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EUGENIA CORREA AND ALICIA GIRÓN

U.S. Federal Reserve Monetary Policy and the First Crisis of Securitization: Mexico and Latin America, 1994–1995

***Abstract:** The decisions of the Federal Reserve of the United States (Fed) determining interest rates have played a critical role in capital inflows/outflows toward Mexico and Latin America. The causal relationship that exists between the Fed and emerging markets is quite close; a clear example of this is the first crisis of securitization on the global level, which originated in Mexico in 1994. The monetary policy of the Fed supported the expansion of U.S. investment banks and some institutional investors, thus creating not only an enormous bubble in Mexico and other local financial markets in Latin America through the expansion of portfolio investment, but also successive financial crises during the 1990s when those financial capital flows reversed themselves. This article analyzes the factors determining the composition of international capital inflows/outflows during those years. Instead of being new commercial bank credit, these flows were propelled forward by the global movement toward securitization, which began in the second half of the eighties and became more dynamic starting in 1991, immediately after renegotiation of the external debt within the framework of the Brady Plan. The article goes*

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on to present the first crisis of securitization in Mexico and some other Latin American countries. In Mexico specifically, U.S. investment banks and some institutional investors participated in the new surge of international financial markets through the net portfolio flows that were placed in private and public sector securities. The change in the Fed's monetary policy led to a massive shift of capital into other markets, and the most devastating banking and economic crisis in Mexico's history.

Keywords: *financial crises, institutional investors, monetary policy, securitization*

The so-called debt crisis of 1982 broke out in the major economies of the developing world partly as a result of the policy of raising interest rates launched by Paul Volcker's Fed in 1979. The U.S. federal funds rate averaged 11.2 percent in 1979 and reached its highest point of 20 percent in June 1981. Because the debt servicing costs were capitalized, the external public debt of some of the largest developing economies grew rapidly in the span of a few months, finally exploding when banks suspended such capitalization and refinancing in 1982. A period of several years of rising payments of accumulated interest and principal began, which was accompanied by continual debt restructuring and economic and budgetary adjustments, punctuated by deep political and institutional transformations.

Although the International Monetary Fund (IMF) described the 1980s as the lost decade for Latin America, changes in public policy and business strategies produced by financial liberalization and military regimes in South America initiated the neoliberal transition in the 1970s. By the early 1990s, a new round of capital flows poured into Latin America, especially to countries that had made reforms to deepen securities markets. These policies included opening the bond market to non-residents in public and private debt markets, equity flotation of large local private firms (many of which had maintained family ownership structures), and the privatization of many public enterprises. Thus, public and private companies restructured liabilities and found new sources of financing by placing financial instruments in both local and U.S. markets. This was all part of the process of change and expansion of U.S. investment banking into developing countries that was driven by the IMF and World Bank through the restructuring of foreign debt and globally encouraged by the stock market crash of 1987.

The deregulation of U.S. institutional investors in the late 1980s was another important milestone in this process, as investment banks were allowed to diversify and expand their portfolios quickly and profitably. These changes, mainly in the U.S. financial market, initiated an accelerated flow of financial funds from commercial banks, investment banks and, in varying degrees,

other types of institutional investors toward Latin American markets. These flows occurred in the middle of a rapid process of privatization, mergers, and acquisitions (Vidal 2008). Rating agencies went along with this new model of financial affairs, finding new areas for expansion in the form of debt securitization, beyond the ratings of country risk.

However, the new flows were based on securitizing domestic assets in international financial markets, which changed the ownership structure of large financial and non-financial firms. In Mexico and other countries in the region, mutual funds lured by high-yield spreads purchased massive quantities of government securities while the stock markets also witnessed significant inflows of foreign funds. Thus, when the Fed again initiated a policy of monetary restriction by raising interest rates, the expectations of returns on financial assets in the region changed and a massive capital outflow occurred in 1994–95.

