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Bond Market Forum

Secondary Market Liquidity in Domestic Debt Markets

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Financial Markets Development in Mexico

May 2008



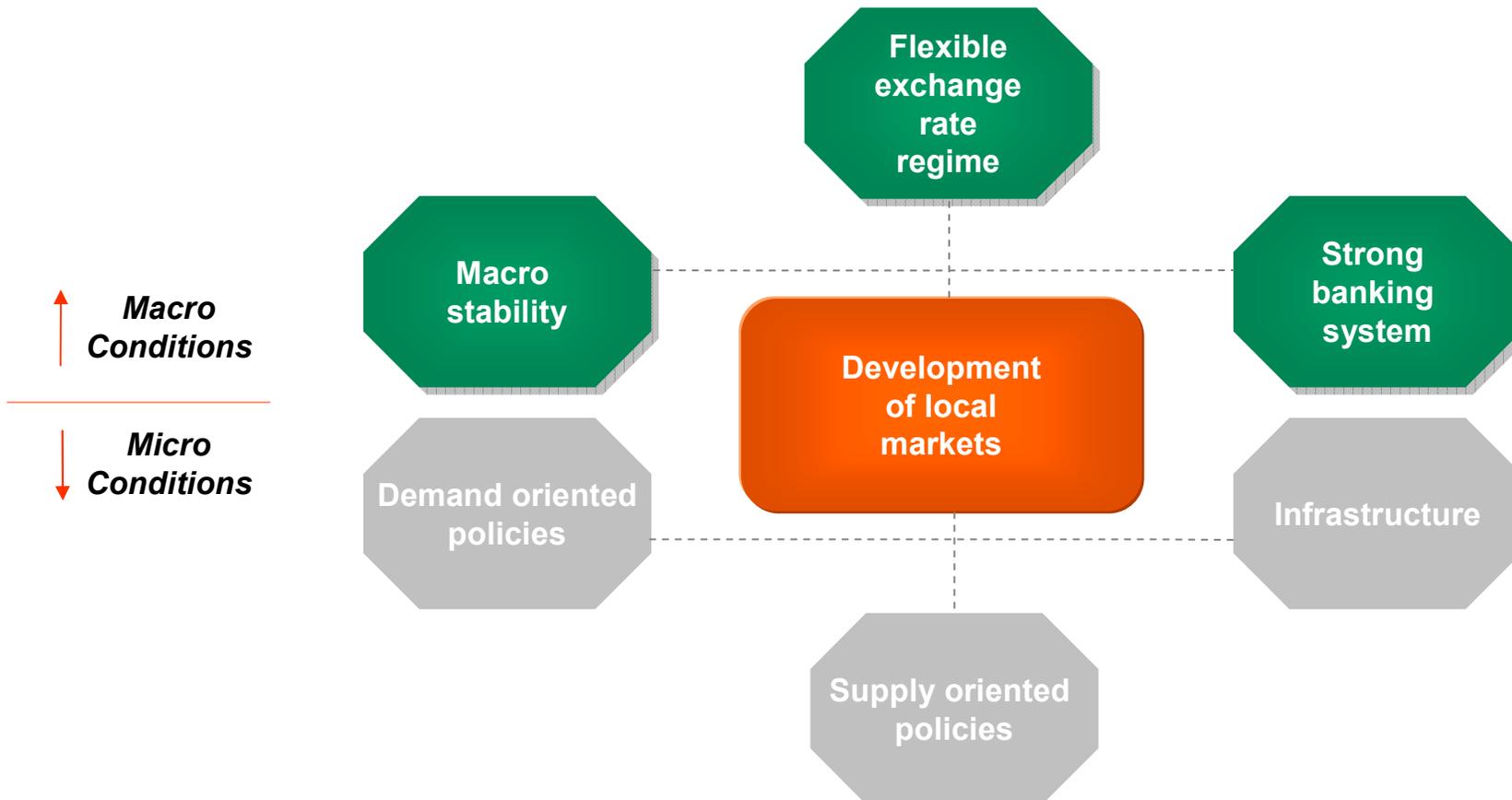
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I. Key Drivers for the Development of Local Markets

