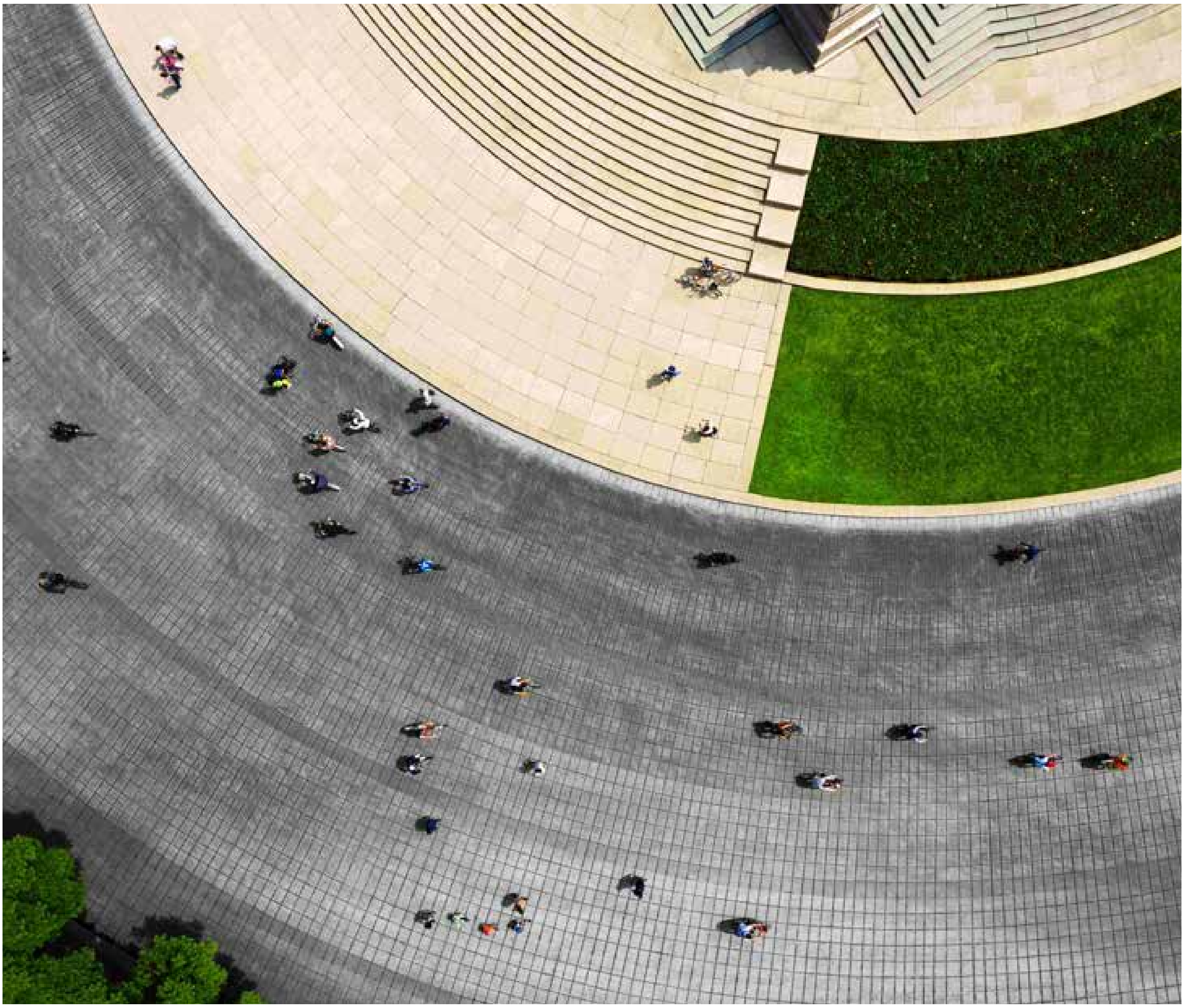
IFR

INTERNATIONAL FINANCING REVIEW

DECEMBER 2024

www.ifre.com

In partnership with: Scotiabank GLOBAL BANKING AND MARKETS



IFR LATAM INVESTOR SERIES: MEXICO

Chair:
Jo Bruni

Participants:
Juan Fullaondo, Jose Jorge Rivero, María del Carmen Bonilla Rodriguez

