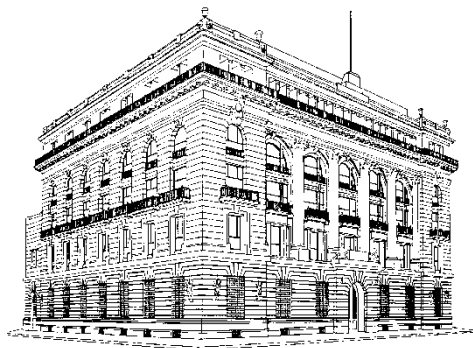


Real sector leverage and liquidity risk measurement challenges



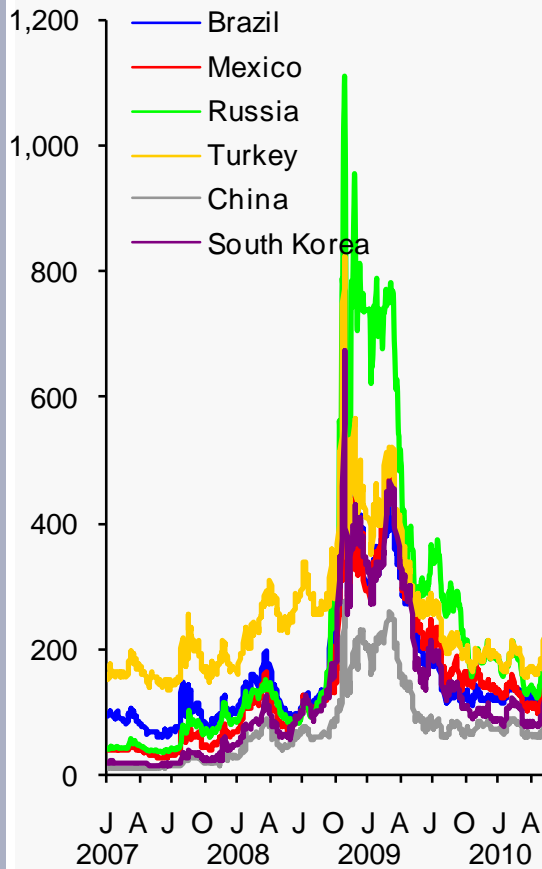

BANCO DE MEXICO

IMF
May 2010



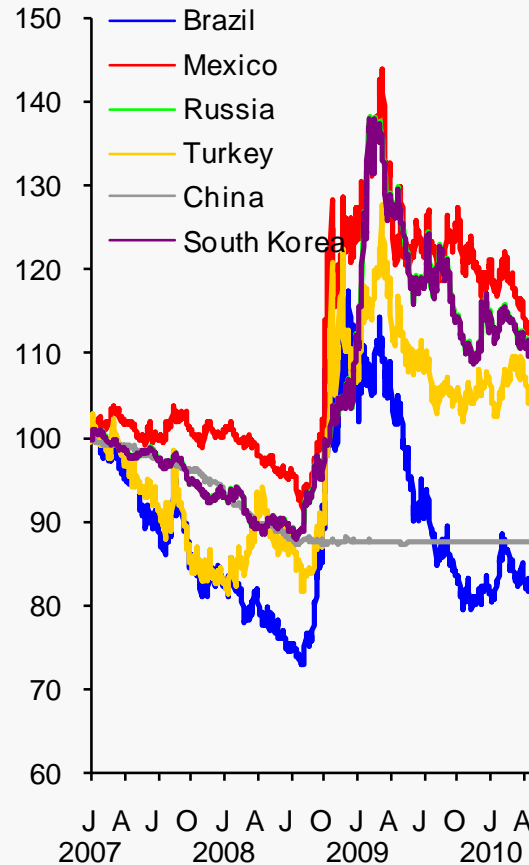
Impact on Emerging Economies

**Emerging Market Credit
Default
Derivatives
Basis Points**