II. Market Performance

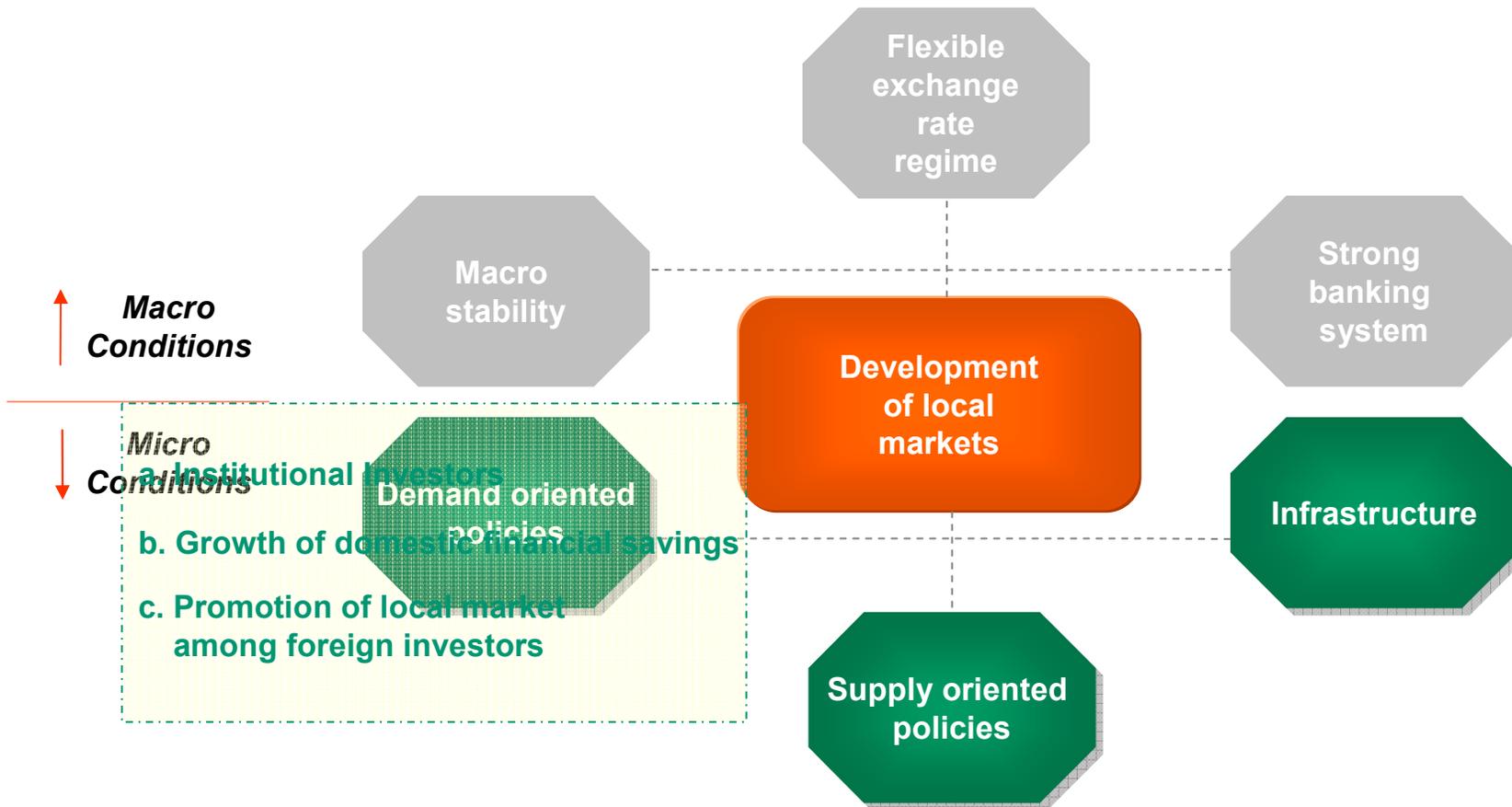
I. Key Drivers for the Development of Local Markets

There are some necessary conditions (macro) that need to be in place for a local market to develop on a sustainable basis. Once those are in place, other elements (micro) may determine the level of efficiency of secondary markets.



