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LADB Staff

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Surge in Overdue Debt Raises Concerns About Health of Mexican Banks

by LADB Staff

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In late May, the Mexican Bankers Association (ABM) reported a staggering increase of 46% in the banking system's total overdue debt as of mid-May, raising concern in both Mexico and the US about the danger of bankruptcy for the Mexican banking system. Speaking at a press conference at a meeting of the finance executives institute (Instituto Mexicano de Ejecutivos de Finanzas, IMEF) in Monterrey, ABM president Jose Madariaga Lomelin said Mexican banks had accumulated an overdue debt of almost 93 billion nuevo pesos (US\$15.1 billion) as of May 12, compared with about 50 billion nuevo pesos in mid-May of 1994.

According to Madariaga, the overdue debt represents about 12% of the total liabilities of Mexican banks. He said the country's three largest banks Banamex, Bancomer, and Serfin were owed 33.9 billion nuevo pesos (US\$5.5 billion) as of the end of March, an increase of almost 39% since December 1994 and more than 57% relative to March 1994. The high liabilities incurred by the three banks are not surprising, since Banamex, Bancomer, and Serfin have managed to retain their share of the Mexican banking market despite an increase in the number of commercial banks operating in Mexico, which have expanded from 18 institutions in 1991 to 41 at present. Madariaga told participants at the IMEF conference that Mexican banks had restructured more than 45,000 loans so far this year, totaling 15.7 billion nuevo pesos (US\$2.5 billion).

The loan restructurings mentioned by Madariaga do not include the debt renegotiated under a new program instituted by President Ernesto Zedillo's administration in April, which denominates loan principal and interest rates in investment units (unidades de inversion, UDIs). The UDIs were created to provide some certainty for debtors by restructuring debt payments at a more stable interest rate, whereby the index would be tied to a daily inflation index, rather than to volatile markets (see SourceMex, 04/05/95 and 04/12/95).

The high rate of overdue debt has raised concerns both in the US and Mexico about the danger of bankruptcy for the Mexican banking system. For example, at a hearing of the Senate Banking Committee in May, US Sen. Alfonse D'Amato (R- NY) expressed concern that US taxpayers may end up paying for continual rescue efforts for the Mexican banking system. The hearing reviewed the rescue package of US\$20 billion in loan guarantees provided by President Bill Clinton's administration to support the Mexican economy. Indeed, in a report to the US Congress reviewing details of the Clinton administration's rescue package, US Treasury Secretary Robert Rubin also raised some concern about the bankruptcy dangers of the Mexican banking system, which he described as a "potential problem."

Ironically, in their reports for the first quarter of the year, many Mexican banks registered net profits. However, analysts at the US-based financial analysis and investment company Salomon Brothers said the reports are misleading, since the accounting methods used by Mexican banks are

relatively lenient. The Salomon Brothers report suggested that if Mexican banks had employed the same calculation methods as their counterparts in the US, the total losses for the Mexican banking sector would have amounted to 4.4 billion nuevo pesos (US\$714 million) in the first quarter of the year. Banks are expected to show improvement in their balance sheets in the second quarter of the year, thanks to the Zedillo administration's UDI program and tighter regulations requiring banks to increase the level of reserves. Indeed, with the assistance of funds provided by the World Bank and the Inter-American Development Bank (IDB), the Zedillo administration shored up the temporary capitalization program (Programa de Capacitacion Temporal, Procapte), which provides funding for banks to bring up their capitalization to at least the 8% rate required by the government (see SourceMex, 03/08/95 and 04/12/95).

