5-31-1995

Foreign Capital Returning to Mexico; Investors Remain Cautious

LADB Staff

LADB Article Id: 56083
ISSN: 1054-8890

Foreign Capital Returning to Mexico; Investors Remain Cautious

by LADB Staff
Category/Department: Mexico
Published: 1995-05-31

According to various reports from President Ernesto Zedillo's administration issued in May, foreign capital appears to be slowly returning to Mexico via the stock market and direct projects, although investors remain very cautious given the continuing uncertainty about the country's economic stability. The concerns about stability were tested in late May, when the Mexican financial markets reacted to a report that the Mexican banking system was in danger of defaulting on international loans due to an overwhelming increase in overdue debt.

The report of the possible default originated at a hearing of the US Senate Banking Committee, which US Sen. Alfonse D'Amato used to renew his criticism of the US$20 billion in loan guarantees provided by US President Bill Clinton, which was part of a total international rescue package of US $50 billion announced in March. At the hearing, Sen. D'Amato also charged that Mexican banking officials, through clever accounting methods, were hiding the extent of the crisis faced by the Mexican banking system. He raised concern that US taxpayers may eventually have to pay for an expensive rescue of the Mexican banking system, which he described as a "financial black hole."

Financial analysts said D'Amato's statements were partly responsible for moderate losses at the Mexican Stock Exchange (BMV) and in the value of the peso relative to the dollar during the last full week in May. The peso, which for several days in early May had remained stable at 5.90 nuevo pesos per US$1.00, declined to about 6.20 per US$1.00 following D'Amato's statements. As of May 30, the Mexican currency was still quoted at 6.17 nuevo pesos per US$1.00 on international markets. Similarly, the main index at the Mexican Stock Exchange (BMV), which had managed to recover strongly to 2,090 points during the week of May 21, declined to 2,011 following D'Amato's statements.

The declines in the financial markets forced Mexico's National Banking and Securities Commission (CNBV) to issue a special statement disputing D'Amato's contention about a possible insolvency in the banking system. The CNBV said the banking system adheres strictly to international accounting practices, which make it impossible to hide statistics related to overdue debt and capitalization. Indeed, the reaction in the financial markets to the possibility of a financial crisis in the banking system raised some questions whether members of the Clinton cabinet and the International Monetary Fund (IMF) were accurate in comments made during May that the Mexican economy had turned the corner and was on the path to recovery. Both the IMF and the US government have a strong interest in promoting a recovery of the Mexican economy, since the two entities provided the lion's share of the US$50 billion in loan guarantees for Mexico to overcome its financial crisis.

In fact, during May the Clinton administration disbursed another US$2 billion of the US$20 billion in loan guarantees allocated for Mexico, bringing the total used so far this year to US$10 billion. The US contribution is drawn from a special fund available to the US Treasury to stabilize the US dollar.

ISSN: 1054-8890

The IMF's contribution to the total package is also US$20 billion, with the remaining US$10 billion contributed by the European-based Bank of International Settlements (BIS). In a speech before members of the Council of the Americas on May 22, IMF managing director Michel Camdessus said Mexico's financial crisis was "under control." Camdessus reasoned that the government has taken sufficient steps to turn the crisis into a "manageable problem."

Camdessus said there were encouraging signs in Mexico, such as the government's ability to turn a trade deficit into a trade surplus, the recovery in the peso, and a decline in domestic interest rates. However, Camdessus's statements were heavily criticized the next day by a members of the four political parties represented in the Chamber of Deputies. The deputies invited the IMF official to visit Mexico to see for himself the problems facing the country, including massive unemployment, increasing bankruptcies, and growing overdue debt, among others. "Some financial indicators have improved, but the 'real economic' situation remains very bad and has not yet reached bottom," said Deputy Francisco Suarez, who chairs the Finance Committee (Comision de Hacienda) in the Chamber of Deputies.

Meantime, US Treasury Secretary Robert Rubin, who also spoke to members of the Council of the Americas on May 22, admitted that the Mexican economy remains very fragile. "While it is too soon to declare victory, we are optimistic that with our support and continued perseverance of Mexico's people, full market confidence and economic health should return," he said. Rubin praised the steps taken so far by the Zedillo administration, including major budget-cutting and revenue-raising measures. "The success of the program should not be judged by the day-to-day movements of the international markets," said Rubin. Furthermore, Rubin pointed out that Mexico has significantly reduced dependence on short-term soft investments such as Treasury bonds (Tesobonos) to support the economy. According to some economists, an overreliance on short-term indirect investments was a major reason why the Mexican government was forced to devalue the peso in December 1994 (see SourceMex, 01/04/95).

According to statistics released by the Finance Secretariat (SHCP), private investment in Tesobonos as of May stood at only US$12 billion, compared with US$30 billion at the end of 1994. The government's decision to reduce reliance on auctions of Tesobonos has attracted foreign investment into other financial instruments. For example, on May 8, Mexico's foreign trade bank (Banco Nacional de Comercio Exterior, Bancomext) successfully placed US$20 million in commercial paper on international markets. The Bancomext issue especially attracted strong interest in European markets, where investors were apparently seeking a substitute for Tesobonos in their portfolios, since the Zedillo administration has reduced the amount of paper placed on international markets in order to lower exposure.

The emission was placed at rates somewhat higher than those previously available to Mexican development banks. Still, this was the first such issue on international debt markets since the Dec. 20 peso devaluation. "Our clients in Europe are no longer as concerned about political instability in Mexico as they were in the days following the devaluation of the peso in December," said Alexander Hayek, director of Indosuez-Mexico, whose parent company handled the issue in Europe. During May, Mexico's largest private commercial bank, Banamex, also succeeded in placing US$206.5 million in commercial paper in international markets.

LADB Article Id: 56083
ISSN: 1054-8890

According to Merrill Lynch president Winthrop Smith, whose company acted as intermediary, this was also the first debt emission by a Mexican private company since the devaluation. Many foreign investors also appear to have regained some confidence in the Mexican Stock Exchange (BMV), after a sharp reduction in the first two months of the year. According to statistics released by the CNBV in early May, foreign investment in the Mexican Stock Market (BMV) approached US$23.1 billion in April, an increase of almost 16% from March. Analysts attributed the increase to a stock market rally which lead the BMV's main index (Indice de Precios y Cotizaciones, IPC) to rise from near 1,400 points in February to above 2,000 points during May.

Better-than-expected first quarter reports among listed Mexican companies also have spurred investor interest. The increased interest in investing in the stocks during April follows a sharp decline in these types of investments in the early part of the year. A report released by the Trade Secretariat (Secofi) showed that foreign investment at the BMV during January and February was down by a net US$170.3 million compared two the same two-month period in 1994. On the other hand, according to Secofi, direct investments during January-February totaled US$3.7 billion, four times as high as during the same two-month period in 1994. Almost two-thirds of the new direct foreign investment was channeled into the service sector, while another 25% went into manufacturing projects. (Sources: United Press International, 05/08/95; Agence France-Presse, 05/16/95, 05/19/95; El Financiero International, 05/22/95; Wall Street Journal, 05/23/95; Associated Press, 05/24/95; New York Times, 05/25/95; La Jornada, 05/22-24/95, 05/26/95; Reforma, 05/18/95, 05/22/95, 05/24/95; 05/26/95, 05/30/95)

-- End --