Head of production:
Clive George

IFR production manager:
Carole Styles

Senior production executive:
Gavin White

Global head – advertising & sponsorship sales:
Shahid Hamid
shahid.hamid@lseg.com

Advertising & sponsorship sales director:
Leonie Welss
leonie.welss@lseg.com

Client Services:
IFR.Clientsupport@lseg.com

Cover image:
© GettyImages

ISSN 0953 0223

www.ifre.com

FOREWORD

Mexico has emerged as a key topic in a recent series of investor webinars hosted by IFR in collaboration with Scotiabank. This session brought together a panel of capital market experts to discuss the landscape of Mexico's sovereign and corporate sectors, highlighting both the challenges and opportunities that lie ahead amid a fluctuating global economic environment.

The discussion provided insight into the performance of the debt capital market over the past year, with a notable focus on the increasing significance of green and sustainable finance in Mexico. The panel featured prominent figures, including María del Carmen Bonilla, head of public credit and international affairs at the Mexican ministry of finance; Jose Jorge Rivero, senior vice president of corporate banking & capital markets at Scotiabank; and Juan Fullaondo, head of Latin American DCM at Scotiabank.

The experts emphasised the Mexican government's commitment to diversifying its debt portfolio and enhancing liquidity in local markets. They discussed the strategic initiatives aimed at promoting ESG investments, which have gained traction, with a substantial percentage of recent issuances being labelled as sustainable. This trend reflects a broader shift towards responsible investing, positioning Mexico as a leader in the region.

The conversation also touched on structural changes in the market, including new regulations designed to facilitate access for smaller companies and improve overall market efficiency. As the panellists highlighted, the nearshoring trend presents a unique opportunity for Mexico, potentially driving economic growth and increasing demand for financing.

Overall, the webinar underscored Mexico's potential as an attractive investment destination, particularly as it embraces sustainable finance initiatives and works to strengthen its capital markets. Investors are keenly watching for emerging opportunities that align with financial returns and environmental goals, making Mexico a focal point for future investment discussions.

Mexico, the second-largest economy in Latin America, holds a significant position on the global stage due to its strategic location, robust trade relationships and diversified manufacturing base. The country is a key player in nearshoring, which has seen many companies relocate their supply chains closer to North America to mitigate risks and reduce costs. This shift has bolstered Mexico's role in global value chains, particularly in sectors such as automotive, electronics and aerospace. Geopolitically, Mexico maintains strong ties with the US and Canada, reinforced by the United States-Mexico-Canada Agreement, which supports trade and investment flows across the region.

In 2023, Mexico's economy grew by 3.2%, marking the second consecutive year of growth exceeding 3%. However, 2024 is projected to see a slower growth rate of 1.5%, with private consumption and investment decelerating and employment growth slowing. According to the IMF, this moderation largely reflects recently a restrictive monetary policy and binding capacity constraints restraining economic activity.

The country's economic policy has focused on maintaining macroeconomic stability, promoting financial inclusion, and investing in public infrastructure. Banco de Mexico has maintained a cautious stance to control inflation and support economic stability. As of November 2024, the central bank's key interest rate stands at 10.25%, reflecting efforts to curb inflationary pressures.

The economy faces several challenges, including stubborn inflation, rising labour costs, high crime rates and the potential economic impact of new administration in the US. Addressing these challenges will be crucial to sustaining economic growth and ensuring that the benefits of nearshoring and other economic opportunities are fully realised.

ROUNDTABLE PARTICIPANTS

Jose Jorge Rivero

Senior vice president, corporate banking and capital markets, international banking, Mexico, at Scotiabank

Jose Jorge Rivero was appointed to his role in October 2023.

As part of his mandate, he optimises business opportunities, manages risk, and maximises shareholder value in global banking & markets' wholesale financial services across Latin America and the Caribbean. He is also responsible for enhancing product capabilities and driving growth in new business segments.