As managing director of the IMF in 1995, Michel Camdessus described the Mexican financial crisis as the first crisis of the twenty-first century. It was also the first massive crisis of securitization based on the new financial business model that had expanded so quickly since the mid-1980s. In a few short years, the financial world had changed significantly. While the Fed's doubling of the federal funds rate (which gained around 10 percentage points in less than twenty-four months) produced a double-dip recession in the United States and a lost decade in Latin America in the 1980s. When the Fed doubled the federal funds rate in 1994–95, there was no recession in the United States and the Organization for Economic Cooperation and Development (OECD) countries saw a minimal loss of growth (Girón 2002), but there was considerable loss of growth in Latin America, especially in Argentina, Colombia, Mexico, and to a lesser extent Brazil.

The change in credit flows and the financial business model has been studied in the post-Keynesian literature, for example by Guttmann (2008), Minsky (1987), and Toporowski (2010), among others. It has also been discussed in the orthodox literature, for example, by trying to explain changes in the transmission mechanism of the Fed's monetary policy (McDonough 2002). This paper examines the institutional transformations of the Fed's 1993–95 interest rate policy from the vantage point of its consequences felt in Mexico and Latin America.

Capital Flows and the Emerging Market Boom

In 1992 and 1993, capital markets pumped \$51 billion and \$113 billion, respectively, into emerging market bonds and equities. Foreign direct investment (FDI) reached \$35 billion and \$56 billion in these years. Direct purchases

in the domestic money and capital markets and bank loans should also be added, bringing total net emerging-market inflows to \$260.8 billion and \$383.9 billion, which is an incredible figure when compared with the negative net amounts of capital outflows from Latin America between 1983 and 1990.

The lower profitability of many financial assets in the United States in the early 1990s was linked to the U.S. economic contraction and declining interest rates, explaining in part the change in direction of capital flows and the growth of those directed toward emerging markets, which were also undergoing accelerated processes of financial deregulation. This was followed by a wave of large privatizations in the region (especially in telecommunications) and the opening of financial markets, processes that were the determining factors for the duration and continuity of the reversal of private capital flows. The well-known debt-for-assets programs of the 1980s lost importance in the 1990s as the secondary debt market gradually recovered and assets were no longer so heavily discounted. The secondary debt market helped to clean up the balance sheets of creditor banks by allowing debt to be purchased at a great discount from less solvent banks. The IMF considered that this “rewarded” the “worst behavior” of lenders with increased the discounts.

Between 1992 and 1993 the processes of debt conversion slowed down dramatically. According to the creditors themselves, this mechanism had been useful to the extent it allowed them to reconfigure portfolios; it also greatly aided those interested in acquiring companies in indebted countries, as it lowered the cost of investment projects. However, such widespread privatization in such a relatively short period created strong demand in secondary markets, reducing or eliminating the aforementioned attractive discount. Nonetheless, through stock flotation and the sale of derivatives, financial intermediaries recovered an important source of profit. Creditor and investment banks channeled the demand for new, highly profitable instruments, securitizing and internationalizing not only the assets of privatized companies, but also those of private companies that had no presence in these markets. Therefore, the conversion program, although attractive at first, showed ever greater limits due to the effect of privatizations and mergers and acquisitions.

Once the creditor banks' balance-sheet problems were solved by securitization backed by Brady bonds, investor preference for debt-equity conversions lost importance. The flotation of private companies that did not previously have shares in the market also expanded the ability of banks to reconfigure funds and portfolios, which in turn enabled them to incorporate a much wider range of investors from developed markets with diverse interests and liquidity requirements. Financial inflows to Latin America in those years can be identified using International Monetary Fund (IMF), Organization for Economic Cooperation and Development (OECD), and Central Banks

Statistics about: (a) bond issuances by private and public companies in more developed markets; (b) share issuance through American depositary receipts (ADRs) and global depositary receipts (GDR) in the United States; (c) direct investment in transnational subsidiaries; (d) government bond issuance (such as, for example, Certificados de Tesoreria (CETES) and later Tesobonos in the case of Mexico) and sale of domestic securities to foreign investors in the money and capital markets.

