Playing with Fire: Internationalization and Condition of Mexican Banks prior to the 1982 Debt Crisis

Sebastian Alvarez
The Paul Bairoch Institute of Economic History
University of Geneva

EABH Annual Meeting
April 29, 2016
Serial defaults and sovereign debt crises in the developing world.
Third world debt represented 2-3 times the capital of international banks.
Latin American countries accounted for about 60% of these claims.
Debt Crises - The Banking Sector Matters

- Government indebtedness and weak banking systems.
  - Recent twin bank-debt crises in Europe (Shambaugh 2012, Lane 2012).
  - Historical association (Reinhart and Rogoff 2009, 2011).

- Domestic banks and international finance.
  - Source of vulnerability.
    - Iceland (SIC 2010).
    - Ireland (Honohan et al. 2010)
    - Greece
    - Spain
## Latin America’s Debt and Banking Crises in the 1980s

<table>
<thead>
<tr>
<th>Country</th>
<th>External Debt 1982 (Mil. $)</th>
<th>Years in Default</th>
<th>Banking Crisis Timeframe</th>
</tr>
</thead>
<tbody>
<tr>
<td>Brazil</td>
<td>94,428</td>
<td>1983-94</td>
<td></td>
</tr>
<tr>
<td>Mexico</td>
<td>86,274</td>
<td>1982-90</td>
<td></td>
</tr>
<tr>
<td>Argentina</td>
<td>43,787</td>
<td>1982-93</td>
<td>1980-82</td>
</tr>
<tr>
<td>Chile</td>
<td>13,959</td>
<td>1983-90</td>
<td>1981-83</td>
</tr>
<tr>
<td>Peru</td>
<td>10,871</td>
<td>1983-97</td>
<td>1983</td>
</tr>
<tr>
<td>Colombia</td>
<td>10,519</td>
<td></td>
<td>1982-87</td>
</tr>
<tr>
<td>Ecuador</td>
<td>7,808</td>
<td>1982-95</td>
<td>1982</td>
</tr>
<tr>
<td>Costa Rica</td>
<td>3,766</td>
<td>1981-90</td>
<td>1987</td>
</tr>
<tr>
<td>Nicaragua</td>
<td>3,037</td>
<td>1979-2002</td>
<td>1990</td>
</tr>
<tr>
<td>Dominican Rep.</td>
<td>2,598</td>
<td>1982-94</td>
<td></td>
</tr>
<tr>
<td>Honduras</td>
<td>1,948</td>
<td>1981-2002</td>
<td></td>
</tr>
<tr>
<td>Uruguay</td>
<td>1,906</td>
<td>1983-85, 1987</td>
<td>1981-84</td>
</tr>
</tbody>
</table>


- **Brazil**: Failure and liquidation of three domestic banks by end-1985.
- **Mexico**: Nationalization of the banking system on September 1, 1982.
Mexican Banks and International Finance

Mexican domestic banking sector, 1950-1982

- Increasing reliance on foreign borrowing as source of funding since 1975.

Source: Banco de Mexico
How did involvement with foreign finance and the funding strategy affect the financial position of the banks?

- Increased exposure to world financial fluctuations.
  - Foreign exchange.
  - Interest rate.
  - Funding.

- International banks were more vulnerable than domestic-oriented banks.
  - Weaker capital structure.
  - Worse liquidity position.
  - Less stable funding base.
The International Expansion of Mexican Banks

- Internationalization process:

- Banks involved:
  - Six largest commercial banks:
    - Banamex, Bancomer, Serfin and Comermex (private banks)
    - Banco Mexicano-Somex and Banca Internacional (mixed banks)
  - Accounted for 75% of the banking system.
From Domestic to Foreign Funding

Liquidity structure of the Mexican banking system (% of all liabilities)

- Substitution of domestic for foreign liquidity.
- Higher risk for the banking system.

Source: Banco de Mexico
The sector became twice more leveraged.
Greater reliance on debt instead of equity to finance its expansion.
International vs. Domestic-Oriented Banks

Debt-to-equity ratio

Source: CNBS Multibank Bulletin

- More aggressive use of debt for growth financing.
More reduced ability to meet short-term obligations with liquid assets.
Risk Indicators

- Capital Adequacy
- Asset Liquidity
- Asset Quality
- Funding Maturity

- International banks
- Domestic banks
The Change in the Funding Structure

Change in the share of deposits and bank borrowing to all liabilities, 1978-81

- Fall in sight deposits made up by an increase of interbank funding.
- Negative feedback mechanism between domestic funding and risk levels.
Final Remarks

- International finance was at the root of the increasing risk levels in the Mexican banking sector during the lead-up to the 1982 debt crisis.

- Banks involved with foreign funding and international lending displayed worse capitalization levels, a weaker liquidity position and a more unstable funding base.

- Foreign finance provided Mexican banks with an alternative to overcome domestic funding difficulties linked to inflation and negative real interest rates in a context of increasing competition from foreign bank loans.

- Large scale incorporation of international liquidity by commercial banks was instrumental for the state-led development strategy of the Mexican government as well as the fixed-exchange rate policy of the central bank.
Mexican Banking Industry

Total Assets in December 1980 (in million dollars)

Source: Bulletin of the CNBS and Mexico’s Annual Report
## Mexican Banks Overseas

### Total Liabilities of Mexican Foreign Agencies and Branches

**June 1982, Millions of dollars**

<table>
<thead>
<tr>
<th></th>
<th>Banamex</th>
<th>Bancomer</th>
<th>Serfin</th>
<th>M. Comer.</th>
<th>Somex</th>
<th>B. Int.</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total Bank</strong></td>
<td>13,528</td>
<td>13,252</td>
<td>5,635</td>
<td>4,724</td>
<td>5,157</td>
<td>2,854</td>
</tr>
<tr>
<td><strong>Foreign branches</strong></td>
<td>2,047</td>
<td>2,165</td>
<td>773</td>
<td>1,126</td>
<td>480</td>
<td>1,121</td>
</tr>
<tr>
<td>New York</td>
<td>580</td>
<td>1,005</td>
<td>33</td>
<td>205</td>
<td>1</td>
<td>106</td>
</tr>
<tr>
<td>Los Angeles</td>
<td>159</td>
<td>377</td>
<td>228</td>
<td>246</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>London</td>
<td>888</td>
<td>523</td>
<td>310</td>
<td>401</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Cayman Islands</td>
<td>0</td>
<td>261</td>
<td>0</td>
<td>280</td>
<td>479</td>
<td>1,015</td>
</tr>
<tr>
<td>Nassau</td>
<td>420</td>
<td>0</td>
<td>201</td>
<td>25</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td><strong>F. Agencies/Bank (%)</strong></td>
<td>15.1</td>
<td>16.3</td>
<td>13.7</td>
<td>23.8</td>
<td>9.3</td>
<td>39.3</td>
</tr>
</tbody>
</table>

Source: FFIEC 002, Bank of England’s archives and CNBS.
Mexican Agencies in the U.S. - Liabilities Structure

Total Combined Liabilities as of June 1982 (millions of dollars)

- About 80% represented deposits or lending facilities from banking institutions.
- 19% were transfers from head offices in Mexico and 1% were liabilities to the non-banking sector.
Mexican Agencies in the U.S. - Assets Structure

Total Combined Assets as of June 1982 (millions of dollars)

- Overall, an estimated 80-90% of the US agencies total assets represented claims on Mexican borrowers.
- About 60% represented loans to the Mexican government or the public sector.