Is The Mexican Peso Too Strong?

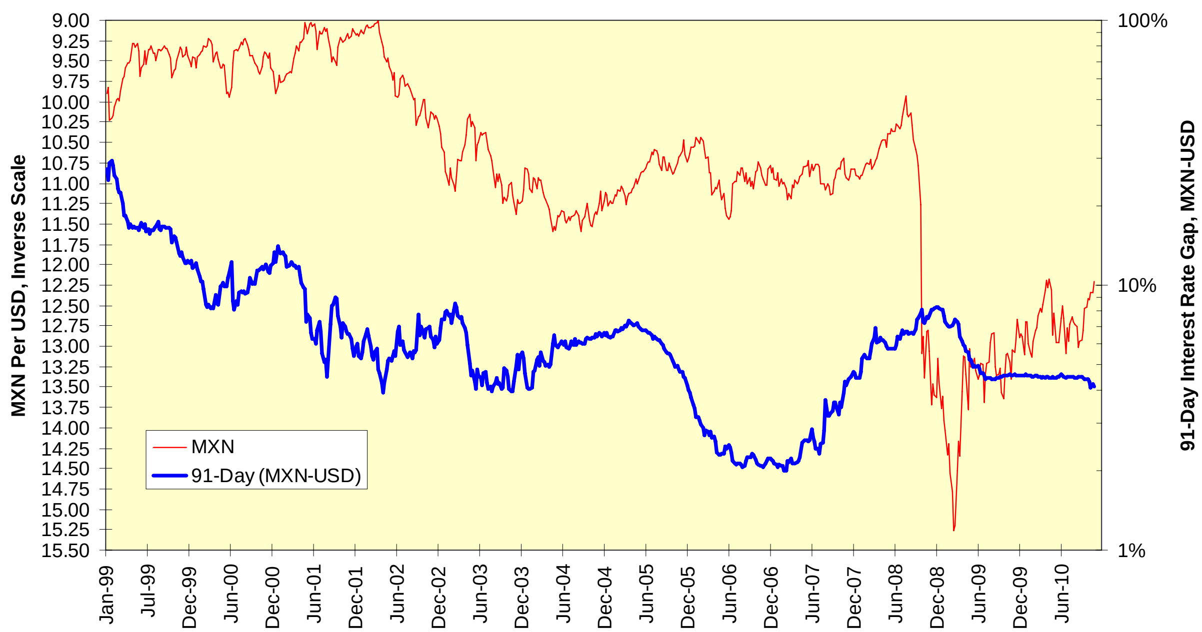
There was a time in a former life when I wrote a daily letter on the Mexican peso as the firm I was with had numerous institutional commodity accounts in Mexico. On occasion I was bullish the peso and would get nothing but grief for my troubles from the Mexican clients, none of whom believed in their own currency for ten seconds. If any of this sounds familiar, let me know.

Mexican exporters were convinced, as exporters usually are, a weak peso was in their best interests and never hesitated to make their feelings known to the Bank of Mexico. The BOM had to balance the needs of external investors in forestalling the catastrophic devaluations that marked the peso's history; this usually was done with sky-high interest rates.

That was then; this is now. Just last week BOM Governor Agustin Carstens warned: "We would consider adjusting our rates." Restated, Mexico is forming its own immigration policy, only dollars moving south and not people moving north are the objects of concern. Those who have derided the "American peso" take smug assurance they have company in Mexico. Ouch.

Peso And The Rate Gap

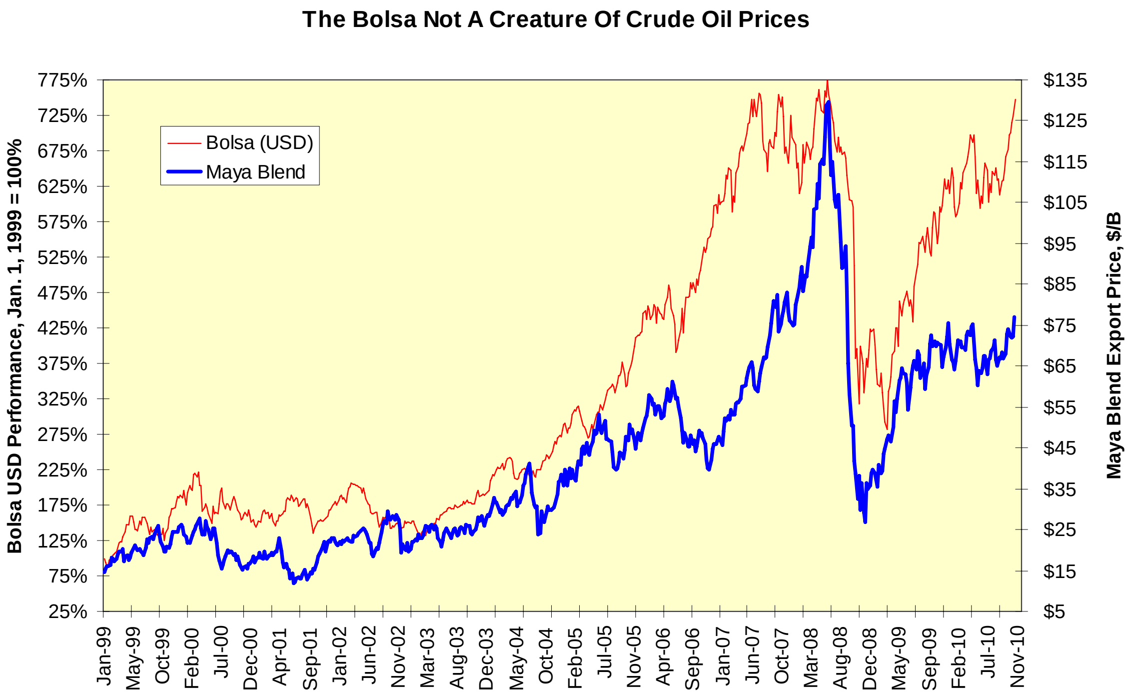
What is interesting about Carstens' threat is how little the peso has moved as a function of the three-month interest rate gap between Mexico and the U.S.; please note how I used a logarithmic scale for that gap in the chart below. When the rate gap was smaller, during 2006 for example, the peso was much stronger. As an aside, I normally use the relative interest rate expectations as opposed to a rate gap in these sorts of analyses, but the structure of the Mexican interest rate markets do not permit that.



Governor Carstens has the same problem mentioned for Brazil recently: So long as the U.S. is pumping out dollars, they will force their way into every nook and cranny in the rest of the world's financial system.

Of Oil And Stocks

Let's take a little detour into the Mexican stock market, or Bolsa, and congratulate them on the dissociation from crude oil prices. It used to be the performance of the Mexican market in USD terms led the price of their benchmark Maya Blend; one seemed to be a good substitute for the other. After the March 2009 low, however, Mexican stocks took off relative to Maya Blend as freshly printed dollars found their way into financial assets. This move is consistent with the opinion offered frequently here that our dollar creation is leading to asset inflation elsewhere as opposed to price inflation in the U.S. For now, at least; that money will jump up and bite us south of our personal borders if you know what I mean and I think you do.



Mexico has treated dollars kindly even as the country has been involved in a low-grade civil war with its various criminal cartels. The iShares Mexico investable market fund has returned 20.96% year-to-date; the U.S. market itself has returned about 11.75% at the time of this writing.