MONETARY POLICY IN DEVELOPED ECONOMIES: THE CASE OF MEXICO, 2000-2020

Noemi Levy Orlik

Lectura 2

- Institutional organisation
- Main Features of the Mexican Economy

Monetary Policy

- The ISI period: main instruments
- Main arraignment of the Export Led Model
- The Central Bank operations and its effect in the Mexican economy

Two financial organisations: Capital market *versus* Bank based financial system

The Anglo-Saxon financial system: Capital based

Bank issue credits for production

and

capital markets provide long term liquidity to finance capital goods or liquidity to non-liquid assets)

Capital market need to be broad and deep; reduced public sector intervention and market forces determine prices

Historically capital market didn't finance industrialisation (Cameron, Pollard). Internal internal funds were the main finance providers

but in periods of financial capital dominates

Firms' treasury activity, rises increasing financial gains, process of overcapitalization (1929, 2008) unfolds

Capital markets are linked **to oligopolistic structures** (K centralisation and concentration -Kalecki and Steindl argument)

Bank-based system: Used by countries that need to "catch -up" development

Bank are the main providers of finance within financial systems with **weak or regulated capital markets.**

There are two models: The German system (universal banks) or Direct State intervention

In the German model, governments are active in determining the markets participants and secure commercial banks intervention in corporation boards –economic groups.

While in the direct state intervention system (East Asia and LA) the public sector mobilizes long term resources through **compensatory mechanisms** (development banks, public trusts, credit policies, legal reserves requirements). The man challenge is the generation of domestic savings.

Government determines the main prices (interest rates and salaries)

Different results ….

East-Asian industrialisation successful experience

Public spending finance private and public investment

Low domestic consumption and **net export** (current account surpluses)

Industrialisation went from simple to complex production activities, including **capital and intermediate** goods

Economic groups were created (*Zaibatsus* & *Keiretsus*) and capital market were strengthen

Strong regulation to prevent external capital flight and luxury imported consumption

Operated in a period of closed economies (with fix exchange rates)

Domestic finance mechanism were created along with endogenous economic growth

Latin America: truncated industrialisation

Industrialisation substituted final consumption goods and was based on K and intermediate imports ➔ **Structural current account deficits**

Foreign corporations dominated dynamic sectors, based on foreign obsolete technology ➔ low productivity with reduced export sector competitiveness

The public sector subsidised K and intermediate imports and public policy didn't develop domestic technology

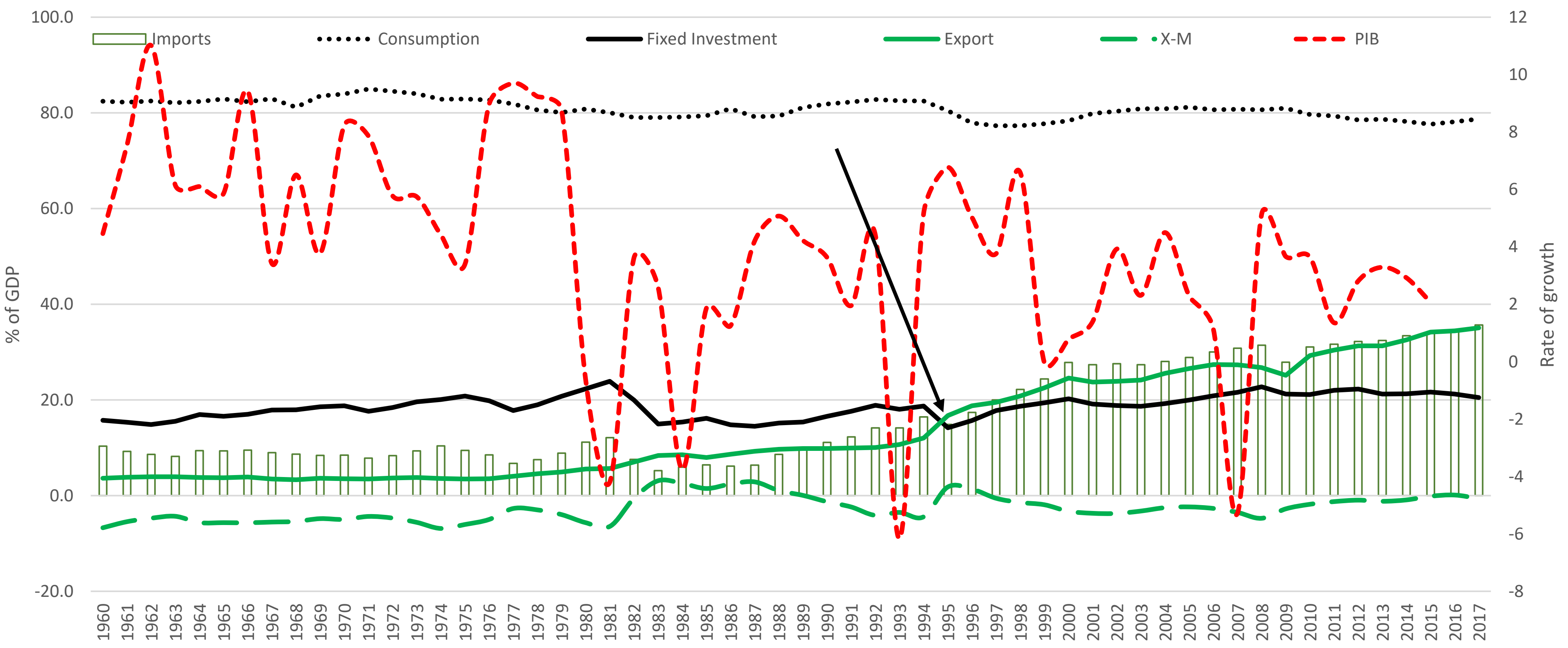
Public (development) banks and trusts plus accommodative monetary policy had a prominent role financing **private and public sectors. Economic groups didn't develop**

Structural fiscal deficit: public debts were partially annulled (weak tax structures and low public utility prices). The private sector was subsidised

ISI model was based on high income concentration that operated with low private investment coefficients. Domestic private savings were extremely low (high luxurious capital consumption and capital flight, Kaldor, 1949)

