

MINISTRY OF FINANCE

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The Exchange Commission Announces Adjustments to the Rule-Based Mechanism to Reduce the Rate of International Reserve Accumulation

Background

- During March of 2003, the Exchange Commission decided to implement a rule-based mechanism designed to reduce the rate of international reserve accumulation. This mechanism was adopted because international reserves had increased, and the perceived benefits associated with further increases had declined.
- As a result, since May 2003, the Bank of Mexico has held daily dollar auctions among the country's credit institutions. The amount of dollars to be sold during the quarter is equal to 50% of the accumulation of net international reserves that would have been registered in the previous quarter had the dollar sales associated to the mechanism had not taken place. The mechanism has been rule-based and non-discretionary, and therefore has not affected the free floating exchange rate regime. It is worth highlighting that

the amount auctioned during the period that the mechanism has been in place is 4,661 millions of dollars.

Changes to the Mechanism

- The daily auction mechanism has been successful in reducing the rate of reserve accumulation. However, the changes in the amount of reserves to be auctioned from one quarter to the next have been highly variable, which at times has generated uncertainty among market participants. As a result, it has been decided to make some adjustments to the mechanism in order to smooth the amounts of reserves that are auctioned throughout the year.
- The following changes will be implemented to the mechanism:
 1. The Bank of Mexico will continue to make quarterly announcements regarding the daily amounts of dollars to be auctioned. The amount to be

sold will continue to be equal to 50% of the accumulation of net international reserves that would have been registered in the previous quarter had the dollar sales associated to the mechanism had not taken place. However, the sales of US dollars will now be carried out during the next four quarters and not only in the next immediate one. As a result, only $\frac{1}{4}$ of the established amount will be auctioned during the next quarter. The rest will be sold in equal amounts during each of the following three quarters. This procedure will be repeated each quarter.

2. The Bank of Mexico will continue to auction on a daily basis, at a pre-established time. As it has been the case, the amount to be auctioned daily will be a function of the number of working days available on the given quarter.
3. If the amount of dollar sales determined for a quarter were an amount which would generate daily sales of less

than 2 million dollars, the daily sales will be of 2 million dollars until the total amount of reserves to be auctioned during that quarter is depleted.

Application of the New Rules

- The changes to the mechanism will become effective in the next sales period (May-July 2004). The amount of dollars to be sold in the next period will be determined according to the procedure described in number 1 above, and it will take into account the accumulation of net reserves that took place from April 16, 2003 until April 16, 2004. Even though the net reserve accumulations of the previous three sales periods has already been used to calculate dollar sales, they are considered to be the best available estimator of the amount of dollars that will be accumulated during the rest of 2004. Therefore, the modifications to the mechanism will have a reduced effect on total dollar sales.