CHAPTER 2

Mexican Banks Go Abroad

In the early 1970s, when major US and European banks and other financial institution from around the world were operating in London and involved in Euromarket activities, Mexican banks had virtually no presence in the world capital markets. However, the first London-based consortium bank with Mexican ownership, the Eulabank, was founded in 1972 and two more, the Libra Bank and Intermex, were created over the next two years. With these institutions, which were established in partnership with some of the world's most prominent banks, Mexican banks made their way into international finance and learned a great deal about foreign banking and the business opportunities that they could develop in the Euromarkets. The participation in consortium banks gave Mexican financial institutions a first direct contact with foreign finance but also with a flavor of the potential benefits that they could derive from engaging in international lending and the petrodollar recycling process.

This chapter is concerned with the reasons why Mexican banks went abroad and the forces driving their increasing involvement with international finance between 1972 and the financial fallout of 1976. After decades of development and increasing penetration in the domestic economy during the postwar period, the Mexican banking sector suffered a drawback in the early 1970s and the volumes of assets and its broader intermediating capacity dramatically shrank since 1972. These were years of major changes in the international economic and financial order and also at a domestic level in Mexico, with inflation becoming

S. Alvarez, *Mexican Banks and Foreign Finance*,
https://doi.org/10.1007/978-3-030-15440-0_2

a raising problem in a country that had long lived with strong economic development coupled with price and foreign exchange stability. For an incumbent administration with policy goals largely focused on improving income distribution through an increasing participation of the public sector in the economy, financing was necessary, and indeed an indispensable element, to carry out the government program. Particularly so in a context were large oil reserves were being discovered in Mexico and huge amounts of investment were needed to exploit them.

A combination of external and domestic factors was at the base of the decision of the largest banks of the country to go international. On the one side, the rise of international liquidity and the increasing involvement of foreign banks in lending to developing countries and particularly to Mexico put pressures on a domestic banking sector with limited capacity to supply credit. On the other hand, in a context of strong economic development and growing macroeconomic imbalances, the need of financing of the Mexican government and to a lesser extent the private sector were great, and they could borrow abroad what they could not fund domestically. The discussions of the Executive Committee of Banamex, one of the largest private financial institutions and a pioneer in Mexican international finance, show the central role that the domestic financial difficulties confronted by the domestic banking industry along with the increasing competition to foreign bank lending played in the decision of the bank to look beyond the national boundaries and get involved in the Euromarkets.

The incursion of Mexico's three largest private banks in the Euromarkets through their associated consortium banks proved a successful experience. In only a few years after their creation, all three Mexican consortium banks have managed to expand the volume of their assets in a considerable way and to engage in profitable international lending operation through the Euromarkets. Intermex, in particular, developed into an important player in intermediating foreign capital with Mexican borrowers, with government development banks eventually buying shares and thereby becoming also owners of the bank. In end-1976, when the peso was devalued after decades of fixed parity with the dollar, the international activities of Mexican banks concerned mainly its consortium banks and they had only small amounts of foreign liabilities in their balance sheets. Unlike what would occur six years later, the impact of the crisis did not represent a major shock to the domestic banking system.

The Historical Context of Mexican Banking

The modern Mexican banking system was formed during the decades following the revolution in a context of political and economic reorganization and reconstruction of the country. The Mexican Revolution that started in 1910 and extended over the decade was a major event in the Mexico's economic history and represented a break with respect to the old financial order. The banking industry, which had consistently grown and developed during the previous regime of Porfirio Diaz, was wiped out with the economic crisis that followed the outbreak of the revolution and remained in a state hibernation for a long period even after the end of the conflict and the restoration of political stability.[1] Between 1925 and 1941, the government initiated a process of financial redesign that allowed the banking sector to take off again and rebuild its presence and role in the national economy.

One fundamental piece in the new institutional framework of the financial system was Banco de Mexico, the country's central bank. Banco de Mexico was founded in 1925 with a Board of Directors comprising representatives chosen from both the public and private sectors. Although with limited monetary and regulatory functions in the years after its creation, it progressively gained modern central banking capacity and became the institution at the center of the financial system over the following decades.[2] Additionally, the Secretary of Finance had created the previous year the Comisión Nacional Bancaria (National Banking Commission), later renamed Comisión Nacional Bancaria y de Seguros (CNBS), as the supervisory agency for the banking sector. Its main purpose was to work as an auditing organization to inspect banks, collaborating with the central bank in the monitoring and regulation of the banking industry.

The Banking Law of 1941 was the second institutional pillar of the new financial system. A number of laws and regulations has been passed in the previous decades, such as the *Ley General de Instituciones*

[1] See Luis Anaya Merchant, *Colapso y reforma la integración del sistema bancario en el México revolucionario 1913–1932* (Zacatecas, 2002); Gustavo del Angel and Carlos Marichal, 'Poder y crisis: historiografía reciente del crédito y la banca en México, siglos XIX y XX', *Historia Mexicana* LII (2003), 677–724.

[2] On the origins and history of Banco de Mexico, see Eduardo Turrent Diaz, *Historia del Banco de México* (Mexico City, 2015); Ernesto Fernández Hurtado (Ed.), *Cincuenta Años de Banca Central: Ensayos Conmemorativos, 1925–1975* (Mexico City, 1976).

de Crédito y Establecimientos Bancarios of 1924 or the *Ley General de Instituciones de Crédito* of 1932 that superseded, but it was the promulgation of the *Ley General de Instituciones de Crédito y Organizaciones Auxiliares* in August 1941 what gave the banking system its final and definitive structure.[3] It established a model of specialized banking that ruled the banking industry until the mid-1970s, when the legislation went through its first substantial modification. Under pretty much the same spirit as the Glass-Steagall Act of 1933 in the USA, this law created different types of financial intermediaries, each one with a specific set of operational boundaries in terms of their funding and lending activities as well as other regulatory instruments such as reserve requirements.

Within this legal framework, commercial banks emerged as the most important domestic financial intermediaries.[4] The law provided these banks with the authority to receive sight and time deposits from the public and firms, while allowing them to grant credits with restriction on the maturity terms, especially regarding operations of more than one year. Commercial banks could also rediscount commercial papers as well as grant letter of credits and hold securities, but they were forbidden some operations such as mortgage loans, for example, a type of financing that was under the explicit legal responsibility of the so-called Mortgage banks. There were also *financieras*, a kind of investment or industrial bank and the second most important financial intermediary in Mexico, which could raise funds through bonds and lend with greater flexibility and longer maturity terms than commercial banks. Along with these institutions, the other, less important, financial firms defined by the 1941 banking law were thrift institution, trust organizations, clearing houses and credit unions among others.

Despite the strict segregation of financial activities by type of institution, commercial banks managed to enlarge the scale of their operations beyond the original grant of authority. They were usually affiliated with other financial intermediaries to expand the variety of financial services they could offer and provide products that were restricted to them by law. Thus, for instance, a bank interested in engaging in

[3] Gustavo del Angel, 'Paradoxes of Financial Development: The Construction of the Mexican Banking System, 1941–1982', Unpublished PhD diss., Stanford University, 2002, 63–85.

