

# Mexico's Improved Macroeconomic Policy Framework



**Edward C. Skelton**

Economist, Federal Reserve Bank of Dallas

Presentation to "Bridging the Border: Reinforcing Ties Between the U.S. & Mexico

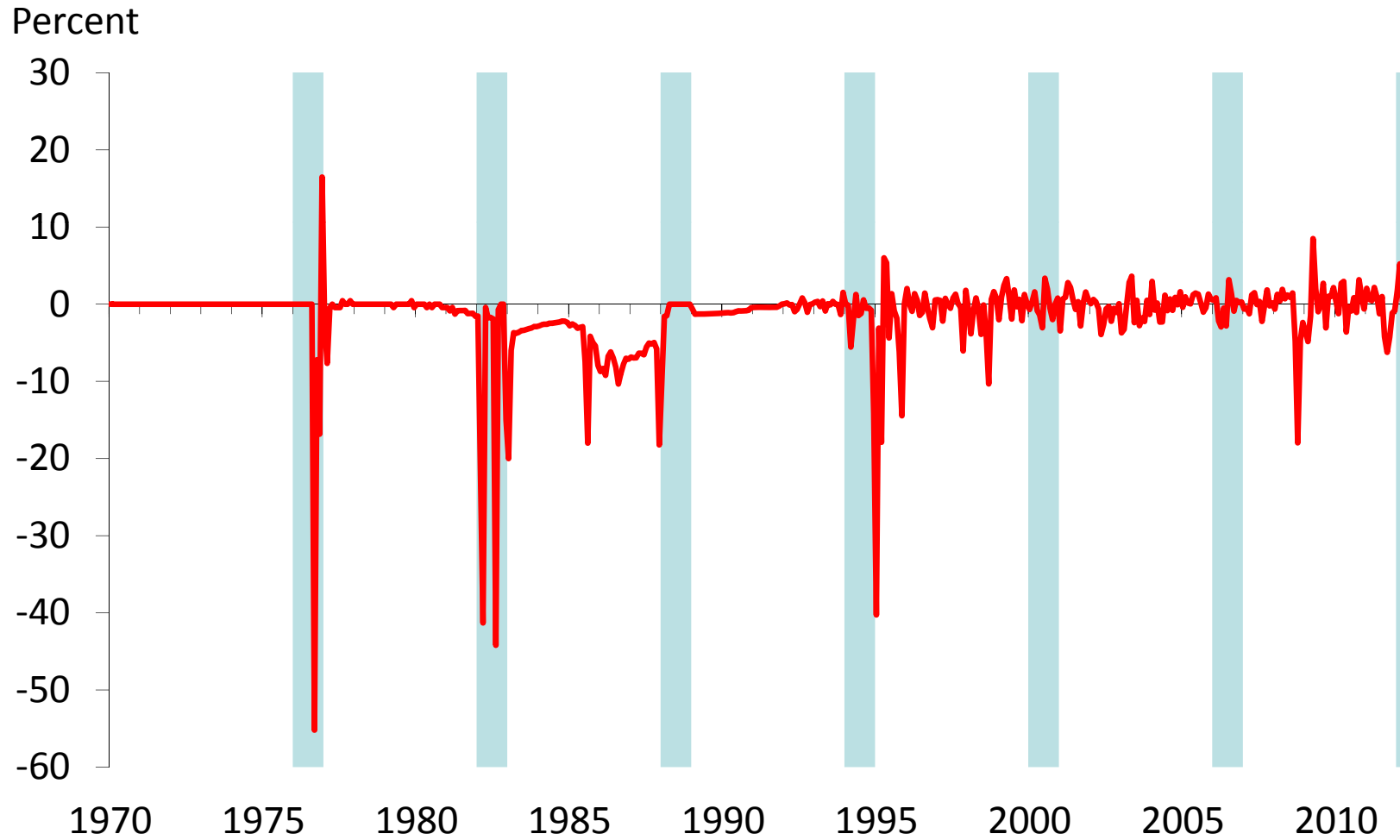
April 12, 2012

# Overview

- Past history of macroeconomic instability
- Changes to the monetary policy framework
  - Adoption of inflation targeting
  - Central bank independence
- Changes to the fiscal policy framework
- Remaining challenges
  - The limits of macroeconomic policy

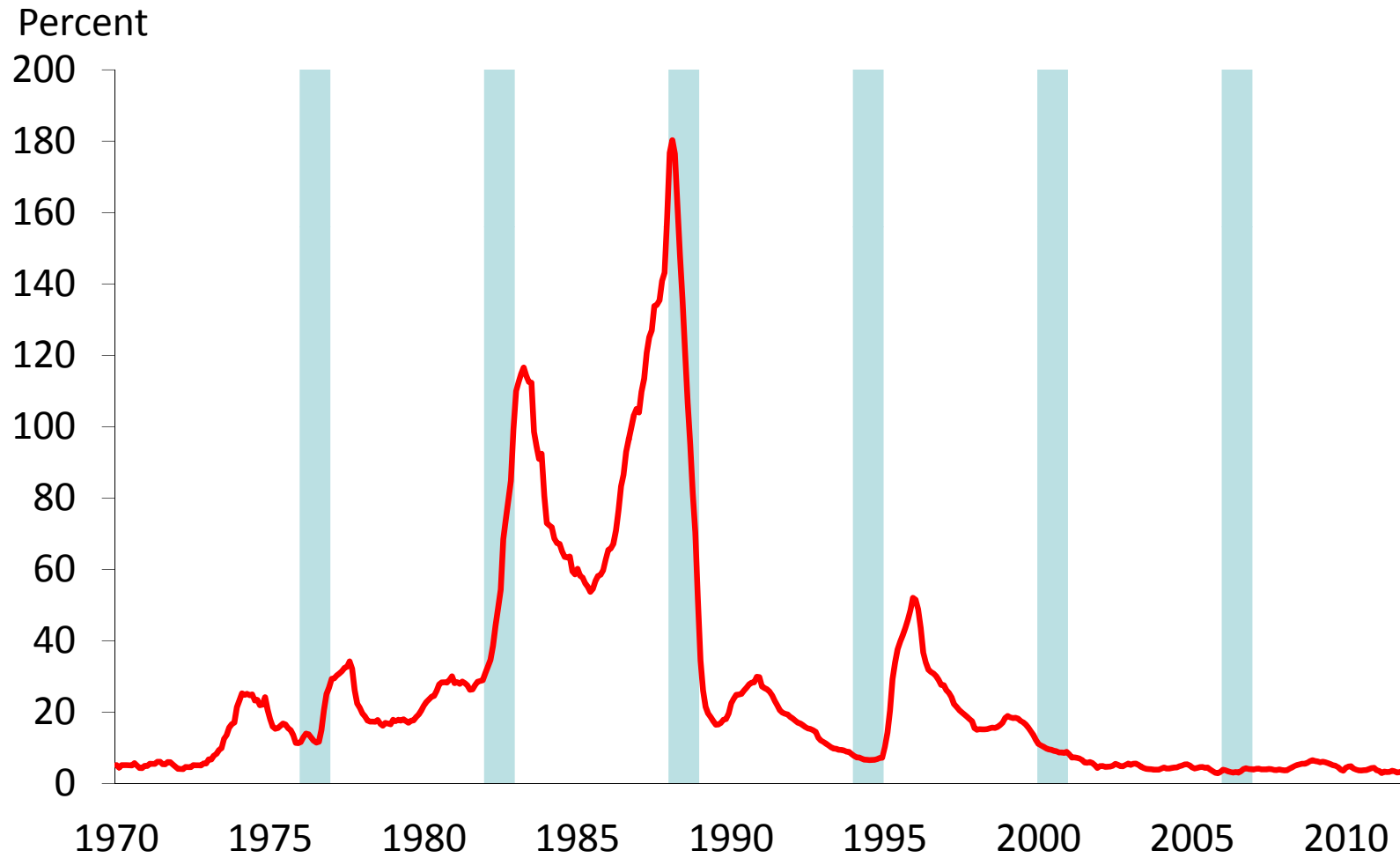
# A history of crises

(U.S.\$/peso exchange rate, monthly percentage change)