Main Features of the Mexican Economy

GDP: Growth rate and its composition

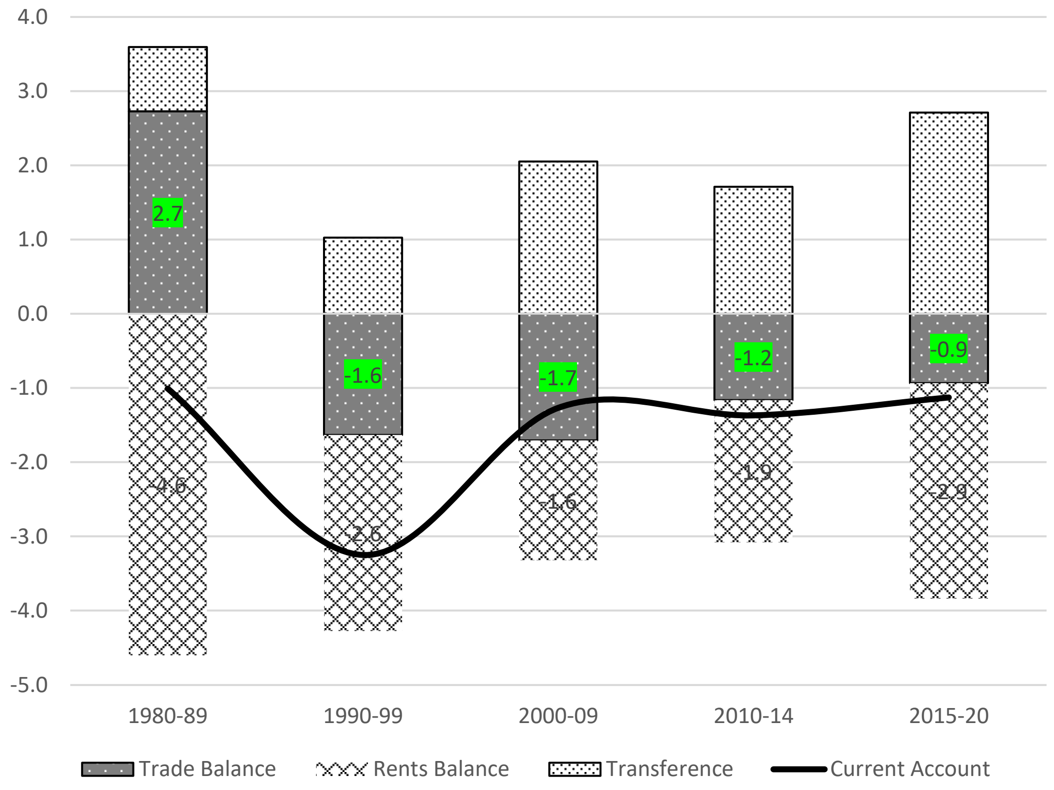


From ISI to Export Led Model: Structural current account deficit

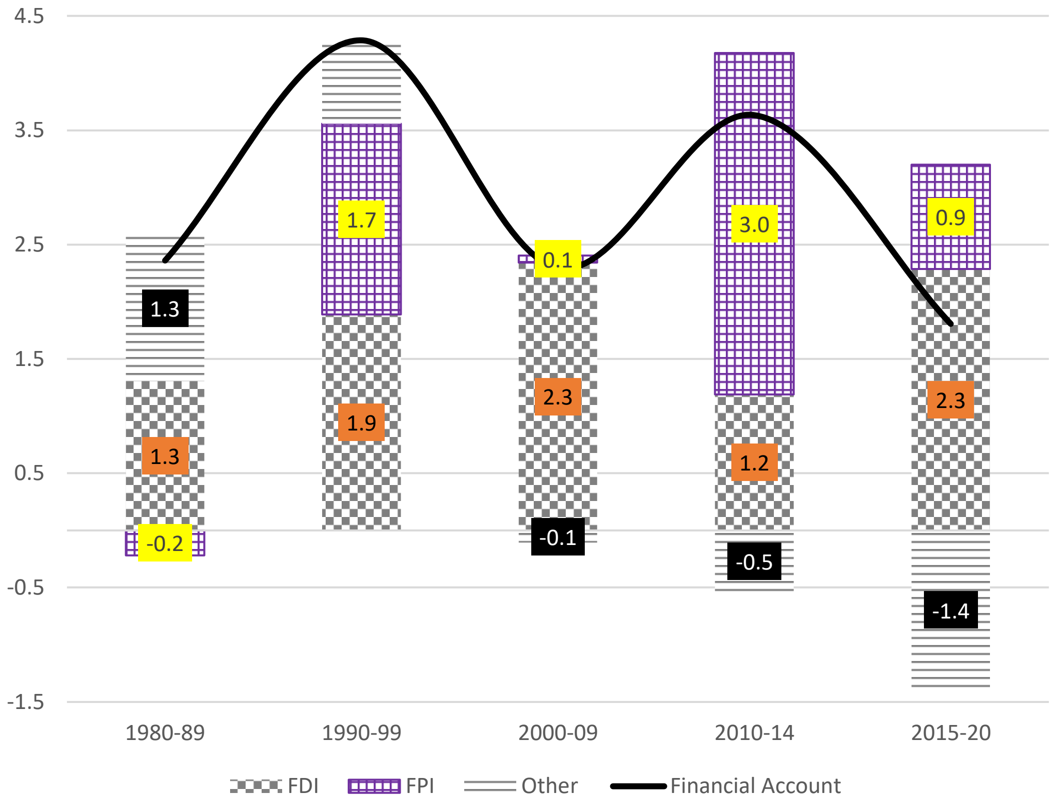
Growth Rates	GDP	Imports	Consumption	Private C	Goverment C	Fix Investment	Private I	Public Gov.	X	trade balance
1960-1981	6.7	7.5	6.5	6.2	9.0	8.8			8.9	6.5
1982-1989	0.7	4.5	1.1	1.0	1.5	-2.9	0.6	-8.9	5.7	-177.9
1990-2017	2.6	7.1	2.4	2.5	1.8	3.4	4.0	0.8	7.5	-0.2
	W/ respect to GDP									
		Imports	Consumption	Private C	Goverment C	Fix Investment	Private I	Public Gov.	X	trade balance
1960-1981		9.2	82.2	77.7	6.4	19.2			4.2	-5.1
1982-1989		7.6	79.7	72.6	7.8	16.7	10.7	6.1	8.4	0.7
1990-2017		27.1	79.7	73.5	6.3	20.0	15.7	4.2	25.2	-1.9

Mexico’s insertion in the global market

Current Account: structural deficit due to trade balance (exports moved from oil to manufacture maquila) and rent balance (profit remittance)

