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

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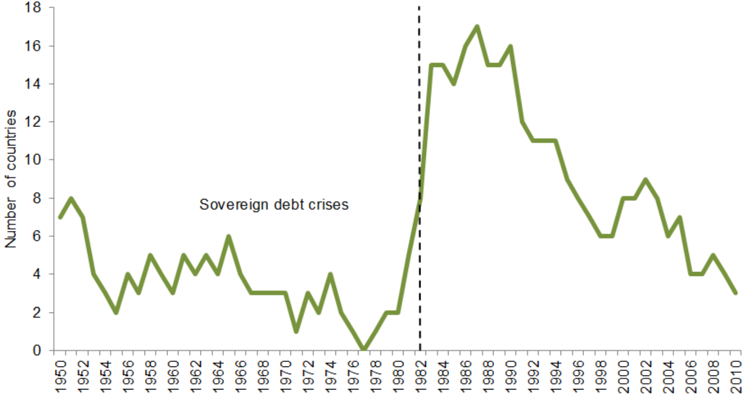
The International Debt Crisis of the 1980s



Source: Reinhart and Rogoff (2011)

- 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)
  - Feedback effect (Attinasi et al. 2009, CGFS 2011).
    - Greece
    - Spain

Latin America's Debt and Banking Crises in the 1980s

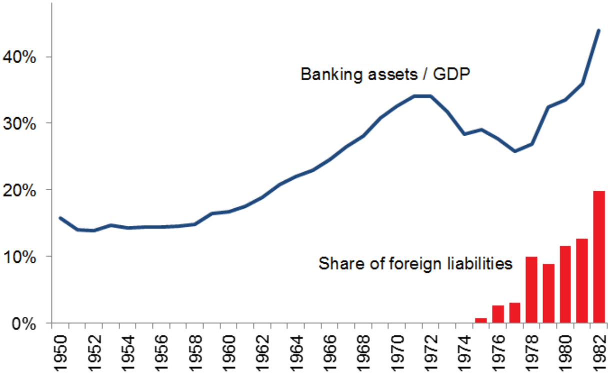
Country	External Debt 1982 (Mil. $)	Years in Default	Banking Crisis Timeframe
Brazil	94,428	1983-94	
Mexico	86,274	1982-90	
Argentina	43,787	1982-93	1980-82
Venezuela	32,181	1983-88, 1990	
Chile	13,959	1983-90	1981-83
Peru	10,871	1983-97	1983
Colombia	10,519		1982-87
Ecuador	7,808	1982-95	1982
Costa Rica	3,766	1981-90	1987
Bolivia	3,422	1980-84, 1986-93	1986-88
Nicaragua	3,037	1979-2002	1990
Dominican Rep.	2,598	1982-94	
Honduras	1,948	1981-2002	
Uruguay	1,906	1983-85, 1987	1981-84

Source: World Debt Tables, Standard & Poor's (2002) and Laeven & Valencia (2008)

- Brazil: Failure and liquidation of three domestic banks by end-1985.
- Venezuela: Six commercial banks failed between 1981 and 1986.
- Mexico: Nationalization of the banking system on September 1, 1982.

Mexican Banks and International Finance

Mexican domestic banking sector, 1950-1982



Source: Banco de Mexico

- Financial disintermediation process from 1972 to 1976-77.
- Increasing reliance on foreign borrowing as source of funding since 1975.

This Paper - Question

- 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.

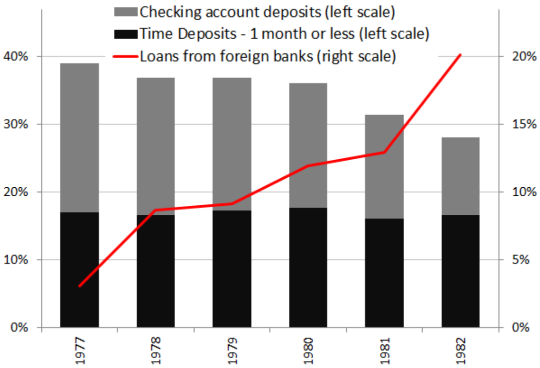
The International Expansion of Mexican Banks

- Internationalization process:
  - Consortium banks: Intermex, Libra Bank and Eulabank (1972-74).
  - Branches and agencies in the London and the U.S. (1975-82).
- 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.