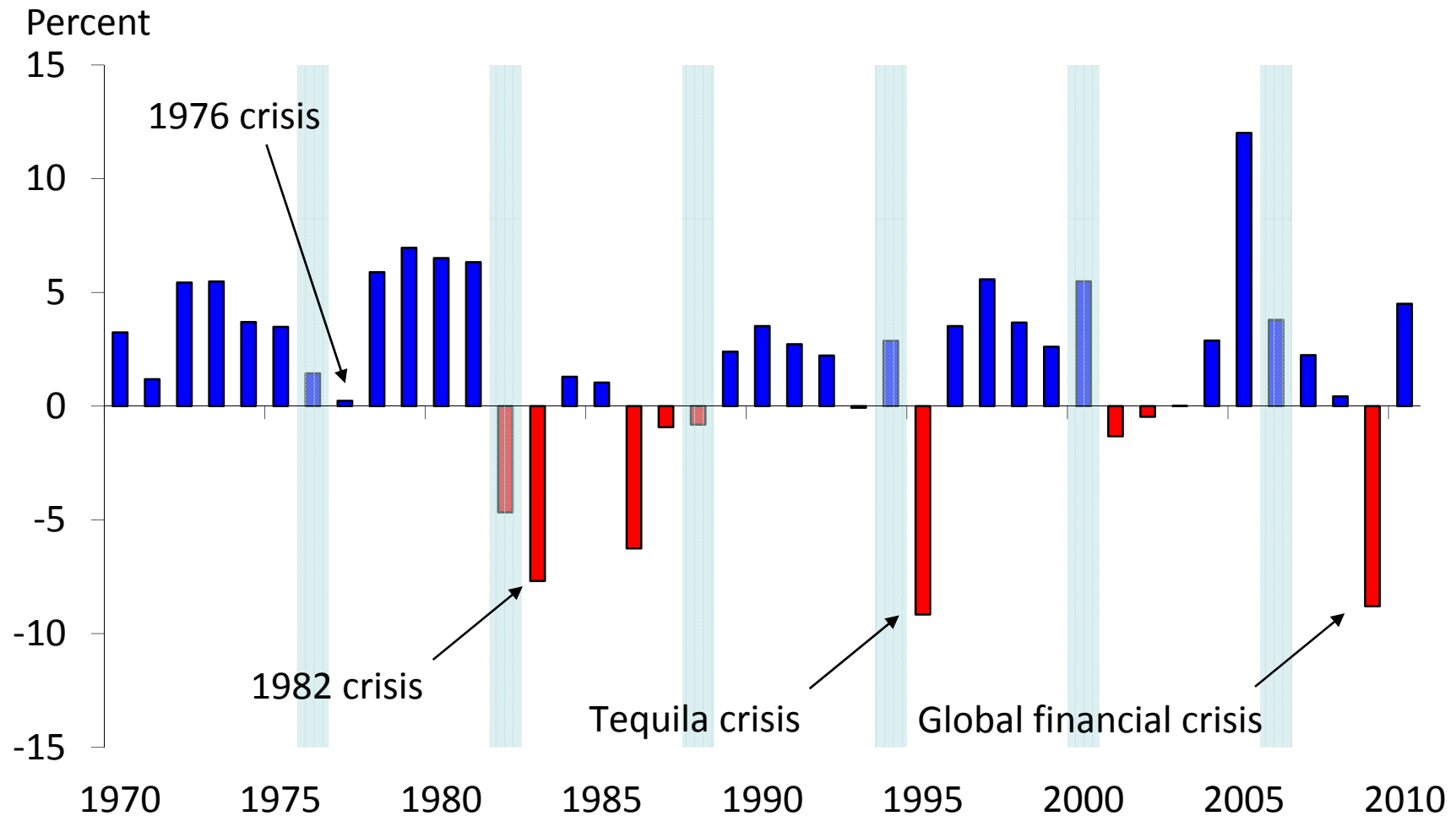
# The rise and fall of inflation

(12-month inflation rate)



# Crises hurt!

(Real GDP per capita growth, PPP-adjusted)

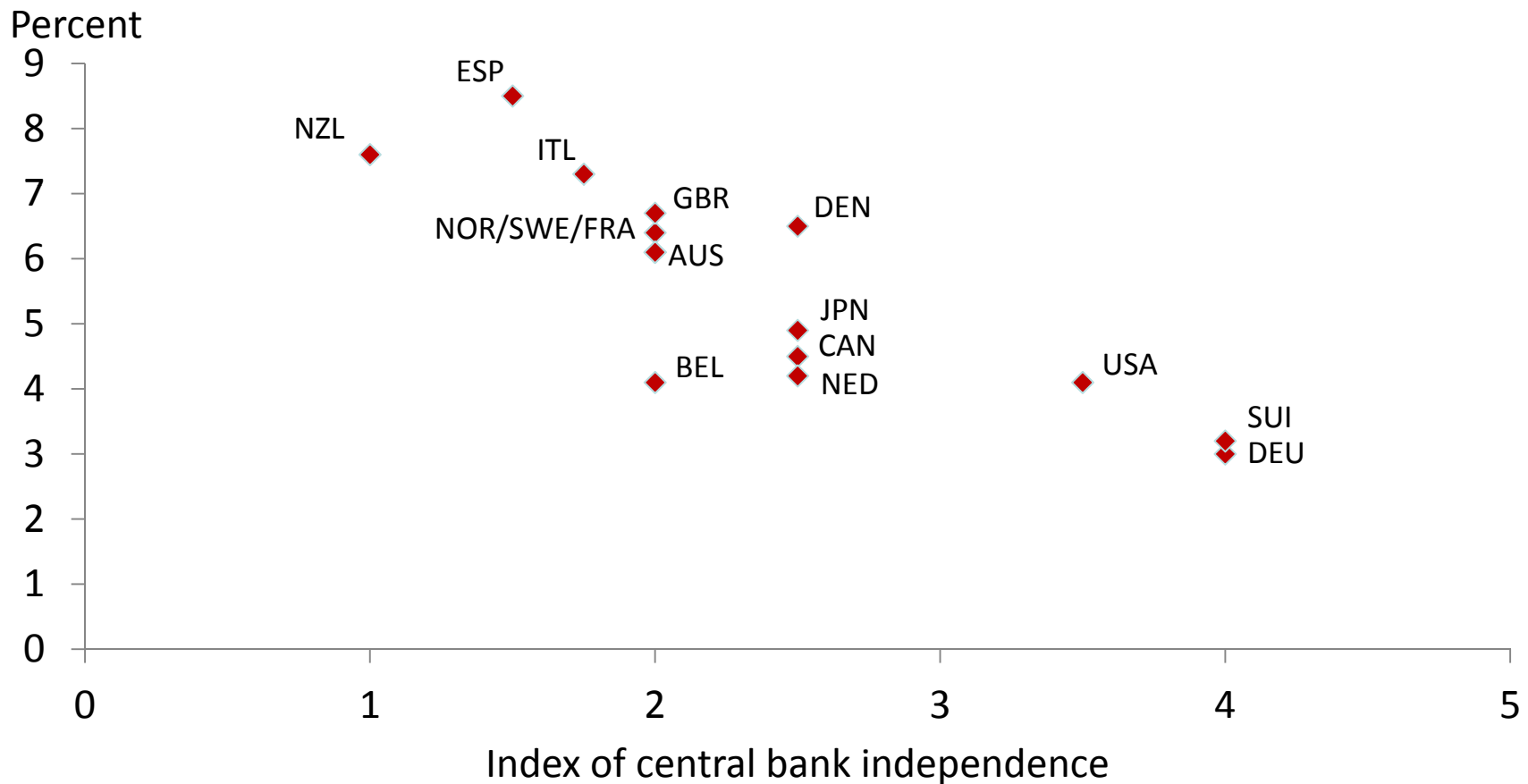


# Central banking conventional wisdom circa 1995

- Central bank independence
  - Focus on longer term objectives
- Inflation targeting
  - Price level is what central banks ultimately control
  - Objective against which an independent central bank can be held accountable
- Taylor Rule as guide to policy decisions

# Independent central banks deliver better inflation outcomes

(Average annual inflation rate, 1955-88)



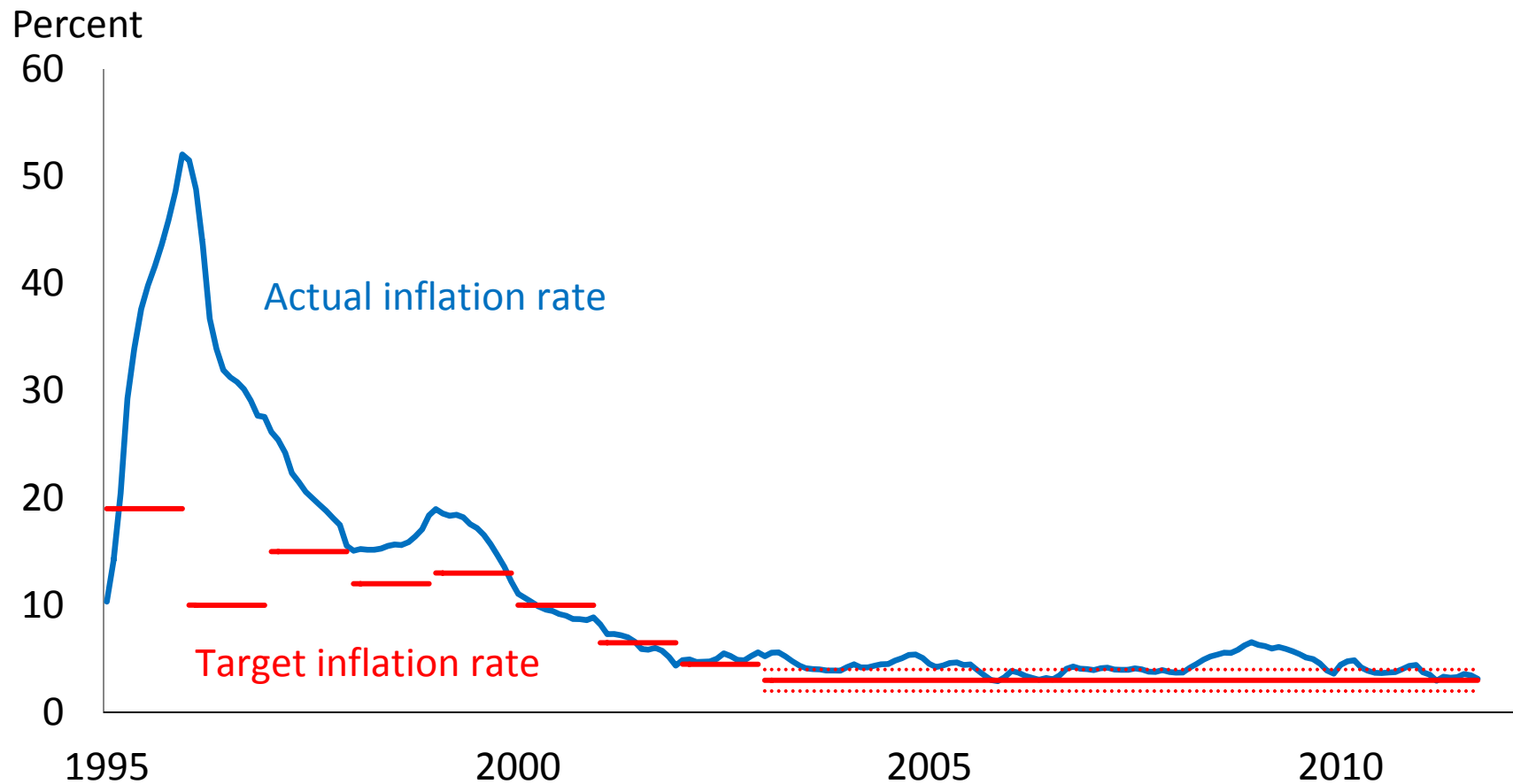
# Independence

“El Estado tendrá un banco central que será autónomo en el ejercicio de sus funciones y en su administración. Su objetivo prioritario será procurar la estabilidad del poder adquisitivo de la moneda nacional, fortaleciendo con ello la rectoría del desarrollo nacional que corresponde al Estado. Ninguna autoridad podrá ordenar al banco conceder financiamiento.”

