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Mexico Launches New Instruments to Help Ease Impact of Devaluation

by LADB Staff

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President Ernesto Zedillo's administration and the Banco de Mexico (central bank) are in the process of developing new financial instruments designed to assist small-scale and medium-sized agricultural producers and businesses deal with the high interest rates and inflation that followed the devaluation of the peso in December. Two of these instruments a new unit of value dubbed Unidades de Inversion (UDIs), plus a program allowing banks to participate in futures market transactions were enacted or approved during March. According to administration officials, other measures to help Mexican businesses deal with economic uncertainties will be announced later in the year, including a program to offer relief for real estate payments.

The decision to create the program for the UDIs was immediately accepted by the Chamber of Deputies and the Senate, which in late March passed legislation to approve the creation of these financial instruments, to be funded by the government with 76 billion nuevo pesos (US\$11.4 billion). Under the program, loan principal and interest rates will be denominated in UDIs, which would remain constant in real terms. The UDIs were created to provide some certainty for debtors by restructuring debt payments at a more stable interest rate, whose index would be tied to a daily inflation index, rather than to volatile markets. The UDIs will also be used as denominations for commercial contracts, but will not circulate as currency.

According to some legislators, their use may be expanded in the future for salary payments and real estate rents. Many banking officials emphasized, however, that UDIs will benefit only those businesses that have demonstrated a past ability to meet their obligations. The UDIs will allow these companies to restructure their debt to stretch out payments over periods of five or 10 years. In a report published on March 29, Grupo Financiero Bancomer detailed the shortcomings of the UDIs, such as the fact that they will not help businesses address insolvency problems caused by high interest rates. According to the Bancomer report, two factors will contribute to maintaining interest rates high: low supply and high demand for loans, and the government's emergency economic measures, which place a strong emphasis on limiting credit in order to restrict inflation.

The concerns about the inadequacy of UDIs to solve the country's credit problems was echoed by leaders of El Barzon, an organization formed to look after the rights of middle- income farmers and consumers. Alfonso Ramirez Cuellar, coordinator of El Barzon in Mexico City, charged that the UDIs program is inadequate, not only because of its limited coverage, but because the program does not reduce other costs for debtors, who will have to make up the difference between inflation and the principal. Additionally, he said the program fails to address the needs of private individuals, whose debts incurred through credit cards are as problematic for the Mexican economy as those incurred by businesses. On the other hand, Victor Manuel Terrones Lopez, head of the manufacturers chamber (Camara Nacional de la Industria de Transformacion, Canacindra) praised the program,

saying that the 76 billion nuevo pesos (US\$11.4 billion) provided under the program will allow the financial rescue of numerous small- and medium-sized businesses.

Members of the Zedillo administration also made special efforts to promote the benefit of UDIs. Speaking to an agricultural producers' group in late March, Agriculture Secretary Francisco Labastida said the UDIs will help the agricultural sector begin to deal with the severe problem of overdue debt that has hampered the ability of many small- and medium-sized producers to obtain new loans. According to Labastida, the accumulated overdue debt by the agricultural sector was close to 6.3 billion nuevo pesos (US\$945 million) as of December 1994. Similarly, during an address before the Chamber of Deputies, Angel Palomino of the Finance Secretariat (SHCP) and Javier Gavito of the government's banking commission (Comision Nacional Bancaria, CNB) explained that UDIs were created as a mechanism to offer some protection to debtors against inflationary swings. Palomino and Gavito said banks will be given wide latitude to determine which businesses will be offered the opportunity to enter the UDIs program, although these institutions will be required to channel assistance to small- and medium-sized businesses. However, they acknowledged that UDIs will only service up to 14% of the overdue debt.

For his part, Jose Madariaga Lomeli, president of the Asociacion de Banqueros de Mexico (ABM), confirmed that bankers will be very selective regarding eligibility for the UDIs program. Speaking at a meeting of the Confederacion Nacional Ganadera (CNG) during March, he said bankers are "extremely concerned" about the growing problem with overdue debts, since banks do not have sufficient funds to cover bankruptcies. According to *El Financiero* daily business newspaper, banks have already started to create special units within their organizations to deal with the UDIs. The newspaper said that the first operation to restructure credit was expected sometime in mid-April.

On a related matter, the Banco de Mexico (central bank) on March 19 announced that Mexican bankers have been authorized to participate in purchase of futures contracts at the foreign currency futures market at the Chicago Mercantile Exchange (CME), based on the anticipated value of the peso in relation to the dollar. The banks have been authorized to conduct these transactions at the CME either for themselves or on behalf of customers. Through the purchase of a futures contract, the banks will be able to lock in a price in dollars for pesos, thus creating an element of certainty for the peso- dollar exchange rate. According to the Banco de Mexico, by locking in the exchange rate, Mexicans will be able to conduct export and import transactions and make investment decisions with greater certainty. [Note: Peso-dollar conversions in this article are based on a conversion rate on April 4 of 6.665 pesos per US\$1.00] (Sources: Spanish news service EFE, 03/19/95; *El Financiero* International, 03/20/95; *La Jornada*, 03/20/95, 03/21/95, 03/23/95, 03/24/95; Inter Press Service, *El Nacional*, *Reforma*, Agence France-Presse, 03/19/95, 03/29/95; Notimex, 03/28/95, 04/01/95; *El Financiero*, 04/04/95)

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