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Resignation of Central Bank Governor Dampens Optimism over OPEC Agreement

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Just days after the Mexican economy received a boost from predictions that oil prices might be on the rise, the announcement that the highly effective chief governor of the central bank (Banco de México, BANXICO), Agustín Carstens, had resigned his post put a damper on that optimism. Global oil markets reacted positively to reports in late November that the Organization of Petroleum Exporting Countries (OPEC) had reached an agreement to reduce production by about 1.2 million barrels per day. According to initial reports, Saudi Arabia, Iraq, United Arab Emirates, and Kuwait will account for the bulk of the cuts, although official details will not be announced until after a meeting of OPEC members with non-member producing countries in Vienna on Dec. 10.

The oil cartel is pushing for non-OPEC members to agree to reductions, which would cut the supply of oil on the market by another 600,000 bpd. Russia and Mexico are among the non-OPEC producers expected at the summit.

Stabilizing global oil prices
The OPEC decision to curtail output is part of an effort to stabilize the global oil market, which has remained weak since prices collapsed in 2014, analysts said. This would be the first OPEC reduction since 2008.

The OPEC announcement had an immediate impact on the global oil market, boosting the price of Brent crude to a 16-month high of US$55 per barrel on Dec. 5, compared with US$47 per barrel a week earlier. The price of Mexican crude reached US$44.57 on Dec. 5, an increase of close to 17% since the OPEC agreement was reported on Nov. 30.

“In announcing these cuts, what [OPEC countries] are really saying is now they are going to attempt to prop up crude oil prices,” energy specialist Robert Rapier wrote in a guest column in Forbes magazine. “That's a big deal, because it is a strategy they will likely pursue for several years.”

Other analysts said the agreement was a necessary step to keep the global oil market from declining further. “This is an agreement that likely puts a ceiling on production,” columnist Enrique Campos Suárez wrote in the daily newspaper El Economista.

The reductions are expected to help Mexico and other countries whose economies have depended on oil exports. Mexican officials reacted positively to the OPEC news, since higher export prices could help boost the federal treasury. Mexico remains fairly dependent on oil-export earnings despite repeated efforts to diversify sources of revenue (SourceMex, June 27, 2007, and Aug. 1, 2012).

At the same time, Mexico has made strides in weaning itself from its dependence on oil, which probably helped the economy remain stable during the slump in the global oil market. According to statistics from the finance ministry (Secretaría de Hacienda y Crédito Público, SHCP), an increase in non-oil tax revenues in 2015 exceeded the decline in oil revenue by 174 billion pesos ($9.6 billion),
or 4% of total revenue, showing that the higher non-oil intake was a bigger factor than falling crude, according to the analysis.

Other sources of revenue, such as income from government services and state-owned companies other than the state-run oil company PEMEX, contribute another 25% to the total federal intake.

Mexico also guarded against the decline in oil prices by locking in prices through futures contracts (SourceMex, Feb. 4, 2015, Feb. 10, 2016, Aug. 31, 2016).

**A ‘positive development’ for Mexico**

Still, the government sees the possibility of higher export prices as a positive development, since budget adjustments were required in the last two years due to low oil-export revenues (SourceMex, Feb. 4, 2015, and May 4, 2016).

“We consider this agreement a good step toward stabilizing the markets and moderating the price volatility that has hit us hard over the past two-and-half years,” Energy Secretary Pedro Joaquín Coldwell said in a radio interview. According to Coldwell, the goal is to boost global oil prices to between US$55 and US$60 per barrel and keep them at that level.

Even with the OPEC agreement, the energy ministry (Secretaría de Energía, SENER) said Mexico intends to keep its oil production target of 1.944 million bpd for 2017, much below the projected output of 2.16 million bpd for 2016.

Finance Minister José Antonio Meade also expressed cautious optimism about the OPEC cuts, pointing out that the move would be positive for Mexico’s finances and the health of PEMEX. “We have to monitor the situation to see how it develops,” Meade said on the day after the agreement was announced. “This appears to be an important agreement that will have positive consequences for Mexico.”

**Carstens moving to ‘central bank for central banks’**

The optimism about the OPEC news was overshadowed the next day by Carstens’ announcement that he was leaving BANXICO for a position with the Bank for International Settlements (BIS). The institution, based in Basel, Switzerland, is often described as the “central bank for central banks” because of its role of fostering international monetary and financial cooperation.

The announcement of Carstens’ departure had a depressing effect on the markets, not so much because of the pending loss of an effective manager of the Mexican economy, but because of the timing of the exit. Even though Carstens has said he will remain as the chief governor of BANXICO until July 2017 (and start in his new post in October 2017), the Mexican and global economy might experience a period of turbulence if US President-elect Donald Trump follows through with the protectionist measures that he promised during the electoral campaign. The US economic policies could have an especially detrimental effect on the Mexican currency. In the aftermath of Carstens’ announcement, the peso lost about 1.4% in value versus the US dollar.