[4] Ibid., 86–110.

long-term financing would typically associate with or create a *financiera*, supply it with funds through interbank transfers, which the *financiera* could then use to grant the credit with greater ease. A similar principle and modus operandi were applied by banks willing to get involved in mortgage loans, issuing securities or providing insurance services. They would develop such activities through the entity allowed by the law to operate in these markets and work out internal funding arrangements with them. As a result, although these institutions were separate legal entities and had their own balance sheet, they were connected to each other through financial transactions and interlocking directorates, integrating the so-called '*grupos financieros*' (financial groups), which in many cases were, in turn, part of larger economic groups or business conglomerates.[5]

Two private banks emerged as the major financial institutions of the country during the period of reconstruction and consolidation of the modern Mexican banking industry. One was Banco Nacional de México, otherwise known as Banamex. Established in 1884, as a result of the merger between Banco Mercantil Mexicano and Banco Nacional Mexicano, the bank had acted as the main financial agent of the government of Porfirio Diaz with important monetary functions. It was reconstructed after the revolution under the command of the Legorreta family, expanding its network of branches all over the country and becoming a leading institution of the banking sector. The bank was at the head of Grupo Banamex, one of the largest financial groups of the country, which included Financiera Banamex, the second investment bank of Mexico, along with other financial institutions, such as the mortgage bank Financiera de Ventas Banamex or the insurance company Seguros América Banamex. During this period, even when they were minority shareholders, the Legorreta family kept the Directory of the bank and the control of the administration of the group.[6]

[5] On the relation between business groups and banks, see Gustavo del Angel, 'The Nexus Between Business Groups and Banks: Mexico, 1932–1982', *Business History* 58 (2016), 111–28; Ruber Chavarin Rodriguez (Ed.), *Banca, grupos económicos y gobierno corporativo en México* (Mexico City, 2010); Nora Hamilton, *México: los límites de la autonomía del Estado* (Mexico City, 1983).

[6] Banco Nacional de Mexico (2004). *Banco Nacional de México: su historia, 1884–2004.* Leonor Ludlow, 'La formación del Banco Nacional de México: aspectos institucionales y sociales,' in Leonor Ludlow and Carlos Marichal (Eds.), *La Banca en México, 1820–1920* (Mexico City, 1998), 142–80.

Banco de Comercio, also called Bancomer, was the other leading commercial bank in Mexico. Created during the early 1930s in Mexico City, the bank would quickly expand its activities to the national level, becoming a major actor in the banking industry and the main competitor of Banamex.[7] In 1955, Manuel Espinosa Yglesias came to the Presidency and centralized the corporate control and management of the bank and its affiliates in his figure. He then founded Financiera Bancomer along with the mortgage bank Hipotecaria Bancomer and the insurance company Aseguradora Bancomer, and later on the leasing company Arrendadora Bancomer and the brokerage house Casa de Bolsa Bancomer, becoming the second largest financial group in the country. Grupo Bancomer, as was also the case for Grupo Banamex, was not controlled by any other specific group or economic conglomerate, an atypical situation since most of the banks in the country maintained a close relationship with larger proprietary groups. They had, however, ownership links with other companies or industrial groups through cross-holding of equity stakes and interlocking directorates.

Mexico's third largest commercial bank was Banca Serfin. Created in 1977, the bank resulted from the merger of Banco de Londrés y México, the oldest Mexican commercial bank founded in 1864, with three other regional banks and *financieras* that were part of Grupo Serfin. This financial group was associated with Grupo Alfa and CyDSA, the two largest industrial groups in Mexico, which in turn belong to a network of larger business conglomerates in northern Mexico, the Grupo Monterrey, under the control of the Garza Sada family. The Banco Comercial Mexicano, that would later become Multibanco Comermex, was another large bank established in the post-revolutionary period to fulfill the needs of a particular economic conglomerate, the Grupo Chihuahua of the Vallina family, of which it became the leading financial arm. A similar relationship existed, for instance, between Grupo Peñoles and Banca Cremi, ICA and Banco del Atlántico, and Vitro and Banpais, in which the banks were at the center of the financial units of the group that usually included several others financial intermediaries.[8]

During the post-war era, as Mexico entered into a period of sustained economic growth, the banking sector grew and gradually consolidated its

[7] Gustavo del Angel, *BBVA-Bancomer. 75 años de historia* (Mexico City, 2007).

[8] Chavarin Rodriguez, *Banca*, 33–55.

position in domestic financial intermediation. Between 1974 and 1970, as documented by Gustavo del Angel, the number of financial firms and branches increased considerably, an expansion that was particularly remarkable in the case of commercial banks and *financieras*.[9] The development of the banking sector came along with an increasing amalgamation of financial firms and a reconfiguration of their links with business groups and economic conglomerates. This process of consolidation and integration of intermediaries within financial groups, which were recognized as distinct legal entities in December 1970, led to increasing integration and concentration of the banking industry into a small number of larger institutions. This process was strengthened with the multiple bank reform of the mid-1970s and the promotion of mergers among domestic financial institutions by Mexican authorities, which resulted in a reduction of the number of banks in the system and the consolidation of the leading position of the country's largest banks.[10]

As for international financial institutions, their activities and participation in the Mexican banking market were strictly limited by the law. Unlike during Porfirian times when foreign banks have a strong presence in Mexican finance, the system reconstructed in the aftermath of the revolution was almost entirely national. With the Law of Banking Institution of June 1932, foreign banks were legally prohibited from having branches and operating in Mexico, although they could maintain representative offices. Citibank was the main exception with full branch facilities and commercial banking activities in the country. The presence and activities of foreign banks nevertheless remained relatively discreet until the late 1960s, when they began to open offices and engage in lending activities in Mexico.[11] The number of representative offices of foreign banks expanded vigorously in the 1970s, growing from 26 in 1969 to approximately 140 in the late 1970s.[12] Although not permitted to collect savings from the public they, could associate with national banks and leverage this network of correspondent banks to conduct business in Mexico.

[9] Del Angel, 'Paradoxes', 88–92.

[10] Ibid., 152–201.

[11] Edmundo Sánchez Aguilar, 'The International Activities of U.S. Commercial Banks: A Case Study: Mexico', Unpublished PhD diss., Harvard University, 1973; Del Angel, 'Paradoxes', 139–48.

[12] Sylvia Maxfield, *Governing Capital: International Finance and Mexican Politics* (New York, 1990), 98.

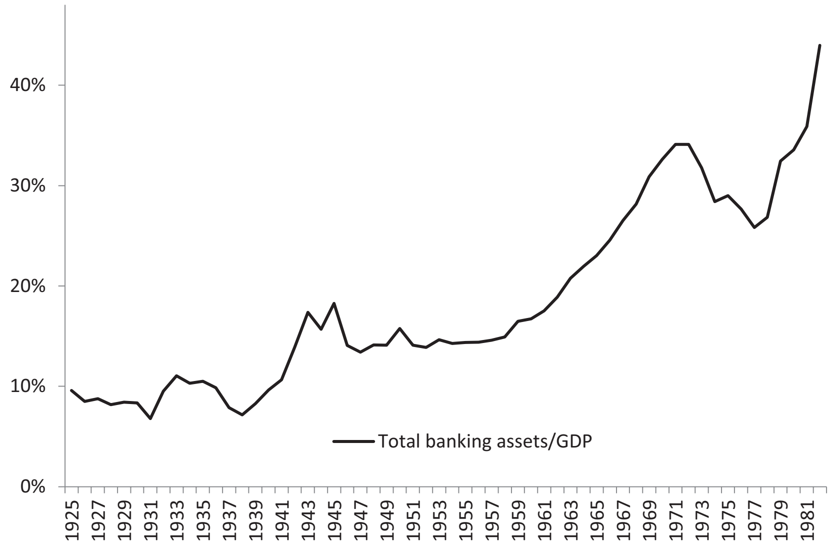

Fig. 2.1 Evolution of the Mexican banking sector, 1925–1982 (*Source* INEGI, *Estadísticas Históricas de México* [Aguascalientes, 1985])

The Financial Disintermediation Years

Following its redesign and reconstruction in the post-revolutionary decades, the Mexican banking sector entered a new phase of growth and increasing penetration in the domestic economy. Figure 2.1 shows the extent to which the banking industry developed and enlarged its financial activities during the postwar period. Between the late 1950s and early 1970s, at a time when the Mexican economy experienced a remarkable expansion, the banking sector deeply penetrated the national economy and strengthened its role in the economic development of the country. While in 1958, total assets of private financial intermediaries represented approximately 15% of the GDP or US$1.5 billion, by the end of 1972 they reached as much as 34.1% or US$15.3 billion.