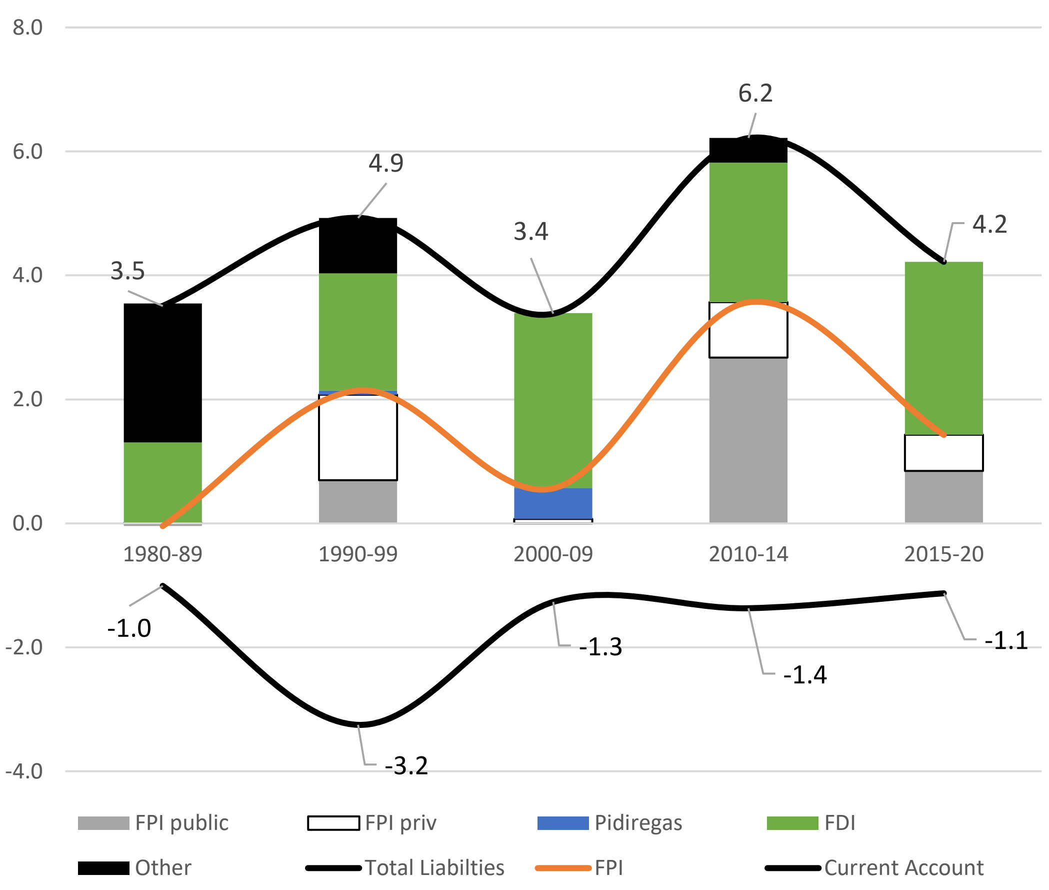


Financial Account: From Credits (other) to Foreign inflows

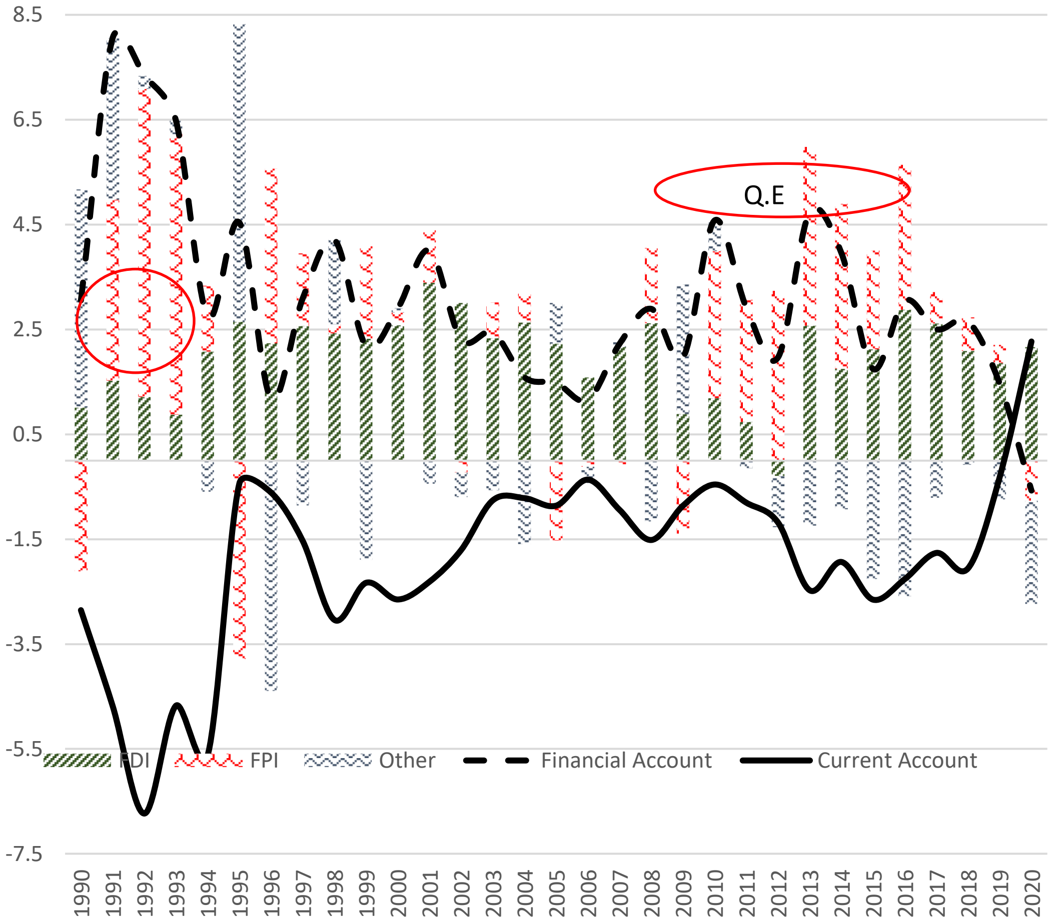


A closer look to the financial accounts: Foreign inflows dominate well above the current account needs

Total liabilities above current account finance



Net financial account : external capital inflows above current account needs. FPI is determined by external factors; FDI responsible of external debt issuance; and FDI has short term capital



Monetary Policy

Monetary Policy in the ISI period

Money Creation

- Money print (till 1954)
- Government long term securities hold in Commercial Banks Reserves

+

- Fix and adjustable exchange rates

(Stable exchange rates with two devaluation events – 1954 – 1976)

and

- Stable interest rate

(Bond and stock market almost inexistant)

