What Happens to Their Economy When Mexico Runs Out of Foreign Currency Reserves?

Mexico is struggling to keep their currency from falling too far and too fast. The problem is that buying pesos with dollar reserves is not helping and it is eating up their currency reserves. *Bloomberg* says **Mexico needs new peso-saving tools**.

> *Mexico's central bank, struggling to lift the peso from its record lows, is getting backed into a corner after spending $2 billion last week with little effect.*
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> *Recent dollar sales aren't helping boost the currency, foreign reserves are faltering and economists expect policy makers to raise interest rates again in February after five hikes last year. While some analysts say Mexico could try dollar swaps or increasing its credit line with the International Monetary Fund, they warn against depleting reserves. That could undermine investors' confidence and intensify the market selloff.*

All of this has to do with president elect Trump declaring war on trading partners such as Mexico and China. Where will Mexico sell its products if Trump slaps huge tariffs on exports to the USA or tears up NAFTA? What happens to their economy when Mexico runs out of foreign currency reserves?

When a Country Goes Bankrupt

The Economist discusses what happens **when a country goes bust**. The point is that when a country runs out of hard currency it cannot pay its debts.

> *When a country fails to pay its creditors on time, it is said to go into "default", the national equivalent of going bankrupt. But sovereign defaults are quite different from business bankruptcies as it is far harder for creditors to repossess the assets of a sovereign entity than to repossess the assets of a company.*

A common solution is to write down debt with bond holders rather than default.

> *But these so-called "haircuts", where the original value of a bond is reduced, can be much more painful for the holders of government bonds than a simple clip of the scissors.*
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> *When Greece defaulted in 2012, bondholders were forced to take hits as high as 50%. In less severe cases, countries may choose to restructure their debt by requesting*

more time to pay. This has the effect of reducing the present value of the bond-so it isn't entirely pain-free for investors.

If you are holding Mexican bonds you ought to be worried that Mexico will run out of currency reserves. And when a country has to write down its debt it commonly must agree to austerity measures in order to balance its books. These measures commonly include reductions in social spending. That can bring on political and social unrest and result at the least in a change in which party rules and a worst in total political and social chaos that leads to revolution. If Trump is unhappy with imports from Mexico he might think twice when the country of Mexico dissolves into social unrest violence and political chaos. The Trump formula for success supposes lower taxes, less regulation and more money in everyone's pocket. It does not suppose a civil war south of our border.