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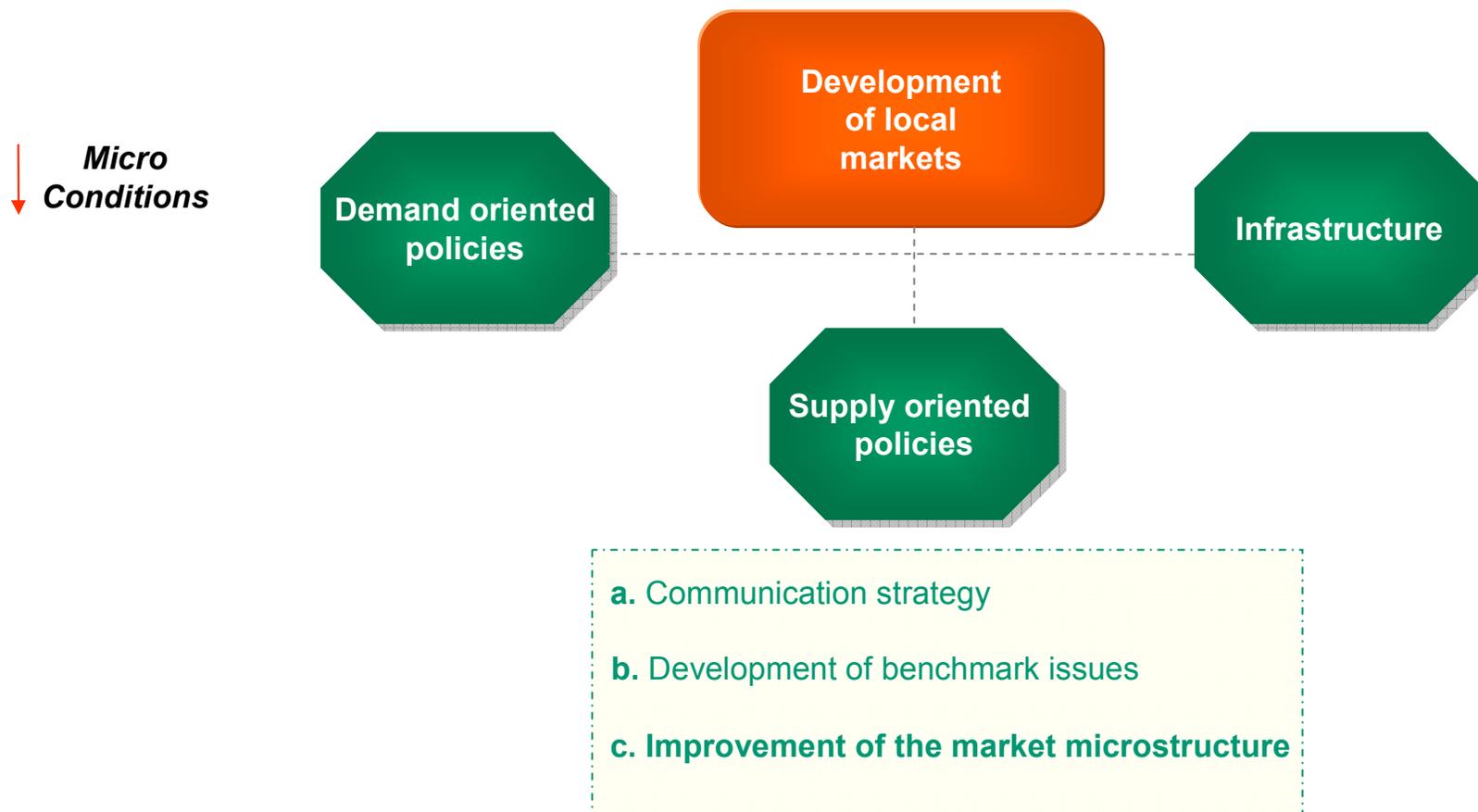