- Article 28 of the Constitution of the Mexican United States, August 20, 1993

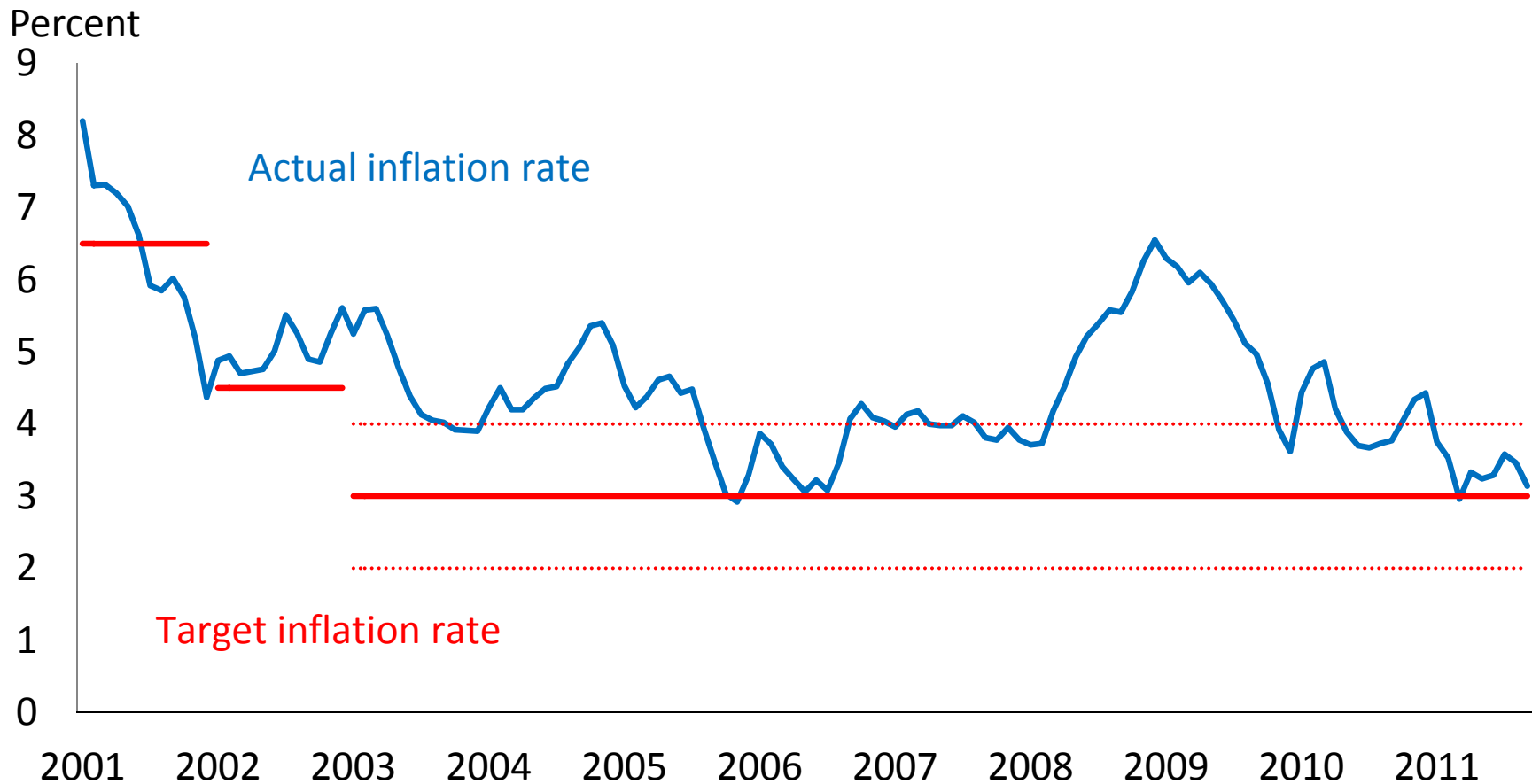


# Inflation targets and outcomes (12-month inflation rate)



# Inflation targets and outcomes

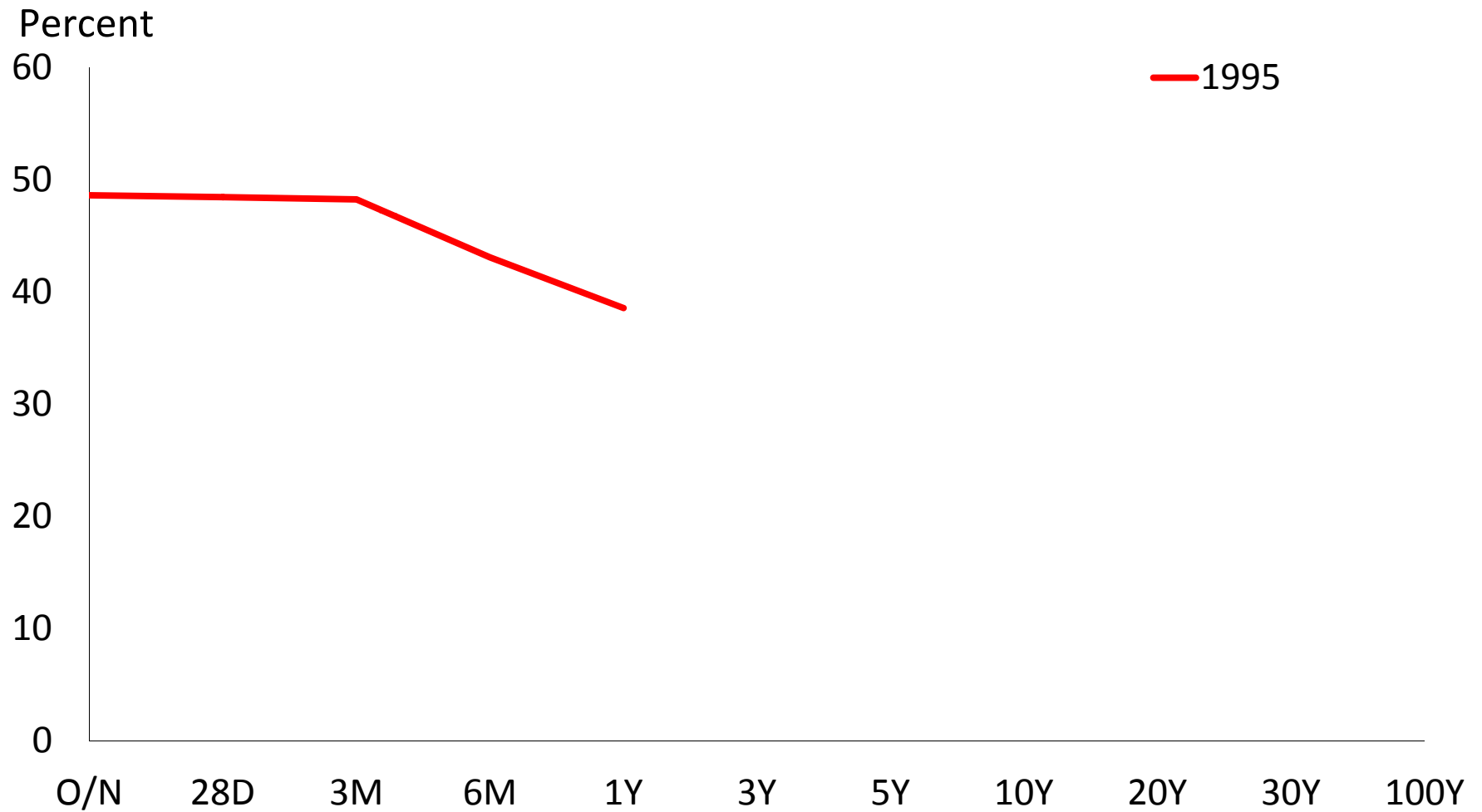
(12-month inflation rate)



