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Mexican Corporations Behind Sharp Decline in Peso.

by LADB Staff
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The Mexican peso, which had exhibited remarkable stability over the past several years, suffered an unusually abrupt decline in mid-October, leading Finance Secretary Agustin Carstens to suggest that the drop was caused by market speculation. Without offering details, Carstens made the comments after the Mexican currency experienced its largest one-day drop in more than a decade, sliding to almost 12 pesos per US$1.00 on Oct. 6.

Even though the currency eventually traded as low as 14 pesos per US$1.00 that week, the finance secretary moved quickly to reassure the markets that Mexico was not experiencing a devaluation similar to the one that occurred in late 1994. But the prospect that market speculation or even manipulation may have occurred raised a firestorm of controversy in Mexico, leading the Mexican Congress and others to ask for a thorough investigation.

Major corporations involved
Carstens revealed his suspicions during an interview with the television network Televisa. He said the peso plunged because several companies and banks conducted a large number of speculative operations in the derivatives markets to improve their financial positions. Foreign-currency derivatives involve contracts tied to the value of the US dollar. Companies use these instruments as a form of insurance against unexpected moves in currency markets.

The wave of speculative selling caused the peso to drop by its largest margin in percentages since March 1995, when Mexico was in the midst of an economic crisis following the 1994 peso devaluation (see SourceMex, 1995-01-04 and 1995-01-11).

The peso continued falling on Oct. 7-8, forcing the Banco de Mexico (central bank) to auction off US $2.5 billion of its dollar reserves to prop up the Mexican currency. Carstens and other officials from the Secretaria de Hacienda y Credito Publico (SHCP) declined to name the companies involved in the massive sale of pesos, but information surfaced later naming several top corporations in Mexico, including the giant retailer Comercial Mexicana, the cement manufacturer CEMEX, business conglomerates Grupo Alfa and Grupo Saltillo and others, tourism-oriented conglomerate Grupo Posadas, and glass manufacturer Grupo Vitro.

The food giant Grupo Industrial Maseca (GRUMA) was also mentioned, but the company denied having played any role in the sharp drop in the peso. Critics challenged the finance secretary to conduct an exhaustive investigation to get to the bottom of the situation. "Agustin Carstens knows which business predators forced the release of foreign reserves," columnist Ricardo Aleman wrote in the Mexico City daily newspaper El Universal. "We know a few names...but why not identify all the predators?"
Others had similar thoughts. "They swindled us again. There is no doubt about this," wrote columnist Martin Moreno in the Mexico City daily newspaper Excelsior. "No matter how much the neoliberal government [of President Felipe Calderon] wants to explain or justify these transactions, the truth is that, in just three days, US$8.9 billion disappeared, or about 11% of our national reserves." Legislators from the opposition Partido Revolucionario Institucional (PRI) called for a complete investigation, asking that the companies involved be punished. "This gang of speculators must be denounced," PRI Deputy Samuel Aguilar said at a hearing on this issue by the finance committee (Comision de Hacienda) in the lower house.

The maneuver backfired for at least one of the companies involved, retail giant Comercial Mexicana, which suffered significant losses by having used these instruments to sell rather than to buy dollars and was forced to file for bankruptcy protection. The company, which had recently reported strong growth, surprised the market when it filed for bankruptcy protection after failing to meet a loan payment. The retailer listed more than US$2 billion in liabilities, including US$1 billion from derivatives tied to Mexico's peso.

Some officials questioned whether the Mexican retailer should have even been involved in the derivatives market. "That company doesn't have a reason to be in those types of activities," Guillermo Ortiz, the chief governor at the Banco de Mexico, said in an interview with the radio network Radio Formula. Ortiz also criticized the "lack of professionalism" at the investment banks that sold the derivatives.

For some companies like GRUMA, which has operations throughout the world, the participation in foreign-currency transactions is not uncommon. In addition to its plants in Mexico, the company operates facilities in the US, Central America, Venezuela, Australia, and several nations in Europe and Asia and exports to 50 countries. Still, the company denied having participated in the transactions that drove the peso lower in early October. "Even with the high volume of its operations, GRUMA did not acquire dollars in the Banco de Mexico's auctions that resulted in the pressure on the exchange rate," the company said in a news release.