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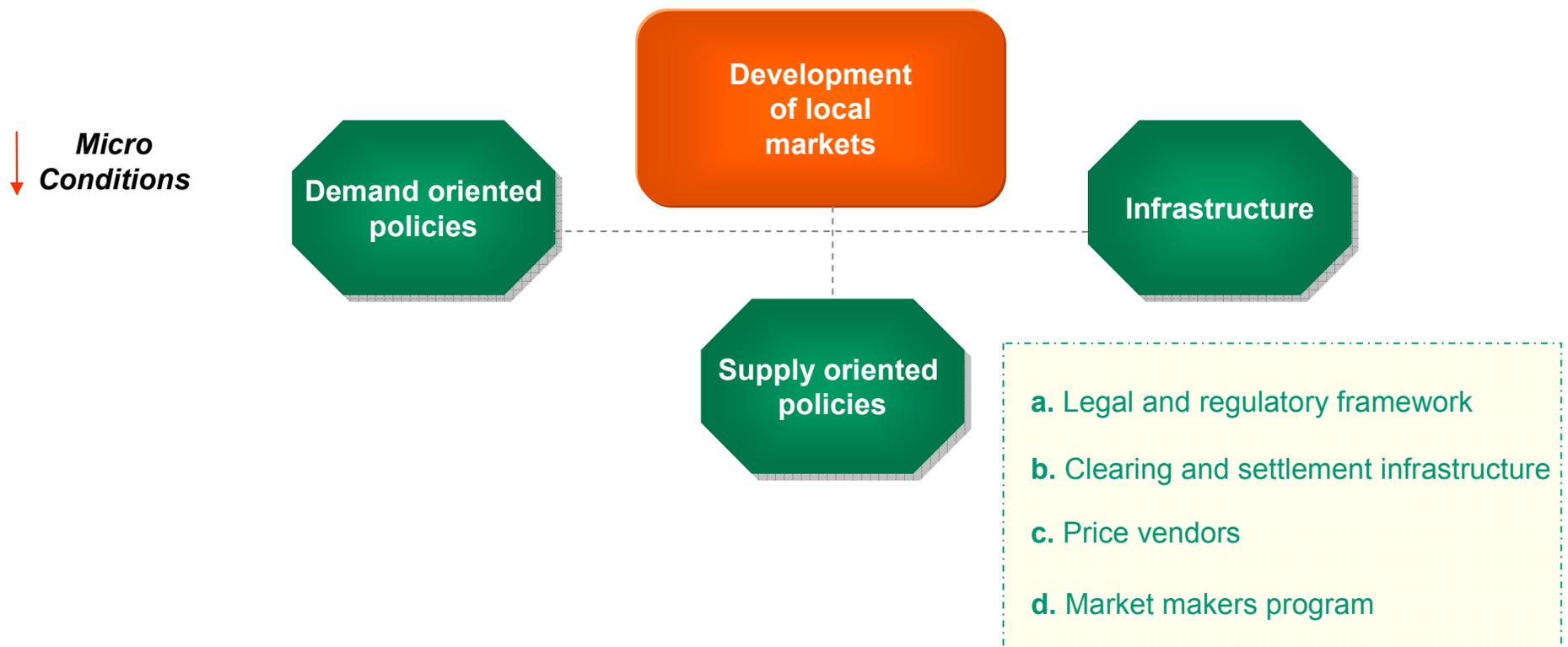