ISI didn’t not created indigenous economic growth

M substitution didn’t reach capital or intermediate goods

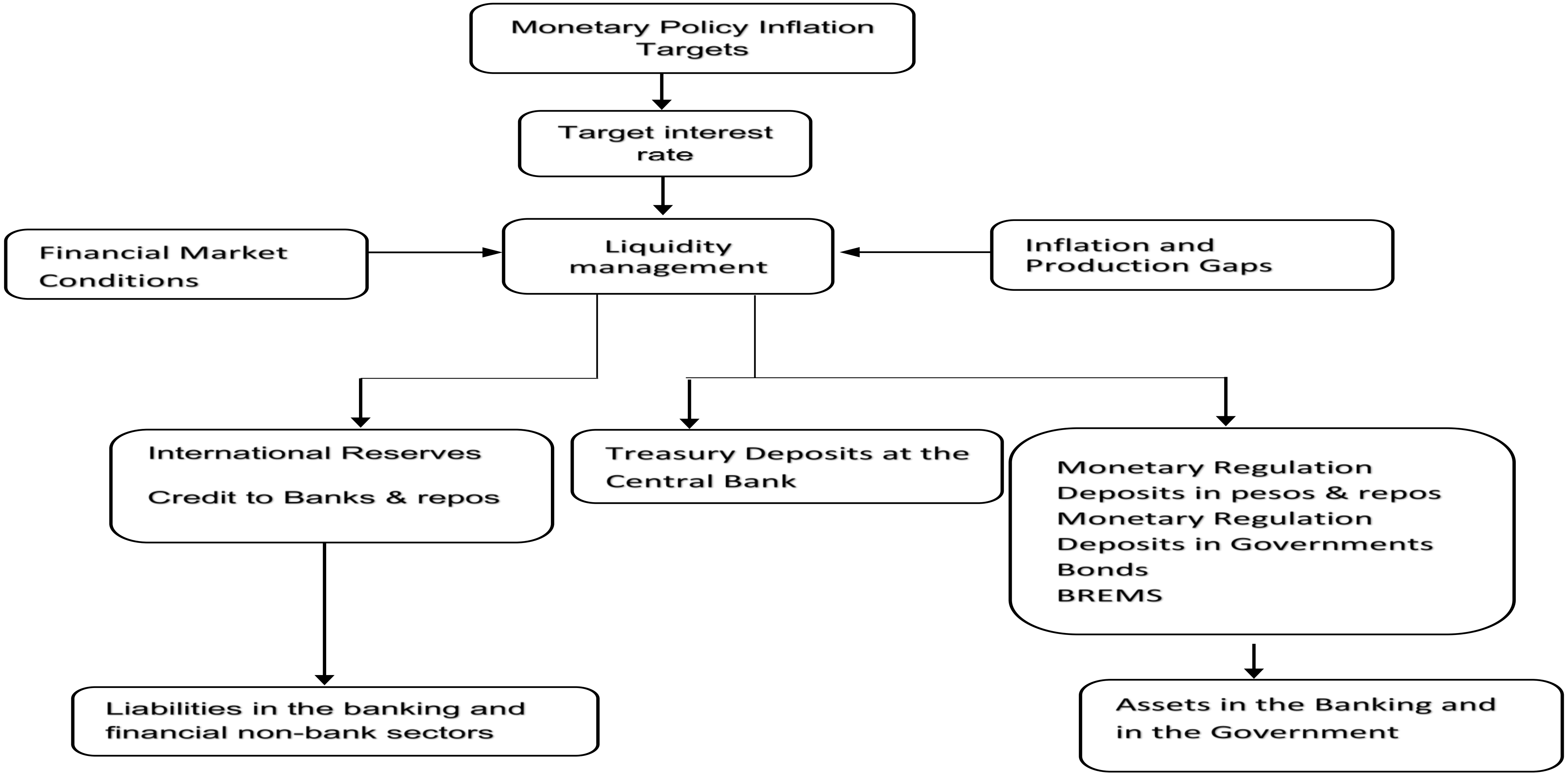
Banco de México S.A
(Commercial private banks participate in the Governing Board Decisions)

Monetary Policy Instruments

- **Central bank control of commercial interest rates of bank deposits and loans interest rates** (maximum deposits interest rate and in some lending interest rate)
- **Legal Reserve Requirement + Rediscount Facilities**
- **Selective credit policies** (Finance economic growth of private and public activities)

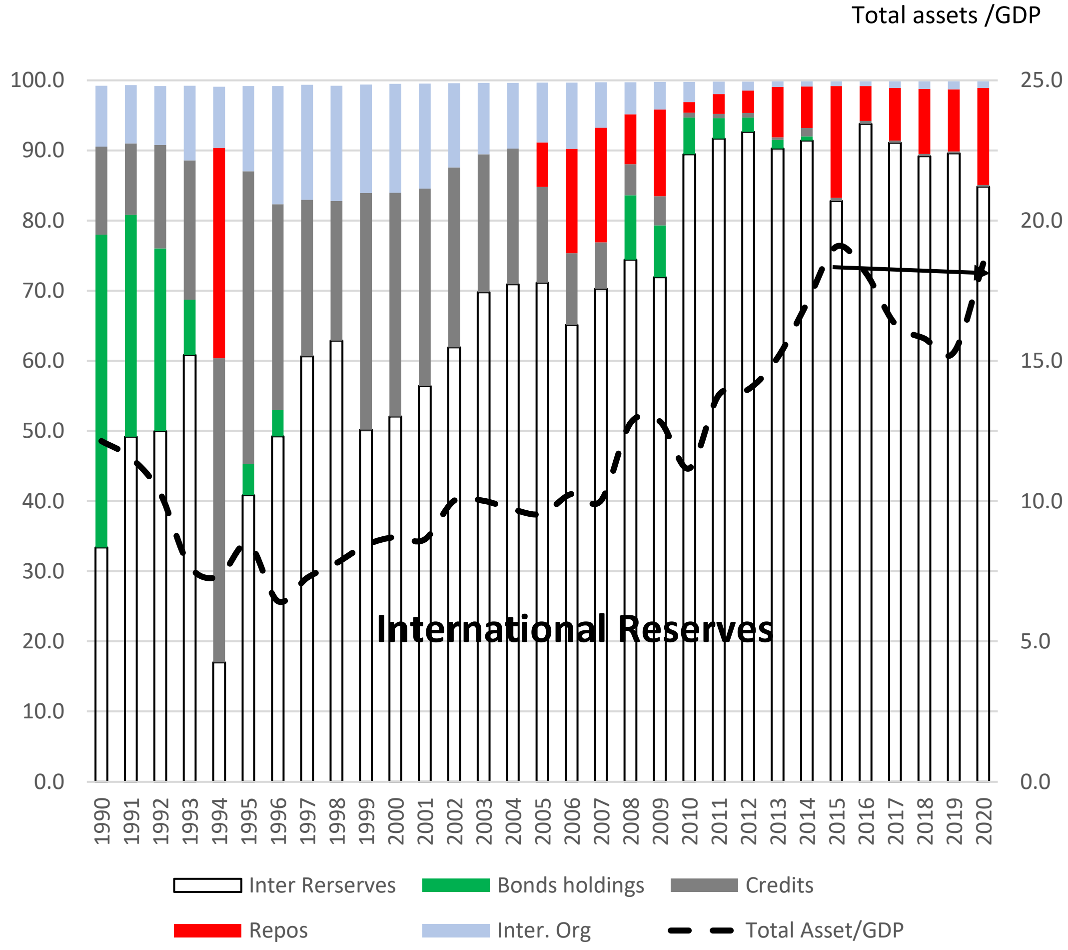
Central bank assets	Central banks liabilities
Credits to government Public trust finance Credits to banks	Deposits in the central (LRR)
Comm1ercial banks finance	Liquidity destruction (low taxes + low public commodities

