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Government, Banks Create Massive Debt-Relief Program for Millions of Borrowers

by LADB Staff

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In late August, President Ernesto Zedillo's administration and the Mexican banking industry announced a comprehensive plan to provide debt relief to more than six million borrowers in Mexico. The plan, drafted jointly by the bankers association (Asociacion de Banqueros de Mexico, ABM), the Finance Secretariat (SHCP), and the Banco de Mexico (central bank), provides relief from high interest rates and creates a mechanism for borrowers with overdue debts to restructure their obligations to the banks.

A central element of the plan dubbed the Acuerdo para el Apoyo de Deudores (ADE) is to set ceilings on interest rates for a wide range of borrowers during a 15-month period beginning on Sept. 1. The new ceilings apply automatically to borrowers who have kept current on their payments. Those borrowers with overdue debt will have to settle on an interest rate as part of their debt restructuring negotiations with their institutions. Under the ADE, the interest rate for credit card holders who have kept current with their payments has been reduced to a maximum of 38.5% from the previous rate of about 70%. The rate of 38.5% will only apply to the first 5,000 nuevo pesos (US \$795) owed by the credit card holders.

Similarly, the interest rate ceiling for business loans was reduced to 25%, compared with a previous rate of 56%. The rate of 25% will be applicable to the first 200,000 nuevo pesos (US\$31,796) owed by each business. For consumer loans, the interest rate was lowered to 34% for the first 30,000 nuevo pesos (US\$4,769). The previous rate was 65%. As part of the program to assist with restructuring of personal loans, the government and banks agreed to suspend most legal proceedings against debtors through Oct. 31, 1995. Those borrowers who agreed to renegotiate their debt will be given another grace period through Jan. 31.

Additionally, no new guarantees will be required for those borrowers who restructure their debt. The exception will be those businesses that owe more than 400,000 nuevo pesos (US\$63,593). The new program announced by the Zedillo administration and the ABM also creates a restructuring mechanism for mortgage and agricultural loans.

For mortgage loans, borrowers will be given the opportunity to restructure loans through the use of investment units (unidades de inversion, UDIs). Under this plan, banks will charge a rate of 6.5% in real terms for balances up to 200,000 nuevo pesos (US\$31,796) during the first year of restructuring. Rates will rise to 8.75% for any subsequent years. UDIs are a tool created by the Zedillo administration earlier this year to provide some certainty for debtors by restructuring debt payments at a more stable interest rate, whose index would be tied to a daily inflation index, rather than to volatile markets. Under this mechanism, loan principal and interest rates are denominated in UDIs, which would remain constant in real terms (see SourceMex, 04/05/95).

For agricultural borrowers, interest rates under the ADE will be reduced to 25% for the first 200,000 nuevo pesos (US\$31,796) of debt. The ceiling for the interest rate on agricultural loans will be extended through Feb. 28, 1997. Under the program, agricultural borrowers will be given the opportunity to restructure debt for as many as 15 years, plus a grace period of another three years.

Many banks also agreed to pick up the notary and financing costs incurred in restructuring agricultural loans. The plan received a strong endorsement from a number of prominent business organizations. Among the groups represented at the ceremony to unveil details of the program included the national manufacturing industry chamber (Camara Nacional de la Industria de Transformacion, Canacintra), the business coordinating council (Consejo Coordinador Empresarial, CCE), and the confederation of national chambers of commerce (Confederacion de Camaras Nacionales de Comercio, Concanaco). Executives for the three business organizations praised the banking sector for taking a "more realistic" and "equitable" stance by supporting the ADE. In fact, the program became a reality only because the banks agreed to advance some of the funds needed to operate the ADE.

In an interview with the daily newspaper La Jornada, Canacintra director Victor Manuel Terrones said the program, which will help both small and large businesses, will contribute to promoting an increase in Mexico's GDP during the final months of the year. Indeed, the new program was announced only days after the Finance Secretariat (SHCP) reported a sharp decline of 10.5% in the country's GDP during the second quarter of the year (see SourceMex, 08/23/95). According to political and economic analysts, the Zedillo administration was forced to create the program to help reduce criticism that the government was not doing enough to ease the burden of high interest rates and other effects of the economic crisis that followed the peso devaluation in December of last year. Still, the announcement of the ADE represented a departure from President Zedillo's rigid fiscal policies.

The cost of the program, which is expected to be about 15 billion nuevo pesos (US\$2.38 billion), will be shared equally between the banks and the government. This means new expenditures of 7.5 billion nuevo pesos (US\$1.19 billion) on the part of the Zedillo administration. The Zedillo administration's commitment to spend the 7.5 billion nuevo pesos (US\$1.19 billion) for the ADE initially created some concerns in financial markets that the government would ease its strict fiscal policies in place since December. However, Zedillo moved quickly to dispel this concern. "In order to maintain fiscal discipline, which is essential for healthy economic growth, it will be indispensable to sacrifice other public spending projects to back this accord," Zedillo said in a televised speech.

