Mexico tries to save the banks with a hyperinflationary bailout

by Carlos Cota Meza

The Mexican banking system came within a hair's breadth—again—of collapsing into generalized insolvency over the last four to six months. Official reports issued in early April matter of factly noted that the government had pumped $16 billion in *new* emergency funds into the banking system between October 1997 and February 1998.

This latest hyperinflationary bailout was executed through the government's Banking Fund for the Protection of Savings (Fobaproa). According to the Finance Ministry's spokesman, Marco Provencio, Fobaproa "grew by more than 45%, in nominal terms, between October 1997 and February of this year," purportedly to help out the country's "small depositors." This "nominal" amount converts to $16.3 billion, which Fobaproa, over a five-month period, forked over to the country's private banks, and their associated brokerage houses, so that they wouldn't go bankrupt during the period in which the misnamed "Asian crisis" made itself felt in Mexico.

These new monies come on top of the more than $48 billion which Fobaproa had previously sunk into purchases of bad commercial bank debt, stemming from the bank blowouts caused by the December 1994 explosion of the debt bomb in Mexico. Of the $100 billion or so in banking system assets which existed at that time, it now emerges that about 75% became non-performing: The bulk was taken over by Fobaproa, and the remainder was reorganized through the government's "UDI" and other bailout schemes.

So, once again, Mexico has become insolvent, and is facing the same problems which the Salinas de Gortari government faced, and which led to the great crisis of December 1994. Mexicans are now demanding to know: Who executed these latest bailout operations, with whom, and to what end? Somebody has to answer for Fobaproa's monstrous $65 billion debt, which amounts to 14.5% of the country's GNP.

Current account deficit

Let's start with the latest round of budget cuts. Depending on how you add them up, but using an exchange rate of 8.5 pesos to the dollar, what was cut out of the national economy over the last 90 days is something between $3.11 billion and $3.705 billion in spending. The size of this figure is no great mystery: The country's foreign debt service for the first quarter of 1998 was $4 billion, and Mexico had no way of paying it, after the country's oil income dropped by 35% over the same period.

What *is* a great mystery to the government of Ernesto Zedillo, is how it is going to cover the foreign debt service for the rest of the year, which is an additional $12 billion. Contrary to what most people assume, it is not the falling price of oil which is causing the insolvency of the Mexican economy. The drop in oil income is only revealing the debt-recycling operations which are at the root of the problem.

The government has admitted that the current account deficit for 1998 will be about $15 billion. But, judging by last year's trade balance, it is highly likely that the current account deficit for 1998 will end up closer to $22.5 billion, given the overall drop in exports (not only of oil) and the growing imports required by the border *maquiladora* (sweat-shop labor) plants.

Opening the dictionary of economic terms to the relevant page, we find: a current account deficit, broadly speaking, is made up of the sum of the trade deficit (imports greater than exports), plus the payment of interest on the foreign debt. The way in which a current account deficit is maintained, is by an equivalent flow of foreign capital which enters the country.

To address this problem, the Mexican government suddenly proposed a "financial package" in March, consisting of three pieces of draft legislation: 1) the Recovery of Assets law; 2) the Deposit Guarantee Fund law; and 3) legislation which grants the Banco de México, the country's central bank, greater autonomy.

The cornerstone of the package is the first item, the "Recovery of Assets" law, which is the equivalent of the desperate issuance of "Tesobonos" (dollar-denominated Mexican treasury notes) which the Salinas de Gortari government launched in March 1994, and which culminated in that year's debt explosion in December.

The "Recovery of Assets" consists of: a) the conversion of the obligations contracted by Fobaproa in the course of bailing out the insolvent banks, into domestic public debt—i.e., direct government obligations; and b) allowing foreign banks to purchase up to 100% of domestic banks.

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According to the draft legislation, the "consolidation" of Fobaproa's liabilities will add up to "532.3 billion pesos, as of Feb. 28, 1998." The same legislation specifies that (converting the official peso amounts into dollars at the exchange rate of 8.5 pesos per dollar) $42 billion of this is Fobaproa's, and $23 billion is due to the activities of the Stock Market Support Fund (Fameral). While Fobaproa was busy bailing out the banks, Fameral was bailing out the brokerage houses owned by the same banks. The combined total is $65 billion.

