1st Regional Workshop
on Government Bond Market Development in Latin America

Discussion Notes

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Money Market.

Argentina, Brazil and Mexico:

Argentina, Brazil and Mexico have well developed money markets for financial institutions. With small variations, they in general work for banks in the form of one day Repos of government securities. The counterparts of the Repos are other banks or the Central Bank.

In Brazil, and now in Argentina, the CPMF tax cripples the money market for corporate clients and other non-financial institutions. Brazil also has the IOF tax, which makes investments with horizons under 30 days practically prohibitive. Hence, in both countries 30-60 days bank CDs are very popular. In Brazil, buying LFTs (Gov. Bond with floating interest reset daily) is also a way to earn money market interest rate.

In Brazil, non banking institutions that manage to bypass the tax issues (funds) receive over night rates very similar to the inter bank rates. The same benefit repeats itself in Mexico since clients and funs have access to the Repo market. In Argentina however, the rate passed on to clients maybe 100 b.p. lower than the interbank rate.

In Argentina and particularly in Mexico (because of the “corto” monetary policy), the Central Bank control money supply and influences interest rates indirectly. The competition for money determines the overnight daily interest rate, which may oscillate substantially.

On the other hand the Brazilian Central Bank sets, on a monthly basis, the Selic rate. The daily overnight interest rate in Brazil is usually within a few b.p. from the Selic rate.

Other smaller Latins:

The money market is used mainly in the interbank market.

Colombia has a “inflation targeting” monetary policy similar to Mexico, and uses open market operations in TES (Titulos de Tesoreria), repo and reverse-repo to control liquidity directly and interest rates indirectly. Overnight rates vary somewhat and are referenced on the DTF rate (the average of the 90-day deposit rate), published weekly by the Central Bank.

Central Bank of Chile targets overnight rate directly, similarly to Brazil. In contrast with the other Latin countries, Chile local debt is not concentrated in the short term (since Social Security reform has been done) and rates are low. Hence, overnight MM are underdeveloped and not very demanded for. Money market funds are usually the alternative for cash surplus.

In Venezuela Central Bank closes early (2:00 pm cutoff time) and banks usually have surpluses of cash at the end of the day. Hence, overnight rates are low at around 5%. Central bank does not conduct Repo operations daily. In case a bank needs funding, the CB will conduct reverse repo with penalizing rates (currently around 32%).

Intermediation

Argentina, Brazil and Mexico:

Secondary market for government debt is most developed in Brazil, perhaps because of it's the large ratio of domestic debt to GDP (40%) and the fact that trading occurs also over a local exchange, instead of exclusively OTC. But liquidity is also reasonable in both Argentina and Mexico.

In these 3 countries there are official Central Bank Dealers that are requested to provide a minimum level of liquidity on the secondary market.

There are efficient electronic trading/confirmation systems (Brazil – CISBEX , Argentina – SIOPEL, Mexico – Reuters) for the OTC trades. Government debt can also be traded through a local exchange in Argentina (Buenos Aires Stock Exchange) and Brazil (Bolsa do Rio).

Counterpart credit risk is not an issue in these 3 countries since trades are settled through a Central Bank clearing house (Brazil – SELIC and Argentina – CRYL) or on Deliver–Versus-Payment system. Argentina also allows trades to be settled through Euroclear, which facilitates somewhat the participation of foreigns on its local debt markets.

Other smaller Latins:

In Chile 83% of the market is controlled by the 4 largest Pension Funds. Since these institutions tend to hold bonds until maturity, the secondary market is illiquid. Recent Pension reform has been proposed to allow the banking sector to play a larger role in the pension system. This will probably induce a higher intermediation on the government debt market.

In Venezuela domestic debt is low at about 4% GDP. There are official Dealers but they are not formally required to provide minimum level of liquidity. Settlement is also done through a Central Bank clearing mechanism but trading is done OTC through brokers. As a consequence, the local secondary market for Venezuelan sovereign debt is very illiquid.

In Colombia, around 60% of the government's local debt is held by public sector entities. They are required to invest their excess liquidity in these instruments through direct transactions with the Treasury. Another 10% is held by the Social Security Institute, which is obliged to invest in government securities. With this local market structure, the poor liquidity of the secondary market should cause no surprise. The CB has been trying to improve it by imposing to official Market Makers minimum levels of liquidity.