Ben S Bernanke: Celebrating 20 years of the Bank of Mexico's independence

Remarks by Mr Ben S Bernanke, Chairman of the Board of Governors of the US Federal Reserve System, at the "Central bank independence – progress and challenges", a conference sponsored by the Bank of Mexico, Mexico City, (via prerecorded video), 14 October 2013.

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It is a pleasure to offer a few remarks at this conference marking the 20th anniversary of the Bank of Mexico's independence. In August 1993, Mexico's congress approved changes to the country's constitution that granted policy autonomy to the Bank of Mexico and made price stability its primary mandate. Over the past two decades, these actions, along with a number of other constructive steps taken by Mexican policymakers, have paid substantial dividends in terms of improved economic performance.

At the time that the Mexican congress changed the status and mandate of the central bank, the nation's economy had been suffering periodic bouts of economic instability for many years. The 1970s through the mid-1990s in particular were marked by episodes of high inflation, boom-and-bust cycles, and financial crises. Indeed, shortly after the new Bank of Mexico law went into effect in April 1994, the Mexican economy entered the throes of the so-called peso crisis. However, the changes to the monetary policy framework, along with greater fiscal discipline and the adoption of a more flexible exchange rate, soon bore fruit. Notably, inflation fell to single-digit levels by the early 2000s. And in 2001 the Bank of Mexico formally adopted an inflation-targeting regime, which – outside of some temporary fluctuations – has succeeded in keeping inflation at around 4 percent.

Importantly, the improved monetary policy framework, together with other reforms, has thus far helped reduce Mexico's susceptibility to financial crises. When the recent financial crisis in the United States and other advanced economies threatened to spill over to Mexico, the inflation credibility enjoyed by the Bank of Mexico allowed it to counter economic weakness by easing monetary conditions, even though headline inflation was running above its target range at the time. The Bank's rate cuts helped stabilize the economy, and Mexican output returned to its pre-crisis level by late 2010. Strong countercyclical policy actions of this type were unlikely to have been feasible in Mexico a few decades ago; with little in the way of inflation-fighting credibility and an immature financial sector, the monetary authority in earlier years was often forced to respond to a crisis by tightening monetary conditions, rather than loosening them, in an effort to limit capital flight, exchange rate depreciation, and increases in inflation.

Of course, we should not be surprised that central bank independence has contributed to Mexico's improved macroeconomic stability over the past two decades. A broad consensus among economists – supported by considerable empirical evidence – holds that a central bank's credibility and effectiveness are enhanced when it is able to make monetary policy based on its assessment of what is in the economy's long-run interest rather than in response to short-term political pressures. The benefits of a sound monetary framework are further enhanced when combined with good fiscal, regulatory, and trade policies.

As you probably know, the Federal Reserve is also celebrating an anniversary this year – the centennial of its founding. Like the Bank of Mexico, the Federal Reserve is an independent central bank, and, as in the case of the Bank of Mexico, that independence has evolved and gradually strengthened over time. For example, in the early years following the Fed's founding in 1913, the Secretary of the Treasury and the Comptroller of the Currency served on the Federal Reserve Board, an arrangement that only changed in the 1930s when the Fed underwent significant structural reforms. The Federal Reserve was also less than fully independent during and just after World War II, when it agreed to keep Treasury yields at low levels to reduce the cost of financing wartime deficits. After the war, as inflation pressures rose, Federal Reserve policymakers wanted to return to independent rate setting, but the Treasury demurred, hoping to keep the cost of servicing the national debt low. The conflict was resolved in 1951 through the Treasury-Fed Accord, an agreement that reestablished the Federal Reserve's ability to set rates as dictated by the needs of the broader economy. During the 1980s, under the leadership of Chairman Paul Volcker, the Fed further established its credibility and independence by taking the necessary steps to bring inflation under control. As in Mexico, the benefits of central bank independence in the United States have included low inflation, well-anchored inflation expectations, and increased policy credibility, which contribute to a more stable overall economic environment. Indeed, during the recent financial crisis and the ensuing recession, the Fed has been able to take aggressive monetary policy actions to help stabilize the economy without dislodging longer-term inflation expectations.

We should recognize, though, that in democratic societies, central bank independence must be accompanied by accountability to the public and its representatives. In this regard, transparency is key. To ensure appropriate accountability, while also making monetary policy more effective, central banks in the United States, Mexico, and around the world have worked hard to increase their transparency over the past 20 years or so. For example, in the United States, the Fed's policymaking arm, the Federal Open Market Committee, releases a statement after each meeting explaining its decisions and reporting the vote, publishes detailed minutes three weeks after each meeting, and provides a quarterly summary of Committee participants' economic and policy projections. My colleagues on the Board and I often testify before congressional committees, we speak regularly in public, and I hold news conferences four times a year. The Bank of Mexico has likewise significantly increased its transparency since becoming independent, through steps including the adoption of a target range for inflation, the regular publication of inflation reports and policy statements, and the timely release of minutes following each policy meeting.

The economies of the United States and Mexico not only have in common independent central banks, they are also closely tied by geography and history. The United States is by far Mexico's largest trading partner, accounting for about two-thirds of Mexican merchandise trade. In turn, Mexico accounts for about one-eighth of U.S. foreign trade, thereby ranking, along with Canada and China, among our three largest trading partners. In addition, remittances coming from Mexican workers in the United States benefit the Mexican current account and are a welcome source of income for many Mexican families.

The strong links between our economies have led to close cooperation between our central banks. An example is the bilateral currency swap arrangement between the Federal Reserve and the Bank of Mexico that was set up during the global financial crisis. This swap line was one of 14 that the Fed established with foreign central banks around the world. These swap arrangements proved their value as they helped alleviate dollar funding pressures, reduce interbank borrowing rates, and calm market fears during some of the worst phases of the crisis. The swap line with Mexico was in addition to a line established in 1994 along with the North American Free Trade Agreement. The Federal Reserve and the Bank of Mexico also work closely together – and with other central banks – through international meetings, seminars, and conferences; in the provision of technical assistance; and through other activities in forums such as the Bank for International Settlements (BIS), the Group of Twenty (G-20), and the Center for Latin American Monetary Studies, or CEMLA.

I would be remiss if, before ending, I did not note the strong leadership that Governor Agustín Carstens continues to provide at the Bank of Mexico. His leadership in economic policy, in several key roles, has been instrumental in solidifying the progress that Mexico has made over the past two decades. Agustín has also built an impressive record in the international policy community more broadly. He is currently the chair of the BIS Consultative Council for the Americas, has recently been appointed chair of the BIS Economic

Consultative Committee and the Global Economy Meeting, and played a key role in Mexico's successful presidency of the G-20 last year.

To conclude, I would like to congratulate the Bank of Mexico on the 20th anniversary of its independence. I wish you a productive conference marking this auspicious occasion. And I wish the Bank of Mexico continued success in its work to stabilize and strengthen the Mexican economy.