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**BANKING SECTOR FACING INCREASING STRAIN FROM PESO DEVALUATION**

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The country's private commercial banks are facing increasing pressure from both the executive and the legislature to take steps to help the government address the impact of the devaluation of the peso on the Mexican economy.

High interest rates, which have tripled to about 90% since the Dec. 20 devaluation, are forcing many businesses, agricultural producers, and private consumers to default on their loans. The non-payment of loans, in turn, has created difficult conditions for banks, many of which may be in danger of bankruptcy. According to some estimates, overdue debt this year is expected to approach 20% of all outstanding loans.

Indeed, the increase in overdue debt and the rising level of bankruptcies have led legislators and government officials to impose new restrictions on the country's commercial banks. At the same time, the government is reviewing ways that it could assist bankers in overcoming the present crisis.

On March 3, members of the Chamber of Deputies met with banking executives to express their concerns about high interest rates. During the meeting, attended by members of the four political parties represented in the legislature, bankers were given an ultimatum to work with the Finance Secretariat (SHCP) and the Agriculture Secretariat (SARH) to resolve the growing problem of overdue loans, which are becoming a drain on the Mexican economy.

For its part, on Feb. 28 the banking regulatory agency Comision Nacional Bancaria (CNB) ordered Mexican banks to increase the ratio of reserves on hand to at least 60% from the prevailing rate of about 50% to cover overdue debts.

The CNB directive is intended to help Mexico's financial system address the expected wave of bankruptcies and defaults by Mexican companies weakened by the peso crisis. Banking executives expressed concern about the directive, however, since the requirement would cause many institutions to forego profits or even enter into debt themselves.

"It is painful for the banks because if you increase reserves it will affect your earnings and capitalization," banking analyst Rafael Bello of Morgan Stanley said in an interview with the Reuter news agency.

According to some analysts, Mexican banks will need at least US\$2 billion, and possibly as much as US\$25 billion, to reach the required capitalization levels and write down bad loan portfolios. "Right now the banks are not in good shape to be creating so much reserves," said Susan Ornelas, a banking specialist at Baring Securities in Mexico City. "Some of them are closer to 40% than 60%."

Nevertheless, Banco de Mexico governor Miguel Mancera defended the reserve requirement, which he said would boost the amount of reserves available to address bankruptcies to about 4 billion nuevo pesos (US\$570 million).

Mancera, who made the comment in testimony before the Senate, said the Zedillo administration has created a special program to capitalize the banking system, dubbed the Programa de Capitalizacion Temporal (Procapte). The program is aimed at assisting financial institutions raise needed funds by providing emergency government loans to the banking sector.

The administration's decision to create Profapte was met with mixed reactions. While many bankers applauded the move to create a new source of capital for the ailing banking system, they also expressed concern that the new system increases the influence of the government over commercial banks.

An even greater concern, however, is that the program may not be sufficient to rescue the banking sector. "It's an icebag, a band-aid at best, when what was needed was surgery," said economist Roberto Salinas Leon in an interview with *El Financiero International* weekly business newspaper.

The endangered condition of the banking sector was already evident in early March, when the government took control of Grupo Financiero Asemex-Banpais, the holding company for Banpais--one of Mexico's 10 largest banks. In a one -page statement, the SHCP cited "irregularities" committed by the company, including a lack of reserves and capital that "put its financial health at risk." The statement gave no other details for the actions.

According to *El Financiero International* weekly business newspaper, Banpais was already severely undercapitalized before the devaluation, resulting in an 89.4% decrease in earnings for 1994. The SHCP intervention also affects the Asemex-Banpais insurance companies, Aseguradora Mexicana and Seguros Banpais.

In addition to Banpais, other Mexican banks are expected to face similar problems with a lack of reserves because of the impact of the devaluation. "It's going to be impossible to get through the year 2000 with this banking system," said economist Rogelio Ramirez of the Ecanal Research company. He predicted that one out of every five banks may have to fold in the next six years because of sharp reductions in equity.

Indeed, the devaluation of the peso has led many of the foreign banks that received permits to operate in Mexico to proceed very cautiously, even though a new law passed in January allows foreign institutions to gain a 49% share in Mexican banks (see *SourceMex*, 02/01/95).

In a report released in late February, the labor group representing banking employees (Federacion Nacional de Sindicatos Bancarios, Fenasib), said the uncertain condition of the Mexican economy has led the 20 foreign banks that received permits to operate in Mexico to delay full entry into the Mexican market. According to Fenasib, layoffs are anticipated across the board in the banking sector, including large institutions such as Bancomer, Banamex, and Serfin.

For its part, the banking industry has resisted proposals to impose a moratorium on loan repayments. For example, on Feb. 20 Jorge Madariaga Lomeli, director of the banking industry association (Asociacion de Banqueros de Mexico, ABM), rejected proposals requesting that commercial banks allow businesses to suspend payments on loans.

Speaking in a private meeting with business groups in Monterrey, Madariaga expressed confidence that stability would soon return to the Mexican economy, which would result in a decline in interest rates and increased access to loans for most businesses. On the other hand, Madariaga suggested, a moratorium on loan repayments could create an economic "chaos" for the Mexican banking sector.

On a related matter, Raul Villegas, director of the credit card holders organization (Asociacion de Tarjetahabientes) reported that debt owed through credit cards by 5 million consumers in Mexico has reached 100 million nuevo pesos (US\$14 million). Villegas said the majority of the debt is owed to large banks such as Banamex, Bancomer, Serfin, and Multibanco Mercantil Probusa, all of which doubled their interest charges for consumer credit cards from about 36% in December to about 70% at the end of January.

Villegas emphasized that roughly 70% of the credit card loans were incurred for purchases of necessary consumer goods such as food and clothing, and not for luxury items. Villegas urged banks to restructure debts for credit card holders, since an "enormous proportion of family earnings are now destined toward payments of credit card debts."

Meantime, Mexican banks have started to receive support from overseas to help finance imports of capital products and parts, which are expected to decline because of the devaluation. On Feb. 23, Mexico's second largest bank Bancomer announced a US\$10 million loan from Swedish bank Skandinaviska Enskilda Banken to be used exclusively to provide long-term loans to the private sector to import capital equipment from Sweden.

Similarly, Banca Serfin on March 1 announced two loans of more than US\$97 million from the US commercial banks Chemical Bank and NationsBank to finance imports of US products. The loans--US\$61.5 million from Chemical Bank and US\$35.9 million from NationsBank--will be guaranteed by the US government's Export-Import Bank (Eximbank).

For its part, the Mexican government is proceeding with plans to continue to encourage the creation of new financial institutions to help address the lack of funds available for loans. On Feb. 28, the SHCP approved an operating permit for the new credit union, Union de Credito Mexicana, S.A. de C.V. According to the federal register (Diario Oficial), the new credit union- -which will be permitted to operate in the city of Queretaro--will begin functioning with 6 million nuevo pesos (US\$857,000) in starting capital. (Sources: La Jornada, 02/20/95, 02/21/95, 02/24/95; United Press International, 02/27/95; Agence France-Presse, 02/27/95, 02/28/95; Notimex, 02/23/95, 02/28/95, 03/02/95; El Financiero, 03/03/95; El Financiero International, 02/20/95, 02/27/95, 03/06/95; Reuter, 02/27/95, 03/03/95, 03/06/95; Associated Press, 03/02/95, 03/07/95)

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