Carstens, who served as first finance secretary under former President Felipe Calderón (2006-2012) (SourceMex, Oct. 25, 2006) and also held important posts with the International Monetary Fund (IMF), will continue to lead Mexico’s central bank during the first six months of the Trump administration, but some analysts said his steady hand might be needed to guide the economy beyond that period.
“This is not the best time to announce the departure from the Banco de México,” Campos Suárez wrote in El Economista. “However, July wouldn’t be a good time to make the announcement, either. But the BIS timetable does not necessarily take into account our financial anxieties.”

Campos Suárez added, “Carstens is not only a highly effective financier but also an icon of stability for our country. There is a storm outside, and Agustín Carstens has been a safe harbor.”

Others agreed that Carstens’ departure creates a difficult situation for the Mexican economy. “Yes, the anxiety is justified,” columnist Enrique Quintana wrote in the daily business newspaper El Financiero. “Perceptions are one of the most important driving forces in the markets and the economy in general. The thought that inflation will remain under control, and that BANXICO is going to do everything in its power to keep consumer prices from increasing, contributes to building credibility. This is what Carstens did for years. That is why his absence, even if it won’t come for another seven months, is generating concerns.”

Because of the potential uncertainty, there is strong pressure on President Enrique Peña Nieto to name a replacement as soon as possible. “I hope that President Peña Nieto understands that the has the power to end the uncertainty that followed Carstens’ resignation,” financial columnist Maricarmen Cortés wrote in the daily newspaper Excélsior. “The challenge is that the nominee has to instill confidence among investors, not only because of his qualifications but also because of his independence and his commitment to strengthen the central bank.”

According to Cortés, several names have already emerged, including former finance secretaries Luis Videgaray and José Ángel Gurría, and current Finance Secretary Meade. Gurría, the secretary-general for the Organization for Economic Cooperation and Development (OECD), served as head of the finance ministry (Secretaría de Hacienda y Crédito Público, SHCP) during the administration of Ernesto Zedillo (1994-2000) (SourceMex, Dec. 17, 1997, and Jan. 21, 1998). Videgaray, who was Peña Nieto’s first finance secretary, resigned earlier this year following the outcry over then-presidential candidate Trump’s visit to Mexico. Videgaray had recommended to Peña Nieto that he meet with Trump, even though Trump was highly unpopular in Mexico because of his stance on immigration and his xenophobic comments (SourceMex, Sept. 7, 2016). Peña Nieto named Meade to replace Videgaray as head of the SHCP (SourceMex, Sept. 14, 2016).

Another name that has emerged is Alejandro Werner, a former deputy finance secretary who now holds a high-level post with the IMF. Werner, a respected economist, cannot head the central bank unless the Congress removes a prohibition that prevents foreign-born Mexicans from holding the post. Werner, a naturalized citizen, was born in Argentina.

**Peña Nieto urged to act promptly**

Key legislators also called on Peña Nieto to appoint the new head of BANXICO as soon as possible. “It would be good for us to know the nominee for the chief governor of the central bank by the first half of 2017 so the Senate can proceed with its ratification tasks,” said Sen. Pablo Escudero, president of the upper house.

“It is important to point out that during his term, Carstens presided over a balanced and responsible monetary policy in the face of a complex global financial scenario,” added Escudero, a member of the Partido Verde Ecologista de México (PVEM). “Because of this, our country has earned recognition in the international financial community.”
Some pointed out that Carstens deserved to move on to the prestigious position with the BIS. “The governors of the central banks of the US, France, England, Italy, Japan, and the European Union selected him as the general manager of the institution that serves as the central bank for central banks,” columnist Marco Provencio wrote in the daily newspaper Milenio.

Others noted that the amount of time between the announcement of the resignation and the actual departure provides Peña Nieto with sufficient time to find Carstens’ replacement. “The financial stability of a country does not depend on one person, it depends on institutions,” Carlos Serrano, an economist with BBVA Bancomer, said in an interview with the business publication Expansión. “The timing of the resignation provides sufficient time to ensure an orderly transition.”

Despite all the accolades for Carstens, there is some speculation that the chief governor might have had some disagreements with the administration. “It would be worthwhile to know the reasons why he is compelled to leave at this time,” said Campos Suárez.

Cortés noted that Carstens announced his resignation “in the midst of strong rumors of a confrontation with the government over management of the economy, particularly the growth of the debt and the public deficit.” She also cited talk of differences with finance secretary Meade, who has resisted reducing the GDP growth forecast for 2017 from its current range of 2% to 3% (SourceMex, Sept. 14, 2016).

“BANXICO has already reduced its projection to between 1.5% and 2.5%,” Cortes said.

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