Bond Issuances by Public and Private Companies

The bond market was the most dynamic in terms of international capital flows toward emerging markets, although the equities and derivatives market, which hardly existed before 1990, also produced significant flows to emerging markets. According to OECD data, in 1994 bonds issued in developing countries accounted for almost 9 percent of the world supply of international bonds. However, bond issuance in these countries fell to 3.6 percent in the first quarter of 1995. The supply of bonds from Latin America was 3.2 percent in 1993 and fell to 2.4 percent in 1994. In the first quarter of 1995 it was only 0.3 percent. However, Latin American bond issuance was very important in 1993, when it came to represent over 40 percent of the developing countries' supply of bonds, only to drop again in the first four months of 1995 to 10 percent (OECD 1995).

In 1993 Latin America's issuance totaled \$23.5 billion and began its fall in the first quarter of 1994. According to the IMF, the net total of bonds issued by developing countries reached \$117 billion in June of 1994, with 42 percent corresponding to private sector borrowers. Amounts to be amortized from this debt grew quickly due to the relatively narrow profile of maturities. For 1994, the IMF estimated credit commitments of around \$7 billion (IMF 1995a: 14).

In 1994, Latin America issued bonds worth about \$10 billion, but in the first half of 1995 it issued barely \$1.2 billion worth. Latin American countries issuing bonds included Argentina, Brazil, Mexico, and Venezuela, and to a lesser extent Barbados, Bolivia, Chile, Colombia, Costa Rica, Guatemala, Peru, Uruguay, and Trinidad and Tobago. The vast majority of issues were in U.S. dollars (between 75 and 80 percent), but also in yen and marks. This is explained by the investment banks' sale of these instruments to U.S. mutual funds, the higher credit rating that issuing countries had achieved, and the effect of the Fed's relatively low interest rates. Changes in U.S. market regulations also provided a major push to issue and place bonds based on Rule 144a, which exempted external private issuance from information and solvency requirements that the United States Securities and Exchange Com-

mission (SEC) demanded foreign issuers to meet and thus enabled qualified institutional investors to privately trade security issuances without waiting the two years usually stipulated (IMF 1995a: 7).

The factors that market participants take into account when rating bonds have invariably been fundamental in determining bond prices. Among the elements taken into consideration are: (a) political conditions and government's willingness to undergo economic reform and ability to implement policies and maintain popular support; (b) macroeconomic conditions, particularly inflationary expectations, growth, and fiscal policy; (c) progress in structural reforms; and (d) the balance of payments and its prospects (IMF 1995a: 19).

Placement of Equities Through American Depositary Receipts and Global Depositary Receipts

Developing countries' placement of equities in international markets grew rapidly between 1991 and 1993, but declined in 1994. In 1993, Latin American companies placed equities in the international market in an amount estimated at \$5.7 billion. This amount fell in the first quarter of 1994 and the year closed at \$2 billion, with the numbers continuing to fall throughout 1995 (IMF 1995a: 21).

Latin American equities were issued through ADRs and GDRs, initially supported by the privatization process, particularly in the energy and communications sectors. The list of examples is significant: (a) \$2.4 billion placed in 1993 as a result of the privatization of *Yacimientos Petrolíferos Fiscales de Argentina*; (b) share placements made in 1991 of *Telefonos de Mexico*, which had been privatized shortly before that; (c) placement of shares resulting from Brazil's 1997 privatization of *Companhia Vale do Rio Doce*, valued at the time at \$12 billion; and (d) share issuance resulting from the privatization of the Mexican petrochemical industry. The public offerings made in international markets by many of the largest public and private companies should also be counted (Alfa, Carso, Cemex, Eletrobras, Telebras, Televisa, Usiminas, and Vitro), as well as those by banks in the region (such as Banamex, Banco de Bogotá, Banco de Chile, Banco do Brasil, Banco Galicia, Banco Rancher, Bancomer, Bradesco, and Itausa.).