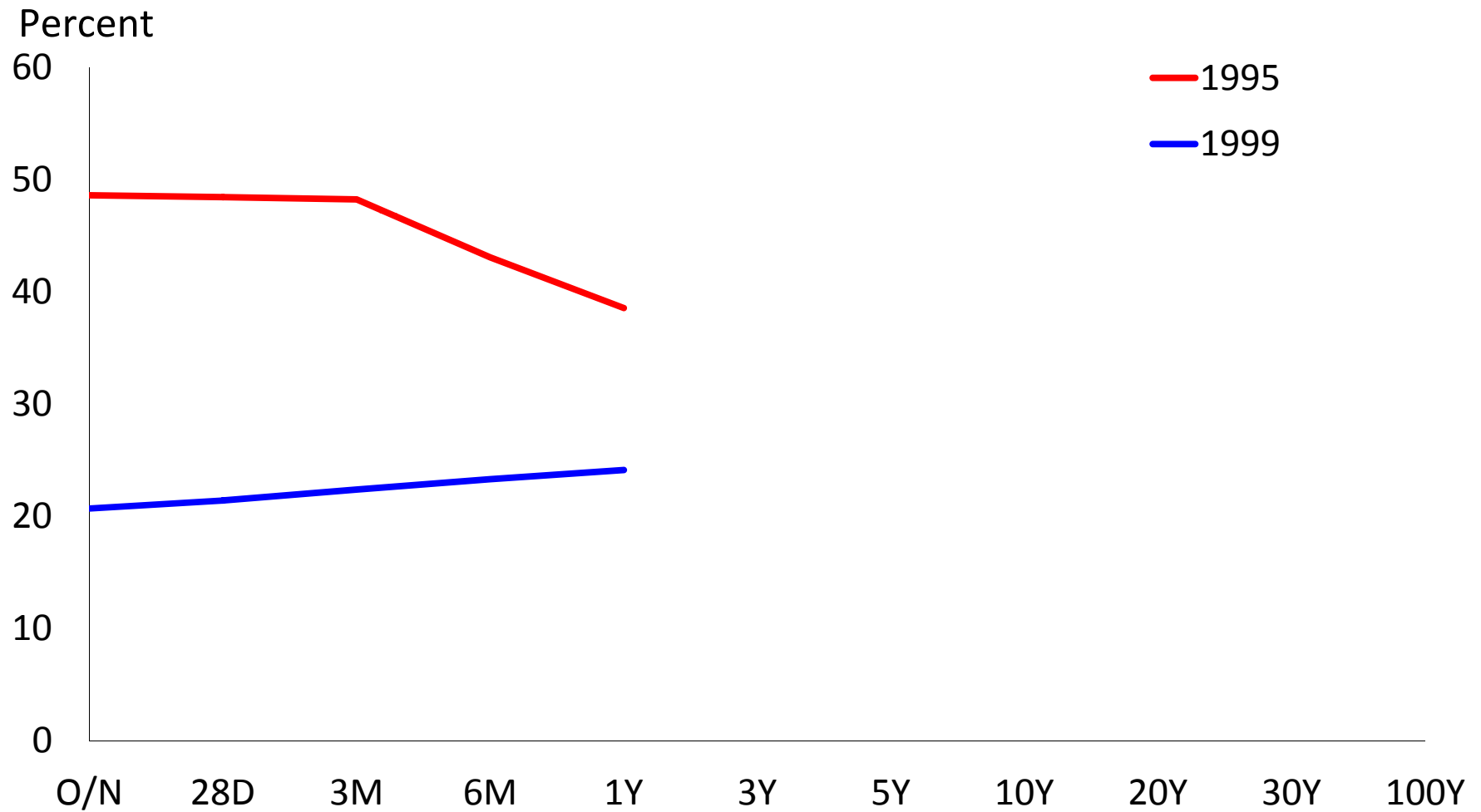
# Independence good for price stability

<b>Period</b>	<b>Average annualized monthly inflation</b>	<b>Standard deviation</b>
Prior to independence (1970 -1994)	43.3%	42.9
Since independence (1994 – current)	11.1%	15.5
Since inflation targeting (2001 – current)	4.4%	2.4
1995 – 2000	22.1%	21.0

