

Agustín Carstens: Cooperation among central banks at the beginning of the XXI century

Keynote speech by Mr Agustín Carstens, Governor of the Bank of Mexico, on the occasion of the 60th anniversary of the Center for Latin American Monetary Studies (CEMLA), Mexico City, 19 July 2012.

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Good evening, everyone. We are pleased to welcome you in Mexico and we are honored to share this dinner with you to commemorate the 60th anniversary of CEMLA. We are very proud of the fact that the Center for Latin American Monetary Studies is celebrating its 60th anniversary.

We are particularly thankful to Javier Guzmán for the invitation and I congratulate him for having organized this Conference to discuss the importance of cooperation among central banks at the beginning of the XXI century.

Precisely this spirit of collaboration was the foundation in the creation of CEMLA. Today, just like at its beginnings, such spirit is the element supporting the institutional bonds among its members, providing cohesion and substance to the joint efforts aimed at confronting similar challenges, recognizing, at the same time, the differences and peculiarities of each member, which add richness and variety to the cooperation and collaboration.

Nowadays, CEMLA's main objective is to promote a better understanding of the core issues in central banking in Latin America and the Caribbean, giving priority to the following:

- a) Monetary stability,
- b) Financial stability, and
- c) Regional and international coordination.

There is no doubt that in the last 60 years the economic environment in Latin America and the Caribbean, and of course around the world, has changed considerably. For example, central banks' functions have evolved throughout these six decades. It has been a long institutional development, which emerged from a relatively narrow vision where central banks' key role was to provide money to the economies. Later on, Latin America went through a period when our institutions put an emphasis on credit allocation policies. Finally, with greater institutional independence came the next step towards a modern central bank, where the main priority is the mandate to procure monetary and financial stability. Thanks to this transition, the concurrent periods of economic and financial crises in the region came to an end. It must be acknowledged that major advances have been accomplished in this regard.

However, the fact that we have greater macroeconomic stability in Latin America does not mean that we can lower our guard. On the contrary, we should maintain discipline in our fiscal and monetary policy frameworks and strengthen regional cooperation in order to face external shocks to which we all are exposed.

It is clear that one of the lessons of the recent global crisis was to highlight the close economic and financial ties of the world economy. Thus, the crisis once again exposed the paramount importance of international agreements regarding cooperation among financial and monetary authorities worldwide. And this, I believe we have already learnt it, is indispensable both in times of crisis and in those periods of relative calm, that we call "normal".

If we speak of the global crisis, of which we in Latin America are still more or less passive or suffering subjects, we cannot avoid the consideration of certain points, which, if analyzed in retrospective, revealed insufficient international monetary cooperation. Likewise, this review

allows us to mention some areas that we must attend to as a priority in our region to strengthen the current framework that has been established to encourage this cooperation.

As you know very well, the international macroeconomic situation before the crisis was characterized by low interest rates and abundant liquidity in search for yield. Great global imbalances, together with the rapid financial innovation, contributed to accelerate the lending boom, in particular in advanced economies.

Despite the alerts from different international forums and economic analysts regarding the risks of global imbalances and the accelerated growth in prices of certain financial assets, no one imagined the magnitude of the problem.

In turn, although the monetary authorities in advanced countries were aware of the risks posed by global imbalances, the necessary corrective actions were not implemented on time. On the other hand, there was no sense of urgency, or at least evident concern, among the competent authorities regarding the lending boom or the great expansion of complex financial instruments that in essence escaped conventional regulation and supervision tools.

During the first phase of the current crisis, the authorities responded with caution, facing specific problems of the financial markets as they arose. In retrospect, the authorities did not manage to react timely in a forceful and decisive manner given the magnitude of the crisis. There was a lack of a comprehensive vision, a strategic point of view that would have a global perspective. In particular, we could state that, apart from the swap lines established among the U.S. Federal Reserve and other central banks, in the early stages of the crisis no decisive measures were taken to face it in a coordinated manner at the international level.

It was not until the collapse of Lehman Brothers when the first multilateral measures were implemented. This was the moment when a series of coordinated and multilateral actions were taken in order to tackle the crisis.

For instance, the coordinated policy rate cuts at the beginning of October 2008, by the U.S. Federal Reserve, the European Central Bank, the Bank of England, the Bank of Canada, the Swiss National Bank and Sweden's central bank.

Later, U.S. dollar liquidity facilities, which had been established by the U.S. Federal Reserve and other central banks of advanced economies, were expanded in order to include emerging economies, such as Mexico, Brazil, Korea and Singapore. In Europe, injections of capital into the banking system in various countries were agreed upon, as well as the commitment to jointly confront the crisis.

Regarding fiscal policy, several advanced and emerging countries started to implement countercyclical programs to stimulate the economy and to foster a faster recovery, taking into account that a broad simultaneous stimulus would yield better results relative to unilateral increments in public spending.

Additionally, efforts were made to strengthen the international financial architecture in several international forums, aimed at designing a system which would allow a timely, efficient and coordinated response during global episodes of stress.

These turbulent episodes showed that international coordination in implementing policies is more productive and efficient than unilateral implementation. This thesis is not only widely supported by academic literature, but also by recent and even current experience: in times of crisis the benefits of coordinated action are more than evident. A multilateral response has positive externalities and the costs of not acting in concert are much higher, such that the different parties have sufficient incentives to strengthen their cooperation.

Thus, the challenge is to design international arrangements, which facilitate greater cooperation among our countries. In this sense, the existence of international institutions and forums that contribute to the early identification of risks and signs of instability are of utmost importance.

In Latin America and the Caribbean we should continue to strengthen the dialogue. The first point in order to understand the importance of this collaboration is the lack, the great deficiency, of a consistent theoretical framework to analyze the role that the financial sector has in economic activity and its function in the propagation of crises. Despite all the progress made in order to model the contagion through trade, as concerns the financial channels, it seems as if we spoke different languages. There is no consistent framework that would provide us with a standard model to set up our discussions. There does not even exist, I need to point out, a common terminology. Unfortunately, it is clear that even today international liquidity and macroprudential measures can be understood quite differently.

Recognizing these deficiencies, I consider that there is a great value added in strengthening research activities in the central banks of our region. One way to do this is to support more vigorously the work of CEMLA. Research and divulgation activities are essential in order to assure the relevance of the Center. Even though training is its fundamental activity, it cannot be sustained without a continuous program of economic research, nurtured by the active participation of central bank members. Something similar happens with technical assistance, which should be a link between the Institution and its members.

During the last decades, CEMLA played a fundamental role in increasing and facilitating the collaboration among central banks in Latin America and I am sure that this will not change in the following decades. It is precisely the permanence of institutions like CEMLA that helps to maintain and improve our common goals. They are the institutional witnesses of our shared work and responsibility. We are able to detect the change, and the evolution of our goals thanks to the continued presence of our institutions, of our will to continue collaborating.

Thank you very much.