and becoming an important backstop for financial markets. Up until the end of May, around 30 billion USD had been used to provide collateralized funding to financial institutions (that represents 2.4% of GDP). Around 18,000 SMEs and 215,000 households had also benefited from such measures.
- As the worst of the crisis was left behind, the focus shifted to an orderly winding-down of the extraordinary facilities, and staying the course towards the development of liquid and resilient financial markets.

Policy response

- In response to financial markets' volatility, weaker economic growth, and lower inflation and inflation expectations, Banco de México announced several policy measures, targeting four dimensions. If fully implemented, these measures would have represented about 5% of GDP.

Monetary Policy

- Reduction of target interest rate from 7.00% to 4.00%.
- *Last week, the Central Bank raised its interest rate to 4.25% to strengthen the monetary policy stance in order to avoid rising inflation to materially affect inflation expectations.*

Liquidity Provision

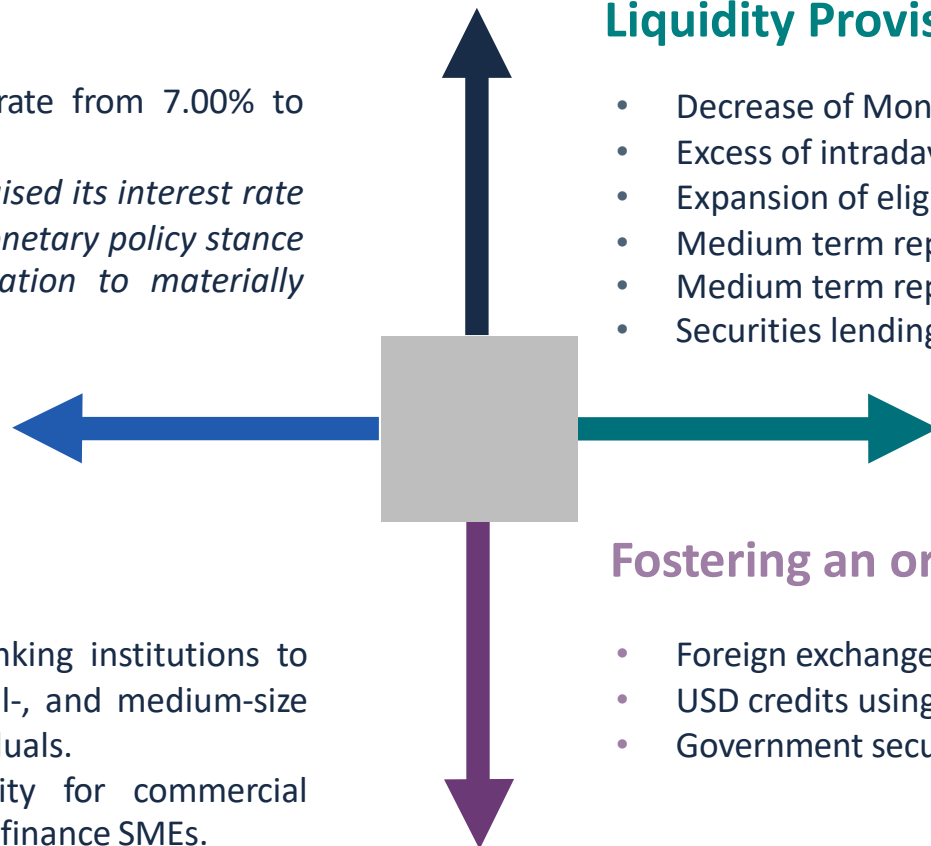
- Decrease of Monetary Regulation Deposit
- Excess of intraday liquidity.
- Expansion of eligible collateral for liquidity facilities.
- Medium term repo facility for government securities.
- Medium term repo facility for corporate securities.
- Securities lending facility (swap collateral facility)

Credit Channel

- Provision of resources to banking institutions to channel credit to micro, small-, and medium-size enterprises (SMEs) and individuals.
- Collateralized financing facility for commercial banks with corporate loans, to finance SMEs.

Fostering an orderly behavior of markets

- Foreign exchange hedges (2 billion USD)
- USD credits using the Federal Reserve swap line.
- Government securities exchange operations.