So far this year, six banks have required assistance from Procapte. A seventh bank, Multibanco Probursa, was eligible for Procapte assistance, but the CNBV decided to delay a decision for that institution pending the sale of majority ownership to Spain's Banco Bilbao Vicaya (also known as BBV) this month. In the transaction, which was concluded in late May, BBV increased its ownership ratio of Probursa from 20% to 70%. Under terms of the sale, the Spanish institution agreed to pay the equivalent of US\$350 million, which included the assumption of about US\$180 million of Probursa's debt. Probursa reported net losses of 76.2 million nuevo pesos (US\$12.3 million) in 1994. According to banking industry sources, BBV is in a strong position to acquire Probursa, since the Spanish institution is 25 times larger than the Mexican bank. The Probursa transaction, which moved forward on the basis of a new law passed by the Mexican legislature in February, is the first case in which a foreign institution gained controlling interest in an existing Mexican bank.

Other foreign banks, mostly based in the US, have entered the Mexican market by establishing their own operations. Meantime, the CNBV and several private financial analysts raised the possibility that other banks may be allowed to sell majority ownership to foreign institutions. "The sale of majority ownership to foreign interests is an option to attract new capital to those institutions that will need funds, given the dangerous situation with growing overdue debt," said CNBV president Eduardo Fernandez at the recent IMEF conference in Monterrey. He said a major advantage of such transactions is that the banks would regain financial health without having to resort to the government's savings protection fund (Fondo Bancario de Proteccion al Ahorro, Fobaproa), or to Procapte. According to Fernandez, the most likely candidates for takeover are those institutions that have received assistance under the Procapte program: Inverlat, Confia, Bitel, Del Centro, and Oriente. Fernandez said another institution that will be sold to domestic or foreign investors in the next three months is Banca Cremi-Union, a former subsidiary of Grupo Cabal, a business organization established by fugitive businessman Carlos Cabal Peniche.

The Finance Secretariat (SHCP) took over Banca Cremi-Union in September of last year because of its involvement in a massive fraud scheme to swindle the government out of millions of dollars (see SourceMex, 09/14/94).

Financial columnist Alberto Barranco Chavarria of the daily newspaper Reforma said two other likely candidates for majority purchase by foreign investors are Banco Mexicano (previously known as Somex), and Banco Internacional. Barranco said the two most likely suitors that have emerged for Banco Mexicano and Banco Internacional are based in Spain: Banco Santander and Banco Central

Hispano (BCH). Indeed, according to private analysts, foreign investors are very interested in acquiring the Mexican banks, but are also taking a cautious approach before making a commitment, given the tentative financial state of the Mexican banking system.

Mexican banks, for their part, are not only seeking capital to improve their liquidity, but also access to new technology. "There are so many Mexican banks in search of foreign capital that it's easier to make a list of those who are not seeking partnerships," said Rafael Bello, an analyst with the US broker Morgan Stanley. To facilitate the entry of foreign banks, the Zedillo administration has decided to ease the regulations that were implemented at Mexico's request in the North American Free Trade Agreement (NAFTA). Under those regulations, foreign banks had to establish a full operation in Mexico before being allowed to purchase an existing bank. "This will allow a faster opening of the financial sector," said Fernandez.

The possible sale of several Mexican banks to overseas investors has raised concerns among many Mexicans that foreign interests will soon control the Mexican banking sector. However, the CNBV's Fernandez said the legislation passed in February has safeguards to keep the banking sector in Mexican hands. "This means that there is no possibility that foreigners will ever become majority owners of the three largest banks, Banamex, Bancomer, and Serfin," he said. Serfin, the only large bank to seek assistance from Procapte in March, recently sold a minority share of 13% to US-based GE capital. Still, Fernandez stressed the need to continue to attract new capital into the banking sector. "I believe that in the long run, we will reach some sort of equilibrium between the participation of foreign and domestic interests in our banking sector." [Note: Peso-dollar conversions in this article are based on the Interbank rate in effect on June 5, reported at 6.16 pesos per US\$1.00] (Sources: El Economista, 05/29/95, 05/30/95; Wall Street Journal, 05/31/95; Reforma, 05/30/95, 05/31/95, 06/01/95; El Nacional, El Norte, 06/01/95; Reuter, 05/30/95, 06/04/95; La Jornada, 05/30/95, 05/31/95, 06/01/95, 06/05/95; El Financiero International, 06/05/95)

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