Monetary Policy in the globalisation period: exchange rate stability via foreign capital inflows and interest differentials



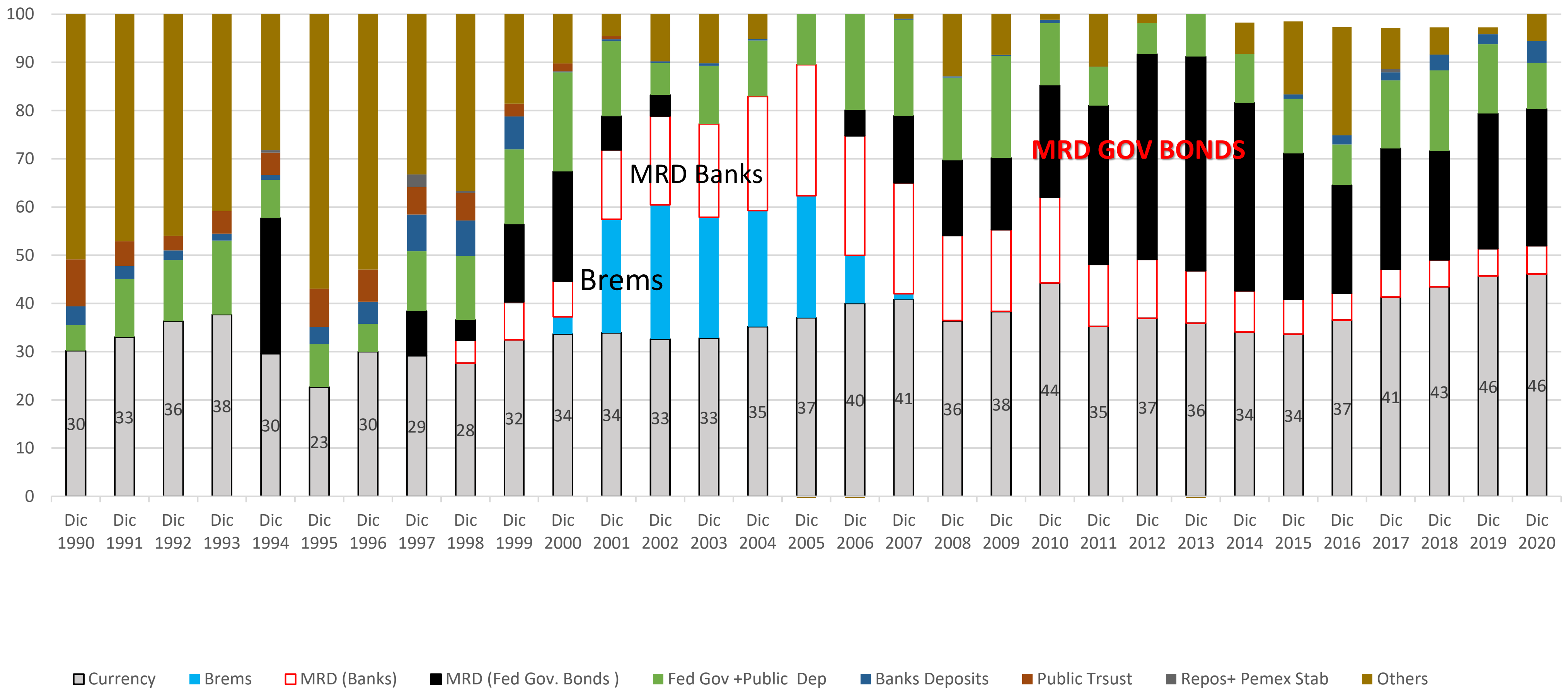
How it operates?

Mexican Central Bank Assets: dominated by International Reserves and repos manages banks liquidity