MBI MBO

From Domestic to Foreign Funding

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

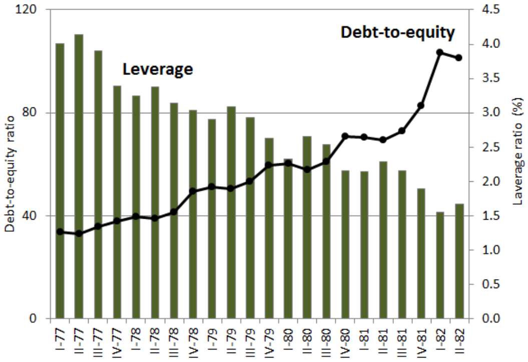


Source: Banco de Mexico

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

Underlying Weaknesses of the Mexican Banking System

Risk indicators at the industry level

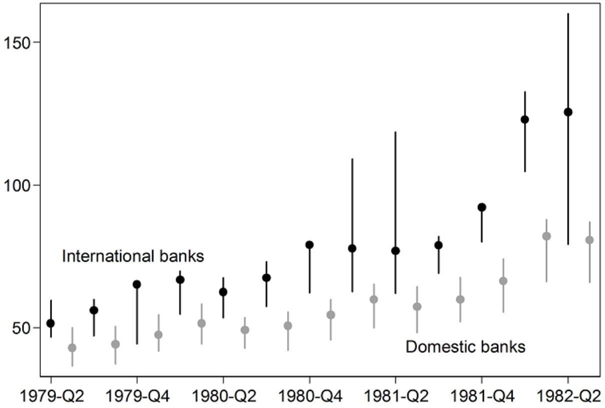


Source: Banco de Mexico

- 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

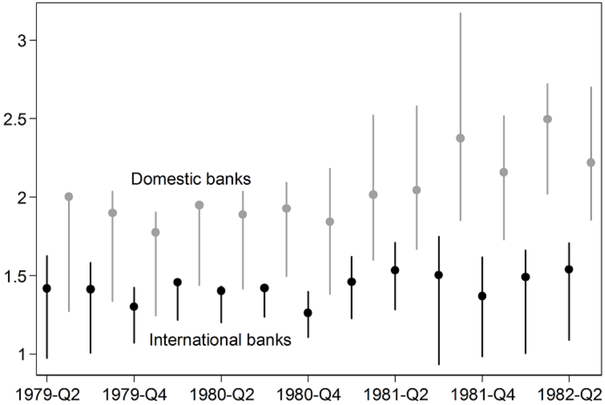


Source: CNBS Multibank Bulletin

- More aggressive use of debt for growth financing.