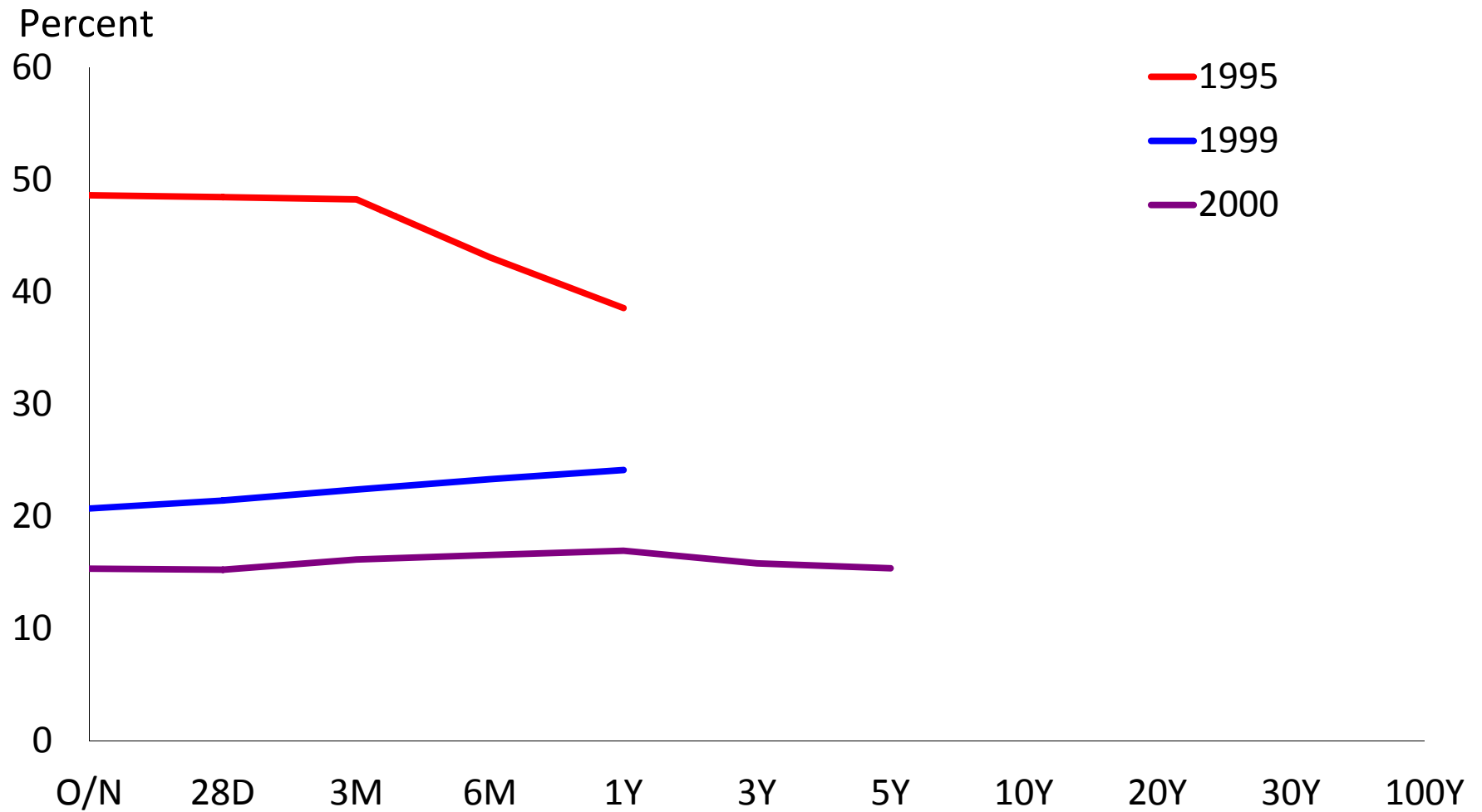
# Mexico grows a yield curve



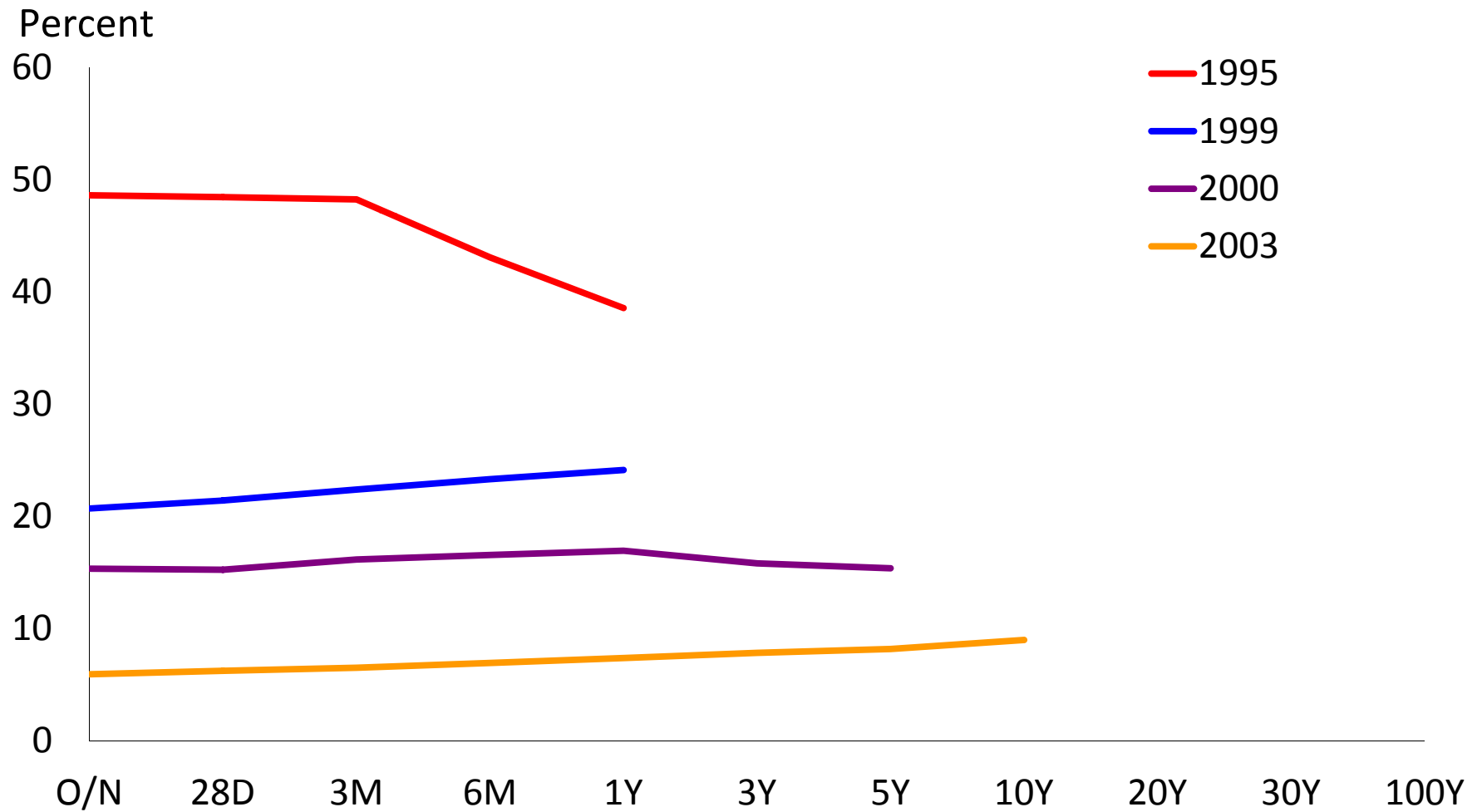
# Mexico grows a yield curve



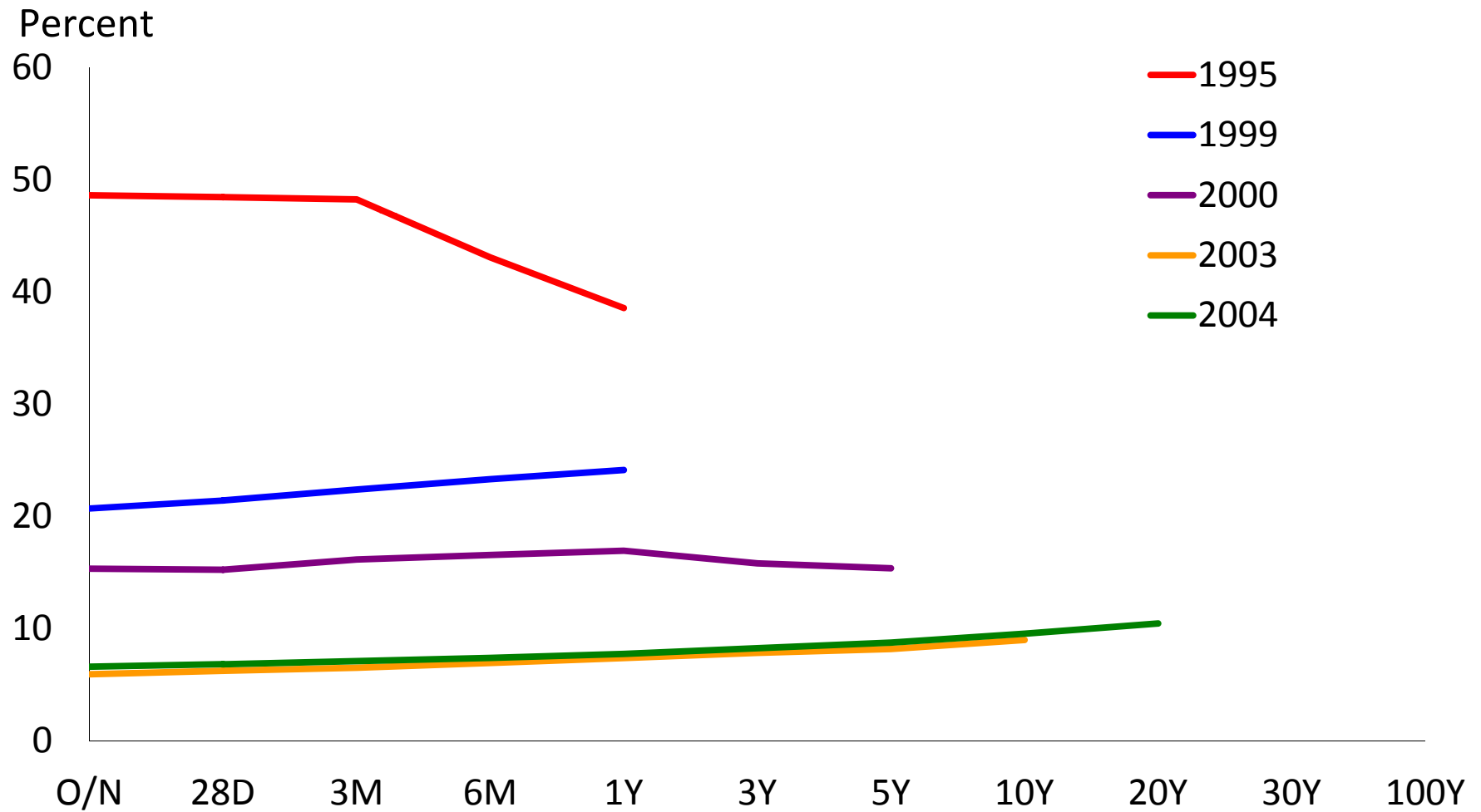
# Mexico grows a yield curve



# Mexico grows a yield curve

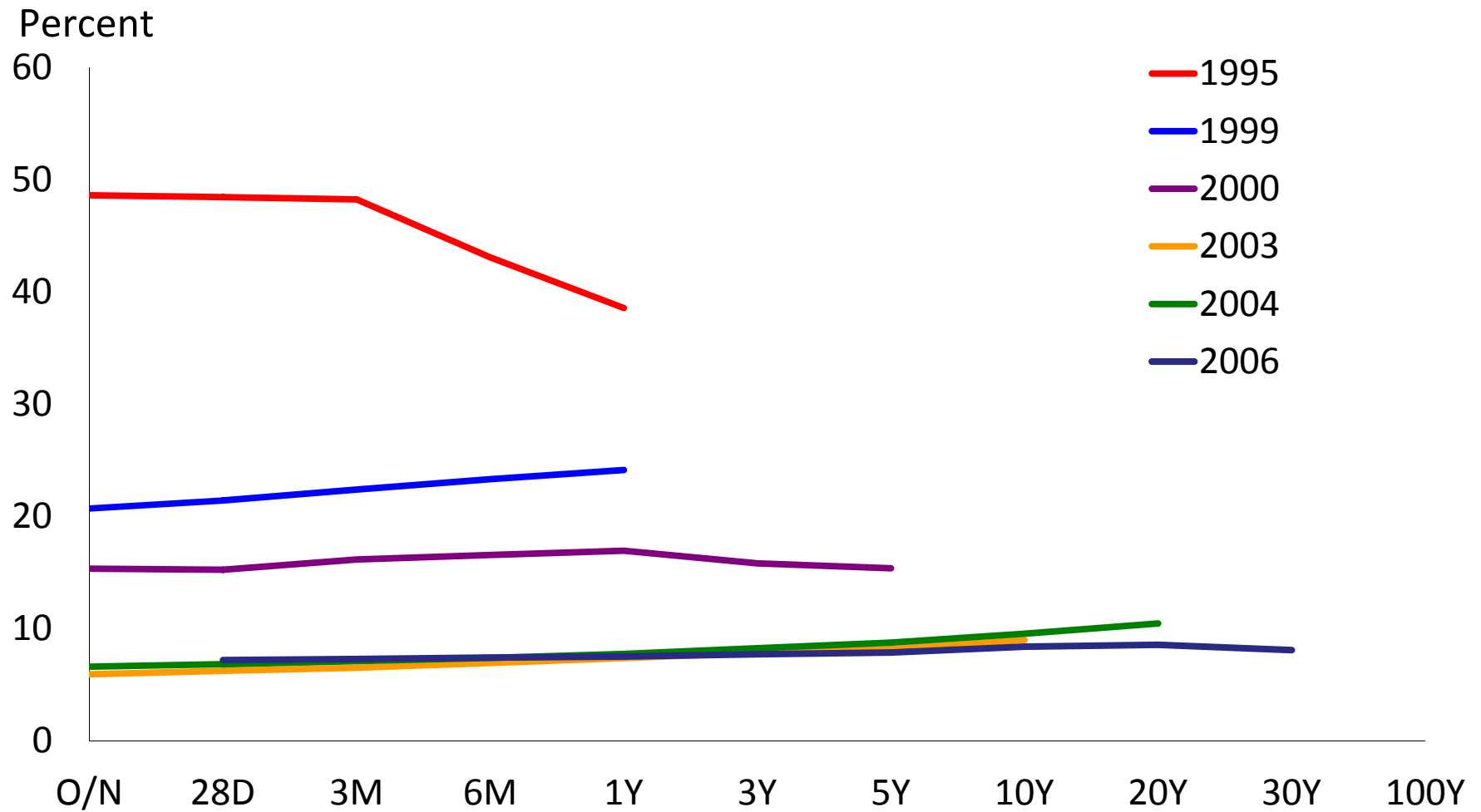


# Mexico grows a yield curve

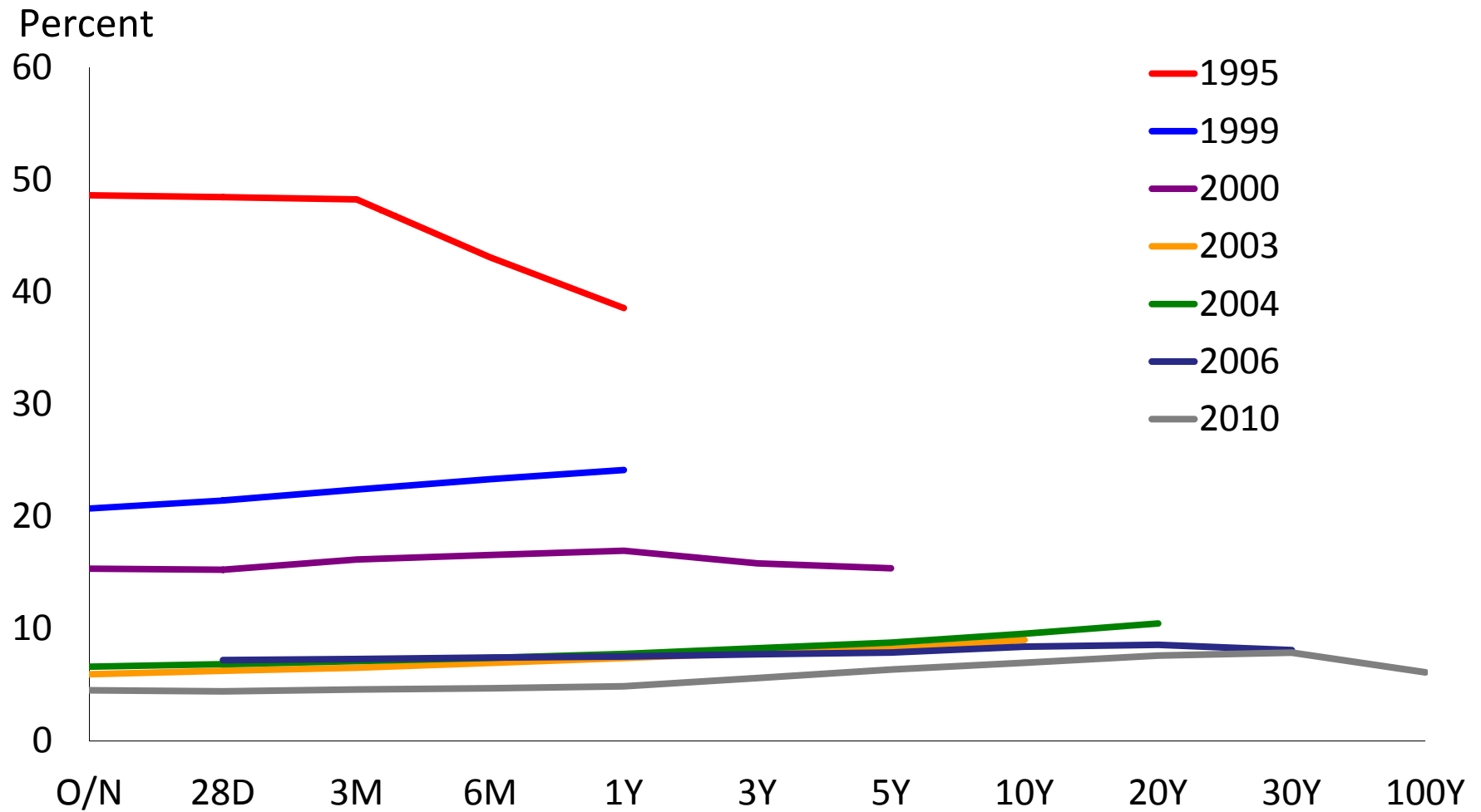




# Mexico grows a yield curve



# Mexico grows a yield curve

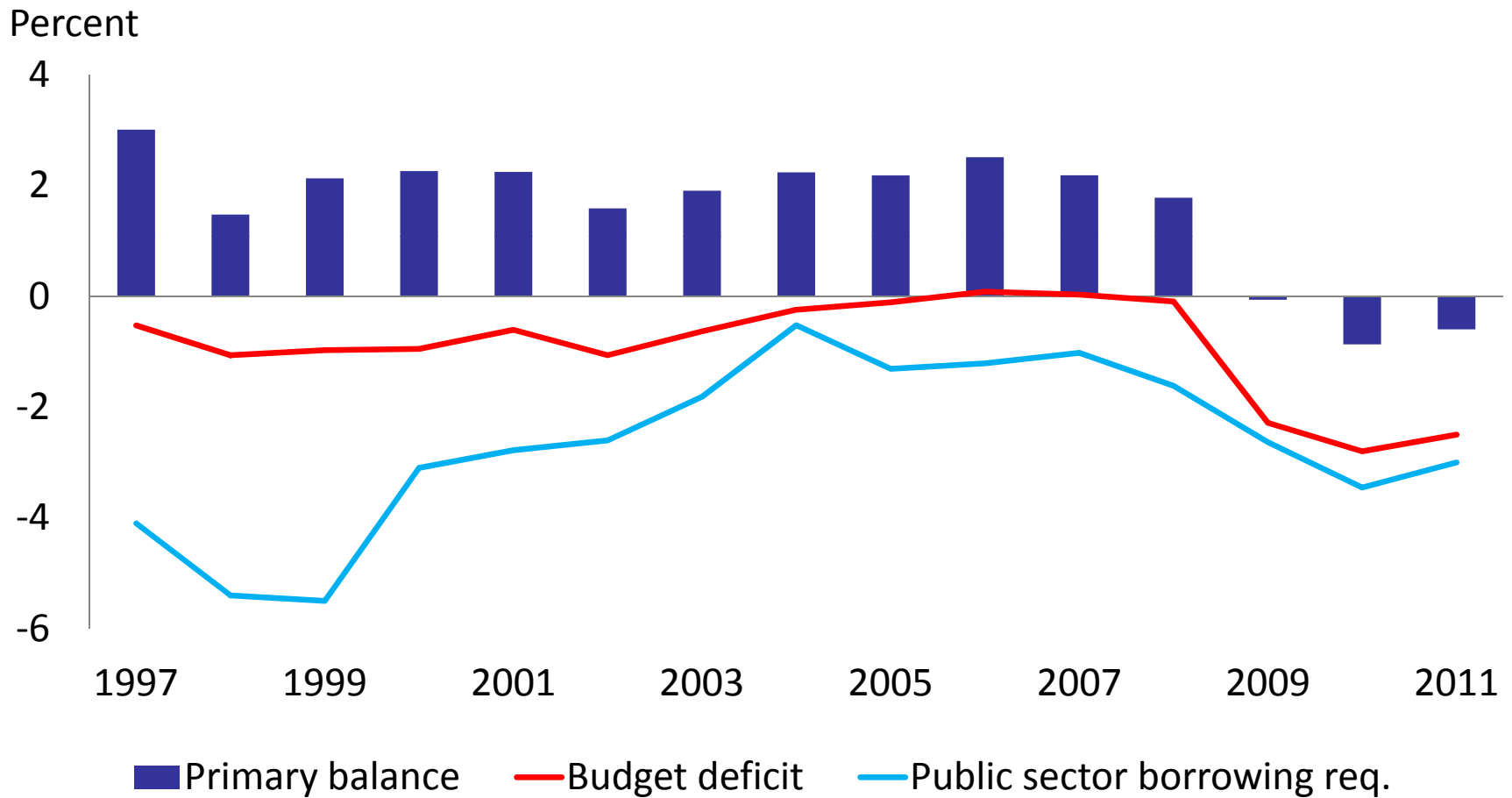