In addition to equity placement through both ADRs and GDRs, the direct purchase of equities or other instruments in the money market by international investors was another important source of capital inflows. However, by their very nature these flows were temporary, unstable, and procyclical. An idea of their magnitude can be seen in the growth of the portfolios of investment funds specializing in emerging market securities, which went from \$91 bil-

lion in 1988 to over \$650 billion in 1994 (IMF 1995a: 25). Such rapid growth also reflected the increase in stock prices, particularly during 1993, when the stock markets of developing countries grew by around 75 percent. For Latin America, the funds represented 12 percent of total net assets of funds in emerging markets (IMF 1995a: 25). In the case of Mexico, the allocation of foreign investments to the money market was further encouraged when in 1993 the SEC granted "ready market status" to Mexican government debt instruments denominated in pesos (Ajustabonos, Bondes, and Cetes,). U.S. institutional investors would only incur a 7 percent charge on capital instead of the 100 percent required previously. Moreover, in many creditor countries, average requirements to cover exposure to developing countries decreased gradually (IMF 1995a: 34).

Foreign Direct Investment Through Subsidiaries

The increase in FDI toward some developing countries coincides with the period of increasing portfolio investment. This increase is linked to factors that have limited influence over a period of time, such as privatizations or the relocation of foreign firms' asset holdings in response to economic reforms. However, even the IMF has recognized that it was a mistake to consider FDI as a stable source of funding because when difficulties arise in the balance of payments, the net effect of the transactions associated with such investment on external accounts can exacerbate the imbalance (IMF 1995a: 35).

According to figures from the IMF and the World Bank, FDI in Latin America amounted to \$14 billion in 1992, \$13 billion in 1993, and \$38 billion in 1994. Most of it was directed into Argentina and Mexico, and to a lesser extent into Brazil, Chile, Colombia, and Venezuela. Notably, over 50 percent of FDI flows toward developing countries went to Asian economies, especially China. In Latin America, the privatization process and the pace of economic growth attracted flows, although the subsequent increase in foreign investment in emerging markets began to depend on the amount of government assets that could be sold, the privatization of public services, and the expansion of raw material and energy extraction, among other factors. These have also been present in the most recent wave of capital flows into Latin America in the first decade of the twenty-first century.

Regional economic growth explained the rise in FDI in the second half of the 1990s and the beginning of the 2000s, as it offered significant investment opportunities as well as funds for reinvestment. The reinvestment of profits has a lower cost for businesses and has been a major part of FDI flows since those years. However, this also behaves procyclically, putting further pressure on the current account balance.

Securitization, Tesobonos, and Mexico's Financial Bankruptcy

The participation of foreign investors in the market for Mexican government bonds rose from 3.2 percent at the time of the market's opening to foreign investment in 1990 to 32.8 percent in 1992, and 38.9 percent in 1993. Incidentally, a similar figure was achieved in 2013 just before the privatization of the energy sector. The circulation of Tesobonos,¹ which were dollar-denominated instruments, witnessed an increase of 286 percent in 1993 (Banco de Mexico 1993). The Fed's rate hikes and the political fragility in Mexico during the first half of 1994 forced the government to replace securities denominated in pesos (Ajustabonos, Bondes, and Cetes) with Tesobonos, that is, instruments having a dollar value that would be sheltered from exchange rate variations.

The demand for Tesobonos allowed the exchange rate some temporary stability in the midst of the constant increases in the Fed's federal funds rate and the presidential elections in Mexico, but it did not prevent capital flight.² The change in direction of capital flow created a serious deterioration in the capital account balance; the Mexican Central Bank reported that Tesobonos represented 2.8 percent of outstanding government securities in 1993. A year later, this figure had increased to 55.3 percent (Banco de México 1995).

The landscape changed with the December 1994 peso devaluation. In 1995, the Bank of Mexico had to settle \$29 billion worth of Tesobonos (99.1 percent of the balance that existed in December 1994), about two-thirds of which were repaid in dollars. The last round of payouts was made through the \$50 billion financial package³ that the secretary of Finance and Public Credit was able to establish in conjunction with the U.S. government and with the support of international financial institutions, the Bank of Canada, and the Bank for International Settlements (BIS). The credit guarantee to the U.S. government was future revenue from the sale of crude oil.