International vs. Domestic-Oriented Banks

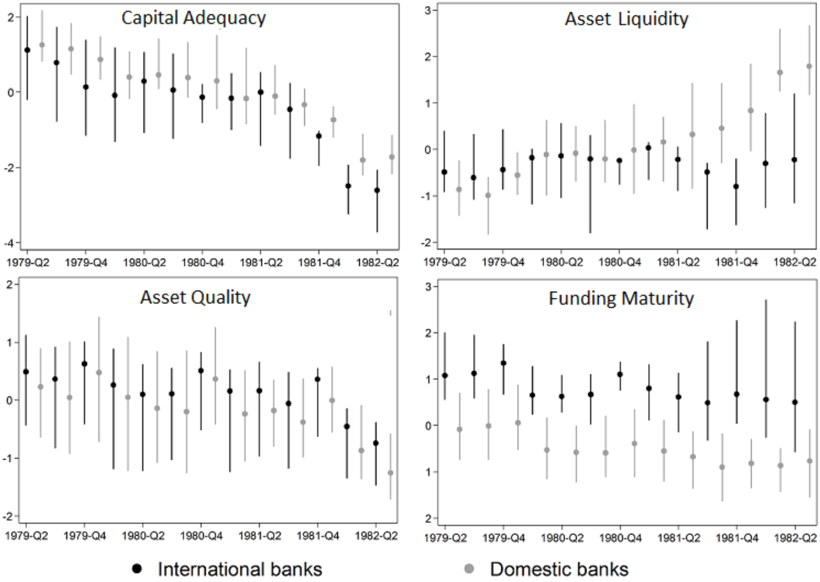
Quick Ratio



Source: CNBS Multibank Bulletin

- More reduced ability to meet short-term obligations with liquid assets.

Risk Indicators



The Change in the Funding Structure

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

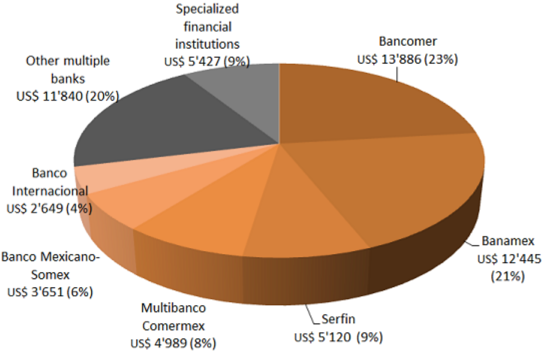
- Fall in sight deposits made up by an increase of interbank funding.
- Negative feedback mechanism between domestic funding and risk levels.

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 instable 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

Return

Mexican Banks Overseas

Total Liabilities of Mexican Foreing Agencies and Branches
June 1982, Millions of dollars

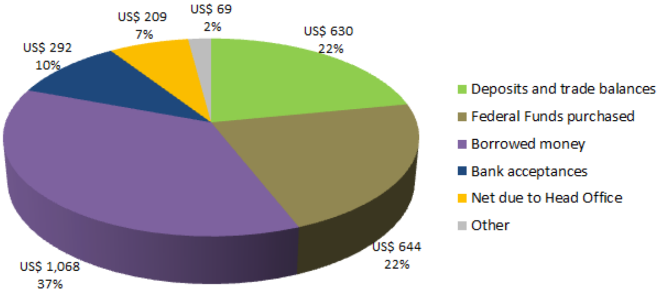
	Banamex	Bancomer	Serfin	M. Comer.	Somex	B. Int.
Total Bank	13,528	13,252	5,635	4,724	5,157	2,854
Foreign branches	2,047	2,165	773	1,126	480	1,121
New York	580	1,005	33	205	1	106
Los Angeles	159	377	228	246	0	0
London	888	523	310	401	0	0
Cayman Islands	0	261	0	280	479	1,015
Nassau	420	0	201	25	0	0
F.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

Source: FFIEC 002, Bank of England's archives and CNBS.

Return

Mexican Agencies in the U.S. - Liabilities Structure

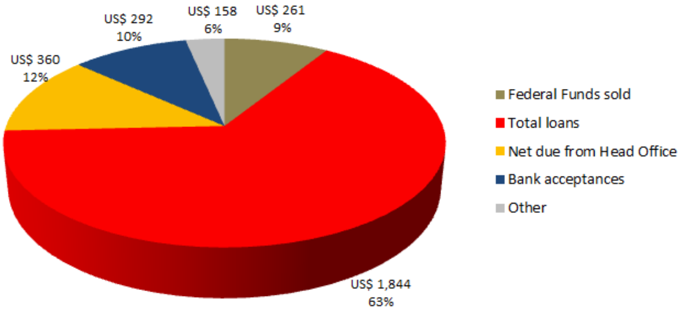
Total Combined Liabilities as of June 1982 (millions of dollars)



- About 80% represented deposits or lending facilities from banking institutions.
- 19% were transfers from head officies 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%t represented loans to the Mexican government or the public sector.