

The mexican peso crisis of december 1994

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There are three different types of foreign exchange regimes that can be used by developing countries once their currency has stabilized. The first one is called the managed float. Also called the dirty float, the managed float is a system when exchange rates are able to change due to the nature of the market, but leaves the option for the government to intervene if the fluctuation is not desired. It is the regime that has been used by the monetary system since 1973. The second regime is called the crawling band. The crawling band, in this case, would combine Mexico's crawling peg with a wider band. The crawling band is a compromise between a system of entirely fluctuating exchange rates and those that are inflexible. The parity levels would be adjusted either up or down as a moving average of the actual exchange rates that would fluctuate on a wider band. The exchange rate would be only allowed to move a maximum percentage. The amount of the percentage is called the annual crawling peg.

The wider band that would cover the crawling peg would allow for the actual exchange rate to fluctuate. The third regime is called the floating exchange rate system. Also called the flexible exchange rate system, the exchange rate fluctuates based solely on market forces in this regime. A floating system allows countries to have independent monetary and fiscal policies. Also, central banks would not have to hold onto a large international reserve to back a fixed exchange rate system.

Capital flight was one of the main reasons for Mexico's financial collapse of the peso. Capital flight is when assets and money flow out of a country due to an economic event that doesn't assure investors things are okay. Capital

flight differs from capital flow because capital flight occurs when investors feel that prices are about to fall and it becomes a race to get your money out before the prices fall. The assassination of presidential candidate Luis Colosio definitely played a factor in the capital flight out of Mexico.

In 1994, the United States, the International Monetary Fund (IMF), and a few others created a rescue package for Mexico. The United States put up \$20 billion of the \$50 billion for Mexico. The IMF guaranteed a credit agreement with Mexico for about \$17.7 billion. The Bank of International Settlements offered \$10 to Mexico and The Bank of Canada offered about \$1 billion. It was not just Mexico mismanagement that caused this crisis. The assassination of the presidential candidate was something that could not have been avoided and it caused the crisis to worsen even more.

It seems like that event was the “last straw on the camel’s back”, so to say. In order to prevent this crisis from happening in the future, Mexico should pay closer attention to its current account balance. Now that this has happened once, Mexico should know what to look for in order to stop it before it gets even worse. Overall, the aid package was risky on the United States to do. No one was certain that Mexico would be able to pay back the money. The United States could just not do anything though.

We have close ties with Mexico through the North American Free Trade Agreement (NAFTA). We weren’t just going to let Mexico fail. Just like the IMF helped Mexico back in 1994, they are currently lending to countries in need today. Countries with emerging markets such as Belarus, Hungary, Iceland, Latvia, Pakistan, Poland, Romania, Serbia, Sri Lanka, and Ukraine are

receiving capital from the IMF. Almost always, low-income countries are also receiving money from the IMF.