He joined Scotiabank in 2002 and has held roles including head of wholesale banking in Chile and head of corporate banking in Mexico.

He holds a Bachelor of Finance from Universidad Panamericana in Mexico and a Master of Business Administration degree from the TEC de Monterrey (EGADE) Business School.

María del Carmen Bonilla Rodriguez

Head of public credit and international affairs unit in the Ministry of Finance

María del Carmen Bonilla is in charge of implementing the financing and risk management policies of the Federal government. She has achieved recognition for implementing the biggest refinancing programme in local and external markets, as well as the implementation of new sovereign bonds and reference curves including those linked to UN sustainable development goals.

She has also contributed to the development of the Mexican taxonomy and the sustainable financing strategy and has participated in international forums and roadshows with investors and multilateral agencies to provide a better understanding on debt management strategy, market development and ESG-related policy implementation from the Ministry of Finance's perspective.

Juan Fullaondo

Head of Latin America and Caribbean DCM Scotiabank

Juan Fullaondo is head of Latin American debt capital markets at Scotiabank, joining the firm in 2018. Before that, Fullaondo spent almost 14 years at HSBC, where he was latterly co-head of Latin American DCM, overseeing local and cross-border bond operations for Mexican and other Latin American issuers. He was also head of investment banking at Mexican broker IXE and started his career in Operadora de Bolsa Serfin's debt capital markets division.

Jo Bruni

IFR

Jo Bruni is a reporter at the International Financing Review covering debt and equity capital markets of Latin America and the Caribbean. As Latin America correspondent, she delves into the intricate landscape of bond and equity deals, uncovering the key forces that shape decision-making around deals among market participants in the region. Before joining IFR, she worked at LatinFinance, establishing herself as a trusted voice in the industry.

MEXICAN SOVEREIGN BOND ISSUANCE

Mexico has made significant strides in recent years in its sovereign bond issuance strategy, reflecting a robust approach to managing its external debt portfolio. Maria del Carmen Bonilla, head of public credit and international affairs at Mexico's ministry of finance, highlighted the government's commitment to maintaining a balanced and diversified funding strategy, which is crucial for ensuring liquidity and stability in the face of global economic turbulence.

There has been a concerted effort to rebalance the portfolio of external debt. The focus has been on keeping benchmarks liquid in major markets while expanding bond issuance linked to ESG criteria. This dual approach not only enhances Mexico's appeal to international investors but also aligns with global trends towards sustainable finance.

In 2023, Mexico issued bonds in various currencies including US dollars, euros and yen, showcasing its ability to tap diverse markets. This multi-currency strategy is designed to attract a broader investor base and mitigate risks associated with currency fluctuations. Bonilla emphasised the importance of diversifying its investor base, which is essential for preserving the performance of the country's debt instruments.

The Mexican government has been proactive in refinancing debt and exploring new funding strategies. The ministry of finance has been working on strengthening the tools in switch tender offers. Among the innovations has been providing investors with the opportunity to switch into sustainable development goal bonds in these operations.

It has also introduced domestic debt instruments such as Bondes F, which are highly liquid floating-rate notes, and Bondes G, which are aligned with ESG criteria. The latter have gained traction and have an outstanding issuance of approximately Ps96bn (around US$5bn), reflecting the increasing interest in sustainable investment options.

The Mexican government is committed to maintaining a strong presence in international markets while using external financing to complement domestic financing. The government plans to keep contained the external part of the debt portfolio and accompany it with a hedging strategy.

As the global economic landscape continues to evolve, Mexico's sovereign bond issuance strategy will remain a critical component of its financial stability. The government's focus on ESG criteria, diversification and innovative financial instruments positions it to attract domestic and international investors. With a solid foundation in place, Mexico is poised to navigate the complexities of the global bond market while ensuring sustainable economic growth.

RISK MANAGEMENT STRATEGY

The Mexican government has placed a strong emphasis on risk management as part of its comprehensive debt management strategy, recognising the importance of maintaining fiscal stability in a volatile global environment. Bonilla outlined the key components of this strategy, which aims to mitigate risks associated with domestic and international economic fluctuations.