# Fiscal reforms

- Budget and Fiscal Responsibility Law (2006)
  - Balanced budget rule
- Integral Fiscal Reform (2007)
  - Improving tax collection
- ISSSTE Law (2007)
  - More sustainable pension system
- Governmental Accounting Law (2008)
  - Harmonization of budget and accounting codes

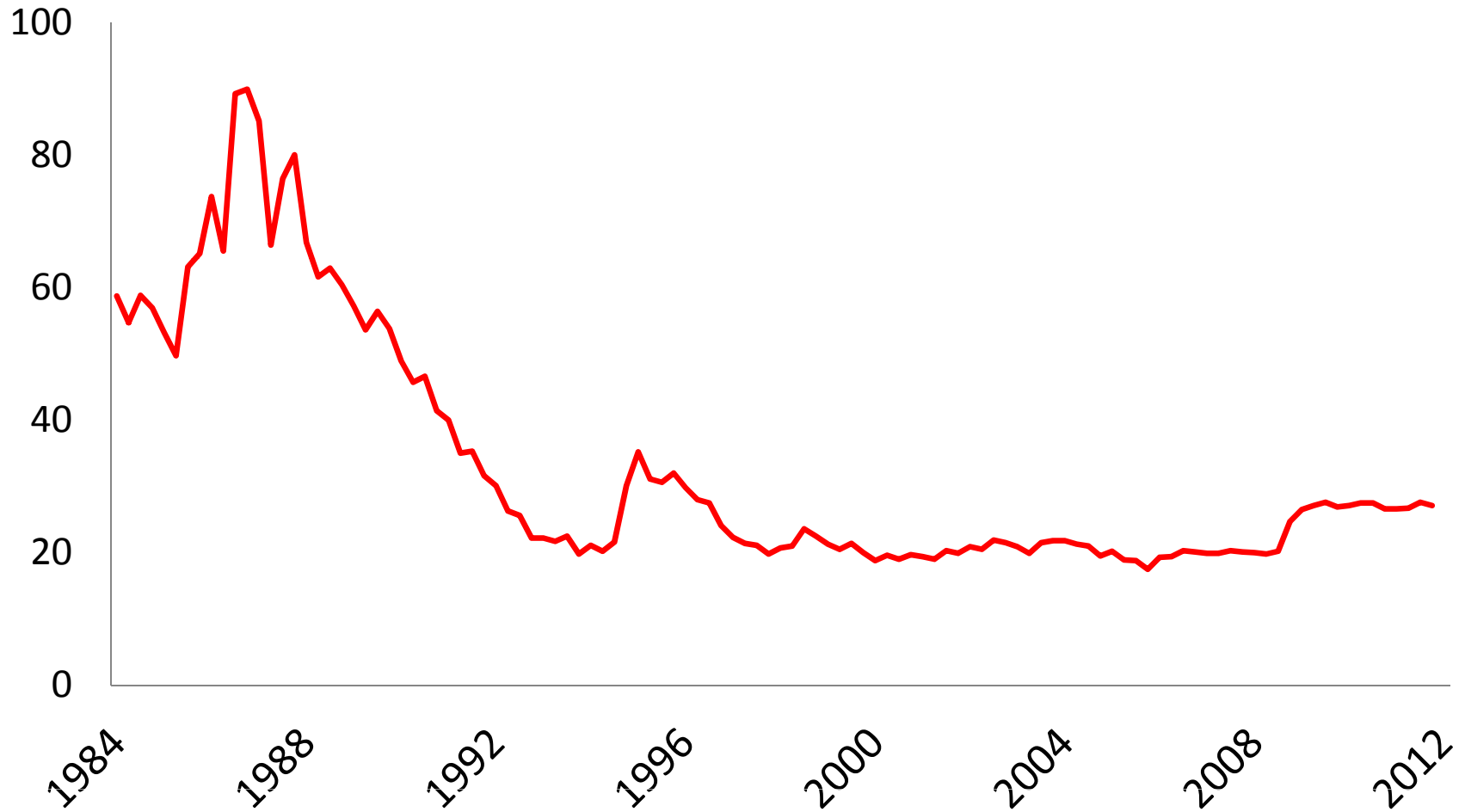
# Fiscal policy has remained disciplined

(Deficit as a share of GDP)