The rise of Mexican banking activities came, however, to a halt in the early 1970s. After the historic peak in 1972, the total assets of the banking system progressively diminished as percentage of the GDP until 1977 when it reached 25.8%. The shrinking of banking assets in the national economy was part of a broader trend in Mexico toward a reduction of intermediation levels within the domestic financial system, a phenomenon that Mexican scholars have identified as the "financial disintermediation process".[13] At an aggregate level, while total financial assets of the public and private sectors represented 27.4% of the GDP in the period 1960–1965, reaching 35.6% in 1966–1970 and up to 43.5% in 1972, they started to fell since then until about 30% in 1977.[14] For commercial banks, as well as the other financial institutions, the reduction of the holding of financial assets by the Mexicans private and public sector in relation to the evolution of the economic activity meant a contraction of their financial intermediation capacities.

In effect, the collection of deposits by the commercial banking system as a percentage of the Mexican GDP grew up to 1972 and decreased afterward. Computations by José Manuel Quijano show that during the period from 1956 to 1960 and 1964 to 1970, while commercial banks' domestic funding increased, respectively, by 10.2 and 18.1% annually in real terms, the average annual growth rate between 1971 and 1978 was a much more modest 1.7%.[15] In similar lines, Edward Buffie and Allen Sanginés-Krause estimate that the total stock of real bank funds fell 13.3% from 1973 to 1976.[16] By 1971–1972, about 93% of the banks' funding base consisted of local deposits and savings from the private and public sector, 4% were transactions between domestic financial institutions and the remaining 3% was made up by other domestic liabilities.[17] In a context where the Mexican economy expanded at an annual rate of

[13] See, in particular, José M. Quijano, *México: estado y banca privada* (Mexico City, 1987), 170–80, and 'El financiamiento al sector industrial: diagnóstico y propuesta de política', *Investigación Económica* 43 (1984), 137–97; Edgar Ortiz, 'La banca privada en México: formación de capital y efectos de la inflación-devaluación', *Comercio exterior* 31 (1981), 27–38.

[14] María E. Cardero, José M. Quijano, and José L. Manzo, 'Cambios recientes en la organización bancaria y el caso de México,' in José M. Quijano (Ed.), *La banca: pasado y presente* (Mexico City, 1983), 161–220.

[15] Quijano, *Estado y banca*, 177.

[16] Edward Buffie and Allen Sanginés-Krause, 'Mexico 1958–86: From Stabilizing Development to the Debt Crisis,' in Jeffrey D. Sachs (Ed.), *Developing Country Debt and the World Economy* (Chicago, 1989), 141–68.

[17] Banco de Mexico, 1972 Annual Report, Table 20, 73.

5.6%, this liability structure and weak fundraising performance implied a relative decline in the financial resources available to banks.

Archival records from Banamex, the institution responsible for about a quarter of the deposit base of the banking system, witness the difficulties that banks confronted in terms of domestic financial resources. During their weekly Wednesday meetings, the members of the Executive Committee discussed about the financial situation of the bank and periodically addressed the issue of the evolution of its funding base. As of August 1971, Banamex's General Director Agustin Legorreta reported that "[their] cash resources [were] nearly exhausted and that given the slow uptake of resources it [was] not possible that the situation [could] improve in the near future." He also mentioned that "the situation was not exclusive to [their] bank, but general to all the credit institutions of the country, particularly affecting small institutions, which have been failing to meet their legal deposits."[18] During the next years, the fundraising difficulties of the banks worsened, becoming a matter of considerable concern also for the national financial authorities, who reformed the Banking Law in December 1973 as to authorize Banco de Mexico to "equip the Mexican banking system with more and more flexible fundraising instruments." The purpose was, as its General Director Fernández Hurtado stated, to "provide domestic savers with a wider range of investment opportunities (…) and try to encourage fundraising (…) giving the Mexican banking system a more competitive position."[19]

The causes of the bank's domestic fundraising problems are to be found in the inflationary process that the country experienced along with the interest rate policy followed by the central bank. After a long period of relative price stability during the so-called era of "stabilizing development"—*desarrollo estabilizador*—between 1954 and 1972, inflation started to grow in the early 1970s and became a real problem since 1973. Inflation rates, which had oscillated between 2 and 5% during the 1960s, passed from 5.6% in 1972 to 21.4% in 1973 and to 20.7% in 1974 and kept at high levels over the following years. The devaluation of the US dollar after the end of Bretton Woods and the rise of the price of oil and other raw material products along with domestic factors,

[18] Banamex archive, Libro No. 2 de Actas de la Comisión Ejecutiva, August 11, 1971 Meeting.

[19] Banco de Mexico archive, Acta No. 2406, February 1974.

such as expansionary monetary and fiscal policies and some bottlenecks in the production structure, generated significant inflationary pressures in Mexico. In addition, unlike during the stabilizing development years, the fiscal and monetary policies adopted by the Echeverria and Lopez Portillo administrations between 1972 and 1982 were highly expansionary, fueling demand and the climb up of prices.[20]

For commercial banks, high and rising inflation was a problem to the extent that they were not allowed to adjusting interest rates on deposits and saving instruments upwards. In Mexico, as in many other Latin American countries, this was a period of heavy financial regulation, or domestic *financial repression*, and interest rates were not market-determined, but instead, established by the monetary authority. During the period of stabilizing development, when inflation was low, Banco de Mexico adjusted interest rates from time to time on an irregular basis as to maintain real deposit rates at positive levels. The management of interest rates did not change, however, in the new context of increasing inflation of the early 1970s. Nominal rates were only occasionally modified and with delay, remaining fixed for long periods, which implied that real interest rates became usually negative. Figure 2.2 shows this shift with nominal interest rates consistently below inflation rates after 1972, the last year with positive real interest rate. Negative real yields discouraged the public from saving and placing deposits with the banking system, thereby eroding its funding base and intermediating capacity.

A main implication of the fundraising difficulties confronted by the banks was the deterioration of their lending capacities. The ability of banks to lend was additionally affected by the changes introduced by Mexican financial authorities in reserve requirement regulations, which was one of the most important instruments of monetary policy in Mexico. Several increases to the reserve ratios were indeed passed by Banco de Mexico between 1970 and 1976 in order to mitigate the inflationary effects of a monetary base under continuous expansion.[21] Besides, since end-1975 and early-1976 the banking system experienced a considerable growth of the dollar-denominated liabilities, which were

[20] Carlos Bazdresch and Santiago Levy, 'Populism and Economic Policy in Mexico, 1970–1982,' in Rudiger Dornbusch and Sebastian Edwards, *The Macroeconomics of Populism in Latin America* (Chicago, 1991), 223–62.

[21] See, for instance, Banco de Mexico archive, Acta No. 2410, October 1974.

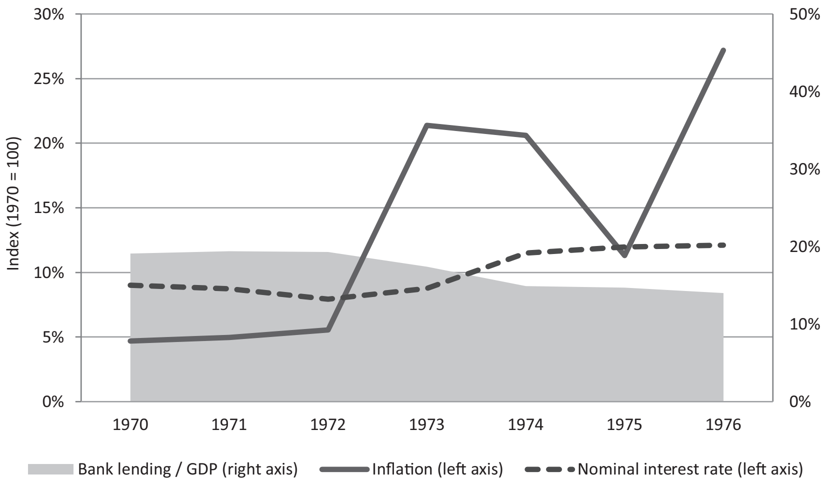

Fig. 2.2 Bank lending and real interest rates, 1970–1976 (*Source* Banco de Mexico's, Annual Reports [several issues])

subject to higher legal reserve requirements and thereby further contributed to the reduction of loanable funds.[22] As a result of these events, as represented in Fig. 2.2, the credit portfolio of the banks passed from representing around 19.1–19.4% of the GDP between 1970 and 1972 to 17.4% in 1973 and 14% by end-1976, a loss of 25% or 5 percentage points of the GDP in only four years.