Since then, Petroleos Mexicanos (Pemex) made ample use of securitization. For example, in December 1998 Pemex guaranteed bonds with future crude oil sales, issuing \$4.1 billion in bonds between December 1998 and July 1999 through a special purpose vehicle established by Pemex Finance and routed through the Cayman Islands. These operations accounted for 24 percent of the total issuance backed by future income in emerging markets in the years mentioned. In addition, this operation was insured by the Municipal Bond Insurance Association (MBIA) and Ambac, lifting the S&P credit rating to AAA.

The Fed's Monetary Policy and Its Implications for Mexico and Emerging Markets

In February 1994, the Federal Reserve Open Market Committee announced an increase in the federal funds rate of one quarter point (from 3 to 3.25 per-

cent). This rate rose six times in 1994 and once more in February 1995. The rate was reduced in July of 1995 due to the economic growth of just 1 percent in the United States in the second quarter, the lowest since the beginning of the recovery. During 1994, the dollar devalued by 10.9 percent against the German mark and 10.8 percent against the Japanese yen. In early 1995, the U.S. dollar accumulated a loss of 20 percent against the other two currencies. The dollar's price against these currencies reflected the effects of the Mexican crisis, as well as the uncertainty regarding the financial authorities' abilities to curb the risk for various creditors, as the bond market registered heavy losses due to the Fed's interest rate hikes.

Securities from emerging markets were affected and their placement began to fall dramatically, even though many thought that these would grow during the second half of the year, in a manner similar to the light fall and recovery seen in 1992. It was thought that the market would recover not only if the number of market participants (the investor base) grew, but also if appropriate prices were established, risk management were improved, and continuity in public policy maintained. However, the flow of funds from private markets fell as a result of rising interest rates. In June 1994 there was a slight recovery, but in the following months it petered out, not because of uncertainty regarding interest rates, but rather because of the certainty of future increases. Net capital flows to Latin America fell from \$63 billion in 1993 to about \$43 billion in 1994 (IMF 1999).

After the market turmoil of early 1994, banks began using credit techniques such as creating bonds with built-in exchange rate hedges, like Tesobonos. Many of these debt securities entered a repayment stage, as they had been issued at the beginning of the decade. Yet borrowers began to have difficulties in paying out maturing debt through the issuance of new debt. The contraction in these flows can be observed in U.S. net purchases of foreign securities, which fell from \$120 to \$60.6 billion from 1993 to 1994 (Bach 1994: 6).

Although Mexico sought to maintain the level of capital flows through hedging instruments (Tesobonos), the issuance of Latin American stocks began to decline in February 1994. As Tesobonos were short-term instruments, they became one of the elements that created the greatest uncertainty for investment funds and banks beginning in January of 1995. Expectations of default on these instruments led to the signing of swaps guaranteed by oil revenue in February of 1995, allowing important portfolio investors, such as Fidelity, Scudder, and Oppenheimer Funds, and investment banks, such as Goldman Sachs, Merrill Lynch and Salomon Brothers, to hedge their positions accordingly (Girón and Correa 1995).

The expansion of capital flows outside the boundaries of important financial markets, such as that of the United States, was largely based on the securitiza-

tion of assets in the early 1990s. According to the OECD, an investor's decision to buy an asset is largely separated from the creditworthiness of the issuing institution. The decision depends on the investor's perception of the ability of the underlying asset to generate the cash flows needed to meet contracted payments, as well as the degree of protection built into the assets' structure (OECD 1995: 33). The most common underlying assets are mortgages, credit cards, and car and consumer loans.

Incentives for asset securitization, precisely because they are in some way disconnected from the solvency of the financial intermediaries, run counter to the strength of such institutions. In the beginning, securitization became a feature of the U.S. financial system even as it quickly spread across all major financial markets. However, it must not be forgotten that portfolio investments lack deposit insurance (OECD 1995: 39), or at least they did until the last great financial crisis of 2007–8.

In 1995, the Mexican crisis jeopardized segments of the portfolios of (principally American) funds and banks. It is therefore important to highlight the \$3.5 billion private bank funding for the Mexican bailout under the Clinton administration's so-called rescue package, which was led by JPMorgan and Citibank. A very relevant fact is that the rescue package was amended to allow for the participation of such firms in the issuance of new government bonds that could be converted into equities in the privatized petrochemical industry and the private domestic banking sector.

