Debt Management Strategy

2015 Roundtable on Treasury Markets and Debt Management

November 2015
1. Public Debt Management Strategy

Two Main Objectives

**Direct**

*Intertemporal funding at an adequate cost-risk trade off*

1. Cost
2. **Risk** (refinancing, exchange rate, interest rate)
3. Permanent access to several funding sources
4. Ability to withstand a wide range of stress scenarios

**Indirect**

*Strategic role of the yield curve – externalities*

1. Promote the development of the local and foreign debt markets
2. Yield curve as a benchmark for other issuers
3. Develop a liquid yield curve
4. Short and long term instruments
To cope with the 2008-2009 crisis fiscal and monetary policies provided unprecedented stimulus to support aggregate demand.

Significant portfolio adjustment towards emerging markets (push and pull factors).

Emerging markets have been strongly influenced by US interest rates and changes in global risk appetite.

Low and uneven growth among regions will continue to induce FX volatility.

Global conditions and lower growth in China have put pressure in commodity prices and some emerging markets.
3. Debt Management Challenges and Opportunities

Macroeconomic Dynamics

✓ Strategic role of the yield curve for aggregate demand management (externalities)

Regular business-cycle (incentives well aligned: separability principle) vs Crisis/crash (incentives may differ)

✓ Links between monetary policy and public debt policies
  • Risk free vs. risky debt (spreads pricing/ratings)
  • Role of the central bank and firewalls

✓ Public debt sustainability (stress testing, etc.)

✓ Local (national) currency debt
3. Debt Management Challenges and Opportunities

Global Portfolio Reallocation (pull-push factors)

- Increasing role of foreign investors
  - Diversification of the investor base
  - Improved price dynamics
  - Increased tail-risks (liquidity buffers are needed)

- Key role of global benchmarks

- Increased correlation in investors’ risk appetite

Liquidity

- Regulatory challenges (derivatives, capital ratios, etc.)
- Buy and hold investors
- Market-makers
4. Issuance Strategy

Mexico’s debt management strategy takes into account the trade-off between expected cost and risk to optimize its debt portfolio.

Source: SHCP.
4. Issuance Strategy
The Federal Government has sought to reduce costs and lower portfolio risks through an adequate mix of currencies, debt instruments and maturities.

Source: SHCP.
4.1. External Markets Strategy
Diversify funding sources and extend average maturity

Government Debt Breakdown by Currency*

<table>
<thead>
<tr>
<th>Year</th>
<th>USD</th>
<th>Yen</th>
<th>Euro</th>
<th>GBP</th>
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</thead>
<tbody>
<tr>
<td>2006</td>
<td>97.0</td>
<td>0.3</td>
<td>2.7</td>
<td>6.5</td>
</tr>
<tr>
<td>2015</td>
<td>72.3</td>
<td>3.9</td>
<td>17.3</td>
<td>0.3</td>
</tr>
</tbody>
</table>

* Considers only market debt.

Average Maturity of External Government Debt (years)

<table>
<thead>
<tr>
<th>Year</th>
<th>With UMS 100yr</th>
<th>Without UMS 100yr**</th>
</tr>
</thead>
<tbody>
<tr>
<td>2006</td>
<td>0.00</td>
<td>5.00</td>
</tr>
<tr>
<td>2007</td>
<td>5.00</td>
<td>10.00</td>
</tr>
<tr>
<td>2008</td>
<td>10.00</td>
<td>15.00</td>
</tr>
<tr>
<td>2009</td>
<td>15.00</td>
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<tr>
<td>2010</td>
<td>20.00</td>
<td>25.00</td>
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<td>2013</td>
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<tr>
<td>2014</td>
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<tr>
<td>2015</td>
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</tbody>
</table>

**Excludes UMS, EUR, USD and GBP 100 year bonds.

Source: SHCP.
4.1. External Markets Strategy

Maturity extension objectives: lower refinancing risk, increases diversification, broadens the investor base and helps differentiate from other issuers.

Source: SHCP.
4.2. Local Markets Strategy
The relative importance of short-term and floating rate notes has diminished and duration has been increased (between 7-8 years since 2011).

Composition of Local Government Debt (%)

Average Maturity of Local Government Debt (years)

Mexico’s Yield Performance (USD and Peso)

Source: SHCP.
4.2. Local Markets Strategy
Local debt markets have coped well with complex and challenging external conditions in the last years.

M Bonds Yield Evolution
2008-2015
(\%)

Quarterly Issued Amounts of M Bonds
2008-2015
(million pesos)

The box limits are the 75th and 25th percentile.

Source: SHCP.
4.3. Stress Tests
Foreign holdings of local securities have been resilient to volatility episodes.
5. Final Remarks

Debt Management Strategy

✓ A sound debt management strategy is a key element of strong macroeconomic fundamentals
✓ Importance of flexibility in debt issuance programs (consider market conditions - local and external risk appetite)
✓ Debt Managers should maintain a wide range of options regarding funding alternatives (option to issue)
✓ Diversify the investor base (look for less correlated investors)
✓ Consider the strategic role of the yield curve:
  o Aggregate demand tool
  o First building block in any funding in national currency (corporates and households)
✓ Importance to be perceived as a regular and predictable issuer in local currency funding
✓ Consider flexible issuance and hedging strategies (timing) in markets where you are not a price setter (funding vs exposure)