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The US government's decision to rescue the giant financial institution Citigroup and its proposal to assist the three major US motor-vehicle manufacturers could have significant repercussions on the Mexican financial and automotive industries.

In late November, US President George W. Bush's administration announced a plan to inject US $20 billion into Citigroup to keep the company from bankruptcy. The move is important to Mexico because Citigroup owns the country's second-largest bank Grupo Financiero Banamex, and a collapse of the US financial giant would directly affect its Mexican subsidiary.

At the beginning of December, the US Congress was also considering an economic package for US automakers Ford, General Motors, and Chrysler to keep the companies afloat. All three automakers operate assembly plants in Mexico that produce motor vehicles primarily for sale in the US market. Citigroup's woes raise concerns about subsidiary Grupo Banamex

As with a similar US rescue operation for several financial institutions in early October, the move to shore up Citigroup had an impact on Mexico and on its markets (see SourceMex, 2008-10-01). The Citigroup action was more relevant to Mexico, however, because it had direct implications on Banamex, a Mexican institution. Citigroup acquired Banamex in a highly publicized and controversial transaction in 2001 (see SourceMex, 2001-05-23).

In addition to injecting US$20 billion in capital into Citigroup, the US administration effectively agreed to assume most of the potential losses on about US$306 billion of Citigroup's high-risk assets.

Among those welcoming the US government's rescue of Citigroup was President Felipe Calderon. Speaking during a trip to Argentina, the Mexican president said the move, along with the announcement of US President-elect Barack Obama's economic team, would help restore some stability to global financial markets.

Timothy Geithner of the Federal Reserve Bank of New York, who was nominated as the new treasury secretary, will lead Obama's economic team. "The injection of US$20 billion to Citigroup and [Obama's decision] to name an economic team with high credibility...are steps in the right direction, and I am certain that they will help restore confidence in the global markets," Calderon said during an address to the Consejo Empresarial Mexicano de Comercio Exterior, Inversion y Tecnologia (COMCE), and the Camara de Comercio Argentina-Mexicana.

The stronger reaction, however, came from the financial markets. The main index at the Mexican stock exchange (Bolsa Mexicana de Valores, BMV) rose by 7% following the Citigroup news.

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Similarly, the Mexican peso increased by 2.7%.on that day. "[The positive trends] are all related to the optimism generated by the US government's decision to rescue Citigroup," said Hector Zuniga of Casa de Cambio Tiber. Others concurred. "There were two things driving the market the optimism after the rescue plan for Citigroup and last week's decline that left relatively attractive prices," analyst Carlos Hermosillo of Vector brokerage told Reuters.

Banamex sale discarded

Another concern in Mexico was that Citigroup's financial troubles could lead the US-based financial institution to sell off its assets, including spinning off Grupo Banamex, to improve its liquidity. By some estimates, Citigroup could have obtained close to US$15 billion for Banamex. In an interview with the Mexico City daily newspaper Excelsior, Banamex officials acknowledged that the sale of Banamex was one of the options under discussion in the markets, but added that it was never seriously considered. "Regarding the sale of Banamex, officials noted that this was mere speculation, but there was no official mention of this," the newspaper said.

The Banamex officials said the US rescue of Citigroup all but eliminates the need to sell the company's Mexican subsidiary. "With the help of US authorities, Citigroup avoids having to sell one of its most valuable assets," they said, pointing out that Banamex provides about 10% of Citigroup's earnings. Prominent among those mentioned as possible suitors for Banamex were Spanish-based bank Santander, which already operates in Mexico, and Mexican billionaire Carlos Slim Helu, who owns Grupo Financiero Inbursa. Heavy activity by Slim's companies in financial markets during November and December, including the purchase of at least US$150 million worth of Citigroup shares, further fueled speculation that Slim and his cousin Alfredo Harp Helu were maneuvering to gain full control of Banamex.

Market sources said, however, that the activities of Slim's companies were simply an effort to take advantage of favorable market conditions by acquiring shares in troubled US companies. The price of Citigroup shares dropped to their lowest level since 1992, making this a favorable purchase for Slim. In addition to acquiring Citigroup stock, Slim increased his share of hard-hit US luxury retailer Saks to about 18%. "[Slim] is simply taking advantage of prices," Rogelio Gallegos at Actinver brokerage in Mexico City said in an interview with Reuters. "It's the best moment in the last five years to take stock market positions."

Ford, GM, Chrysler have extensive operations in Mexico

The action by the US Congress to put together a rescue package for the three major US automobile manufacturers has even greater repercussions for the Mexican economy than shoring up Citigroup. The US auto industry found itself in a crisis at the end of 2008, in large measure because of a credit crunch and the downturn in the US economy during the year. The situation became so serious that there was talk that one or more of the three companies would go under without some assistance from the US government.

In early December, the US automakers asked Congress to approve as much as US$38 billion in loans and other assistance to help them get through the crisis, which resulted in the lowest car sales in almost 25 years. Analysts say the US Congress is likely to approve a rescue package as long as the auto industry meets certain conditions, including changes that would make motor vehicles more fuel

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efficient and environmentally friendly. During testimony to Congress in early December, executives from the US automakers presented details of how they plan to use the rescue money and what changes they plan to make.