Some financial observers had also expressed concern that the Banco de Mexico would have to make adjustments in its monetary policy. However, the central bank's chief governor, Miguel Mancera Aguayo, told reporters the reduction in interest rates applies only to 25% of total bank credit. Additionally, Mancera reinforced Zedillo's statements that the administration would continue to maintain a tight fiscal policy. He also noted the ADE would have little impact on such factors as internal credit levels set by the Central Bank, the normal operation of financial markets, and the policy of maintaining flexible interest rates.

In addition to the effects of the ADE on economic policy, analysts also noted some concern about the impact of the plan on the banking sector itself. The ADE is expected to squeeze bank profits in one area that has underpinned many financial institutions catering to the public income earned from interest rates, which were already fairly high before the devaluation of the peso. According to some estimates, the loss of income through a reduction in interest rates will lower profits by 5 billion to 10 billion nuevo pesos (US\$794 million to US\$1.58 billion). "Outside of Bancomer and Banamex, most banks can't afford much in the way of forgiveness," said analyst Cynthia Harlow, who follows the Mexican banking industry for US-based CS First Boston.

According to Eduardo Fernandez, president of the banking and securities commission (Comision Nacional Bancaria y de Valores, CNBV), the Zedillo administration will have to rescue the banking sector by providing direct or indirect subsidies totaling 4.5 billion nuevo pesos (US\$715 million) during the life of the program. On the other hand, the program also benefits banks in the long run by ensuring that financial institutions do not become swamped by defaults on loans. According to some estimates, banks are owed more than 95 billion pesos (US\$15.1 billion) in overdue debt. This represents 16.5% of all loans at Mexico's largest banks. Still, some analysts suggested the Zedillo administration is not overly concerned about the impact of the program on the banking sector. "The benefit to reduce social tension and boost Zedillo's standing outweighs what the plan does to the banks," said Gray Newman, an economist at Interacciones brokerage house in Mexico City.

Meanwhile, the announcement of the ADE was greeted with mixed reactions among debtors. An informal survey conducted by the sister daily newspapers Reforma of Mexico City and El Norte of Monterrey showed immediate support for the program from respondents. In Mexico City, 54% of respondents said the ADE will help them to manage their debt situation better. The same was true for 65% of respondents in Monterrey. On the other hand, a group of prominent organizations that in the past have criticized the government's policies on interest rates and debt charged that the ADE is a token program that will benefit only a small percentage of the population. As an alternative to the ADE, a coalition of organizations including the credit card users association (Asociacion Nacional de Tarjetahabientes) and the citizens debtors' assembly (Asamblea Ciudadana de Deudores) proposed their own plan, which creates a repayment scheme based on the ability of individual debtors to pay back their loans. They also proposed to set interest rates based on the profitability of each economic sector.

For their part, members of the prominent agricultural movement El Barzon said they would proceed with plans to suspend payments to banks despite the announcement of the ADE. On the day the ADE was announced, representatives from two member organizations of El Barzon each held separate press conferences denouncing the government for misleading the public. They noted that five debt restructuring programs promoted by the government since 1993, including UDIs, had failed to improve the debt situation of most Mexicans.

El Barzon leaders also criticized the Zedillo administration for overstating the percentage of Mexicans who would benefit from the ADE. According to El Barzon president Juan Jose Quirino Salas, the program will only benefit a fraction of all borrowers, and not the 75% estimated by the Zedillo administration. El Barzon estimated that only 7% to 11% of its own 350,000 members would benefit from the ADE program. The organization is composed primarily of middle class agricultural

producers, but in recent months has managed to recruit members in the cities, particularly credit card holders with large debts.

Quirino called on the administration to convene broad negotiations to address the debt situation. "We insist that new solutions be found to the debt problem," said Quirino. "The negotiations should include participation from members of all political parties, legislators, banks, churches, and debtors." Quirino and other El Barzon leaders also criticized the ADE for lacking a targeted effort to reactivate the economy. To underscore El Barzon's rejection of the ADE, on Aug. 28 several members of the movement initiated a series of public protests in front of SHCP offices and several banks throughout Mexico.

The ADE plan also received mixed reaction from opposition legislators. For example, Alejandro Encinas, national secretary for the Democratic Revolution Party (PRD), described the ADE as a "good signal" and a first step to restore economic recovery to Mexico. However, the chief of the PRD delegation in the Chamber of Deputies, Jesus Ortega Martinez, rejected the program as "populist ploy" by Zedillo to gain support for his beleaguered administration. Ortega said the plan lacks a definitive solution to resolve the country's lingering problems with overdue debt. [Note: Peso-dollar conversions in this article are based on the Interbank rate in effect on Aug. 30, reported at 6.29 nuevo pesos per US\$1.00] (Sources: Agence France-Presse, Reuter, 08/23/95, 08/24/95; El Economista, Notimex, New York Times, 08/24/95; Associated Press, 08/23/95, 08/25/95; El Norte, 08/17/95, 08/25/95; El Norte, 08/24/95, 08/25/95; El Financiero International, 08/28/95 Excelsior, 08/24/95, 08/29/95; La Jornada, Reforma, 08/24/95, 08/25/95, 08/29/95)

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