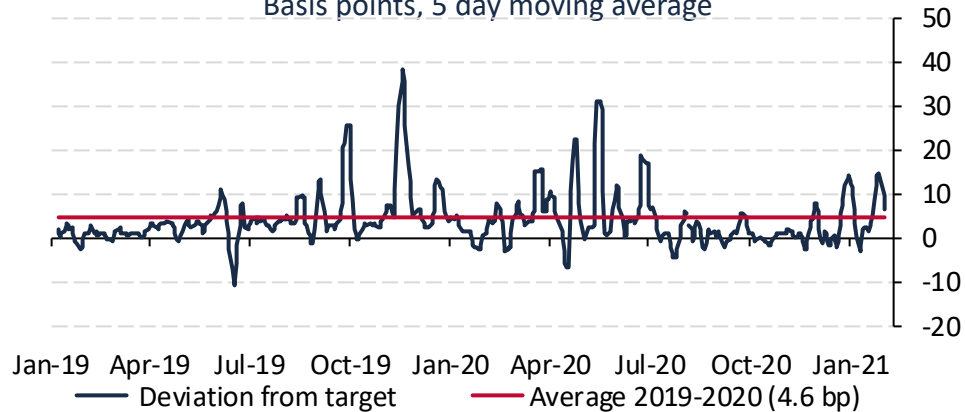


Policy response

- As mentioned, these measures have helped Banco de México to successfully implement monetary policy and prevent an unwelcomed tightening of financial conditions.

Spread between target rate and interbank funding rate

Basis points, 5 day moving average

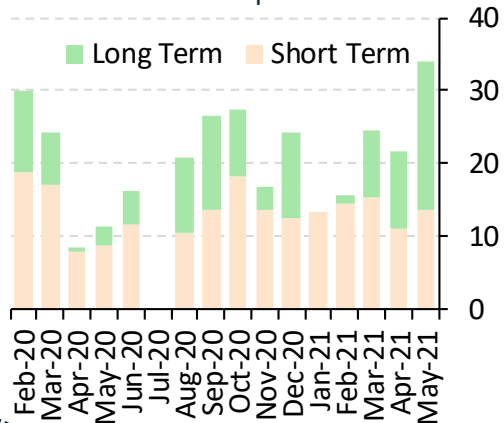


Money market stability

- Good liquidity conditions in payments and financial system.
- Interbank funding rate has not shown major deviations regarding the monetary policy target rate.