For Mexican banks, as Banamex' General Director pointed out, the lack of funding was exacerbated in a context in which the demand for credit that banks faced from both the government and the private sector was raising. On the one hand, "many clients that [had] not normally used their credit lines [were] making use of them and others that normally did not resort to credit [were] demanding and it [was] difficult to deny it when they [had] kept strong deposits [in the bank] for years." On the other hand, "the public sector [was] increasingly urged of funds for the accomplishment of its projects and [was] exerting strong

[22] Banco de Mexico archive, Acta No. 2422, April 30, 1976.

pressures on the credit institution for obtaining them."[23] In acknowledgment of this situation, Banco de Mexico opened a rediscount line to commercial banks with "the purposes of, in the first place, reactivating the economy, and second, to compensate [them] for the lack of growth of the deposits."[24] This program, however, would not be enough to meet the strong demand for credit in Mexico, and Banamex as well as other commercial banks had to eventually restrict their lending.

Bank Finance and Development

The diminishing lending capacities and broader retrenchment of the domestic banking sector were problematic within a framework of strong expansion in the domestic economy. As of the early 1970s, Mexico was transiting a process of steady and long-term economic growth that had started in 1935 after the period of reconstruction and reorganization that followed the revolution of 1910. During those years, the country passed from being an agrarian and rural economy into a predominantly urban and industrial one, and domestic commercial banks, along with the national development banks created during the decades of the 1920s and 1930s, had an important role in the transformation.[25] This process was imbedded in the developmentalist strategy and import-substitution industrialization (ISI) policies of the Mexican government, as part of what Luis Bértola and José Antonio Ocampo call the state-led industrialization development, and financing was a crucial element of the program.[26]

Indeed, the years of the Echeverria presidency during the first half of the 1970s were of particularly strong economic growth. Following a brief slowdown of economic activity in 1971 due to temporary contractionary

[23] Banamex archive, Libro No. 2 de Actas de la Comisión Ejecutiva, August 11, 1971 Meeting.

[24] Banamex archive, Libro No. 2 de Actas de la Comisión Ejecutiva, November 3, 1971 Meeting.

[25] See, for example, Enrique Cárdenas Sánchez, *La política económica en México, 1950–1994* (Mexico City, 1996), and *La hacienda pública y la política económica 1929–1958* (Mexico City, 1994); Rafael Izquierdo, *Política hacendaria del desarrollo estabilizador, 1958–70* (Mexico City, 1995).

[26] Luis Bértola and José A. Ocampo, *The Economic Development of Latin America Since Independence* (London, 2012).

measures, the Mexican GDP expanded by 8.5 and 8.4% in 1972 and 1973, respectively, and at an average growth rate of 5% during the period 1974 and 1976. This was a period of substantial aggregate demand increase underpinned by dramatic expansionary fiscal and monetary policies. In a context of a popular rejection to the economic strategy of the stabilizing development, the Echeverria regime adopted a "share development" approach based on an increasing participation of the government in the economy to improve income distribution and the development of areas where private investment was not forthcoming.[27] Between 1972 and 1976, current expenditure by the public sector grew at an average annual rate of 14.2% in real terms and the share of total public expenditure in the GDP increased from 22.9 to 32% over the period.

The flip side of the vigorous expansion of the Mexican public sector was the increasing need for funding. A salient feature of this process was that, despite a small one-percent-rise of the sales tax rate at the beginning of the Echeverria administration, the increase of public expenditure occurred without passing any significant tax reform.[28] Between 1970 and 1976, the revenues of the Mexican public sector grew from 18.9 to 23.8% of the GDP and about two-thirds of this increase came for oil, which became an important source of revenues for the Mexican government with the rise of exports in the 1970s. This increment in revenues was, however, insufficient to match the buildup in spending previously described, which is reflected in the increasing fiscal imbalance experienced by the public sector. The fiscal deficit climbed from 2.3% of the GDP in 1971 to 6.3% in 1973, reaching as much as 9.3 and 9.1% by 1975 and 1976, respectively. Part of these deficits was financed by borrowing from Banco de Mexico as well as through the seigniorage revenues derived from escalating inflation, but it also entailed an increase of the demand for credit from other sources and financial institutions.

The domestic banking sector was an important provider of fund for the Mexican public sector. At that time, there were not Treasury bonds in Mexico—*Certificados de la Tesorería* or Cetes would be introduced toward the end of the decade, and the main mechanism that the government used to access public savings was through the legal reserve requirement system, which consisted of a very complex regulation

[27] Bazdresch and Levy, 'Populism and Economic Policy', 237–46.

[28] Ibid.

structure with different fundraising instruments subject to different ratios or coefficients. The funds that the banks set aside and deposited with Banco de Mexico where then channeled to specific credit programs according to regulatory procedures or lent to the Treasury to finance the public-sector deficit. However, in the midst of the financial disintermediation process and the poor performance of bank deposits of the post-1972 years, the reserve channel provided virtually no additional resources despite the fact that the ratios increased by about 63.2% on average over the period.[29] On the contrary, the funds available to finance the government through the reserve requirement system decreased since 1973, both in real terms and as a share of the GDP.[30]

Under such circumstances, the Mexican government was to increasingly seek for more direct financial assistance and credit lines from the domestic banking sector. By way of example, in August 1973, Legorreta reported a conversation with Banco de Mexico's General Director Fernández Hurtado concerning the financial needs of the Federal government, which were estimated in 2 billion pesos (approximately US$160 million) for the rest of the year. After dismissing the possibility of increasing reserve requirements, Fernández Hurtado requested financing from the banks, to which Legorreta proposed to prorate this amount among the six largest banks of the country. He requested the authorization of the Committee to confirm the contribution of Banamex—estimated in about 500 million pesos or US$40 million, indicating that "on the one hand it represent[ed] serious problems [for Banamex], but, on the other, not accepting could lead the country to other more serious consequences."[31] At a sector level, credits to the government doubled its participation in the loan portfolio of the banking system from 24.2 to 41.9% between 1970 and end-1976, which illustrates the heightening role of domestic banks in financing the public sector.[32]

However, the lending capacities of a banking sector in funding difficulties were to prove largely insufficient to meet the overwhelming financial needs of the Mexican economy. On the one hand, the flow of bank lending to the government as a share of the GDP increased between

[29] Buffie and Sanginés-Krause, 'Mexico 1958–86', 146.

[30] Quijano, *Estado y banca*, 143–52.

[31] Banamex archive, Libro No. 5 de Actas de la Comisión Ejecutiva, August 29, 1973 Meeting.

[32] Banco de Mexico, Annual Reports (several issues).

1970 and 1973 when it reached its maximum value of 6%, decreasing during the following years up to 4.7% in 1976. In real terms, after a last increase in 1973, bank lending to the Mexican government fall between 1973 and 1976 at an average annual rate of 4%.[33] On the other hand, although the public sector was the largest demander of funds during this period, banks also faced a rising demand for credit from the private firms. Within a process of strong economic growth, the business opportunities and investment needs of the non-public sector also grew, with many of the most important private companies and business groups of the country, such as VISA or the Alfa Industrial Group, considerably expanding their scale of operations and indebtedness levels.[34]

In the context of rising demand for credit and insufficient domestic supply, the financing that domestic banks were not able to provide came to be supplied from abroad. Data on public external debt compiled by Rosario Green shows that the recourse to foreign borrowing by the Mexican government started to accelerate vigorously beginning in 1973. While between 1970 and 1972 the Mexican public sector had raised US$2.08 billion in the international capital markets, in 1973 alone, it borrowed US$2 billion, and as much as US$12.5 billion during the following three years.[35] In other words, in each successive year between 1973 and 1976, the Mexican public sector took on five times more foreign loans than during the entire 1970–1973 period. Figure 2.3 plots the amounts borrowed by the Mexican government abroad along with the evolution of the GDP and the ratio of domestic bank lending to GDP measured in terms of index. The chart makes evident the increasing recourse to foreign finance as opposed to the decreasing lending capacity of domestic banks and high economic growth in Mexico.

