Economic Analysis

Banxico's Measures Do Not Print Money to Fund the Government

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- **Banxico's measures look to meet three main targets: an orderly function of local fixed income markets, facilitation of banking credit flows and the injection of more liquidity into the Mexican financial system under the current economic context**
- **The extension of the Ordinary Additional Liquidity Facility to development banks and the reduction in the Monetary Regulation Deposit have created suspicion that Banxico may be printing money**
- **Nevertheless, Banxico will neutralize the monetary impact of such measures and, therefore, no money creation will occur**
- **Banxico's measures will help to mitigate the risk of the current economic crisis turning into a financial crisis**
- **We reiterate that such measures will be more forceful to the extent that the monetary policy rate decreases further and development banks participate decidedly through credit guarantees**

Last week, Banxico announced a set of ten new measures in addition to the four that it had published on March 20. In general, with these new measures Banxico seeks to achieve three main objectives: the more orderly functioning of domestic fixed-income markets; to facilitate bank credit flows; and to inject greater liquidity into the Mexican financial system in the current economic context.

The measures recently announced by Banxico can be classified into four broad groups: (i) three refer to injecting greater liquidity into the money market, increasing the range of instruments eligible as collateral and the inclusion of development banks in a liquidity facility; (ii) four relate to specific operations of certain financial instruments that in total provide resources of up to 400 billion pesos (1.7% of GDP); (iii) two could be very useful in the current economic context and are aimed at facilitating the flow of credit to micro, small and medium-sized enterprises (MiSMEs) for an amount of resources of up to MXN 350 billion (1.4% of GDP); and (iv) one makes it possible to carry out auctions of currency hedges for settlement by differences in USD during the trading hours of the Asia and European markets.[1]

One of the ten additional measures shows Banxico allowing development banks access to the Ordinary Additional Liquidity Facility, enabling them to obtain liquidity at a cost of 1.1 times Banco de México's one-day interbank interest rate target through repurchase agreements or secured loans. In another measure, Banxico decides to free up resources for commercial and development banks by reducing the Monetary Regulation Deposit (MRD). These two

1/ For more details on each of the measures announced by Banxico, please see 'Banxico: Sound and Decisive Additional Measures to Promote Orderly Behavior,' available here.

measures appear to be sparking concern due to the wrong misinterpretation that Banxico is resorting to printing money to fund the public sector through development banking.

The extension of the FLAO to development banks by including repurchase agreements and secured loans will lead to an injection of liquidity by Banxico. This action will increase both the reserves of such banks and, to the same extent, the liabilities of Banxico. As these financial instruments generate interest yields, Banxico will absorb the aforementioned surplus of pesos. However, as any of these operations represents a credit policy action by the Central Bank, its monetary impact is either neutralized or sterilized.[2] Therefore, the surplus of pesos from interest yields will neither create money nor increase the monetary base. Meanwhile, sterilization enables Banco de México's one-day interbank interest rate to remain around its target level.

It is worth mentioning that a discussion has emerged as to whether these measures involve the use of Banco de México's international reserves. This is not the case: foreign exchange market transactions can be made under the swap line agreement with the US Federal Reserve.

Regarding the reduction of the MRD by MXN 50 billion (0.2% of GDP) that Banxico announced on March 20 to free up resources from commercial and development banks, the Central Bank reported that it would sterilize the monetary impact of this measure. In other words, this is a credit operation by Banxico that does not involve creating money or increasing the monetary base.

Conclusions

The measures announced by Banxico that include credit operations with development banks have been designed within the framework of the Law of Banco de México. This law prohibits the Central Bank from funding public deficits through the direct acquisition of government securities. As the measures that involve such banks are purely credit policy actions, they do not involve an expansion of the monetary base. In addition, these measures in no way make use of international reserves nor do they allow Banco de México to acquire toxic or low credit quality assets through secured loans or new instruments eligible as collateral. On this occasion, the economic crisis resulting from the COVID-19 pandemic finds banks in a relatively favorable position in terms of capitalization and liquidity. In general, Banxico's measures will help to mitigate the risk of the current economic crisis turning into a financial crisis.

2/ Sterilization refers to a set of open market operations carried out by a central bank so that the monetary base remains unchanged after international currency movements or movements in bank reserves.