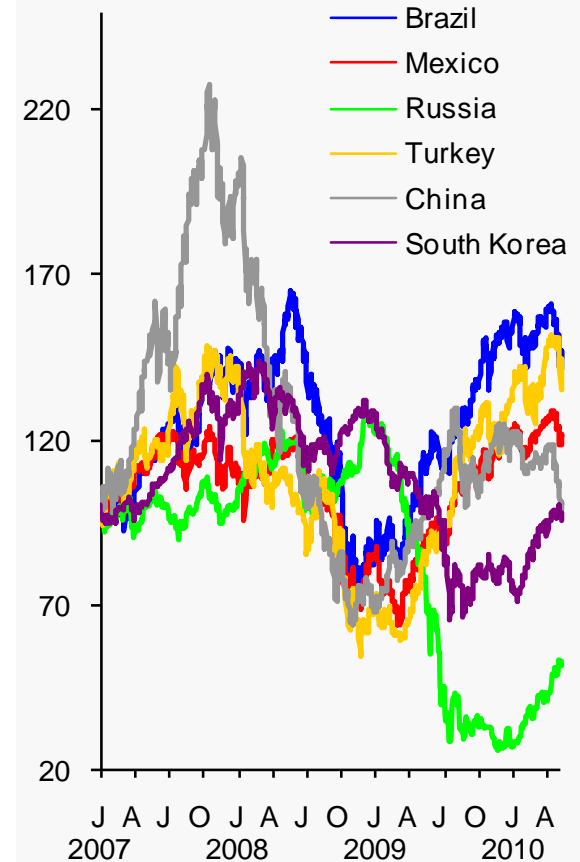
Source: Bloomberg

**Exchange Rates
January 2007 = 100**



Source: Bloomberg

**Stock Market Indices
January 2007 = 100**

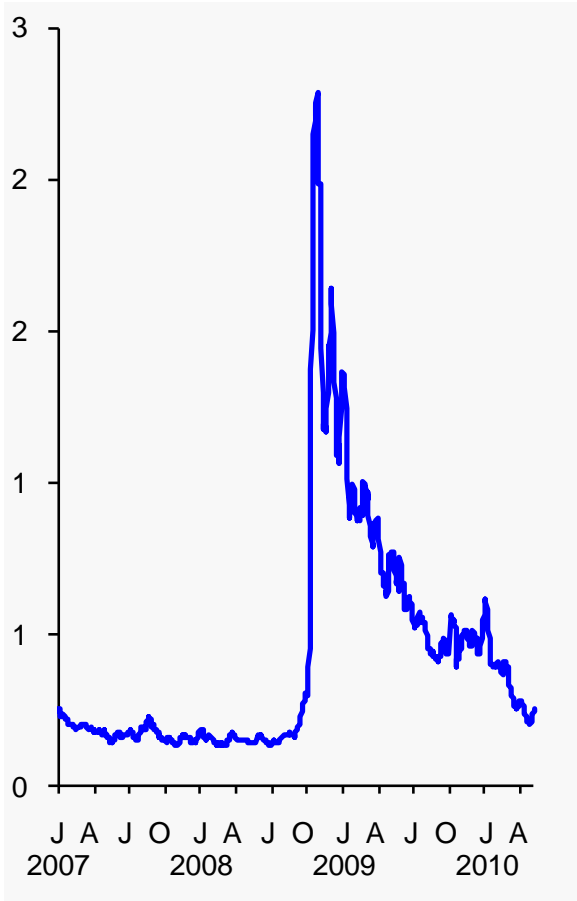


Source: Bloomberg



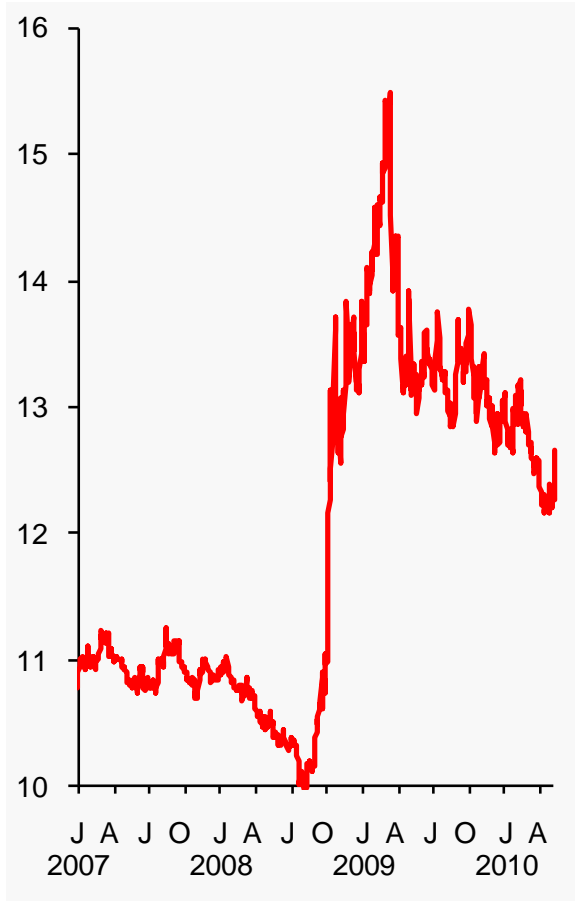
Peso Foreign Exchange Market

Buy/Sell Spreads
Peso cents (10-day moving average)