**Securities regulator launches investigation**

The situation prompted the government's securities and banking regulating agency (Comision Nacional Bancaria y de Valores, CNBV) to begin an investigation of the circumstances that led to transactions that caused the sharp decline in the peso. Some analysts emphasized that there is nothing to prohibit Mexican companies from entering into these types of transactions. Rather, the investigation is focused on whether these companies properly reported their holdings of derivatives in financial reports.

Under Mexico's securities law, the failure to disclose certain transactions could result in fines and, in some rare cases, criminal charges. "Speculation is not a crime. Neither is earning money or even losing your company in the process," said Carlos Lloret de Mora, a columnist for the Mexico City daily newspaper El Universal. "The crime is not providing information of financial transactions to councils and stockholders." The Mexico City newspaper La Jornada said Comercial Mexicana had accumulated derivatives in its treasury, which it had failed to report to its creditors, including several Mexican banks. CNBV president Guillermo Babatz said the decision of companies to keep
their transactions secret could hurt Mexico's financial markets in the long run. "[This situation] does terrible damage to the reputation of financial institutions and to the market," Babatz told the London-based Financial Times.

Carstens said the securities and banking regulator plans to conduct a review on whether the banks that sold the instruments, and companies that bought them, violated regulations on disclosure or other rules. "The government is going to take a tougher stance, ensuring that all banks and companies [listed on the Mexican stock exchange] meet all transparency requirements," the finance secretary told participants at an annual meeting of the World Bank and the International Monetary Fund (IMF) in mid-October.

**Senate to tighten rules for derivatives market**

The Mexican Senate is also considering proposing legislation to tighten regulations for Mexican companies participating in the derivatives market. "We are going to put together a series of proposals to regulate the derivatives market so that all risks to companies and the financial system are revealed in a timely fashion," said Sen. Gustavo Madero Munoz, floor leader for the governing Partido Accion Nacional (PAN) in the upper house. Madero said the proposed changes were presented to Banco de Mexico chief governor Ortiz during a meeting, which also included Senate leaders from the two other major parties, Sen. Manlio Fabio Beltrones of the PRI and Sen. Carlos Navarrete of the center-left Partido de la Revolucion Democratica (PRD).

Among other things, regulations would cover certain over-the-counter operations, which are frequently not revealed to administrative councils and investors. Beltrones said Ortiz was very open to the proposals presented by the Senate leaders. There was also some concern that the problems in the derivatives market could have an adverse effect on Mexican banks. Babatz dismissed those concerns, pointing out that the Mexican banking sector is subject to much stricter oversight than participants in the financial markets.

**Government dismisses concerns of devaluation**

Amid the chaos that resulted in the Mexican financial markets, officials were careful to emphasize that the sharp drop in the value of the peso was not related to macroeconomic factors. "[The peso decline] has nothing to do with the fundamentals of the economy," the finance secretary said during his address to the World Bank and IMF. "We cannot call this a devaluation," Economy Secretary Gerardo Ruiz Mateos said during an address to the Consejo Nacional de la Industria Manufacturera y Maquiladora de Exportacion (CNIMME). "This was simply a situation where several companies decided to buy dollars at the same time."

Some private analysts said the loss of value of the peso is not the main concern, but rather it is the market reaction. "What is worrisome is the large amount of money that was used to make the adjustment," said analyst Roberto Galvan of Vanguardia Investment, in reference to the Banco de Mexico's sale of almost US$9 billion. "This is a reflection of the high level of nervousness in the market." Even before the plunge of the peso in the first half of October, the Mexican currency had been losing ground relative to the dollar because of the US economic crisis. In particular, there is concern that the US could experience a recession, greatly reducing Mexican exports to the US.
A US economic slump is affecting Mexico in other ways, such as contributing to a decline in remittances received from expatriates and reducing the influx of US tourists (see SourceMex, 2008-10-01). And observers say the US government’s recent decision to rescue the US financial sector has had little impact on the Mexican currency. "Since Sept. 22, when the rescue package for US financial institutions was first announced, the peso has lost about 13% in value, while the US dollar has reached its highest level [against the peso] since 1992," said La Jornada.

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