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Reforms lift Mexican peso

Currency has gained 2.6 percent in March

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Analysis

MEXICO CITY – Mexico's peso is scaling new highs amid confidence in the country's reform push, a likely credit rating upgrade and profit-taking after last week's interest rate cut, sparking speculation about how far it will rise before authorities act.

The peso has gained 2.6 percent since the start of the month, the best performance of the 152 currencies tracked by Thomson Reuters, and broken through key level of 12.50 to the dollar for the first time in 18 months. The rise has come despite a 50 basis point cut in benchmark interest rates to a record low 4 percent on Friday, which only served to fuel investor optimism about the outlook for Latin America's No. 2 economy.

A signal from ratings agency Standard and Poor's that it might upgrade Mexico's credit rating and the announcement of plans to introduce more competition into the communications sector have also boosted Mexico's standing.

"As an investor, this is positive. ... and it will attract more capital to Mexico," said Rudy Amoresano, founder of boutique fund manager Caerus Management, of the reform plan.

More capital is the last thing the central bank wants. The Banco de Mexico warned that heavy inflows could lead to an 'unnecessary' tightening in monetary conditions, as a stronger peso would drag on growth.

"The market is testing to see how far the central bank will allow the peso to appreciate without taking any kind of action," said Enrique Álvarez, Latin America strategist at IDEAglobal.

Even though the rate cut has not dissuaded investors in the short term, the famously non-interventionist Banco de México has more options up its sleeve.

It could officially drop a mechanism triggering an automatic offer of dollars if the peso weakens sharply, introduced when the currency was going through a weak patch in late 2011.

Banorte-Ixe economist Gabriel Casillas said this could be a first step, possibly followed by reinstating a monthly auction of dollar "put" options. This would build up Mexico's foreign reserves cushion and also pour pesos into the market.