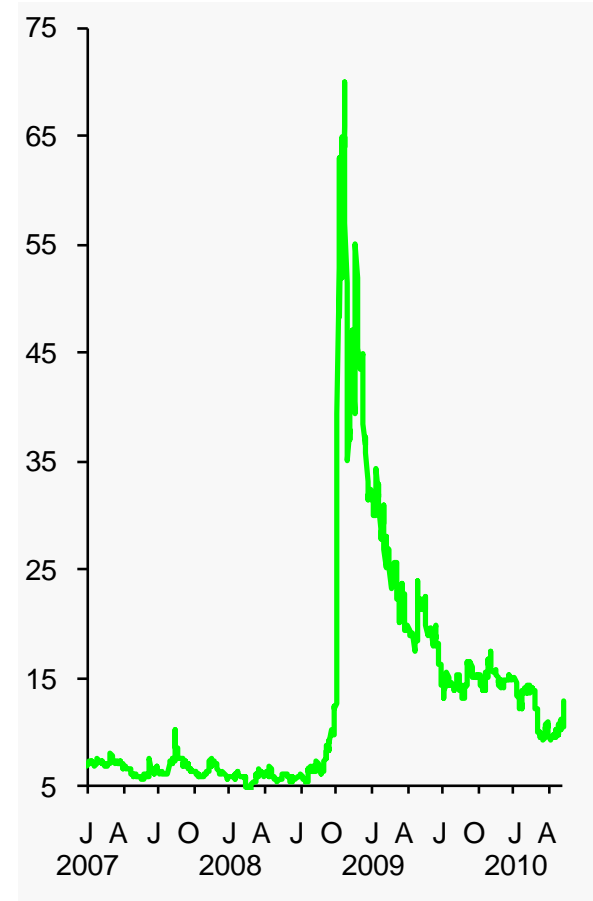
Source: Reuters

Peso-Dollar Exchange Rate
Pesos per dollar



Source: Reuters

Implied Volatility in One-Month Peso-Dollar OTC Transactions
Percent



Source: UBS



No significant impact on the financial sector

- High capitalization of FX and interest rate positions
- CB: limits to FX open positions
- CB: liquidity coefficient in FX
- CB: to operate derivatives, institutions must demonstrate capacity to assess and control risks.
- CB: monitoring of market, credit and liquidity risks



Important losses in large non financial firms

Lessons:

- Risk management policies;
- Complexity of financial products and understanding of inherent risks;
- Incentives faced by financial intermediaries;
- Quality of public information;
- Performance of rating agencies;
- Oversight of derivative transaction;
- Legal documentation.



Companies Risk Management Policies

- Prolonged period of macroeconomic stability;
- De-linkage between financial risks and core business;
- Access to information;
- Internal controls;
- Oversight of transactions;
- Corporate governance and risk management.



Financial Intermediaries across borders

Financial intermediaries face different incentives when operating across borders.

- Domestic intermediaries: Many business lines (credits, treasury, payrolls, payment services, cash management). Long-term relationships are important.
- Cross-border transactions: maximizing short term profits. Remuneration structures encourage maximization of commissions.



The Quality of Public Information

- Lack of knowledge of size of corporates' global exposures;
- Incomplete information impeded a proper assessment of the financial situation of borrowers;
- Need to increase quality and timeliness of information provided by issuers;
- Companies must disclose their potential risks.



The Performance of Rating Agencies

- Conflicts of interest;
- Lack of diligence;
- Financial institutions used external ratings.



Oversight of Derivatives Transactions

Commercial Bank Dervative Positions Million Dollars

	Currencies			Interest Rates		
	Forwards	Options	Swaps	Forwards	Options	Swaps
Net position	-381	-255	-664	-35	-2,883	348
Long position	513	11,614	622	3,931	16,768	1,361
Local financial institutions	42	3,409	156			271
Foreign financial institutions	383	5,009	192	161	15,152	639
Local individuals						
Local companies	65	3,196	171		1,616	301
Other local investors	22		104	3,770		93
Foreign companies						
Short position	894	11,869	1,237	3,966	19,651	1,013
Local financial institutions	37	2,301	157			284
Foreign financial institutions	457	7,521	642	156	16,617	359
Local individuals		1			33	
Local companies	159	2,047	372		2,637	232
Other local investors	241		60	3,810	363	133
Foreign companies			5			5



Legal Documentation of OTC Derivative Transactions

- Lack of legal documentation;
- Difficult to settle differences;
- Very important when different jurisdictions are involved.



- Information
- Indicators
- Surveillance



- Central counterparty
- Trade repositories
- Exchange and central counterparty



Information: Trade Repositories

- TR for OTC derivatives held by Mexican companies;
- Currently, Mexican regulators gather derivatives trades information from financial institutions;
- The TR should gather information from Mexican firms, including their trades with foreign counterparties;
- How to ensure the quality of the information
- How to accommodate exotic derivatives



- Sensitivity analysis
- Stress testing
- Systemic view



- Coordination
- Information exchange
- Scope of regulation