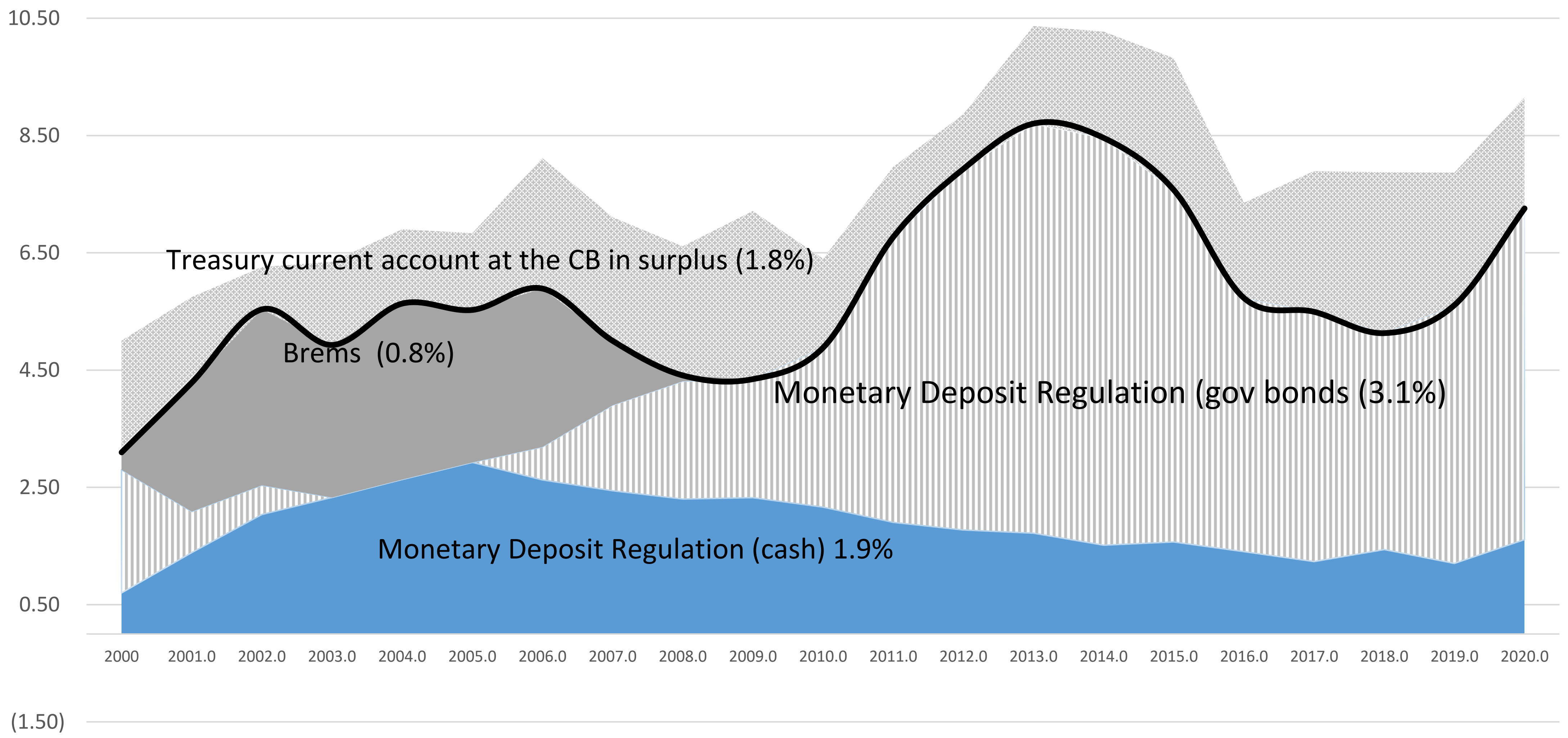


	Asset/GDP	Inter Rerserves	Bonds holdings	Credits	Repos	Inter. Org
1990/2020	11.5	68.0	4.9	13.9	5.1	7.6
1990/1994	9.8	42.1	22.0	20.1	6.0	9.0
1995/1999	7.7	52.7	1.6	29.4	0.0	15.4
2000/2004	9.4	62.2	0.0	24.9	0.0	12.4
2005/2009	11.1	70.6	3.3	7.8	11.4	6.6
2010/2014	14.2	91.1	2.4	0.7	4.1	1.5
2015/2019	16.9	89.3	0.0	0.4	9.3	0.9
2020	18.5	84.8	0.0	0.2	13.8	1.0

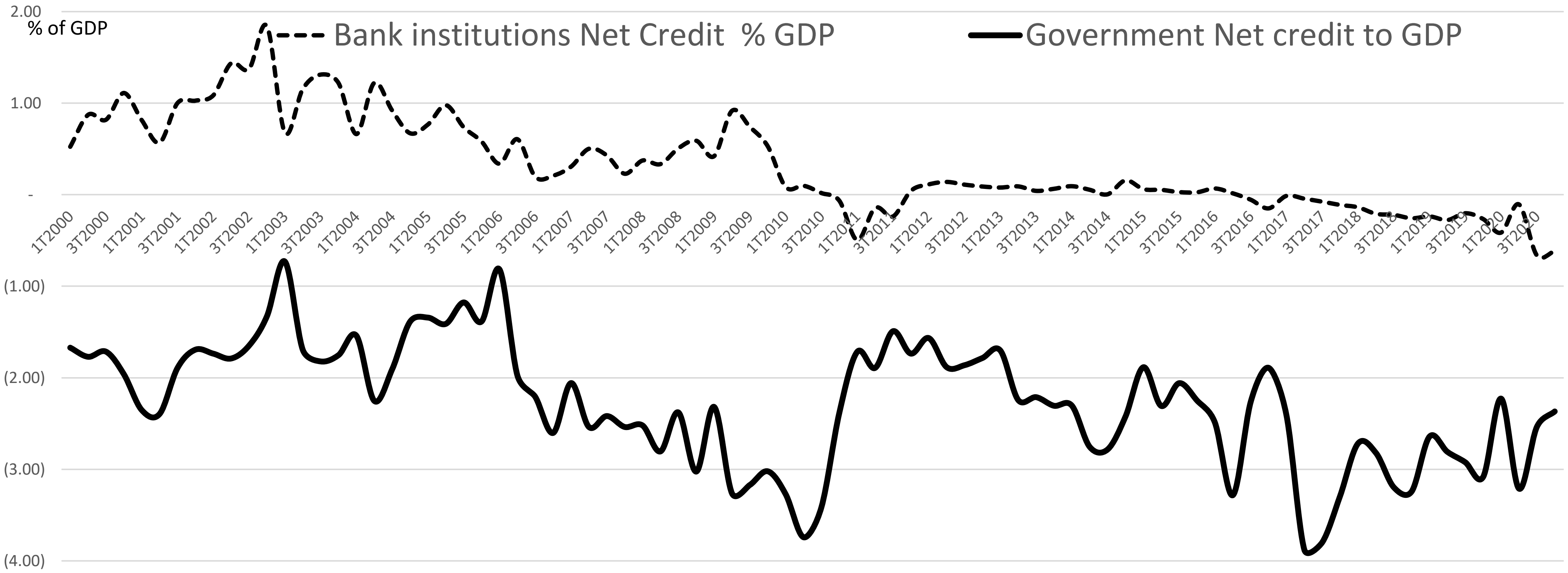
BdeM liabilities: From 2007, monetary regulation deposits based on government bonds reducing monetary regulation deposits in cash



Contractive monetary policy: A closer look on Central Bank Liabilities in terms of GDP shows that Monetary Deposit regulation based on government bonds dominated over MDR in pesos and the Treasury account at the central bank is in constant surplus, limiting government spending



Negative net internal credit. Goverment switched from debtors to creditors



Monetary Regulatory Deposits based on government bonds (% of total governments bonds in circulation)

% of bond government in circulation	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**
	1.02	7.0	9.5	10.2	8.3	16	21.2	22.3
	2014	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	
	21.3	21.3	15.6	14.8	13.4	13.6	14.1	

