

Agustín Carstens: Interview in *Central Banking Journal*

Interview with Mr Agustín Carstens, Governor of the Bank of Mexico, in *Central Banking Journal*, United Kingdom, conducted by Ms Claire Jones on 8 October 2010, Washington DC.

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The governor of the Bank of Mexico tells Claire Jones about how the central bank is improving its capacity to safeguard financial stability.

You have had several spells working at the Bank of Mexico. I was wondering if you could tell me about how the central bank has changed over your career.

It has changed dramatically. I started in the early 1980s. Then the concept of the central bank was to be a kind of black box where there was little communication with the market. We only published data on reserves three times a year, for instance.

There was a view that the markets didn't know how to administer the information.

The central bank was also fully dependent on the government. We had virtually no independence. Now it's almost the opposite.

We have complete autonomy. We've moved from being a very interventionist central bank, in terms of the way we conducted monetary policy, to a market-orientated monetary policy with a fully fledged flexible exchange rate regime. And a very important component of this is having a precise communications strategy.

Since you've taken over what has changed?

Going back to communications, we've tried to be clearer in expressing the motivations for our policy decisions. We've tended to keep rates on hold this year, but still we've tried to be more precise in saying why that's been the case.

We've also tried to express the issues that are concerning us. The market has appreciated this, judging by the feedback we've had from analysts and commentators.

We've also done an internal restructuring, the most important feature of which is the creation of a department which will concentrate fully on financial stability. We've increased our resources there.

Can you tell me a little bit more about the new department?

The department will have around 60 or 70 people and a very important part of its work will be to gather information and organise this in a way that will better enable us to see whether firms are complying with regulation.

Also, we need to ensure we have sufficient information to judge whether there are systemic vulnerabilities in the Mexican financial system. It is a field that's not very developed in Central Banking though many central banks are taking similar steps.

You must have all the evidence at hand to do the analysis for macro and micro issues. You also need to have coordination between the authorities.

In addition to information gathering, we'll have more resources devoted to analysis and also have the ability to make policy recommendations.

When you say policy recommendations do you mean just in terms of regulation or also in the context of monetary policy?

The idea is to see the whole map and even to make policy recommendations in areas that might not be in the direct control of the central bank.

It is not only the central bank that's focusing on financial stability. It is also the finance ministry and the financial regulatory agencies. Through a presidential decree a financial stability board has been created, on which there are representatives from the central bank, the ministry, the deposit insurance institute and the regulators.

The secretariat is housed within the central bank and a lot of the work in the financial stability department will feed into the financial stability board. The idea of the department is therefore not only to deal with areas in the domain of the central bank, but also to contribute to the discussion that will occur at the level of the financial stability board, the Council for Stability of the Financial System.

What powers will that financial stability board have?

More than anything, the motivation for setting it up was to have a structure through which you could have formal coordination of policy between the financial authorities.

The policies that will be agreed at that level will be implemented through the authorities represented on the board.

The idea is to evaluate the system as a whole and then to quell any vulnerabilities as they emerge.

There are some grey areas among the authorities, but the idea behind this is that you're more likely to have a coordinated, timely response rather than overreacting.

Does the fact that the financial stability board could in theory call for a rate hike to tackle financial imbalances not conflict with your inflation targeting framework?

Not really. The idea is to respect as much as possible the mandates of each authority. If there is, say, asset-price inflation and there is a threat to financial stability, then it might be possible to address the issue through regulatory aspects rather than interest rate hikes. The idea is to align the policy response as much as possible to the primary mandates of the respective authorities.

Our primary mandate is inflation targeting and it will remain so. As you know, Mexico wasn't hit by a financial crisis in 2008 but nevertheless we felt the need to be prepared. By having a much stronger preventive attitude, we want to stop the events that really could compromise our inflation targeting objective. If we were to have a financial crisis, then the central bank might be forced to guide monetary policy by other considerations rather than inflation per se.

We want to avoid that distraction by making sure the financial system remains strong. We see it as a serious attempt to fully gear monetary policy actions to inflation considerations.

It's difficult to say that you can avoid crises, but there is less chance if the authorities are making a coordinated attempt to stop them.

As much as we can we want to keep the price stability and financial stability mandates distinct. That might not always happen but you have to at least try. What we want to avoid is a full-blown financial crisis because then you might not have the option to use monetary policy solely for controlling inflation.

We have seen this at other central banks, which have used monetary instruments for financial sector issues.

Perhaps not in Mexico, but elsewhere a lot of criticism has been directed at inflation targeting and central banks' focus on CPI inflation. Is this criticism at all justified?

Right now I would say that we have to learn the lessons of recent episodes. At least from my first stock-taking of the issue, the conclusion that I've come to is that we, as central banks, have to pay close attention to what's happening in financial markets. And, as much as there is compatibility between inflation fighting and maintaining a sound financial system, a central bank should act on it.

When you were talking about data gathering before, what sources of data were neglected pre-crisis perhaps not just in Mexico but elsewhere as well?

In Mexico we already have a pretty good system. We learnt our lesson in 1995 with the Tequila Crisis. Right now Mexico's at the forefront of data gathering. We've taken care of the granularity of information. We have pretty much transaction-by-transaction information. However, we need to hold more information on transactions between Mexican companies and their foreign counterparties. During 2008, the most severe glitch that we had – I mean it wasn't systemic at all – was some exotic derivatives that the big Mexican corporations contracted with foreign counterparties. We didn't know about these. They didn't disclose these exposures to stockholders. It impacted the volatility of the foreign exchange markets. So we need more information on such positions. At this stage, that is all settled and the risk isn't there anymore but we don't want to risk a repetition of this.

Are there any concerns that you have about the structure of your financial industry?

We have a very healthy banking system and I don't have any concern about its structure. However, I'm quite concerned about the non-banks that are involved in the mortgage business. Some of them tend to fund themselves in the market and so the maturity mismatch here is a concern. It only accounts for 2–3% of GDP in terms of loans, but it is still worth looking at. That's the most important factor.

About 70% of our banks are foreign owned but we have a very clear subsidiary scheme and so far our system has been thoroughly ring-fenced from the home countries so we've prevented contagion. We've also been able to prevent the foreign subsidiaries of Mexican banks taking risks with the home banks' capital. So there's not so much of a problem here.

The macroprudential toolkit still appears to be in the very early stages of its development. People aren't quite sure yet how the tools will take shape, or at least there's no consensus on this. What are your thoughts on what tools there should be?

It's very much a work in progress for us too. What we want to strengthen first of all is our ability to monitor the financial system in a very precise way, find out what the vulnerabilities are, find out what the tail risks are, and then after that devise the tools. That may involve leaning against the wind, but we're not at that stage yet. All options are on the table at the moment.

What's your view on Basel III?

We're broadly supportive. Our banking system complies pretty much with it already so it's appropriate for the rest to catch up! We have some concerns about the impact of the measures on systemically important financial institutions, however. Why? Because since we have local subsidiaries of systemically important financial institutions, we still don't know how this will impact their Mexican operations.

We also want to avoid a form of taxation without any benefit. If home-country regulation causes the cost of credit to rise without this benefiting Mexico, if they have to hold more capital at the homecountry level, we don't want that to apply to Mexico if they're not systemically important here.¹

¹ The CSFS first session was held on 11 August 2010.