The bulk of the foreign financing that flowed into Mexico came from international banks operating in the Euromarkets. Although the country had been borrowing abroad prior to the early 1970s, the boom in international lending began in earnest, as Fig. 2.3 illustrates, at the

[33] Quijano, *Estado y banca*, 143–52.

[34] Roberto Gutierrez R., 'El endeudamiento del sector privado de México. Expansión y negociación', *Comercio exterior*, 36 (1986), 337–43.

[35] Rosario Green, *Lecciones de la deuda externa de México, de 1973 a 1997: de abundancias y escaseces* (Mexico City, 1996), Table I.12, 42. See also Romeo Flores Caballero and María de los A. Moreno, 'El endeudamiento externo de México, 1970–1974', *El Trimestre Económico* 43 (1976), 805–17.

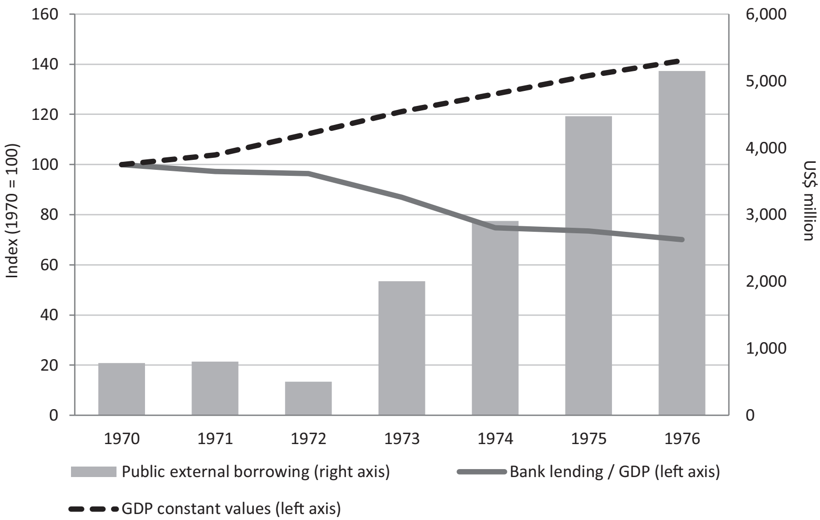

Fig. 2.3 Economic growth and domestic versus external financing (*Source* GDP and Bank lending: Banco de Mexico's, Annual Report [several issues]; Public external borrowing: Green, *Lecciones de la deuda externa* [see text])

time of the oil shock of 1973 and took off of the petrodollar recycling process. Mexico was an attractive destination for international commercial banks, not only because of its impressive record of economic growth over the last decades, but also because of its political stability under the PRI party and the monetary discipline reached during the previous stabilizing development regime. In addition, important oil fields had been discovered after 1972, allowing the country to pass from being a net importer of crude and its derivatives to become a net exporter by 1975, which reinforced the confidence of foreign investor in Mexico as a creditworthiness borrower. The radical change and increase in the supply of foreign funds to Mexico along with a strong demand of credit and the lack of domestic bank funding converged to mark a turning point in the country's external indebtedness process as of 1973.[36]

[36] See Secretaria de Hacienda y Crédito Público, *Deuda Externa Pública Mexicana* (Mexico City, 1988).

The Decision to Internationalize

The increasing role of international commercial banks in lending to Mexico became an important threat for the domestic banking industry. The high amounts of petrodollar liquidity available to banks operating in the Euromarkets that could be lent to clients in developing countries led to an increase in competition with new foreign players entering into a domestic market eager for financing. For Mexican banks, which were in the phase of financial disintermediation, the increase in competition implied the possibility of a loss of market share to foreign institutions in terms of lending to both the public and private sectors. In the case of leading domestic commercial banks like Banamex and Bancomer, which were at the head of the most powerful financial groups of the country, this situation did not only affect lending interests but their economic and business position more generally.

The archival records of Banamex provide a clear illustration of how Mexican bankers perceived and reacted to the new environment. In early 1972, there were already some important worries among the members of Banamex's Executive Committee about the lending difficulties of the bank in a context of increasing supply of credits from foreign banks. As Agustin Legorreta explained to his colleagues, "with the economic development of the country and the constant creation of big industrial companies, such as Fundidora de Hierro y Aceros de Monterrey S. A., Celanese Mexicana S. A., Industria Eléctrica de México S.A. and others, more and more often we found ourselves faced with the impossibility of meeting the demand for credit with domestic resources."[37] In the eyes of Legorreta, the weak lending capacity of the bank was problematic because foreign banks were ready to provide the funding the country was demanding to finance its economic development in considerable amounts and at more competitive rates. Additionally, unlike domestic lending, international loans were not regulated and thereby foreign banks enjoyed from much greater flexibility to grant credits than Mexican banking law allowed to the institutions operating inside the country.

[37] Banamex archive, Libro No. 3 de Actas de la Comisión Ejecutiva, February 9, 1972 Meeting.

Under such circumstances, the alternative available to Mexican banks was to turn towards the international capital markets and looked to what their foreign counterparts were doing. Banamex, a pioneer and leading institution in Mexican international finance, had had a first experience in international lending and Euromarket deals already in the early 1970s. In 1971, it participated with US$2 million in a syndicated Euroloan of US$100 million to Nafinsa and Banobras, the two big Mexican development banks. The credit was jointly granted with N. M. Rothschild & Sons, Rothschild Intercontinental Bank and Bancomer, the other leading Mexican bank involved with foreign finance.[38] In September of that year, Banamex's Executive Committee approved the participation of the bank, up to a maximum of US$1 million, in a new syndicated deal of US$20 million to Banobras, an operation arranged and managed by Bank of London and South America (BOLSA). Banamex was the only Mexican institution invited to take part of this deal, and the Committee considered that, for reputational reasons, it was important to participate in this kind of operations with foreign institutions to finance the public sector.[39]

However, to face competition from foreign banks and to engage in international lending, Mexican banks needed a volume of funds that they could only find abroad, namely in the Eurocurrency markets, and that required for international presence. Up to that point, as Agustin Legorreta explained, "all the businesses in which Mexican banks have intervened to finance large companies in the country with resources from abroad have been promoted and arranged by large American banks such as the Chase Manhattan Bank and the Bank of America," and "Mexican banks [were] undoubtedly not in a position to displace those large foreign banks, and [had] to limit themselves to taking small shares in these operations." To him, "the economic development of the country made Mexican banks feel the increasing need to turn the eyes toward the international currency markets, because if they do not intervene in them, they would be condemned to be a mere supplement to foreign

[38] Banamex archive, Libro No. 2 de Actas de la Comisión Ejecutiva, September 22, 1971 Meeting; Sergio Negrete Cárdenas, 'Mexican Debt Crises: A New Approach to Their Genesis and Resolution', Unpublished PhD diss., University of Essex, 1999, Table B14, 361.

[39] Banamex archive, Libro No. 3 de Actas de la Comisión Ejecutiva, September 22, 1971 Meeting.

banks."[40] It is within this particular juncture of poor domestic funding and rising competition from foreign banking institution that Mexican banks decided to go abroad and step into the Euromarkets.