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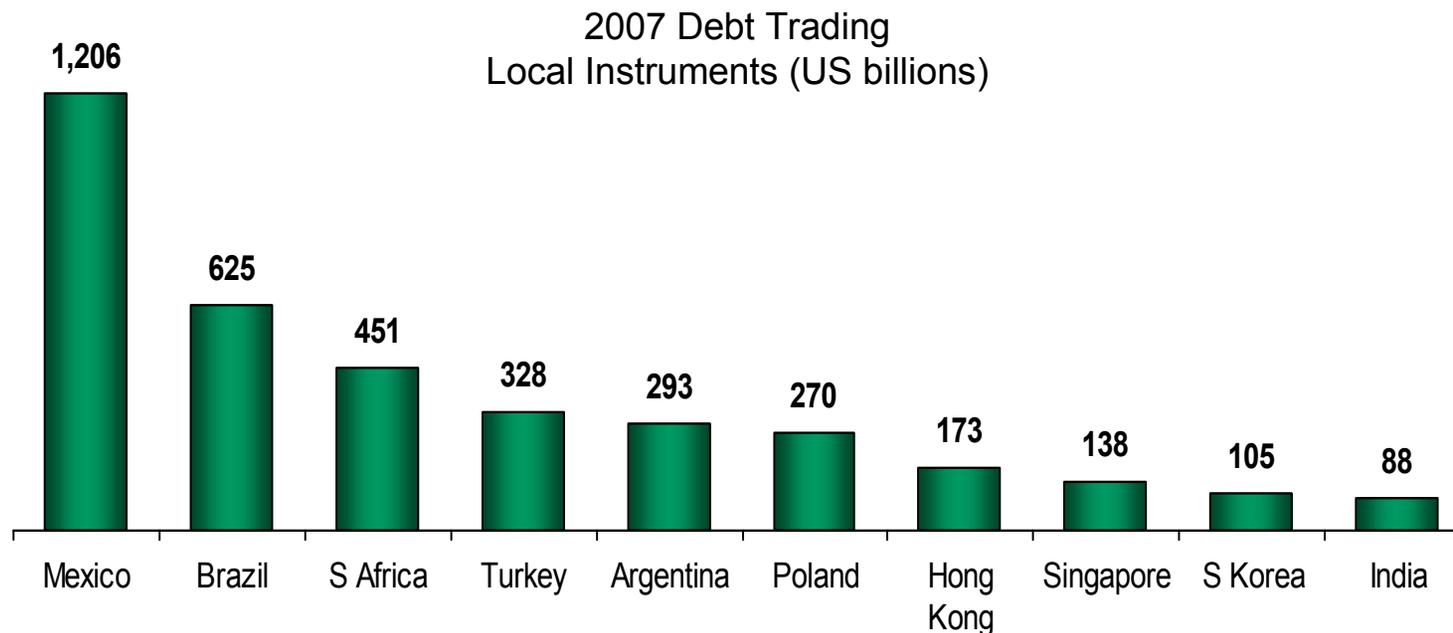
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Case Study 1: Government Securities

As result of the Federal Government's efforts, the Mexican local government bond market has attained good levels of liquidity by international standards. Mexican local instruments accounted for 28% of local markets turnover of all local emerging market trading, while Brazilian and South African local debt activity accounted for 15% and 11%, respectively.



Source: EMTA "2007 Annual Debt Trading Volume Survey"

II. Market Performance



Case Study 2: Inflation linked instruments

The issuance of inflation linked instruments (Udibonos) is an important component of the public debt strategy. They represent 14% of local government securities. Since housing and infrastructure development will require a more intensive use of this market, the government has embarked in a decisive effort to make this market more efficient:

Jul 2007	In July 2007, a survey was conducted among market participants regarding the Udibonos Issuance Policy and the potential for further development of this market.
Oct 2007	The Government started issuing a new 3-year benchmark in order to complement the development of the real interest rate curve in the short end.
Jan 2008	The 20-year Udibono is no longer issued, while the monthly amounts issued at the primary auction of the 10-year and 30- year Udibonos were increased in order to strengthen these benchmarks
Jan 2008	An exchange program for Udibonos has been implemented in order to strengthen benchmarks and increase their liquidity.
Sep 2008	Udibonos will be incorporated in the Market Makers Program, with the purpose of improving secondary market liquidity.

