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Ruled by "fear of floating". Mexico's exchange rate policy during the interwar period, 1925-1936

Gobernado por el "miedo a flotar". La política cambiaria de México durante el periodo de entreguerras, 1925-1936

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ANALYTICAL SUMMARY

The Great Depression of 1929 represented a watershed in exchange rate regime history and a crucial moment for central banks. While many countries changed their plans of action jettisoning rigid exchange rate regime targets in favour of domestic macroeconomic goals, others states maintained fixed exchange rate regimes even after the temporary suspension of gold convertibility.

This paper shows that during the interwar years, exchange rate regime changes in Mexico were not driven by a radical change in policymakers' mindset from orthodoxy to heterodoxy. Monetary and banking reforms during those years were not dictated by a new master plan, but rather resulted from a series of improvisations dictated by circumstances. Bank of Mexico (Banxico)'s reforms, which followed the currency and banking crisis of 1931, allowed the government to regain a modicum of monetary autonomy. Nevertheless, policymakers were reluctant to increase the money supply and always prioritized the defence of the fixed exchange rate. Indeed, when the dollar bloc was formally established, government officials and Mexican central bankers rushed to join it.

In the first part of the paper I propose a new classification method which helps to provide an overview of the Mexican exchange rate policy between 1925 and 1936. This allows to differentiate between how exchange rates effectively moved (regime outcome) with respect to what the monetary authority was trying to do (regime intention). Moreover, it permits to compare Mexico's effective monetary regime features with both the modern and interwar exchange rate regime classifications that are typically found in the literature.

Using a qualitative historical approach, the main corpus of the article analyses in detail the historical conditions under which policymakers made their decisions, their ideas about what exchange rate system was best for the country, and the factual problems they faced in pursuing their goal. I follow this development primarily through the lens of Bank of Mexico officials, in order to show why Mexican policymakers of the time considered the fixed exchange rate the ideal regime to employ.

The analysis shows that reasons behind the 'fear of floating' have to be found in the belief that without a strong nominal anchor it would have been impossible to control speculation, avoid inflation, and have a normal trade relationship with Mexico's main economic partner, the United States. Some of these convictions were dictated by real problems the country experienced during those years. The financial fragility caused by the underdevelopment of the national monetary and banking system fostered waves of speculation that were unmanageable without a pegged exchange rate regime. Other, more ideological preoccupations, such as the fear of inflation, were instead the result of deeply rooted beliefs that dated back to revolutionary years.

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