Banamex's Executive Committee considered three possible ways to enter and intervene in the Eurodollar market. A first possibility was to open a branch or an agency of the bank in London, the home of the Eurocurrency money markets and the operational center of the petrodollar recycling activities. The second one was to organize an independent banking institution in London under the direct control of the bank. Finally, there was the option to associate with other European and American banks to create an institution, namely a multinational or consortium bank, in which Banamex held an important share. To Legorreta, this seemed the most convenient solution because of the advantages that working together with large international banks represented in terms of network and reputation, which would facilitate the access to the Eurocurrency markets.[41] At an international level, Banamex was not big and experienced enough as to expect to raise foreign liquidity on its own, and an associated bank was seen "as an instrument for intervening in the international money markets and so to be able to complement [their] supply of services and serve both the public and private sector of the country."[42] In the following months, the Executive Committee commissioned Alejandro Medina Mora and Agustin Legorreta himself to travel to the USA and Europe, and meet with representatives from the world's largest banks, such as Rothschild, Bank of America, Deutsche Bank among others, to discuss about the possibility of participating as shareholders in the project of a multinational bank.

Opening a multinational bank and getting involved with foreign finance required, however, the approval, or at least the consent, of Mexican authorities. By that time, the participation of domestic banks in the international capital markets was not regulated, but the Federal government saw with "good eyes" (sic) the intervention of Mexican banks

[40] Banamex archive, Libro No. 3 de Actas de la Comisión Ejecutiva, February 9, 1972 Meeting.

[41] Ibid.

[42] Banamex archive, Libro No. 5 de Actas de la Comisión Ejecutiva, June 20, 1973 Meeting.

in the international capital markets.[43] To the knowledge of Legorreta, the SHCP have been also considering the possibility of creating a consortium bank, similarly to the European Brazilian Bank (Eurobras) founded by the Brazilian government, with the joint participation of official and private banking institutions.[44] In fact, by that time Nafinsa, which was the main development bank of the Federal government, had already established contacts with the Deutsche Bank and other international banks to discuss a similar project. According to Legorreta, the presence of Mexican banks in the Euromarkets was desirable for the government because that could help to support the secondary markets of Mexico's international debt, which up to then had been only deficiently managed and with only occasional participation of Mexican institutions, but it also represented an access to direct or syndicated loans to finance its fiscal deficit and economic development program.

Over the following years, the Mexican government and financial authorities passed some important measures to formalize and legally frame the increasing international activities of domestic banks. In this regard, a salient feature of the current banking legislation as of the early 1970s, was the absence of any specific provisions about the activity of Mexican financial institutions in foreign markets, either regarding the opening of branches or associated entities or with respect to asset and liability operations with residents abroad. In this regard, the banking reform of 1974 introduced important changes, as Banking Law Professor Francisco Borja Martinez explains, by explicitly contemplating, and thereby recognizing, the possibility that domestic banks could participate in the capital stock of foreign financial institutions and open agencies and branches upon receiving authorization from the SHCP.[45] This amendment to the legislation empowered Mexican banks willing to expand their business abroad and to gain international presence and deeper engagement with the Euromarkets.

[43] Banamex archive, Libro No. 3 de Actas de la Comisión Ejecutiva, February 9, 1972 Meeting.

[44] Banamex archive, Libro No. 3 de Actas de la Comisión Ejecutiva, August 9, 1972 Meeting.

[45] Francisco Borja Martínez, 'Desarrollo del derecho bancario mexicano (1968–1977),' in *Jurídica. Anuario del Departamento de Derecho de La Universidad Iberoamericana,* Tomo I (1978), 414–37, esp. 431–34.

These changes aligned with other measures taken by the Mexican financial authorities at that time that tended to liberate the domestic financial sector. In their study on the legislation regarding the domestic financial system and capital account transactions, Graciela Kaminsky and Sergio Schmukler find that between 1973 and 1974 Mexico passed from a repressed regime to a rather liberalized one.[46] In terms of the capital account, the process of liberation included a relaxation on offshore borrowing by domestic financial institutions and non-financial corporations. As for the domestic financial sector, there was a softening of the regulation on interest rates, the allocation of credit as well as a simplification on the reserve requirement system used to control bank lending. Deregulation continued in the following years through the permission to operate with foreign currency deposits—the so-called mexdollars—and increases on dollar borrowing and lending limits. The introduction of multipurpose banking in 1975, which will be addressed in further detail in Chapter 3, was a step forward because it lifted regulations that had previously pushed specialized financial institutions to operate in a single financial market, providing banks with greater flexibility in their intermediation activities.

Mexican Consortium Banks

The outcome of the multinational bank project launched by Banamex in early 1972 was the creation of the International Mexican Bank Limited in London in April 1974. Intermex, as it was known, took the legal form of a consortium bank and its main purpose, as stated in the advertisements published in the newspapers and financial press after its inauguration, was to attract investments and provide international financial services to Mexico as well as other Latin American countries.[47] As most of the consortium banks actives in London at that time, its operational base was the Euromarket and their main activities, which consisted of granting credits to the private and public sector, marketing of commercial paper, and security underwriting, were largely of international nature.

[46] Graciela L. Kaminsky and Sergio L. Schmukler, 'Short-Run Pain, Long-Run Gain: Financial Liberalization and Stock Market Cycles', *Review of Finance* 12 (2003), 253–92.

[47] See, for instance, *The Ottawa Citizen*, April 8, 1974, 11.

The bank was created with a paid-up capital of £2.5 million—about US$ 6.25 million, which was subscribed by seven partner banks from six different countries. Banamex was the main shareholding bank with 38% of the shares, followed by Bank of America and Inlat (DESC Industrial group) with 20 and 13%, respectively, and Deutsche Bank, Union Bank of Switzerland (UBS), Banque de France et Pays Bas (Paribas), and Dai-Ichi Kangyo Bank Ltd.—the largest bank in Japan—with 7.25% each. While Banamex provided with background and experience about Mexican borrowers, the other shareholders contributed by opening money markets in their home countries and London. The chairman was Agustin Legorreta from Banamex and the appointed Managing Director was Gerard Legrain, a 37-year-old French banker based in London since 1972, who had previously worked for Citibank and spent some time in Mexico as part of his professional career. The position of Deputy Managing Director was occupied by another Banamex official, Francisco Willy, who had acted as commissioner for starting up the company and developing a network of contacts among bankers in the City. As for the Executive Commission, which was the decision-making body of the institution, it was composed by one representative from each of the shareholders, and Saúl Carreño was the representative of Banamex.[48]

Over the next few years, Intermex managed to significantly expand its business and became indeed an important actor in international lending to Mexico. At the end of 1974, its first year of operations in London, the total assets of the bank reached £19.6 million, climbing up to £59.3 million by end-1975 and as much as £149.1 million in 1976, which represents a 7.6-time increase in only two years (see Table 2.1). Although engaged in the underwriting of Mexican issues on the international bond markets and the trading of Mexico's international debt on the secondary markets, the principal activity of Intermex consisted in the arrangement of, and participation in, Eurolending or syndicated credits to the Mexican government and private companies. In terms of resources, their liabilities passed from £17.1 million in 1974 to £54 million in 1975, of which 15% consisted of deposits from clients while the remaining 85% were funds raised in the international money markets through interbank transactions with other Euromarket participants. Such strong expansion of the lending and borrowing activities of the bank eventually

[48] Banamex archive, Libro No. 6 de Actas de la Comisión Ejecutiva, April 17, 1974 Meeting.

Table 2.1 Finances of Mexican consortium banks, 1972–1976 (£ million)

	1972	*1973*	*1974*	*1975*	*1976*
Libra Bank					
Total assets	n.a.	110.6	142.6	172.5	273.9
Capital & Reserves	n.a.	6.6	7.6	9.2	10.8
Pre-tax profit	n.a.	0.6	2	3	4.2
Dividend	n.a.	0	0	0	0.4
Intermex					
Total assets			19.6	59.3	149.1
Capital & reserves			2.5	5.3	6.4
Pre-tax profit			0.1	0.7	2.2
Dividend			0	0	0
Eulabank					
Total assets			n.a.	42.3	103.7
Capital & reserves			n.a.	8.8	10.2
Pre-tax profit			n.a.	0.7	1.8
Dividend			n.a.	0	0

Note 'n.a.' indicates not available
Source Roberts, *Take Your Partners* (see text)

required new contributions from shareholder banks to increase in its capital base, which doubled from £2.5 to £5 million between 1974 and 1975.