A central aspect of the risk management approach is the containment of external exposure and the diversification of its debt. Approximately 16% of the government's total debt is sourced from external financing, a reduction from 20% in previous years. This shift is designed to minimise exposure to foreign currency risks while ensuring that the government can effectively manage its liabilities. Bonilla emphasised that while there is no specific target for external debt, the goal is to keep this share contained and manageable.

The government has also implemented a hedging strategy that includes currency diversification. This initiative is crucial considering recent global economic uncertainties, which have heightened the risks associated with foreign exchange fluctuations. By diversifying its currency exposure, the government aims to stabilise its financial position and reduce the impact of potential shocks on its balance sheet. Bonilla said this strategy has proven successful, allowing the government to cap interest rate expenses and maintain a more predictable financial environment.

In addition to currency diversification, the government is focused on enhancing the maturity profile of its debt. The average maturity of external bonds is around 19 years, compared with approximately eight years for domestic market instruments. This longer maturity profile provides a cushion against short-term market volatility and allows for more strategic planning in terms of debt servicing. By balancing the maturity of its debt, the government can better navigate economic cycles and manage refinancing risks.

The government is also aware of the importance of ESG factors in investment decisions. As part of its risk management framework, Mexico is integrating ESG considerations into its debt issuance strategies. Bonilla said approximately 45% of recent external bond issuances have included an ESG component, significantly higher than in many other markets. This focus on sustainability not only aligns with global investment trends but also enhances Mexico's attractiveness to a broad range of investors.

The new sustainability taxonomy also supports the government's broader risk management strategy by facilitating better measurement and assessment of financial risks associated with climate change and other environmental factors. Bonilla said the government is taking a multidisciplinary approach to evaluate transition and physical risks, which are crucial for understanding the potential impacts on the federal balance sheet and for investors.

The taxonomy is also linked to the development of new financial products and instruments that can help mitigate risks. By establishing a robust framework, the government aims to attract more investment in sustainable projects while ensuring that these investments are resilient to economic and environmental shocks.

The government is committed to maintaining a proactive stance in its risk management efforts. Bonilla highlighted the importance of continuous assessment and adaptation of strategies in response to changing market conditions. The annual borrowing plan, published each December, serves as a key tool for evaluating the effectiveness of current strategies and making necessary adjustments based on new findings and economic forecasts.

DOMESTIC MARKET DEVELOPMENT

The Mexican government has undertaken significant initiatives to enhance liquidity and foster the development of its domestic capital markets, reflecting a strategic commitment to creating a robust financial ecosystem. Bonilla outlined the government's multifaceted approach to improving market conditions and ensuring that the sovereign and corporate issuers can access the necessary funding in pesos.

A cornerstone of this strategy is the introduction of a new benchmark, the TIIE Fondeo rate, which provides an organised collateralised rate. The TIIE Fondeo is based on the Mexican repo market, which is highly developed and liquid, and that helps facilitate smoother transactions and better pricing for financial instruments. It also aligns with international best practices for benchmark rates, making it more compatible with global financial systems and improving investor confidence.

The TIIE Fondeo initiative aims to lower funding costs for the corporate sector, making it easier for businesses to secure financing. Bonilla said the format provides significant benefits, particularly in terms of pricing, as it creates a more favourable environment for collateralised transactions in the repo market. By enhancing the efficiency of these transactions, the government is working to improve liquidity in the domestic market, she said.

The government has also shifted its focus from issuing traditional Bondes D to the more innovative Bondes F. The key distinction between the two instruments is that Bondes F is linked to the TIIE Fondeo benchmark rate whereas Bondes D rely on the weighted-average interbank funding rate, or BFR.