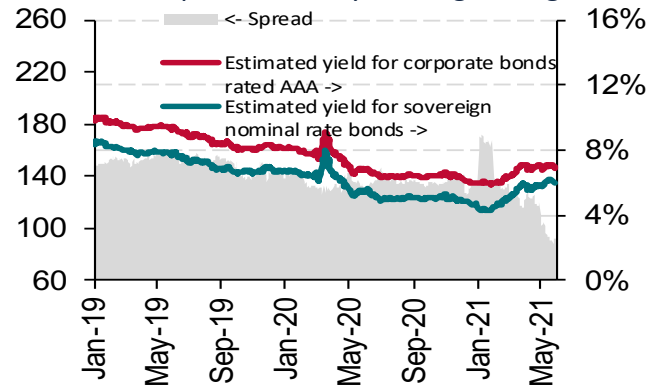
Monthly corporate debt issuance

Billion pesos



Spread between AAA corporate emission and government bonds with similar duration

Basis points, 10-day moving average

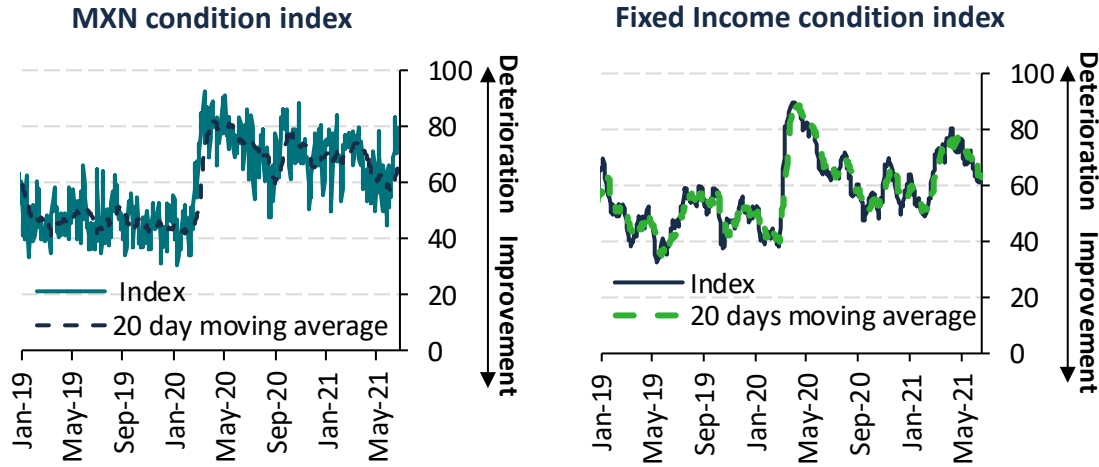


Corporate debt market

- Debt issuance resumed in the second half of 2020.
- More dynamic operation in the secondary market.
- Spreads in corporate debt have tightened.

Policy response

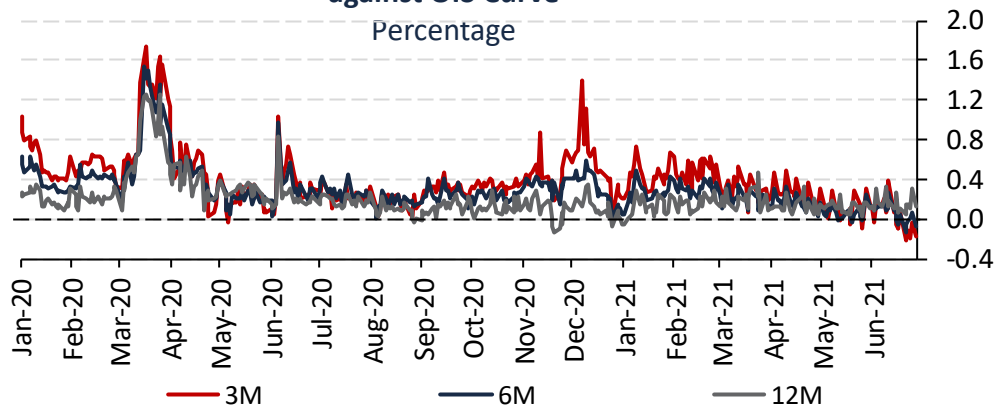
- As mentioned, these measures have helped Banco de México to successfully implement monetary policy and prevent an unwelcomed tightening of financial conditions.



Improvement of trading conditions in Foreign Exchange and Fixed Income markets (not yet in pre-pandemic levels)

- Conditions across markets showed improvement, but were highly dependent to US financial conditions

Spread of USD Forward Implied Yields in the USD/MXN Forward Curve against OIS Curve



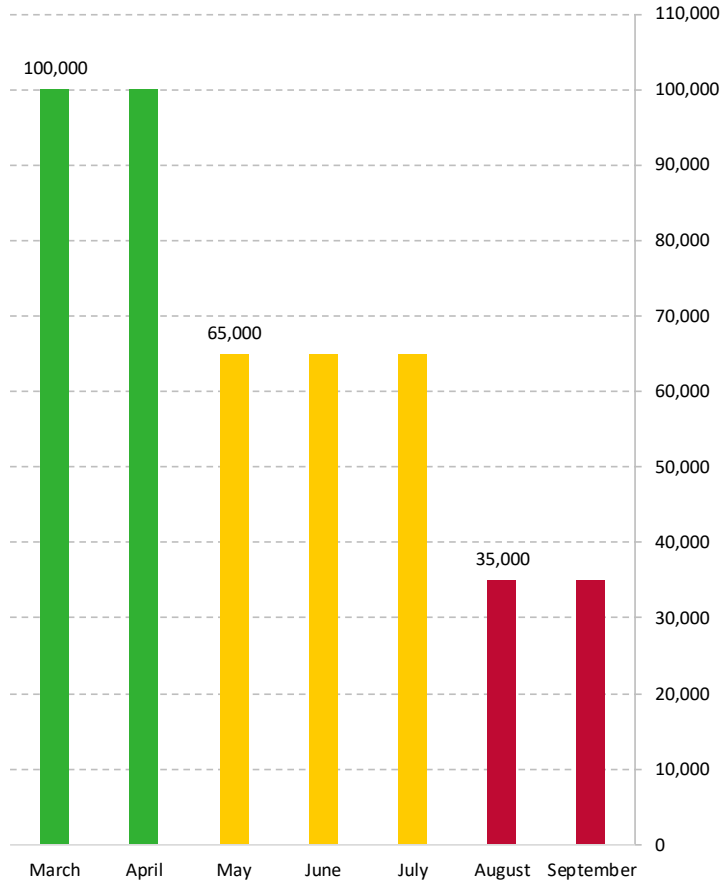
USD funding has also remained stable through time, despite concerns about COVID-19 and the expectation of a bond tantrum

- USD funding rates have presented little deviation from the FED's funding range.