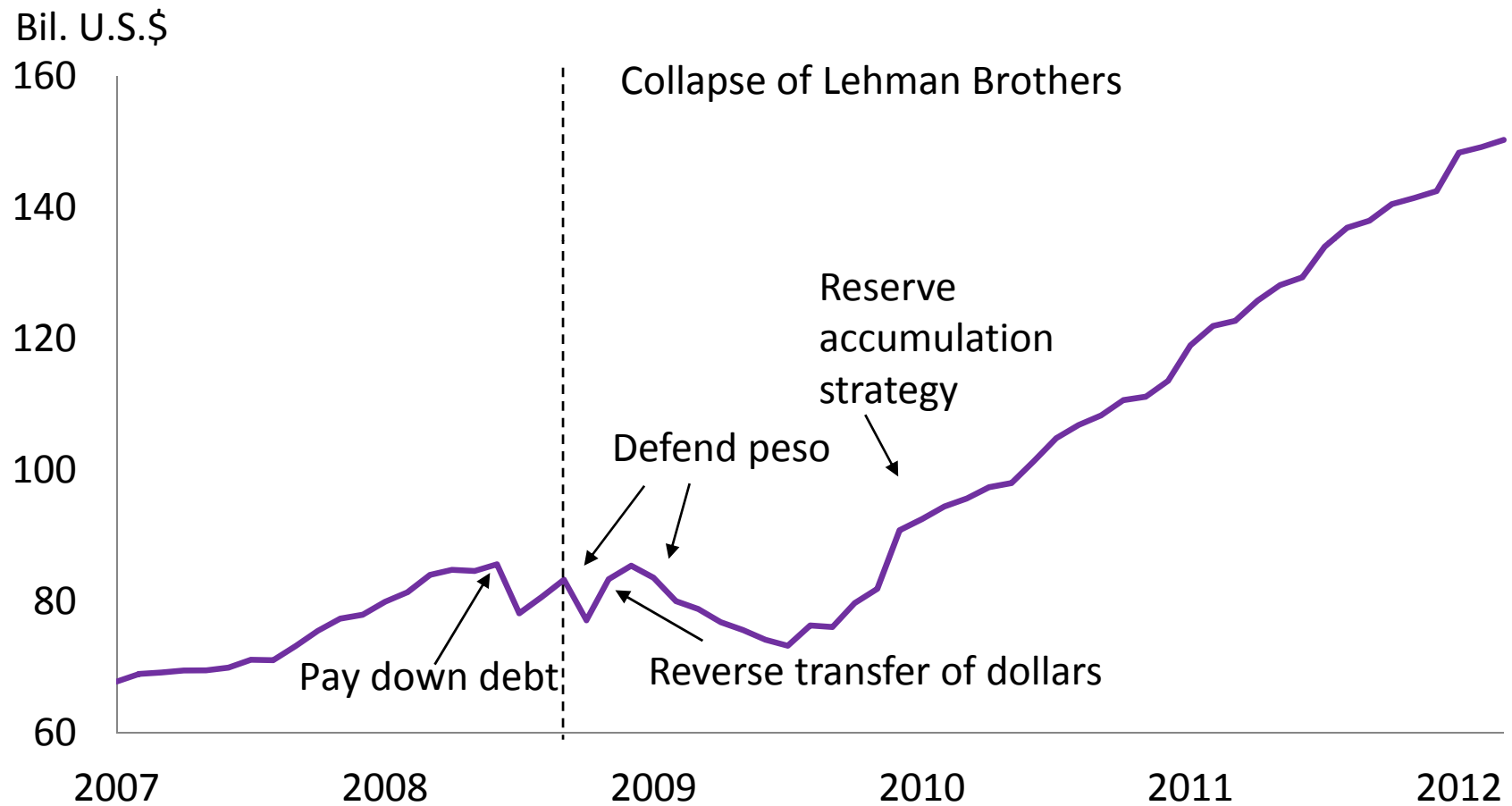


# National debt small

(Debt as a share of GDP)

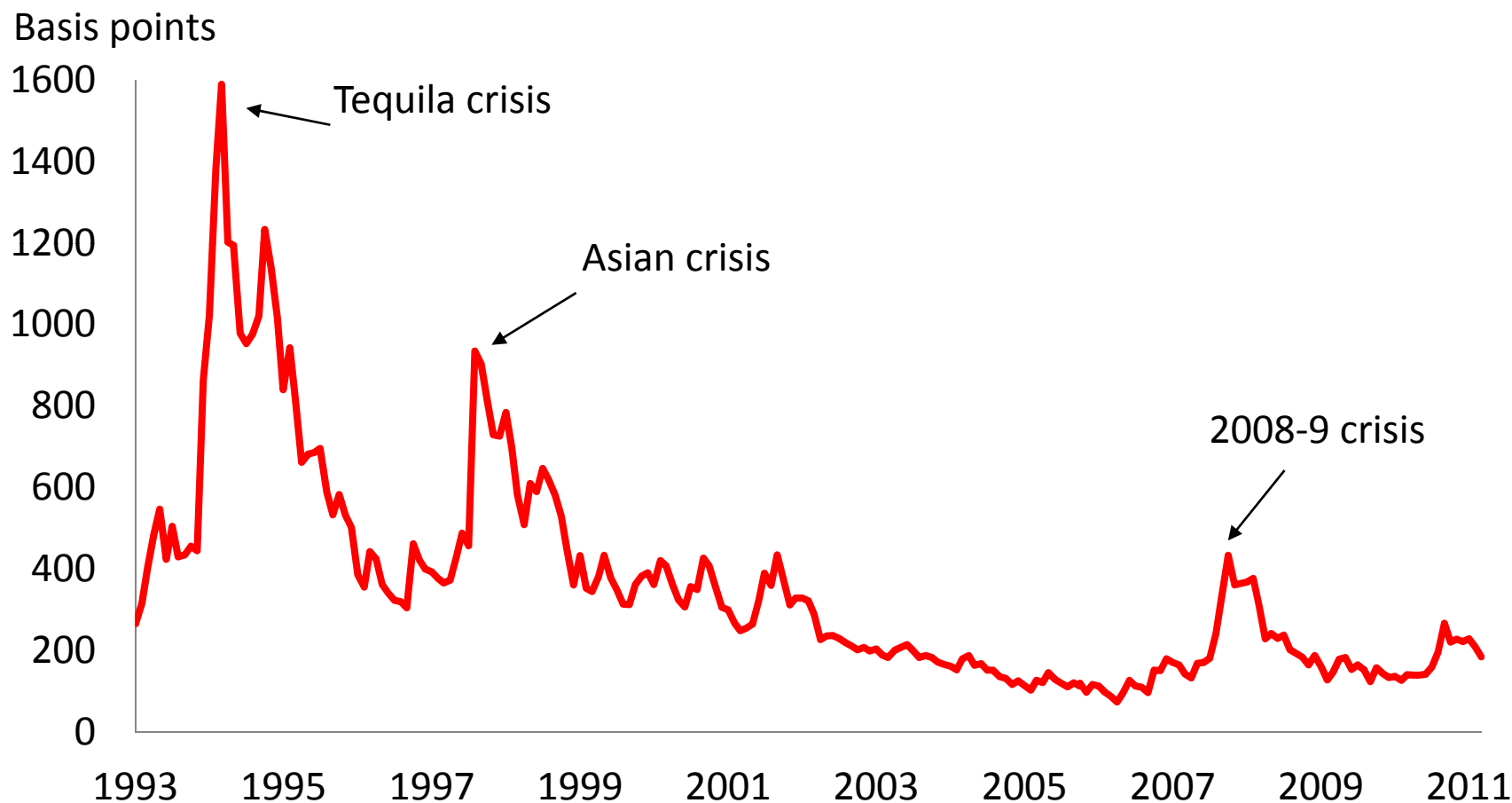


# Reserves used to absorb shock and then grew



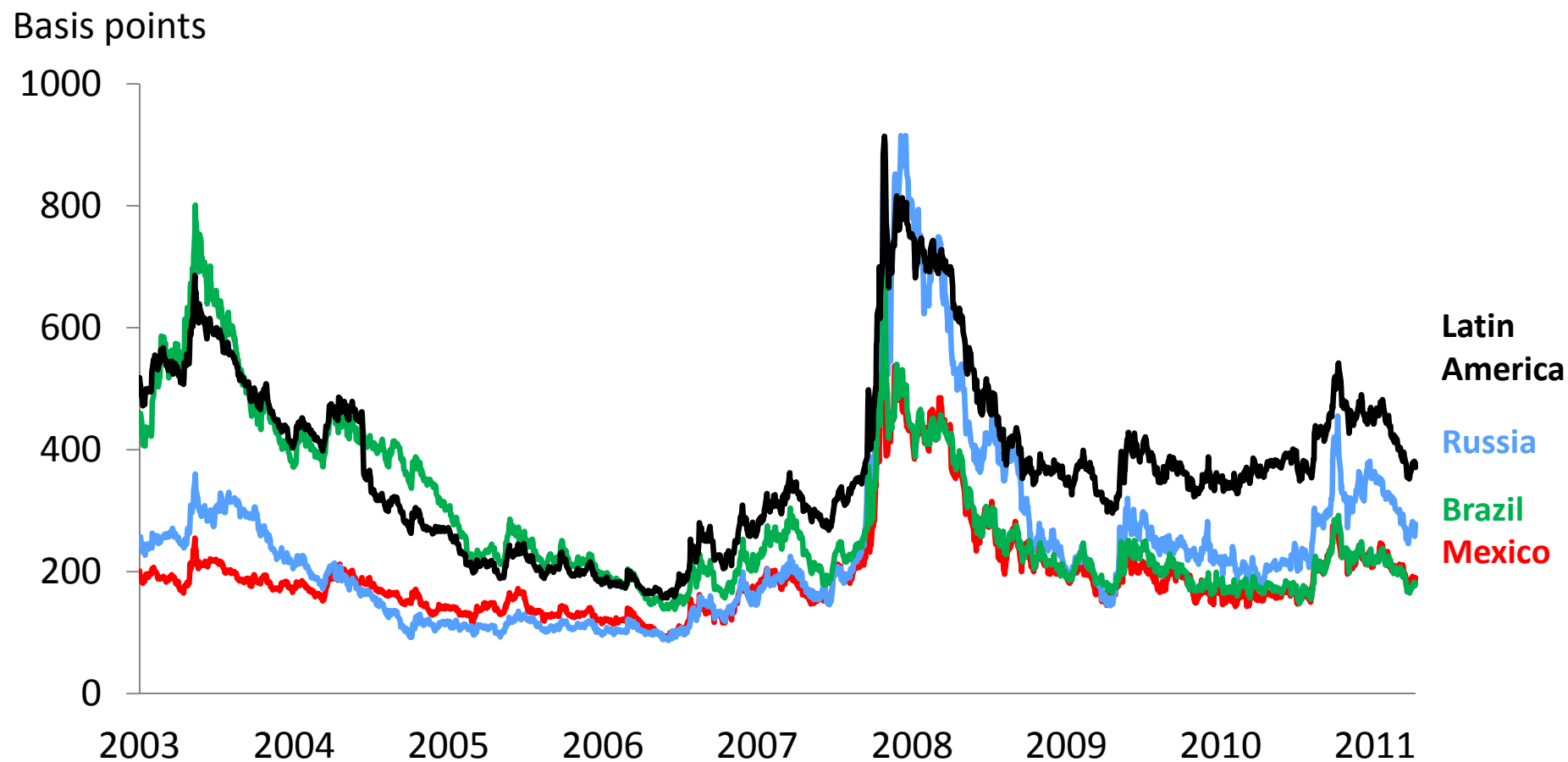
# Premium flare-up was small for Mexico...