Among the advantages of Bondes F are that the TIIE Fondeo rate is floating and adjusts based on market conditions, which can provide better returns in a rising interest rate environment. Also, as Bondes F are linked to the TIIE Fondeo rate, they are generally more liquid in the market. Furthermore, as the TIIE Fondeo rate is closely tied to various financial instruments, including futures contracts, investors can hedge against interest rate risks more effectively, providing a layer of financial security that may not be as readily available with Bondes D. Finally, since the TIIE Fondeo rate reflects the central bank's monetary policy, Bondes F can provide a more accurate reflection of the economic environment, making them a more strategic investment choice during periods of economic change.

The government has decided to stop issuing Bondes D and the last one will settle in August 2026. One of the advantages of the Bondes F structure is that it recognises the new TIIE Fondeo benchmark rate.

The benchmark rate is operating in the cash market, and starting in January, its use will be mandatory in the derivatives market.

"When the market gains traction and increases in volume, it will be easy to buy the cash instruments and trade the derivative contracts, and to switch from fixed to floating rates or vice versa multiple times," Bonilla said.

Mexico's central bank has played a crucial role in these developments, recently releasing new regulations on repo and reserve repo transactions. These regulations are designed to enhance liquidity not only for government securities but also for corporate issuers and development banks. By allowing for greater flexibility in repo transactions, the government is working to create a more integrated and efficient financial market.

Moreover, the introduction of the switch tender offer mechanism has been pivotal in increasing liquidity for benchmark securities. This mechanism allows the government to enhance the liquidity of specific securities outside the regular auction calendar, enabling quicker adjustments to market conditions. By facilitating more responsive liquidity management, the government aims to create a more dynamic and resilient market environment.

The greenshoe option in the market maker programme has also been expanded to address market volatility. This programme allows the issuance of additional securities in response to high demand, thereby providing the ministry of finance with the flexibility to manage its funding effectively. Bonilla said that this initiative has been particularly useful in navigating periods of market uncertainty, allowing for more stable pricing.

The government's efforts to enhance liquidity are complemented by regulatory changes to simplify the process for smaller companies to access capital markets. Recent amendments to the securities market law have introduced streamlined procedures for SMEs, allowing them to list their debt and equity more easily. This initiative is expected to broaden the base of issuers in the market, thereby increasing competition and enhancing market depth. Bonilla said these changes could potentially unlock access to financing of up to Ps70bn annually for SMEs, which is crucial for fostering economic growth and innovation.

As the market evolves, the focus on ESG compliance remains a priority. This trend reflects a growing recognition among investors of the importance of sustainability in investment decisions. The government is committed to providing clear guidelines to prevent greenwashing and ensure that ESG investments are impactful.

Overall, the initiatives aimed at enhancing liquidity and developing the Mexican capital markets are indicative of a broader strategy to position it as a competitive player in the global financial landscape. By fostering a more inclusive and responsive market environment, the government is addressing current challenges and laying the groundwork for sustainable economic growth. As these initiatives take root, they are expected to attract a diverse range of investors, further solidifying Mexico's status as a key destination for capital.

INVESTOR PERSPECTIVES

Juan Fullaondo, head of Latin America & Caribbean DCM at Scotiabank, noted a growing perception of Mexico as a relative safe haven for investors, particularly within the emerging market landscape. This sentiment is underpinned by Mexico's stable economic fundamentals and its strategic integration into North American supply chains.

"Mexico is one of the jewels of the crown," Fullaondo said, emphasising that investor demand for Mexican sovereign bonds remains strong, reflecting confidence in the government's fiscal management.

Fullaondo noted that many investors are "substantially overweight" in their exposure to Mexico, indicating a strong demand for Mexican assets. This was evident during a recent bond issuance, where the Mexican government attracted approximately US$18bn in demand for a proposed US$2.5bn to US$3bn bond, ultimately placing US$4bn in the market. Such oversubscription highlights the confidence investors have in Mexico's economic resilience and growth potential.

Investors are hopeful for a greater supply from Mexico. A key concern among investors is the scarcity of 144A issuances, which has become increasingly pronounced. This scarcity is partly due to the success of domestic markets, which have become increasingly efficient. Investors are now able to place significant amounts – ranging from US$500m to US$1bn – within a 10-year maturity space, often finding better terms than those available in international markets. As a result, many corporations are opting to issue bonds domestically rather than in international markets, leading to a reduction in the availability of 144A securities.