Policy response: Avoiding cliff scenarios

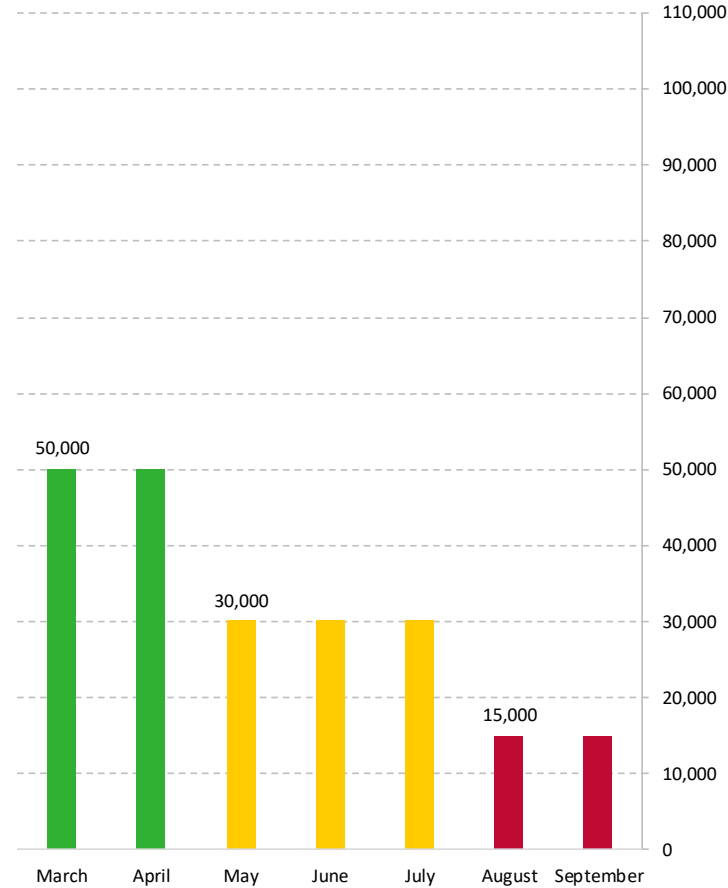
- The gradual reduction of the extraordinary liquidity facilities that were used during the pandemic will contribute to avoid a cliff-effect in local financial markets.

