

4-27-1994

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Recommended Citation

LADB Staff. "Government Raises Rates On Short-term Treasury Certificates." (1994). <https://digitalrepository.unm.edu/sourcemex/3176>

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Government Raises Rates On Short-term Treasury Certificates

by LADB Staff

Category/Department: Mexico

Published: 1994-04-27

On April 20, President Carlos Salinas de Gortari's administration raised interest rates paid on short-term Treasury Certificates (CETES) to 18%, the highest level since November of 1992. The CETES rate increased 3.42 percentage points from the previous week, which represented an attractive alternative to investors who had to decide whether to roll over their expiring CETES or to move their funds to a different investment.

Move intends to stabilize investment climate

According to financial analysts, the Salinas administration took the step to raise rates for Treasury Certificates because of concerns that investors would withdraw their money en masse, or at least limit new investments in Mexican securities and direct investments.

A related concern was that a massive withdrawal of investments in securities would reduce the country's supply of dollars enough to cause a dangerous decline in the value of the peso. In fact, according to a report from the brokerage house Casa de Bolsa Bancomer, an average of US\$218 million per day was withdrawn from Mexican financial instruments between March 25 and April 15.

The flight followed the assassination of the governing Institutional Revolutionary Party's (PRI) presidential candidate, Luis Donaldo Colosio. Casa de Bolsa Bancomer said the exit of dollars from Mexico, while not enough to cause significant concern, nevertheless forced the Banco de Mexico (central bank) to release almost US\$3.3 billion into the foreign exchange markets in order to support the value of the peso.

The decision to raise the rate for CETES appears to have succeeded in supporting the peso, as evidenced by movements at the Mexican Stock Exchange (BMV). In the three trading sessions prior to the announcement of the higher CETES rates (April 18-20), the BMV's main stock index (Indice de Precios y Cotizaciones, IPC) had declined by more than 11%, falling below the psychological support level of 2000 points.

During the next two sessions (April 21-22), the IPC rebounded to close at 2209 points. One of the factors cited by analysts for the rally was the stability of the peso. Some analysts suggested the Salinas administration is likely to retain a relatively high CETES rate at least through the presidential elections at the end of August. In fact, on April 22, the Banco de Mexico announced that only 1.15 billion nuevo pesos (US\$341 million) in the four types of CETES would be offered during the April 27 auction, half the amount which had been offered the previous week, in order to reduce the supply and boost rates.

Still, some financial market analysts told Agence France- Presse they anticipated CETES rates for the May 4 auction to be reduced by the same percentage as they were increased for the April 27 auction.

Meanwhile, some analysts warn that the Salinas administration is taking short-term solutions to restore investor confidence at the expense of long-term growth. One consequence of the higher interest rates, for example, is a lack of liquidity in the market, which could intensify the country's economic slowdown and limit job creation. According to some estimates, this year's GDP growth will not surpass 1%. In fact, according to preliminary government statistics, the GDP growth rate for the January-March quarter was zero. In contrast, the six-year plan presented by Salinas at the beginning of his term in office in 1988 had forecast GDP growth for 1994 at 6%.

Meantime, continuing political uncertainty in Mexico appears to have put a damper on new foreign investment, not only in the securities markets, but in direct projects. For instance, Carlos Orduna, president of the National Maquiladora Industry Council (Consejo Nacional de la Industria Maquiladora de Exportacion), told reporters that parent companies of maquiladora plants have delayed expansion projects worth about US\$3 billion because of concerns over recent political unrest. The investment delay in turn has put expansion plans on hold, and limited creation of new jobs in the maquiladora sector

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