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MEXICO

MINISTRY OF FINANCE

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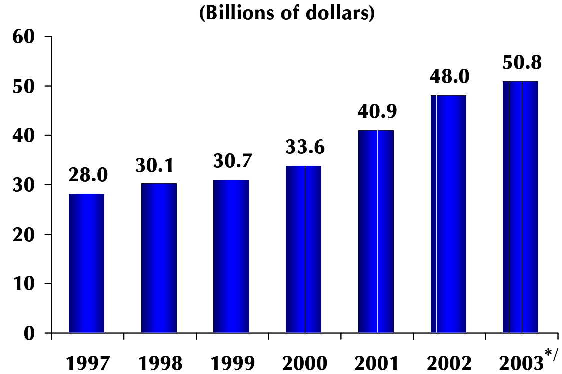
The Exchange Commission Announces a Rules-Based Mechanism to Reduce the Rate of International Reserve Accumulation

1. Introduction

- The level of International Reserves accumulated at the Bank of Mexico has increased sharply in recent years. This build-up of reserves has strengthened investor's confidence in the Mexican economy, has improved access of private and public sector issuers to international capital markets and, in general, has contributed to maintain a stable economic environment.

NET INTERNATIONAL RESERVES

(Billions of dollars)



*/ Figures as of March 17, 2003.
Source: Banco de Mexico.

- However, the accumulation of international reserves has its cost. In particular, maintaining an international reserve position entails a cost of "carry", since the interest rate that the Bank of Mexico pays on the domestic notes it issues to finance the purchase of reserves is generally higher than the yield that it receives from investing these reserves in liquid and high credit quality instruments.

- Given the current level of international reserves and its anticipated pace of accumulation for the year (under current conditions the accumulation of international reserves in 2003 could amount to more than U.S. 7,000 million), it is reasonable to expect that an increasing international reserve position would result in progressively lower net benefits.

2. Rules-Based Mechanism to Reduce the Rate of International Reserve Accumulation

- The Exchange Commission has decided to implement a rules-based mechanism designed to reduce the rate of international reserve accumulation, independently of a particular exchange rate level or range.

- The new mechanism establishes that the Bank of Mexico will sell dollars directly in the foreign exchange market according to the following rules:

1. Every quarter, the Bank of Mexico will announce the total amount of dollars it will supply to the currency market in the following three-month period. The total amount of dollars to be sold during the quarter will be equal to 50% of the accumulation of net international reserves registered in the previous quarter, after considering the dollar sales associated with this procedure that took place in the aforementioned period. That is:

$$SALES_t = \frac{AIR_{t-1}}{2}$$

Where $AIR_{t-1} = IR_{t-1} - (IR_{t-2} - SALES_{t-1})$, and

AIR_{t-1} represents the accumulation of net international reserves registered in the previous quarter.

IR_{t-1} represents the level of net international reserves at the end of the previous quarter.

IR_{t-2} represents the level of net international reserves recorded two quarters back.

$SALES_{t-1}$ represents the total amount of dollars sold under this procedure between the period *t-2* and *t-1*.

2. Based on this total amount of dollars, the Bank of Mexico will auction on a daily basis a fixed amount of dollars following a pre-established schedule. The daily amount to be sold will be determined according to the number of working days in the prevalent quarter. For example, if $SALES_t = U.S.\ 1{,}500\ \ million$ and there are 60 working days in period *t*, the daily amount of dollars to be auctioned will total U.S. 25 million.

3. Only Credit Institutions with full authorization to operate in Mexico may participate in the transactions.

4. The mechanism will be temporarily suspended if $SALES_t$ is less than U.S. 125 million.

5. The mechanism will be reestablished when the level of net international reserve accumulation is higher than U.S. 250 million as compared to the level recorded in the last quarter in which a dollar sale was announced, after adjusting for the dollar sales implemented in such quarter. That is, when:

$$IR_{t-1} - (IR_f - SALES_f) > U.S.\ \ 250\ \ million$$

Where

IR_f represents the level of net international reserves used to compute the accumulation of net reserves in the last quarter in which a dollar sale was announced.

$SALES_f$ represents the last announced amount of dollars to be sold between the period *f* and *f+1*.

6. The daily auction procedure will start operations on May 2nd, 2003, based on the accumulation of net international reserves registered in the period January 17-April 16 of 2003. The precise amount of dollars to be sold in the daily auctions will be announced on April 22, 2003.

Final Remarks

- The objective of the daily auction mechanism is to reduce the rate of international reserve accumulation, without reducing the current position of international reserves in the Bank of Mexico.
- The daily auction procedure is based on a clear set of rules designed to avoid any discretionary participation of the Mexican authorities in the foreign exchange market.
- The Exchange Commission reiterates that the implementation of the daily auction mechanism does not alter the current flexible exchange rate regime nor does attempt to manipulate or target the exchange rate.