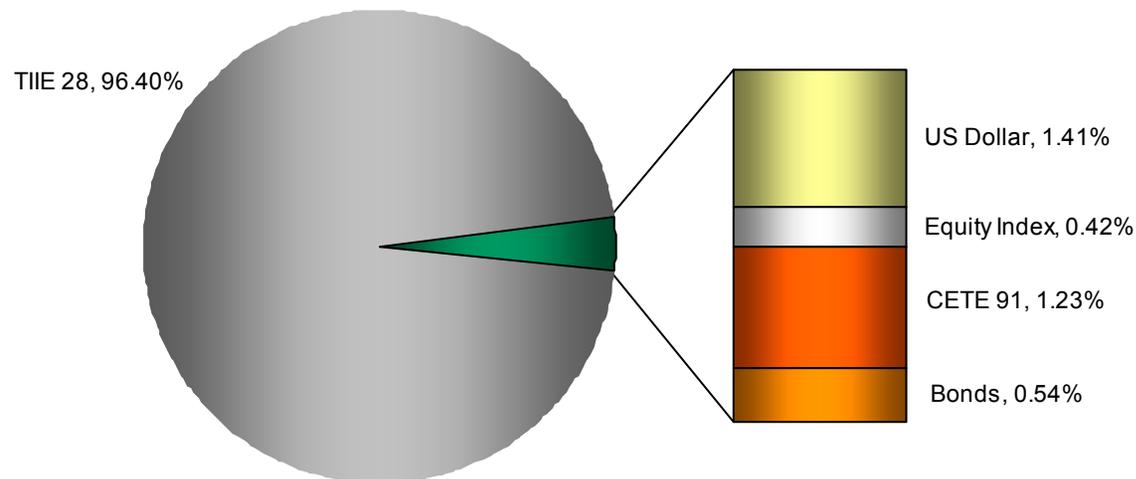
II. Market Performance

Case Study 3: Bond Futures

The Mexican Derivatives Exchange (Mexder) is characterized by being one of the most dynamic on the world; nevertheless, the trading volume of future contracts on Federal Government Bonds has registered a weak performance. Further development of the repo and securities lending market is required to foster the trading of Bond Futures.



Share Volume by Type of Asset
(number of futures' contracts)



2007, Accrued annual
Source: MEXDER



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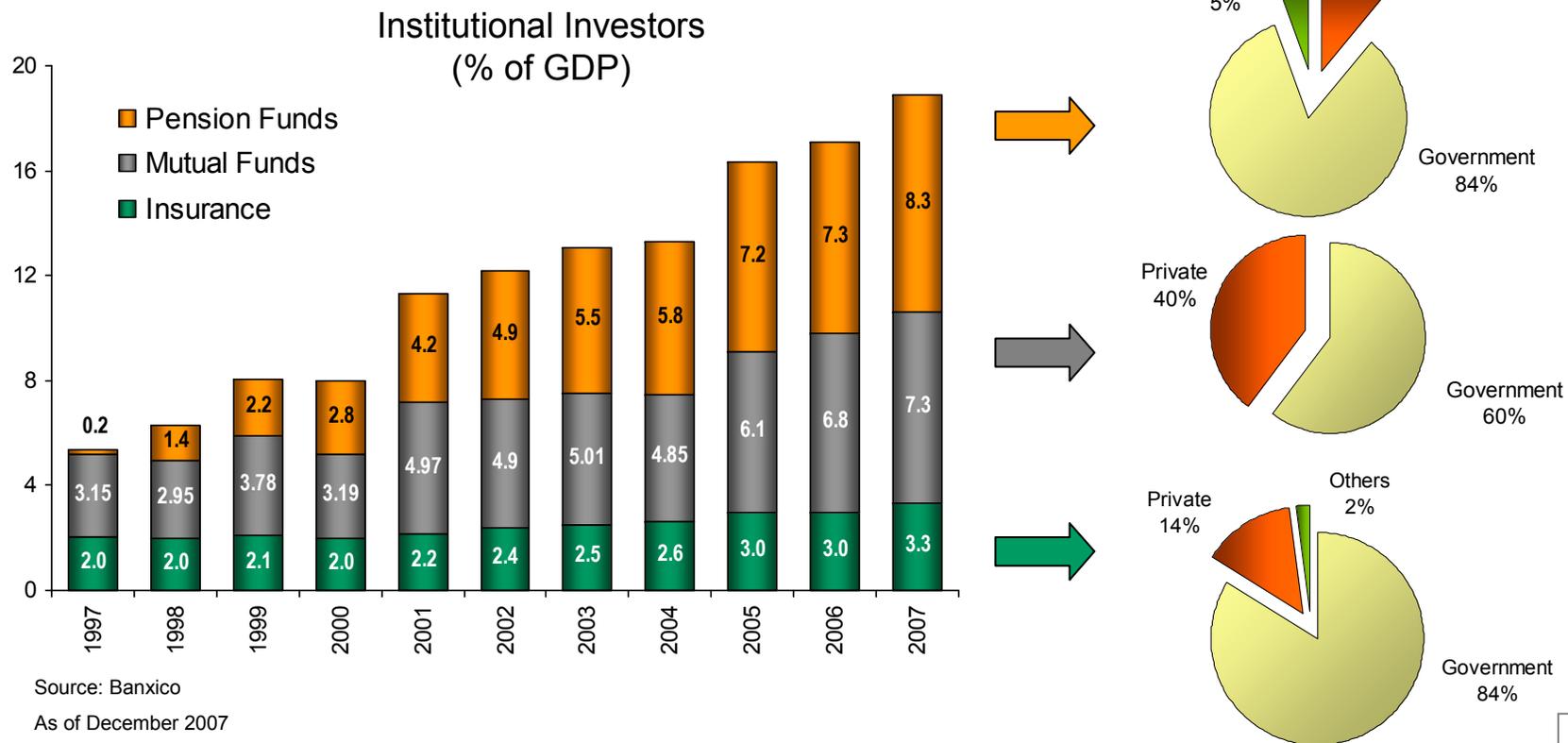
<http://www.hacienda.gob.mx/ucp>