Central Banks liability management costs: Monetary Regulatory Liabilities

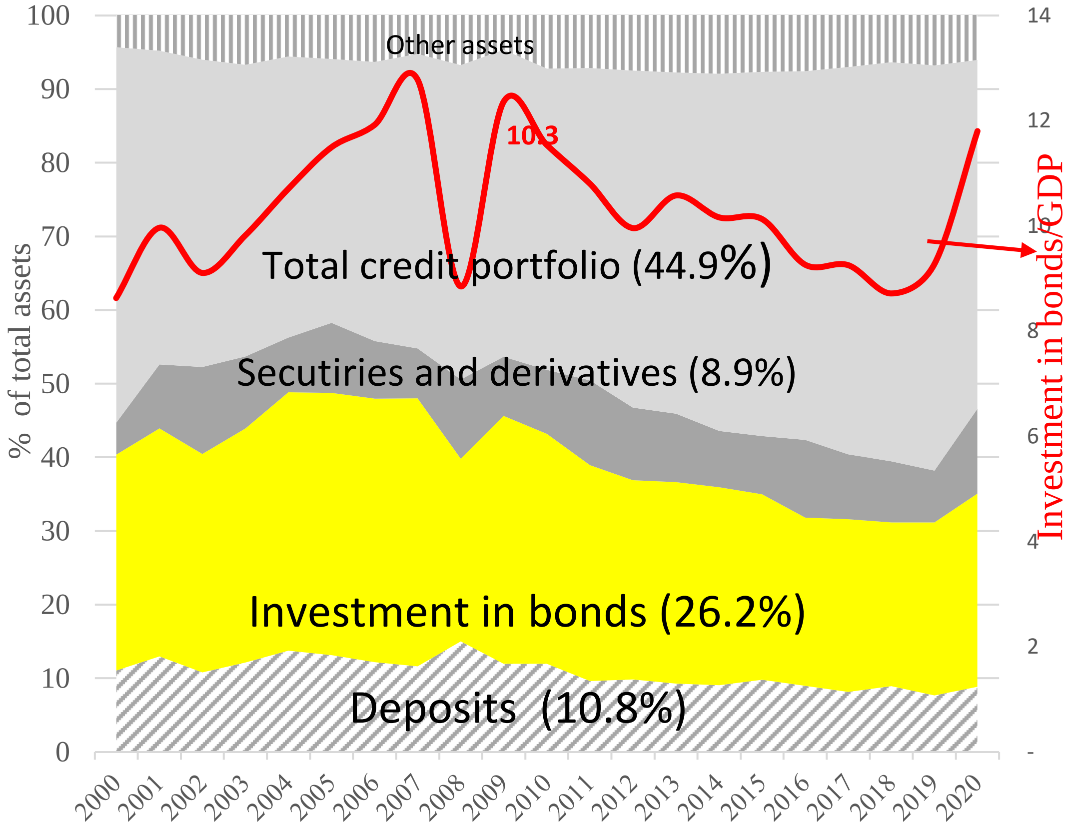
Composition of Bde M costs

	2014	2015	2016	2017	2018	2019	2020
Payments for Government deposits	**74.0**	**73.4**	**70.7**	**75.1**	**73.4**	**75.4**	**73.3**
For current account deposits	19.2	16.3	23.8	32.4	31.3	30.6	24.9
For government deposits	54.9	57.2	46.9	42.8	42.1	44.8	48.4
Payments for Bank deposits	**12.8**	**13.6**	**16.8**	**15.3**	**17.0**	**17.2**	**17.0**
For MRD	11.6	11.1	11.5	9.6	10.0	9.7	7.8
For current account deposits	0.0	0.2	1.0	1.0	2.1	2.7	4.7
For BREMS	1.2	2.3	4.3	4.7	4.9	4.7	4.4
Other expenses	**13.1**	**13.0**	**12.5**	**9.6**	**9.6**	**7.5**	**9.4**
Total financial expenses	100.0	100.0	100.0	100.0	100.0	100.0	99.7
Payments to banks and government, % GDP	0.61	0.33	0.58	0.95	0.98	1.07	0.76
Financial Losses to GDP	-0.63	-0.31	-0.37	-0.18	-0.28	-0.36	-0.09

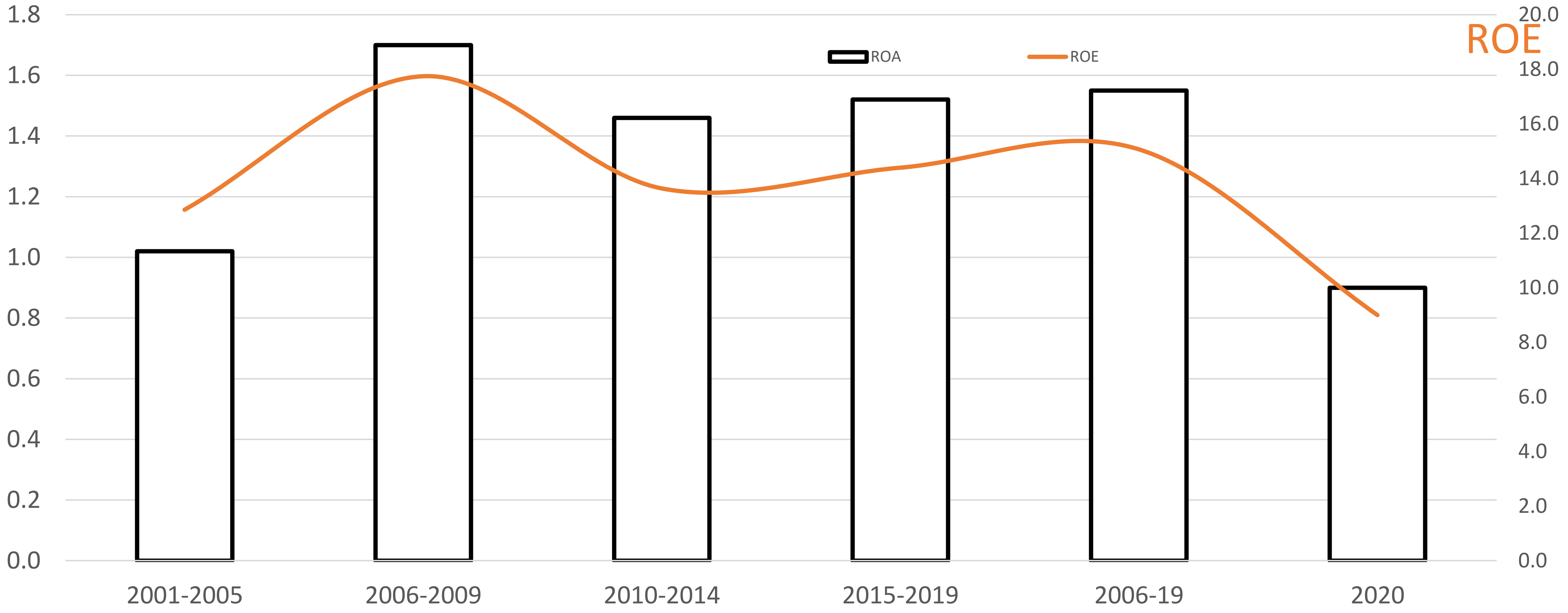
What happened in the commercial bank’s balance sheet