Yet the turmoil in the bond market in 1994 particularly affected U.S. investment banks; even the rating agencies lowered their ratings as their earnings dropped. The ratings of some commercial banks fell even into the third quarter of 1995. Competition in the financial sector intensified, as boundaries separating investment and commercial banking narrowed. In fact, investment banks and commercial banks were increasing their levels of exposure but with insufficient capitalization, and they therefore became more vulnerable. Very soon, with the Asian and Russian crises of 1997–99, they were involved in the most important process of mergers in recent banking history. In 1994, the repeal of the McFadden Act also boosted bank mergers and acquisitions. Such expansion of bank holding companies and the three large mergers that occurred between June and August of 1995 culminated in the merger of Chemical Bank and Chase Manhattan. This undoubtedly redesigned the expansion strategy of U.S. banks in later months and years (OECD 1995: 143).

The U.S. financial authorities tried to control the effects of successive increases in interest rates on U.S. financial markets in 1994. Banks, meanwhile, reconfigured their portfolios within the context of bond market turbulence and the systematic elevation of funding costs that could increase balance sheet fragility. According to the 1994 report of the Federal Reserve Bank of

New York, the successive increases in interest rates caused banks to lose flexibility in managing their reserve positions. At the end of 1994, the potential operational difficulties associated with low reserve balances had reappeared (McDonough 1994: 15).

As an effect of the rising interest rates, the net performance of many bonds held by investment funds was negative that year. This contrasted with 1993, when many of these funds had significant profits. Throughout 1994, important financial losses were observed in the domestic securities market. In some cases, these were associated with exposure to derivatives that magnified the effects of changes in returns and the flows of interest payments. Losses on derivatives during 1994 were estimated at \$6 billion (McDonough 1994: 15).

A soft-landing strategy for the previously high returns in emerging economies, especially in Latin America, was also taken into consideration by financial markets. However, this strategy reached its limits with the Mexican financial crisis. The benefits of diversifying emerging market securities portfolios during moments of expansion may be lost in times of major market disturbances. The IMF, therefore, proposed a soft landing by expanding the group of investors, diversifying instruments and portfolios, and raising the yields and guarantees of money market instruments. In its analysis, the IMF noted that the increase in investors could reduce volatility over time, in as much as it adds liquidity and further diversifies risk preferences (IMF 1995a: 29). However, new investors may differ from previous ones in terms of performance expectations, risk preferences, and liquidity needs, and increasing the investor base may add volatility and not necessarily decrease it.

This was demonstrated when the volatility of earnings in many emerging markets did not decline over time, but increased. Similarly, it is traditionally assumed that individual investors have no ability to influence the price of the assets traded in the market (IMF 1995a: 29). But in uncompetitive market structures, a small number of large investors do have the ability to influence prices. An increase in the number of large investors can therefore actually add volatility to markets.

When stock markets in emerging countries were opened to foreign investors, the volume and volatility of purchases of U.S. investors increased notably. This was particularly evident in the cases of Argentina, Brazil, and Mexico. Later, the intensification of pension fund privatizations was conducted in an open attempt to stabilize markets (Correa 2010).

The securities industry in the United States was damaged in 1994 by the turmoil in the bond market produced by the Fed's monetary policy. This crisis and its eventual resolution was an important part of the era's intense financial competition, expressed in those years by mounting pressures to remove the boundaries between banking and securities trading. Among the participating

companies in Latin American share flotation, there were investment banks such as Bear Stearns, CS First Boston, Goldman Sachs, and Salomon Brothers, and financial conglomerates like Bankers Trust, Chase Manhattan, Citibank, Deutsche Bank, JP Morgan, and Swiss Bank. With its crisis, Mexico took another step toward financial deregulation, as well as toward coordinating its monetary and credit policies with the Fed and eliminating all protection for the Mexican financial sector, including those protections agreed under the North American Free Trade Agreement (NAFTA) (Correa 1995).