The growth of Intermex entailed the expansion in the volume of businesses but also the returns that it earned. Pre-tax profits were not spectacular the first year, but they reached £742 thousands in 1975 and increased to as much as £2.1 million in 1976, which represented a return on assets of about 1.5%. Although modest in terms of assets, Intermex profits were significantly more attractive when compared to the capital contribution made by the partner banks. As Alejandro Medina Mora explained to the members of the Banamex's Executive Committee when looking for further support and the approval of a new increase in its capital base, the bank "has generated resources for its partners, in addition to the fact that it has been operating successfully, since with a capital of 5,000,000.00 pounds sterling last year it closed with a profit of 1,100,000.00 pounds sterling."[49] In light of these results, Banamex's Committee would not only accept an increment of the capital base of

[49] Banamex archive, Libro No. 10 de Actas de la Comisión Ejecutiva, January 5, 1977 Meeting.

Intermex in London but eventually agreed to the opening of associated banking entities in the other financial centers.

In 1977, the shareholding banks created Intermex International, a Nassau-based twin consortium bank with US$4.5 million of paid-up capital.[50] Together with its London counterpart, the two banks became part of the Intermex Group, a Luxembourg Holding Company, which also had an office in Mexico City. The restructuring of the company came along with some changes in its ownership, with Paribas and Inlat dropping out in 1977, and the Mexican government's development banks Nafinsa and Banco Nacional de Comercio Exterior buying 26% of the bank (13% each) in 1979. The shares of these development banks, along with the 25% of Banamex, gave Mexico a 51% controlling interest on Intermex. As for the other owner banks, Bank of America kept 20% of the shares, UBS and Deutsche 12% each and Dai-Ichi Kangyo Bank the remaining 5%.

Apart from Intermex, there were two other London-based consortium banks with Mexican ownership. In 1972, the Libra Bank had been founded by Bancomer (with 8% of the shares) in joint venture with Brazilian Banco Itaú and eight other developed countries' banks, which included Chase Manhattan—the largest shareholder and provider of the managing director, the Royal Bank of Canada, National Westminister, among others. The bank offered a full range of commercial and investment banking services through its headquarter in London as well as its network of offices in five Latin American countries and New York. Between its creation and the outbreak of the Latin American debt crisis of 1982, the bank experienced uninterrupted growth in its assets, which expanded at an average annual rate of 33.8%, and profits, which represented a return of about 2.2% on assets on average. Its principal activity consisted in making and granting loans to governments, public and private corporations and bank borrowers in Latin America. As of end 1973, it has managed or co-managed loans of more than £245 million and £342 million in 1974 mainly to Latin American countries and by 1982, Latin American sovereign debt represented as much as up to 75% of its assets.[51]

[50] 'Intermex Group', International Banking: A Survey. *The Economist*, March 4, 1978, 45.

[51] Richard Roberts, *Take Your Partners: Orion, the Consortium Banks and the Transformation of the Euromarkets* (London, 2001), 265–66.

Finally, there was the Euro-Latin American Bank or Eulabank, which was half-owned by Latin American banks and the other half belong to European banks. On the Latin American side, Banca Serfin was the Mexican representative with less than 6% of the shares, but there also banks from Colombia, Peru, Uruguay, Chile, Venezuela, Argentina, Brazil and, from 1979, Bolivia. The bank was set in 1974 to strengthen the economic ties between Latin American and Europe by providing long-term investment to meet the growing demand for finance in the region. Like Intermex and the Libra Bank, its principal activity was the arrangement of and participation in medium- and long-term Eurocurrency lending and project finance to Latin American public and private sectors.[52] With £42.3 million of total assets in 1975, the bank strongly expanded the volume of business up to £103.7 in 1976 and £160 million in 1977 and continued to grow over the following years up to 1982.

These consortium banks, and in particular Intermex, would take a predominant role during the upcoming years in channeling Eurocurrency liquidity to Mexico through international loans. Based on data collected from the World Bank's *Borrowing in International Capital Markets*, which compiles all publicized foreign loans on a year basis, José Manuel Quijano examined the involvement of Mexican banks in international lending to Mexico and found that between 1974 and 1978, Mexican banks participated in approximately one-third of the total credit raised by Mexican public and private sector borrowers in the syndicated Euroloan market both as leaders or associated members of the syndicate management group. Intermex was the bank with the largest involvement, taking part in a total of 15 syndicated lending operations to Mexico for an amount of about US$2.45 billion. On the other hand, the Libra Bank took part in 7 loans of US$1.7 billion, while the Eulabank had the lowest involvement in sovereign lending to Mexico, participating in only 4 operations of about US$400 million.[53] These figures represent the total amount of the syndicated operation and although do not show the specific contribution of the Mexican consortium banks to the loan, they give an indication of their relative importance and the role they had in intermediating foreign capital for borrowers in Mexico.

[52] Ibid., 252–53.

[53] Quijano, *Estado y banca*, 243–49.

Similar results can be derived from the dataset on Eurocurrency credits to the Mexican public sector constructed by Sergio Negrete Cárdenas. He covers the period 1973–1982 and draws on a number of additional sources that supplement the World Bank publication, such as the Euromoney database, the quarterly reports from the SHCP to the Congress, and the Tombstones published in the financial press, since none of them had a systematic record of all the lending operations carried out during the period. According to his database, Intermex participated in a total of 24 syndicated loans, of which 14 went to state development banks. It ranked at the fifth position in the list of more than 250 banks taking part of these lending operations to the Mexican public sector, just behind the top leaders Bank of America and Bank of Tokyo with 28 and the Bank of Montreal and Citibank with 27. On the other hand, the Libra Bank participated in 17 operations, ranking 17th among the leaders, and the Eulabank in only one loan in 1974.[54] These data show the preponderant role played by Mexican consortium banks, especially Intermex, when compared to other major international lenders to the Mexican public sector.

The Financial Fallout of 1976

As the end of his mandate approached, President Echeverria became confronted to an eventual balance of payment crisis. Since the beginning of the 1970s, and particularly after the oil price rise in 1973, the economy had been accumulating serious macroeconomic imbalances that made difficult to maintain the fixed foreign exchange policy followed by the Mexican central bank since 1955. On one side, the acceleration of inflation with a widening margin over that prevailing in the USA—the country's principal trading partner, led to an appreciation of the real exchange rate, which resulted in a deterioration of the trade balance and a widening deficit as observed in Table 2.2. On the other side, rising public deficit levels were accompanied by inflationary financing and a sharp increase of foreign indebtedness that contributed to the worsening of the current account. The combination of these factors, along with the dollarization of bank deposits and the wave of capital flights that developed in such a context, generated strong pressures against the peso.

[54] Negrete Cárdenas, 'Mexican Debt Crises', Table B17, 400–4.