I. Key Drivers for the Development of Local Markets



Institutional Investors

Institutional investors have played an important role in the expansion of financial savings.



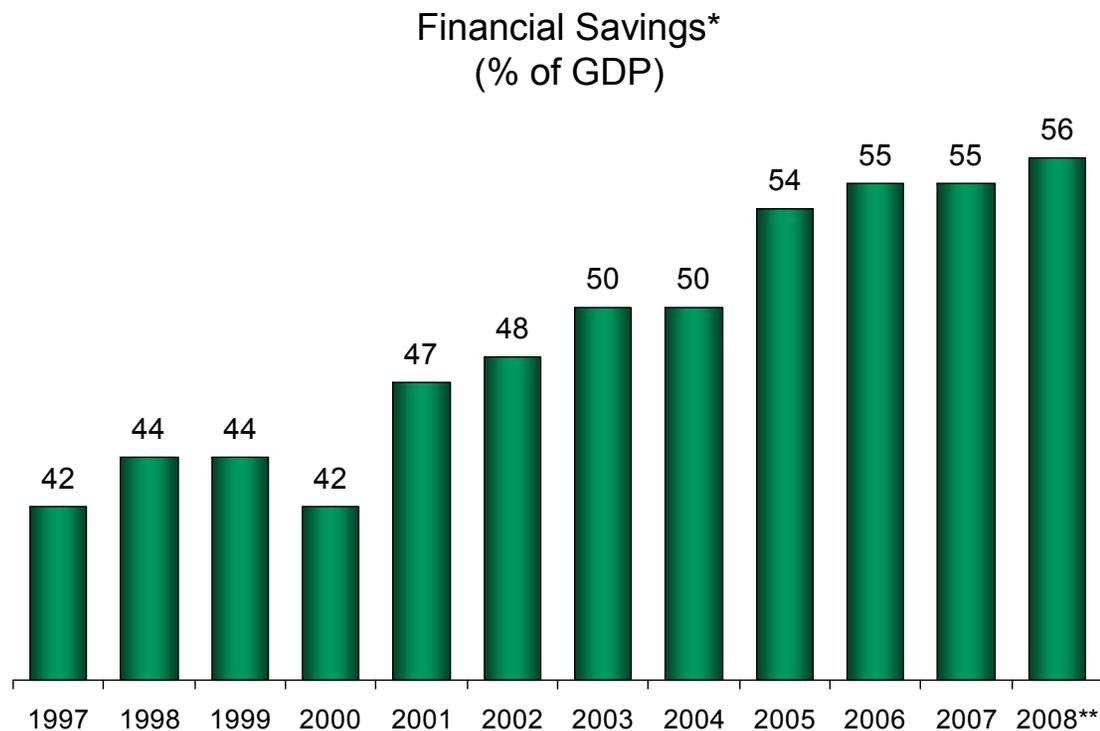
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I. Key Drivers for the Development of Local Markets



Growth of domestic financial savings

The combination of macroeconomic stability and financial reforms had a positive impact on savings.