Trade and financial liberalization in Mexico and Latin America had deflationary effects in the 1990s, repeatedly depressing economic activity in the domestic sector: in production, trade, investment, and employment. In the countries within the region, successive devaluations pushed down the relative prices of tradable goods and productive and financial assets, and thereby depressed income and investment conditions. Although it was not altogether another lost decade for the largest economies, as it had been during the 1980s, these were not years of rapid recovery. Rather, the region suffered the ravages of successive banking crises. The reestablishment of the conditions for domestic financing in local currencies has since been uncertain and uneven, although it is worth mentioning that the countries in which conditions have been better are those that have maintained the institutional structures of public banks (Correa 2008; Marshall 2011).

The Mexican crisis and the almost simultaneous banking crises in Argentina, Brazil, and Venezuela clearly showed that the path of financial opening held a high risk of financial crisis. The participation of U.S. banks in the region's portfolio flows and debt placements required the American financial authorities to perform the tasks, albeit partially, of lender of last resort. While very restrictive credit policies were imposed, the Fed and the U.S. Treasury Department nonetheless came up with the funds to rescue U.S. banks caught up in the crisis. The close dependence of domestic credit—even in the national currency—on international credit was once again demonstrated. The Mexican financial crisis of 1994–95, seen as another episode in the transformation of the global financial markets, showed that even with national currencies intact, the opening of monetary spaces builds a hierarchical credit structure that goes hand in hand with the expansion of global financial and nonfinancial conglomerates.

Conclusions

This article argues that the Fed's decisions regarding interest rates and its monetary policy have had a decisive influence on the way capital flows to Mexico and Latin America. At the beginning of the 1980s, the Fed raised the

federal funds rate by almost 10 percentage points, doubling it in less than twenty-four months and producing a deep recession in the United States and the lost decade in Latin America. However, between 1994 and 1995, the Fed once again doubled the federal funds rate, although this time it did not produce a recession in the United States. However, it did decrease growth in some of the OECD countries, while for countries like Argentina, Colombia, Mexico, and to a lesser extent Brazil, it was devastating.

The change in the consequences of the Fed's monetary policy on economic activity in the 1990s has been discussed in the orthodox literature, which attempts to frame them as changes in the transmission mechanism of the Fed's monetary policy (McDonough 2002). But credit flows had changed, and the expansion of bond markets and credit securitization, especially in the United States, changed the conditions of competition between investment banks and commercial banks. These manifested themselves in the huge expansion of portfolio investment in Latin America's largest economies at the beginning of the 1990s, creating a true speculative bubble in securitization that showed its first consequences in the form of the Mexican crisis of 1994.

Almost twenty years after the first global securitization crisis, it is important to reflect on the role played by the Fed in the course of the recurrent crises around the world in the run up to the "Great Crisis" that began in 2007. As explained in this article, since 1994 the tremendous growth of financial markets has created a powerful, hierarchical, global lender of last resort. This mechanism is at the same time extremely competitive, segmented and opaque. This carefully constructed business model caused its first crisis in Mexico in 1994, revealing its basic characteristics and showing both its weaknesses and its enormous potential to transfer income from almost any economic activity to financial markets. Almost twenty years later and in light of the 2007 crisis, it is now possible to revisit the role played by the Fed and other central banks in the various international financial crises, their close ties to financial conglomerates in global competition, and the role of the great moderation that has been imposed on societies around the world.

Notes

1. Tesobonos were financial instruments of the federal government issued by the central bank and indexed to the dollar. Their purpose was to give certainty to foreign investors and ensure the presence of foreign investors in the Mexican financial market.

2. The results of replacing Ajustabonos, Bondes, and Cetes with Tesobonos was as follows: CETES held by foreigners fell by \$11.588 million, Ajustabonos fell by \$3.894 million, and Bondes by \$799 million. Tesobono holdings grew to \$14.338 million.

3. The financial package (Fondo de Estabilidad de la Paridad) grew to more than

\$50 billion, of which \$17.7 billion were committed by the IMF, \$20 billion by the U.S. government, \$1.1 billion by the Bank of Canada, and \$2.787 billion by the Bank for International Settlements, the World Bank, and the Inter-American Development Bank (IADB).

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