The proposals were met with a generally positive reaction in Congress. Just as important, President-elect Obama, who has strongly supported bailing out the US auto industry, praised the executives for presenting "more serious proposals" than they did during previous testimony to Congress in November, when the bailout was first being considered.

Mexican assembly plants export 75%-80% of their output to US

In Mexico, officials and private analysts raised some concerns that the failure of any of the US motor-vehicle companies could have negative implications on their operations south of the border. Ford operates assembly plants in Cuautitlan in Mexico state and Hermosillo in Sonora state and an engine-manufacturing facility in Chihuahua. General Motors' has facilities in Silao in Guanajuato state, Ramos Arizpe in Coahuila state, Toluca in Mexico state, and San Luis Potosi. Chrysler has plants in Mexico City and Toluca in Mexico state.

A major concern is that the three automakers export 75% to 80% of their production to the US market, where sales have been lagging for an extended period. An analysis published by Grupo Financiero IXE said the situation could have serious implications for the Mexican economy because the auto industry accounts for almost one-quarter of the country's total exports and for about 6% of Mexico's foreign direct investment (FDI). The IXE report said the bottom line is that the crisis in the US auto industry could put an estimated 500,000 jobs at risk in Mexico. The slow sales to the US had already forced some cutbacks in the Mexican operations of the three US companies.

In mid-November, officials at Ford de Mexico said they planned to shut down operations at the Hermosillo plant for about six weeks because of the slow demand in the US. The closure was planned for Dec. 19 through the beginning of February. Workers would be paid 75% of their normal salary during the shutdown, but would still receive 100% of their benefits, company officials said. "This is a problem common to the automobile industry throughout North America," said Ford de Mexico official Marcos Perez. "We have to adjust production to demand."

But the clouds for the Mexican auto industry have a partial silver lining, with exports to Europe and Latin American remaining fairly strong. The problem is that these sales account for only 20% to 25% of the exports for the Mexican auto industry. And while these sales involve some vehicles assembled at plants operated by US automakers, they are mostly helping the Mexican subsidiaries of Japanese and European companies, particularly Volkswagen and Nissan.

The Mexico City daily newspaper Reforma said the two companies have grabbed a larger share of the Mexican auto industry in recent years, with Nissan now accounting for 19.5% of Mexico's total production, compared with 12.3% four years ago. The story is the same for Volkswagen, which now owns a 20.5% share of the Mexican auto industry, compared with 14.8% in 2004. The Asociacion Mexicana de la Industria Automotriz (AMIA) acknowledged that the strong sales to European and Latin American countries have helped keep the Mexican auto industry viable. "There is an opportunity for Mexico to continue as a strong exporter," said AMIA president Eduardo Solis.

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Still, Solis raised concerns about the 23% decline in sales to the US market this year, which he called a "worrisome situation," because the Mexican auto industry still relies strongly on sales north of the border. The negative repercussions are not limited to manufacturers of passenger vehicles but also would have a deep impact on industries such as auto parts. "Each year, General Motors buys about US$11 billion in products from auto-parts companies with operations in Mexico," said Agustin Rios, president of the Industria Nacional Autopartista (INA). "The highest risk for us at the moment is not the actual bankruptcy [of the three US automakers], but the suspension of payments because of a lack of liquidity."

Manufacturers of buses, trucks, and heavy vehicles are also suffering from the credit crunch both in the US and domestic markets. In a report published in mid-November, the Asociacion Nacional de Productores de Camiones, Autobuses y Tractocamiones (ANPACT) reported a decline of 7.6% in exports during the past year.

In addition, sales in the domestic market dropped to their lowest level in 13 years. Mexico considers its own rescue package for auto industry The problems in the Mexican motor-vehicle sector have led the Mexican government to begin discussions with industry officials on a potential rescue package.

Sources said officials from the Secretaria de Hacienda y Credito Publico (SHCP) and the government lender Nacional Financiera (NAFIN) have proposed a package of between 10 billion pesos (US$734 million) and 30 billion pesos (US$2.2 billion) in loans and credit guarantees during their discussions with representatives from AMIA, the Industria Mexicana de Distribuidores de Automotores (AMDA), and the Asociacion Mexicana de Entidades Financieras Especializadas (AMFE). "We want to emphasize to SHCP and NAFIN officials that the auto industry is strategic for Mexico," said AMFE president Mario Sandoval Chavez.

The recent slow sales to the US market have already forced some changes in the subsidiaries of the US manufacturers this year. In May, Ford de Mexico announced plans to invest about US$3 billion to convert its assembly facilities to handle other types of vehicles, many of which will be targeted to the domestic market. The company's plant in Cuautitlan, for example, will stop producing trucks, effective in 2010, and instead boost production of the economy Ford Fiesta model, which is in greater demand. GM Mexico plans to reduce production of pickup trucks, which are normally exported to the US, and instead increase production of its subcompact Chevy and Aveo models. [Note: Peso-dollar conversions in this article are based on the Interbank rate in effect on Dec. 3, 2008, reported at 13.60 pesos per US$1.00.]

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