Multiple Bank Assets trend and composition: low credit ratio and high bond participation

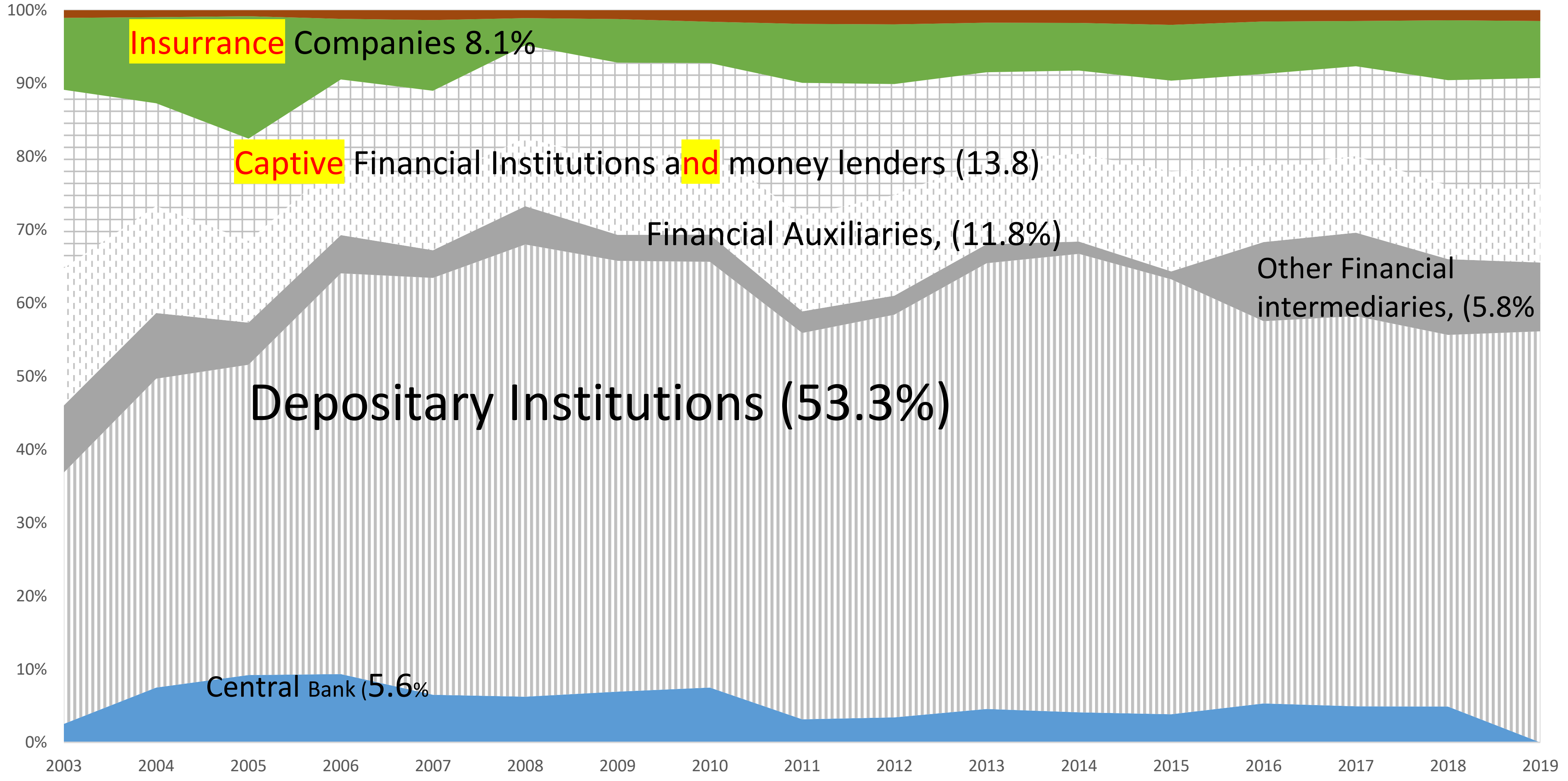
W/ respect to GDP	2000-08	2010-14	2015-20
Total Assets	32.2	37.3	40.6
Deposits	4.0	3.8	3.5
Investment in Bonds	10.4	10.9	9.7
Securities & derivatives	2.8	3.4	3.7
Total Credit	13.2	16.5	20.9
Current portfolio	12.7	16.1	20.4
Commercial Credits	8.9	10.1	13.0
Firms	4.6	7.3	9.7
Financ. Entities	0.4	0.5	0.9
Gover. Entities	3.9	2.3	2.4
Consumption	2.0	3.2	4.0
Housing	1.7	2.7	3.4
Due Portfolio	0.5	0.5	0.5



Banks returns ROA and ROE



Distribution of the net operating surplus in the financial sector, (% of the total): Banks get the biggest shares



Conclusions

Mexico’s financial organisation didn’t developed market mechanism. This led to foreign external flows dependence

Monetary policy changed: In the ISI period the central bank created liquidity through credit issuance to commercial banks and governments along legal reserve requirements to keep central bank balance sheet in equilibrium and channel credit to the productive sector.

In the export led model liquidity depended on international reserves to stabilise the exchange rate along with sterilisation mechanism

Private finance (big corporation) depend on international market liquidity (bond issuance in international financial centres)

International reserves volume was above domestic absorption therefore sterilisation mechanism were unfolded: Net internal credit specially from the government sector turned negative and private banks (mainly foreign) imposed their interest on central bank liquidity management.

Sterilisation mechanism limited government spending (Government treasury account remained in constant surplus and monetary regulatory deposits were based on government bonds, which generates high profits, with virtually no risks, since banks could used this bonds to engage in other operations.

Central bank liability management is highly costly. Most of these returns go back to the banking sector, subsidising by the private financial sector

What to do: create finance in domestic currency and rely less on foreign inflows