*M3a minus coins and bills

** January

Source: SHCP

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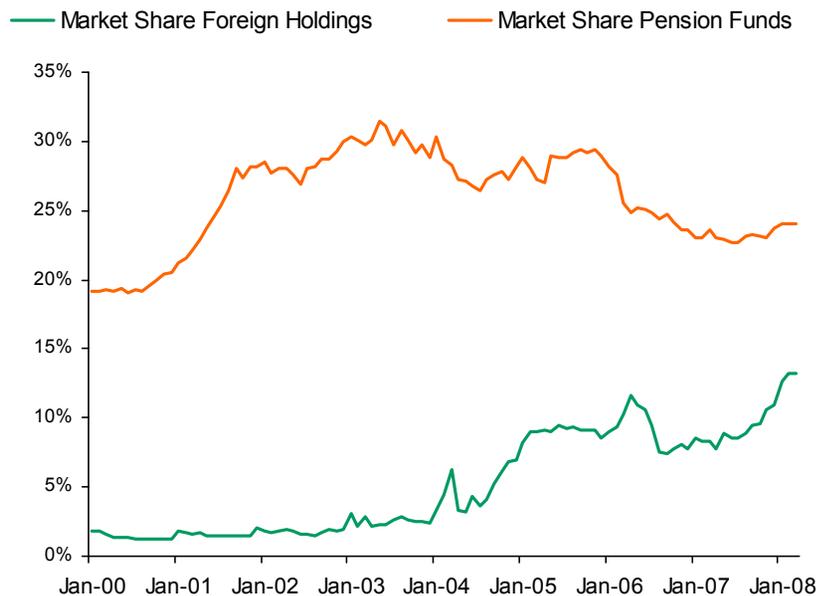
I. Key Drivers for the Development of Local Markets



Foreign investors

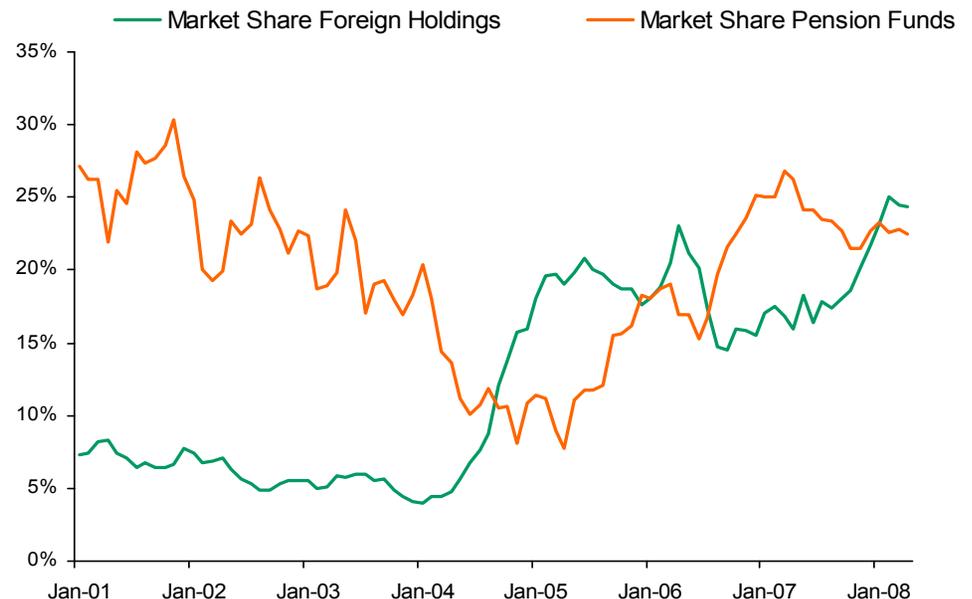
Foreign investors have played an important role in developing Mexican local markets by demanding long duration instruments, bringing best practices in structuring and trading, and generating more liquid markets overall.

Evolution of Foreign Investor Participation
All government securities



Source: Banxico

Evolution of Foreign Investor Participation
MBonos



Source: Banxico

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I. Key Drivers for the Development of Local Markets



Improvement of the market microstructure

The Mexican Ministry of Finance has made improvements in the microstructure of the local market:

Aug 2002	Modification of auction schedule
Jan 2005	Modification of Bond reopening scheme
Feb 2005	New regulation for repo and securities lending markets
Mar 2005	Introduction of Strips Program for government securities
Sep 2005	Exchange Program for fixed rate bonds
Jan 2008	Exchange Program for inflation linked bonds
Mar 2008	Buyback Program for government securities