Table 2.2 Mexico's macroeconomic indicators, 1972–1976

		1972	*1973*	*1974*	*1975*	*1976*
Real sector						
GDP (Bil. US$)		45.4	55.8	73.1	89.7	90.8
Growth rate (%)		8.5	8.4	6.1	5.6	4.2
Public sector						
Expenditure/GDP (%)		22.9	25.8	27.0	31.9	32.0
Revenues/GDP (%)		18.7	20.2	21.1	23.2	23.8
Fiscal deficit[a]/GDP (%)		−4.5	−6.3	−6.7	−9.3	−9.1
Monetary variables						
Monetary base (M1)[b] (AGR, %)		21.2	26.7	20.1	21.1	35.7
Money supply (M4)[c] (AGR, %)		17.9	14.1	18.1	26.8	14.2
Inflation (annual, %)		5.6	21.4	20.7	11.3	27.1
Interest rate	Nominal (YA, %)	7.9	8.3	10.4	11.0	10.0
	Real (YA, %)	2.3	−10.4	−8.0	−0.2	−12.1
Exchange rate	Nominal (YA, %)	12.5	12.5	12.5	12.5	15.4
	Real (1980=100)	103.2	101.3	111.3	114.3	104.4
International reserves (EY, Bil. US$)		1.4	1.5	1.5	1.6	1.4
External sector						
Trade balance/GDP (%)		−2.4	−3.3	−4.5	−4.1	−2.9
Current account/GDP (%)		−2.9	−3.2	−4.7	−5.0	−4.0
Capital account/GDP (%)		−0.3	0.9	2.1	1.8	1.6
Capital flight[d] (Bil. US$)		−0.6	0.7	0.8	0.9	3.0
Terms of trade (1972=100)		100.0	114.7	90.2	77.1	86.5
External indebtedness						
Public sector (Bil. US$)		4.8	6.8	9.7	14.6	20.8
Private sector (Bil. US$)		2.6	3.2	4.5	5.5	4.9
Commercial banks (Bil. US$)		0.0	0.0	0.0	0.2	1.6
Total external debt (Bil. US$)		7.4	10.0	14.2	20.3	27.3
External debt/GDP (%)		16.3	17.9	19.5	22.6	30.1

Note AGR stands for 'Annual growth rate', YA for 'Year average' and EY for 'End year'

[a]Financial deficit includes also "financial intermediation" expenditures, so that it is not equal to the difference between total revenues and total expenditures (fiscal deficit)

[b]Coins and banknotes in hands of the public plus cheque accounts in domestic currency

[c]M1 plus cheque accounts in foreign currency, short-term, up to three-month, saving instruments, medium and long term, over three months, saving instruments

[d]Calculated as a "residual" of the balance of payments

Source Banco de Mexico's Annual Report (several issues); Negrete Cárdenas, 'Mexican Debt Crises'; Leopoldo Solís and Ernesto Zedillo, 'The Foreign Debt of Mexico' in Gordon W. Smith and John T. Cuddington (Eds.), *International Debt and the Developing Countries* (Washington, DC, 1985)

By the end of August 1976, the Mexican government eventually decided to abandon the fixed exchange rate regime of the peso against the US dollar after 22 years of parity. Banco de Mexico ceased supporting the peso at 12.5 per dollar, withdrew from the foreign exchange market, and consequently the price of the dollar increased to 20.5 pesos. During the following couple of months, the authorities attempted to manage the float, but instability continued and the rate was allowed to fall to its low point of around 25.5 pesos per dollar in October. After several changes in intervention policy, including a period in which commercial banks also withdrew from the market, the exchange rate stabilized in the range of 22 and 23 pesos per dollar since January 1977, which represented a final devaluation of about 75–85% with respect to the years of exchange parity. The management of the crisis and the stabilization of Mexico's external financial position required the use of emergency credit lines arranged with the USA and the subscription of an IMF-adjustment program.[55]

For the domestic banking system, the outbreak of the currency crisis created liquidity problems that contributed to aggravate the funding difficulties that the banks were already confronting. In September 1976, following the flotation of the peso, representatives from Mexican private banks held some meetings and informal discussion with the General Director of Banco de Mexico, who proposed a series of measures to support the banking system. On the one hand, as Legorreta reported to Banamex's Committee, the central bank would make easy line application of financial regulation, and "tolerate for an indefinite period of time the current situation regarding the relation of liabilities to capital and reserves," which meant "not requiring the revaluation of liabilities denominated in foreign currency, since all credit institutions would be short in capital and reserve."[56] With a 85% devaluation of the peso, such revaluation would imply an increase in banks' liabilities that may push the ratio of liabilities to total capital and reserves beyond the limits set by financial authorities, bringing the institutions into a situation of noncompliance with the domestic banking legislation.

On the other hand, Banco de Mexico opened new financing lines at market interest rates for domestic banking institutions in needs of liquidity. The purpose was to prevent credit institutions from being forced to liquidate their portfolio in the event of a withdrawal of funds. To introduce liquidity into the system, Banco de Mexico made available to the

[55] Paul Kershaw, 'Averting a Global Financial Crisis: The US, the IMF, and the Mexican Debt Crisis of 1976', *The International History Review* 22 (2018), 292–314.

[56] Banamex archive, Libro No. 10 de Actas de la Comisión Ejecutiva, September 27, 1977 Meeting.

banks two billion pesos in October, one billion in November and other billion in December for investment purposes. These resources were to be distributed "in proportion to the portfolio of each institutions, and [would have] a cost of 13½% annual for deposit banks and *financieras* and of 12½% annual for mortgage banks, the destination of the investment remaining at their discretion." The measure was not meant to improve the lending capacity of the banking system but rather to provide it with means to financially assist firms confronting cash flow difficulties, especially those with dollar liabilities. In the case of Banamex, according to Legorreta computations, the program would imply additional resources of about 800 million pesos for the group, which would be carefully used for "those companies that have been the most affected by the devaluation."[57]

As it turned out, given the raising foreign indebtedness of the last years, the devaluation of the peso generated some debt payment problems on Mexican companies with dollar obligations. The government took steps to assist them in overcoming cash flow problems and allowed them to take immediate tax credit on losses. In January 1977, Banco de Mexico made available additional funding for 1.7 billion of pesos (about US$770 million) to assist companies with liquidity problems, and the credit facilities provided the previous year were extended until end-August.[58] By mid-1977, the new General Director Romero Kolbeck called the attention of the members of the Board of Banco de Mexico to the presence of a mechanism in the business sector that "consisted in obtaining credits in national currency and using those amounts to pay liabilities in foreign currency."[59] This practice, as Mexican financial authorities acknowledged, generated significant pressures on the foreign exchange, but, on the other side, allowed some important firms under financial distress to keep the business going and stay afloat.

The lender of last resort measures implemented by the central bank proved eventually successful to avoid major payment disruptions and losses in the credit portfolio of the banking system. The series of non-performing loans to total loans reconstructed by Gustavo del Angel for the Mexican banking industry during the postwar period show that

[57] Ibid.

[58] Banco de Mexico, 1977 Annual Report, 45; Banco de Mexico archive, Acta No. 2428, January 1977.

[59] Banco de Mexico archive, Acta No. 2432, July 1977.

after 1972, when a peak of 6% was reached, the ratio decreased to up 5% in 1975 and about 4.8% in 1977.[60] It does not seem therefore that the devaluation and financial crisis of end-1976 resulted in major loan delinquencies, loan defaults or foreclosures. For the Mexican government, as Sergio Negrete Cárdenas has argued, the 1976 financial fallout was a short-lived and unnoticed debt crisis with no major consequences.[61] After a brief interruption in international lending to Mexico, the emergency financing provided by the USA and the IMF long-standing stabilization agreement along with the discovery of giant oil fields in the Gulf of Mexico renewed the confidence of the market on the country, and allowed the government to pursue its economic development program and continue to raise foreign capital.

Although it created some repayment problems on domestic loans, the devaluation did not have major effects on the balance sheet of the banking sector. By the time of the crisis, the participation of Mexican banks in international financial intermediation was in its early stages, and external obligations represented only a small share of their liabilities. Most of the banks' dollar liabilities were deposits denominated in foreign currency of the Mexican private sector, the mexdollars, and not external debt. Their balance sheets, therefore, were not significantly exposed to the devaluation or other kind of shocks that could develop in the world capital markets. Up to that point, most of their international activities have been made through their associated London-based consortium banks, which were separate institutions with their own capital base and legally independent from the shareholder banks. In terms of the balance sheets, the financial exposure between them was limited to standby facilities and funding lines granted by Mexican banks and the shares exhibited as part of their assets. Thus, to the extent that these consortium banks were not engaged in significant cross-border operations with their shareholders or any other banks in Mexico, their activities in the international capital markets were not a major source of vulnerability for the Mexican banking system.

[60] Del Angel, 'Paradoxes', Table 2.12, 57.

[61] Negrete Cárdenas, 'Mexican Debt Crises', 209–15.