Wherein lies the similarity with the infamous "Tesobonos"? Fobaproa was created in 1990 as a trust fund administered by the Banco de México, whose mission was to grant "preventive support" to the banks, whose re-privatization was to be completed by July 1992.

This means that Fobaproa has always been a government entity. According to its own operational mechanisms ("purchase of loan portfolios," "capitalization program," etc.), through the 1995 bank bailout, the federal government became the main creditor of the Mexican banks. This is what was meant by the various comments that Fobaproa had "renationalized" the banking system.

So why take a trust fund, which from the outset was a government agency, and convert it into domestic public debt? How explain the fact that the federal government, by law, was converted from universal creditor to sole debtor? And indebted to whom? Whom is the federal government going to pay?

Who is being bailed out here?

According to various published accounts, allowing foreign capital to purchase up to 100% of Mexico's commercial banks, could bring in $10 billion, tops, to help cover the current account deficit. In order to attract that foreign capital, they are being handed the country on a silver platter.

The "Asset Recovery Commission" is being created so that it, in representation of the federal government as sole debtor, can carry out an auction of that domestic public debt, which, at a hypothetical interest rate of 20% per year, would lead to budgetary outlays on interest payments of 110.46 billion pesos ($13 billion). If the interest rate rises, so will the outlays. Foreign capital which purchases Mexican banks, or which already owns them, will be able to purchase that government paper, which, seemingly out of nowhere, has already been outfitted with an initial fund for the payment of interest, totalling more than $12 billion.

For 1998, the interest generated by this new domestic public debt (at a projected interest rate of 18-20%, which may well turn out to be much higher) amounts to four times this year's government budget cuts which were triggered by the drop in the international price of oil. So they cut the budget because they don't have money, but at the same time they have created a speculative bubble which is *n* times larger.

Hyperinflation!

There is a further aspect of the scandal, which *EIR* has under investigation. According to various Mexican press accounts, $26 of Fobaproa's $65 billion in debt came from buying up the non-performing loans of only 550 individual accounts (either individuals, or companies). If $26 billion was spent on 550 accounts, then the average amount of each of those accounts was . . . $50 million! Everything points to the fact that, it is not the "small depositor" who is being bailed out here, but rather the Mexican banks, the foreign creditors of those same banks, *and the nouveaux riche of the Salinas de Gortari era,* who have highly questionable reputations, to say the least, and who were the beneficiaries of loans (and illegal "self-loans") from Mexican banks.

Discovering the addict

In February 1995, when the December 1994 financial meltdown was supposedly under control, President Ernesto Zedillo announced a program of privatizating petrochemical plants, ports, airports, and railroads, which supposedly was going to generate $12 billion in revenue. At the same time, Zedillo asserted that the Salinas government had not only underestimated the current account deficit, but that it had mistakenly financed that deficit with "short-term financial instruments."

Zedillo announced that his administration, on the contrary, would "prudently manage" the current account, promote an "increase in domestic savings to finance the economy," and facilitate the entry of longer-term "foreign direct investment" into Mexico.

Leaving aside the question of what has actually been accomplished by that failed privatization program of 1995, the big question is: Where did today's current account deficit come from? To talk about a current account deficit of about $15 billion, is to be back at the levels of 1993. If that deficit grows to $22.5 billion in 1998, we're back in the ballpark of the $28 billion deficit Mexico had in 1994.

If the current account deficit of the Salinas de Gortari government was financed with highly speculative capital inflows coming from a short-term capital market which was investing in short-term instruments in an "emerging market," how, when, and by whom did this addiction reappear?

The addict is Fobaproa. To bail out the commercial banks, this agency took in short-term capital, at high interest rates, and of questionable origins. And the person who ran Fobaproa was none other than Miguel Mancera Aguayo, who resigned as governor of the Banco de México on Dec. 31, 1997.

When the federal government, by virtue of the "Asset Recovery Law," declared itself the sole debtor, it was simply recognizing that it will pay the bill for an operation similar to that of the Tesobonos of 1994. This is the legacy which Miguel Mancera Aguayo has left his prize pupil, Ernesto Zedillo.