(Interest rate spread)



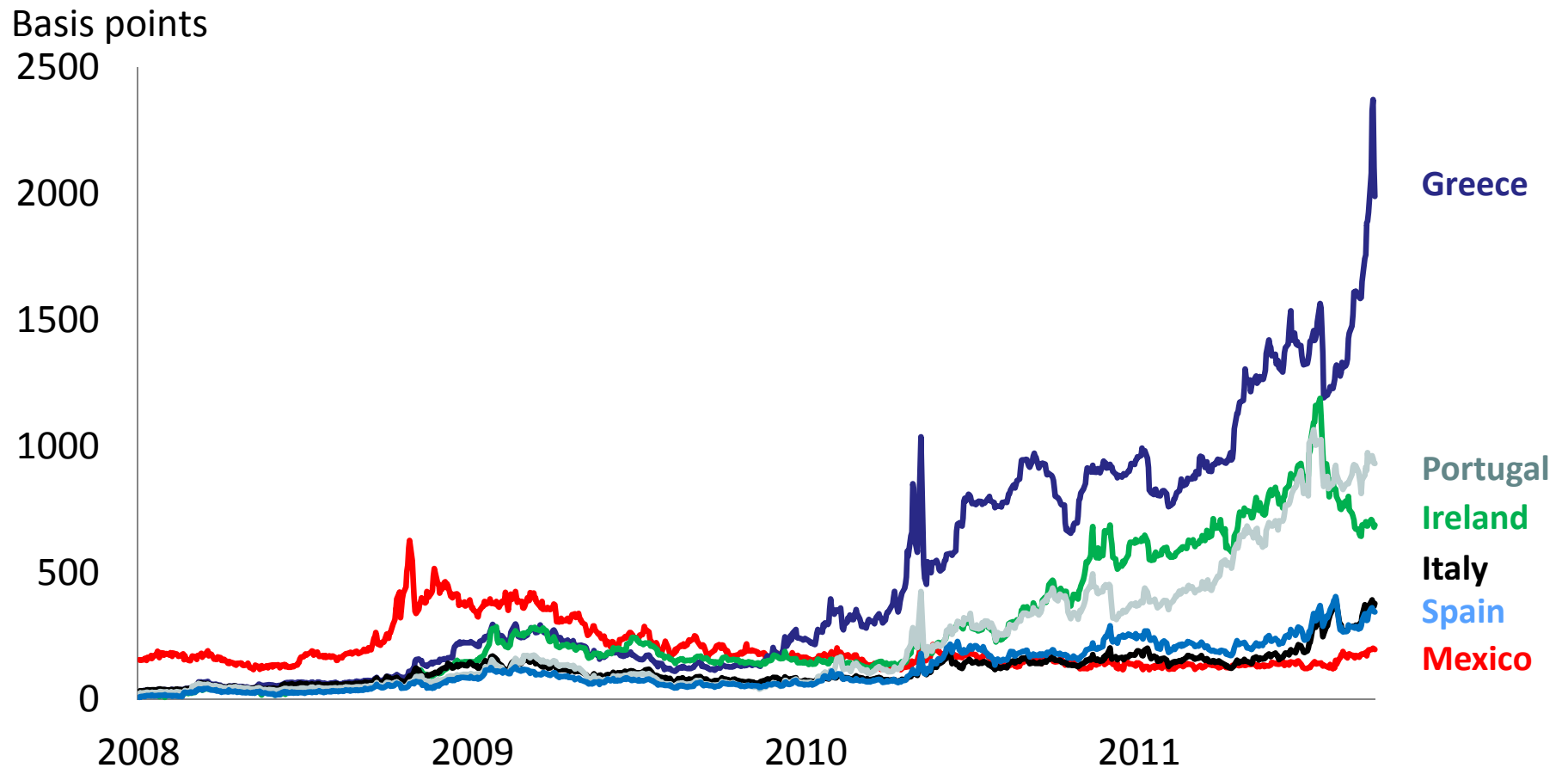
# ...and less dramatic than similar countries...

(Interest rate spread)



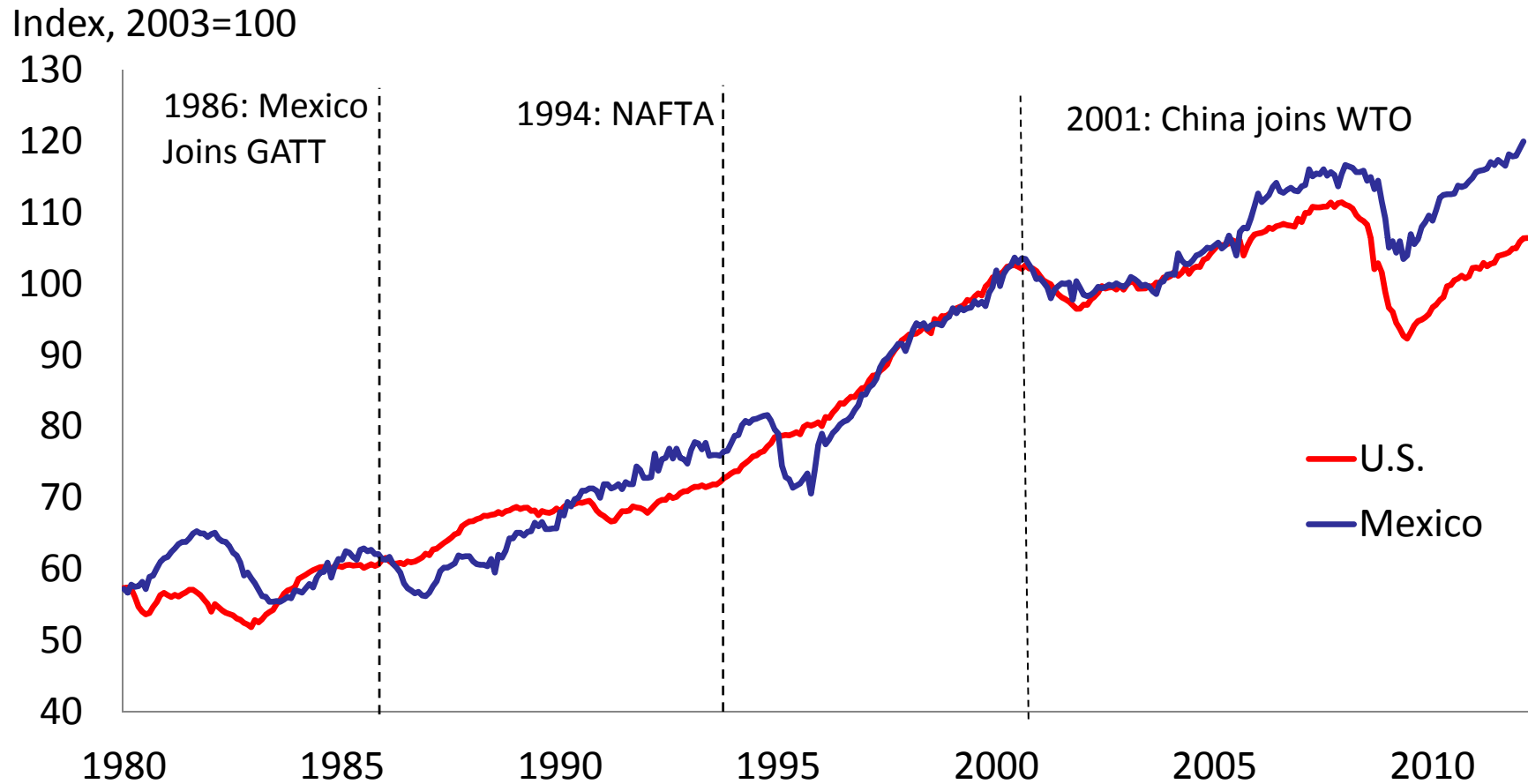


# ...less risky than (peripheral) Europe too? (Interest rate spread)



# Ties that bind

(Manufacturing production)



# Independence not as good for growth

<b>Period</b>	<b>Average annualized quarterly growth</b>	<b>Standard deviation</b>
Prior to independence (1970 -1994)	2.7%	5.4
Since independence (1994 – current)	2.5%	6.3
Since inflation targeting (2001 – current)	1.9%	5.5
1995 – 2000	3.5%	7.7

# Obstacles to development

- Human capital (education) deficit
- Barriers to entry & FDI
- Inefficient institutions
- PEMEX
- At root: Labor productivity deficit
- 2012
  - Presidential election
  - War on drug cartels

# Conclusions

- Major improvements in Mexico's macroeconomic policy framework
  - Monetary policy:
    - Central bank independence
    - Inflation targeting
  - Fiscal policy
    - Balanced budget rule
- Paying off
- Much more to be done!