Government Securities Repurchase Facility Million pesos



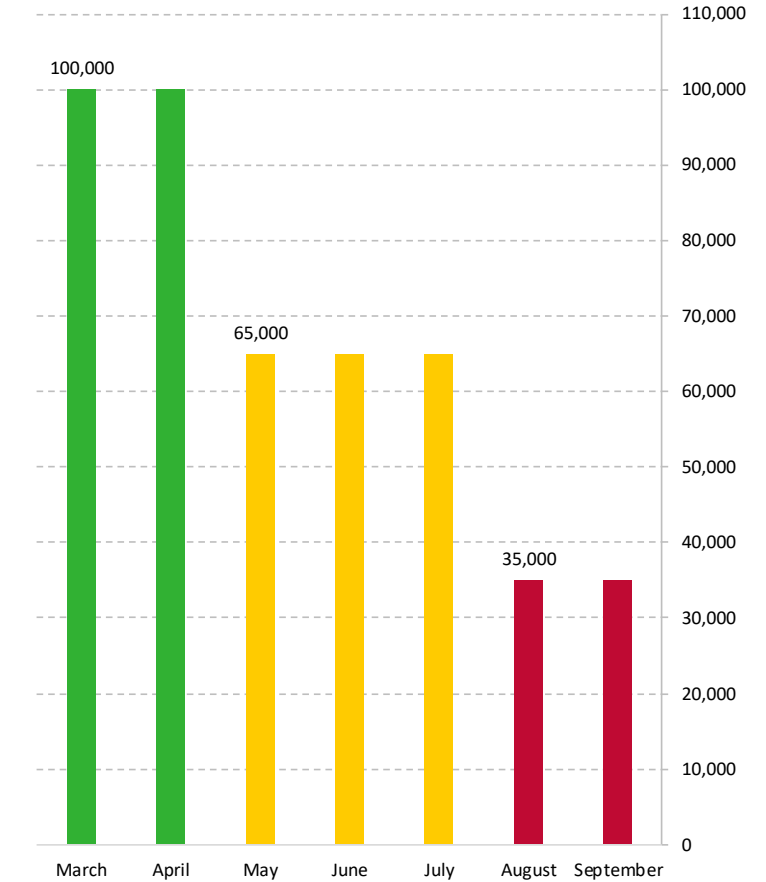
Source: Bank of Mexico

Temporary security swap window for low liquidity instruments Million pesos



Source: Bank of Mexico

Corporate Securities Repurchase Facility Million pesos



Source: Bank of Mexico

From the juncture of COVID to the structural development of markets

- Looking past COVID-19, the focus will be the further development of our financial markets.

Specialized working groups
formed by market
participants, regulators and
supervisors



Working group on
Derivates



Working group on **Repo
Operations**



Working group on
Securities Lending



Working group on
**Inflation Linked
Securities**



Working group on
Corporate Debt



Working group on **Market
Infrastructure (CCP)**



Working group on **Libor
Transition**

Working group on Derivatives



Main objective: Analyze and create initiatives to further develop Mexican derivatives markets (Exchange traded and OTC). Projects and proposals include:

- Credit derivatives as means to further develop corporate debt market.
- Analyze the feasibility of implementing a Market Makers program for the derivatives market.

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Working group on Repo Operations



Main objective: Adopt international best practices to further enhance the liquidity of financial instruments through repo operations. Projects and proposals include:

- GMRA
- Tri-party schemes
- Open repo
- Collateral management

Working group on Securities Lending



Main objective: Adopt international best practices to further enhance the liquidity of financial instruments through the securities lending market. Projects and proposals include:

- MSLA
- Tri-party schemes
- Open loans
- Collateral management
- Regulatory changes in fiscal matters
- Enhancing market reference data

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Working group on Inflation linked securities



Main objectives: Expand the investor base in inflation linked securities in order to enhance its liquidity. Projects and proposals include:

- Including Udibonos in widely used bond Indexes.
- Meeting with investors in order to increase awareness of the characteristics and benefits of these securities.

Working group on Corporate Debt Markets



Main objectives: Expand the investor base in corporate debt securities in order to enhance its liquidity. Projects and proposals include:

- Addressing taxation issues to promote foreign investor participation.
- Developing a reference curve together with quasi-government issuers.
- Analyzing the feasibility of implementing a Market Makers program for the corporate debt market.
- Adjusting valuation methodologies and enhancing market reference data.

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Working group on Market Infrastructure – CCP



Main objective: Analyze the feasibility of implementing a central clearing counterparty (CCP) in order to further develop debt market, repo market, and securities lending market. Projects and proposals include:

- Analyzing the role of a CCP in enhancing transparency in the markets.
- Analyzing the role of a CCP in adopting electronic platforms.
- Cost/benefit analysis given the different characteristics across markets.

Working group on Libor transition



Main objective: Adoption of the new Mexican reference rate *TIIE de Fondeo*. Projects and proposals include:

- Development of futures linked to *TIIE de Fondeo* (CME and Mexder)
- Development of fixed income securities linked to *TIIE de Fondeo*.
- Adoption of *TIIE de Fondeo* in credit products.

Final Remarks

- The COVID-19 pandemic has had a severe impact in the world economy and financial markets. It has also presented extraordinary challenges for central bank policy making.
- Banco de México, acted swiftly to promote an orderly adjustment of financial markets and to stimulate economic activity, providing ample liquidity, maintaining the flow of credit to the economy, and intervening to temper volatility and market dysfunction.
- The extraordinary facilities that were implemented during the crisis will be closed down gradually in the coming months but will remain as part of the toolkit of central banks to address financial stress going forward. This is a key legacy of CB's response to the pandemic.
- Looking past COVID-19, the long-term challenge for EMEs remains: building liquid and resilient financial markets that facilitate the price-discovery process, and work as shock-absorbers during financial turbulence. Doing so will aid EMEs in preventing and mitigating crisis, and in promoting long-term financial stability.
- In that regard, Banco de México has an ambitious agenda to further develop its financial markets in the coming year.



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