

## What Will 2010 Yield For Mexico's Banking Industry?

*Posted at 12:21 AM on December 29, 2009 by Xiaomin (Samantha) Hu*

**Q**The head of HSBC's Mexican unit, Luis Pena, said Dec. 2 that he expects a return to growth at Grupo Financiero HSBC as the country emerges from its recession, suggesting that although Mexico's recovery will be slow, '2010 will be better than 2009.' Will Mexico's banks indeed see growth next year? If so, how strong will that improvement be and which banks are best positioned for growth? How are new entrants in the financial sector like Walmex having an effect?

**A**Ricardo Ortiz and Marta Colomar Garcia, associate attorneys at Diaz, Reus & Targ, LLP in Miami: "It has been a difficult year for Mexico. The United States, which previously bought as much as 80 percent of Mexico's exports, dropped into a recession. As a tourist destination, Mexico was wracked by continuous news of extreme drug-related violence in the nation. In addition, the H1N1 flu struck the country, shuttering businesses and frightening travelers away. Fortunately, economic analysts have projected a 3 percent growth and an increased capital influx for Mexico in 2010. Despite a tumultuous 2009, Mexico's banking system remains robust. Banks are well capitalized and supported by a strong regulatory framework. Unlike its neighbor to the north, the Mexican government was not forced to bail out any of its banks. In fact, one of the best-positioned banks for growth in Mexico is Grupo Financiero HSBC. This financial institution has made it clear that it will continue to extend credit to small businesses, the real estate sector and consumers in 2010. Additionally, Spain's Grupo Santander is also flexing its financial muscles by working actively with Latin American governments and major regional clients to further boost its banking operations. Finally, BBVA Bancomer has received media attention as an institution positioned for growth. Indeed, the U.S. publication 'Banks of the Year 2009' named Bancomer the 'Best Bank in Mexico.' If the predictions are accurate, Mexico will be an attractive market for business. New entrants in the

financial sector will continue to create an incentive for better quality and increased competition. For example, by gaining more market share based on the quality of its product and its low-price campaigns, Walmex has increased competition and has created challenging situations for smaller businesses. Similarly, traditional financial institutions need to adapt new strategies to avoid changes in their relationships with traditional consumers. As Mexico's economy improves in 2010, so will its banking sector. Look for the jumpstart to begin with the business community reactivating the loan market, while the consumer segment becomes more dynamic."

**A**Rogelio Ramírez de la O, director of Ecanal in Mexico City: "Bankers in Mexico expect credit to recover in 2010 and may even incorporate this into their plans. But that would be too sanguine a view of the real economy, which, in the end, is the only sustenance of a healthy credit expansion. The feeble real economy is more likely to contribute to further credit deterioration. For one thing, there is no discernible increase in employment, Manufacturing employment fell 9.4 percent in October, while INEGI data on unemployed and under-employed rose by 2.3 million in the three quarters through last June. Adding those working less than 35 hours a week and those inactive but 'available', the loss in jobs has been 5 million. Most employed workers did not receive a pay increase in 2009 and employers do not plan one for 2010. Thus, due to inflation alone, real wages will lose 10 percent over the last two years. In addition, the recent tax reform will reduce 6 percent of take-home pay in 2010, according to accountants. To be sure, this is what explains that overdue housing loans jumped through October 48 percent on an annual basis, while for businesses the overdue loan rate increased 39 percent. Bankers have sold large consumer loan portfolios at a loss, and even so their consumer overdue portfolio is at 10 percent. This, in turn explains reduced bank lending. Consumer credit fell 16 percent through October, while for business it grew 1.4 percent compared to 27 percent in 2008. The cycle of deterioration in the real economy is far from complete; thus any increase in bank lending would remain risky."

**A**Tapen Sinha, professor of risk management at the Instituto Tecnológico Autónomo de México and professor in the University of Nottingham Business School: "In December 2008, the consensus view of the 'experts' was that in 2009, the Mexican economy would grow 0.38 percent. By December 2009, the consensus view of the same experts was that the economy would contract 7.02 percent. Given this background, it is hard to take the views expressed by the same experts about the growth of banking activity in 2010 seriously. Just over 100 years ago, in 1907, there was a bank panic in the U.S. that eventually led to the birth of the Federal Reserve System in 1913. One direct consequence of bank panic in the U.S. is mentioned less often: the depression of 1908-09 in Mexico. This in turn led to the Mexican Revolution in 1910. Historian Kevin Cahill noted that 'the U.S. depression crippled the Mexican economy. Generating widespread dissatisfaction with President Porfirio Díaz's government, it thus was one of the factors that provoked the Maderistas and other revolutionaries to rebellion in 1910.' It is remarkable how similar the situation is between 1909 and 2009. Of course, it would be foolish to suggest that Mexico is heading for a revolution now. It is not. In October 2009, Walmex received approval for a 'correspondent license,' which enables it to take deposits and cash paychecks in 1,356 branches across Mexico. The two biggest banks in Mexico, Banamex and BBVA Bancomer, each have more than 1,500 branches. However, Walmex will be open for business for 16 hours a day, seven days a week. In comparison, banks are open for six to seven hours a day and around 250 days a year. Thus, it is clear that Walmex will have a big impact on some of the routine services."

**A**David Olivares-Villagomez, senior credit officer for Latin American bank ratings at Moody's Investors Service: "Macroeconomic risks remain high in light of Mexico's sharp economic recession, where GDP is expected to shrink by around 7.5 percent in 2009, and nearterm recovery prospects are weak,

increasing the downside risks to bank activity. The economic recession continues to affect overall business volumes, and stagnant lending is now a clear pattern. We've witnessed a drastic reduction in loan underwriting this year, which combined with important government and corporate loan repayments, led to a modest annual loan growth rate of only 3 percent—a rather low mark compared to some 25+ percent of previous years. Loan contraction responds to scarce demand as a result of high levels of customer indebtedness, weak labor markets and lower consumer confidence overall, or the fact that enterprises find lower demand for their products. Lower lending activity also reflects a rather weak credit supply, indicating that banks are still largely reluctant to lend because they have found themselves forced to adopt stricter underwriting following a period of aggressive expansion into the consumer segment—and because they continue to deal with loan deterioration in a context where borrower credit quality is still worsening. Under such a scenario, we believe that Mexican bank earnings and asset quality performance will continue to be under pressure in 2010, but systemic stress seems unlikely because of banks' strong capitalization and reserves. We expect loan growth to remain below historical levels, in the single-digit range. This opinion mirrors our view of prolonged recessionary macroeconomics and may contrast with some banks' more optimistic growth estimates. "

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