Fullaondo pointed out that this shift has implications for liquidity and pricing, as international investors navigate a landscape with fewer options. To address these challenges, the Mexican government has implemented several strategies aimed at enhancing market liquidity.

As the market continues to evolve, the interplay between domestic policies and global economic conditions will remain critical. Investors are closely monitoring macroeconomic indicators, including inflation rates and interest rate trends, as these factors influence their investment strategies. Fullaondo expressed optimism, noting that the current trend of declining interest rates could spur increased activity in the Mexican bond market.

SCOTIABANK'S COMMITMENT TO MEXICO

Scotiabank has reaffirmed its commitment to Mexico, recognising the country as a strategic priority within its broader North American operations. José Jorge Rivero, senior vice president of corporate banking & capital markets at Scotiabank, emphasised Mexico's unique position in the global economy, particularly through the nearshoring trend, which presents significant growth opportunities. This phenomenon, driven by shifts in supply chains, allows companies to relocate operations closer to the US market, enhancing efficiency and reducing costs.

Over the next five years, Scotiabank plans to intensify its capital deployment in Mexico, aiming to capture a larger share of the advisory, capital markets, and transactional banking sectors. The bank is uniquely positioned as the only Canadian institution with a comprehensive presence across the North American corridor, facilitating seamless service for clients operating in Canada, the US, and Mexico. This strategic focus is not only about expanding market share but also about enhancing product capabilities, particularly in derivatives across various asset classes.

Part of Scotiabank's strategy is its commitment to ESG initiatives. Mexico has emerged as a leader in the issuance of ESG-labelled bonds, surpassing many developed markets. In 2023, approximately 47% of bond issuances in Mexico carried an ESG label. Scotiabank is a leading participant in the ESG league table and has a target of C$350bn (US$250bn) to be deployed globally in climate-related financing by 2030, with Mexico being a part of this goal.

Scotiabank's approach is underpinned by a belief in Mexico's robust economic fundamentals. The country boasts a diversified economy and strong ties to major trade partners, positioning it favourably to attract foreign investment. Rivero highlighted that the stability of the Mexican peso and the absence of significant capital outflows during turbulent times further bolster investor confidence.

Moreover, the bank is actively involved in enhancing local market capabilities, ensuring that Mexican companies can access the necessary financial instruments to thrive. This includes a focus on developing a more sophisticated derivatives market and improving liquidity in local capital markets. By fostering these advancements, Scotiabank aims to create a more resilient financial system that can support Mexico's growth.

OUTLOOK

The outlook for Mexico's debt capital market is characterised by a strategic focus on diversification, sustainability and responsiveness to evolving economic conditions. The Mexican government is actively working to enhance its debt portfolio by issuing bonds in multiple currencies and prioritising ESG criteria, which has led to a significant portion of recent issuances being labelled as sustainable. This commitment positions Mexico as a leader in the ESG space, attracting interest from domestic and international investors.

The nearshoring trend presents a unique opportunity for Mexico to capitalise on its geographical advantages. This shift is expected to drive economic growth and increase demand for financing, prompting financial institutions to bolster their capital market capabilities in the region.

Investor sentiment remains strong, with many viewing Mexican debt as a stable and attractive option. However, there is a notable scarcity of issuance, which limits available investment opportunities. The local market has become increasingly efficient, allowing for substantial placements, yet the lack of 144A issuance has created challenges.

Structural changes within the market are also underway, with new regulations aimed at increasing liquidity and facilitating access for smaller companies. Initiatives like the introduction of the TIIE Fondeo rate are designed to improve funding costs for corporates and enhance the overall market structure. Additionally, a comprehensive risk management strategy is being developed to mitigate potential external shocks, particularly in light of global economic uncertainties.

The future of Mexico's debt capital market appears promising, driven by strategic government initiatives, a strong emphasis on sustainability, and the potential for increased foreign investment. As the market continues to evolve, the focus on local participation and sustainable financing will likely play a crucial role in shaping its trajectory, making it an exciting landscape for investors.