eye to the practice.

The obvious alternative is credit cards, but these are still in their infancy, except for the retailers' own cards run by one or two big stores.

Another retail banking service which is just beginning to develop is automatic telling. In late January, a group of banks finally reached agreement to develop a collective chain rather than each going it, expensively, alone.

The $2.5 million initial investment, plus a later $8 million will be borne by seven banks, including the two biggest, Banco de Chile and Banco de Santiago, and Citibank, which will unite their existing individual networks to form a chain of 142 cashpoints.

Among them this group manage 294,000 current accounts (of a total 522,000), and 151,000 of an existing 161,000 automatic banking cards. They are aiming to bring the total up to 300,000 cards and 200 cashpoints. A second group of seven banks, including the Banco del Estado, Nacional and O'Higgins, are planning a similar network.

Banco Nacional, like the rest, has had a look at the credit card business, but it is holding off until it sees how the ATM system develops, Echeverria said.

The bank's strength (its weakness, say its critics) is its close relationship with the business interests of its owner, Francisco Javier Errazuriz. That relationship gave it access to the expertise within the group in investment banking areas, such as project evaluation, or in insurance, or foreign trade, said Echeverria. "We can offer a pool of services, and we assess the overall profitability of the client rather than an individual operation."

The bank's indentification of interests with a single client closes the doors firmly with Errazuriz's competitors. Since he is active in the growing fruit and forestry industries, as well as in insurance and supermarkets, that cuts it off from a considerable range of alternative business. In practice, a staggering 226% of its capital and reserves is committed to related companies.

Banco de Credito e Inversiones, too, has gone for retail banking, with a separate "personal banking" department. It has a big national network with 89 branches (though Banco del Estado has 190, Banco de Chile, 140). That gives it cover from northern Iquique (where Chile's duty free zone, and the banks there capture a slice of the profits of the drugs traders in neighbouring Peru and Bolivia) right down to the Antarctic (where the solitary bank clerk can find himself sleeping in the bank when the weather is really bad).

The big branch network has allowed the bank to expand its client base, for example among traditional farmers, who have seen their business recover since the government adopted more protectionist policies in agriculture four years ago.

"You can tell the banks are busy banking," said a foreign banker, "look how little they appear in the press these days. a year or so ago they spent their time lobbying publicly against changes in the laws. Now they've decided to live with them, and there's a lot less bitching and a lot more business."

That is not to say that the criticisms have stopped. At Banco Nacional, Echeverria said: "The superintendency has enormous discretional powers. He can make or break companies, virtually, by the credit classification he gives them."

The category, from A to E, obliges the bank to make higher provisions the lower the classification of the potential borrower, and can make lending to a risky company just too expensive.

"Now, the superintendency team is made up of reasonable people," said Echeverria. "But if there is a change of government, the new regime will have a powerful weapon in its hand through which it can control a large slice of the economy." □

A BRIGHTER SHADE OF GREY

Bankers and brokers in Mexico City reacted with dismay to the Economic Solidarity Pact. "The financial system has been hobbled," said one.

The pressures and constraints on Mexico's bankers and their customers — together with the constant movement of goalposts by the government — has encouraged a grey market financial system to flourish as customers adapt to the rules of a game which change weekly and sometimes daily.

By Douglas Bartholomew.

It's no secret that times have been tough in Mexico in recent years. And for Mexican bankers, things got still tougher in January and February. Already short of capital to lend because of the central bank's near-insatiable appetite for reserves, the banks were required to further tighten their credit belts. The government's new anti-inflation accord, the Economic Solidarity Pact signed last December 15 by business, labour, and *campesino* (peasant) groups, required the country's commercial banks to cut loans outstanding by 10% in January and 5% more in February. "The Mexican financial system has been hobbled," said a stockbroker in Mexico City.

The Pact is not the only problem bankers face. Last year's change in the corporate tax law eliminated interest deductions except for interest costs less inflation. So the plain vanilla term loan from bank to corporate borrower went the way of the $40 barrel of crude.

It is because of these pressures and constraints on bankers and their customers that a grey market financial system has sprung up in Mexico, as companies adapt to the new rules of a game which change weekly and sometimes daily. The means of this unregulated market are often creative seven-day money, 180% annualised returns on 30-day paper, and short-term peso loans arranged without aid of bank or broker.

Bankers are not active in this market, except as backstops to informal financing arrangements—for instance, they will guarantee a company's commercial paper.

This informal financing network among the Mexican blue chips bypasses even the country's securities market—the extra borsatil—thus avoiding the 15% value-added tax companies must pay for this type of financing.

"There is a clear incentive for this parallel market," said one foreign banker. "The cost of funds is reduced for the borrower and enhanced for the investor. And it is all done outside the banking system. There is no legal reserve requirement for these funds."

Grey market lending poses a special problem for the Mexican central bank—the Banco de Mexico. Through a variety of measures, it has continually sought to exert closer control over the country's scarce and nervous capital. Since it owns the banks, it can easily control the flow of funds through the banking system.

But the central bank's monetary policy has failed to hold sway over most of the country's private wealth, much of it in the hands of large corporations. "The monetary policy of the government is very limited in scope," said Jaime Castillo, a director at IFI de Mexico, an investment banking house affiliated to Lazard Frères. He estimated that Mexico's largest companies control 80% of all funds in the country's money markets. These funds are flighty, have a short fuse, and know no national boundaries.

"Companies are not taking any bank loans these days, mostly because there is no money around in the financial system for them to borrow," Castillo added. "Debt is extremely expensive, and the tax advantages are not as attractive as they once were." The net effect, he said, is this: "If a treasurer or chief financial officer needs P1,500 million [$750,000] now, he can get it the next day by making a telephone call to another treasurer. Why should he wait a week for a bank to process his loan?"

Mexican interest rates are so high – 30-day government *cetes*, or treasury certificates, paid 153% in early February, while commercial paper on the extra-borsatil or unlisted market was commanding rates up to 185% that many

Bancomer's Lyon: "Our commercial lending, as well as that of the other banks, has been severely restricted."

cash rich firms have taken to playing on the money markets. "The big companies can go from pesos to dollars, or dollars back to pesos, like that," said Castillo, snapping his fingers.

This *golondrino capistrano*, or money that migrates (the term derives from the swallows that migrate north and south each year to and from San Juan Capistrano in the US) flows both ways across the border very swiftly, Castillo said. But according to one foreign banker, last autumn's flow of funds out of Mexico was not a *saca dolares*, or true flight of capital. Most sources, including the government, agree that the net outflow during and after the stock market crash of October—November (Mexico's borsa lost 75% of its value in five weeks) was reversed by a net inflow of dollars to pesos in January.

Castillo saw the latter trend continuing in February due to the high returns offered on the Mexican money markets. "This money doesn't mean there is a permanent inflow," he said. "In March, it could go back out again."

"Companies with cash can employ it very profitably in this market, one foreign banker added. "The bulk of this peripatetic capital belongs to the corporate treasuries of large triple-A rated firms.

So, lending and borrowing terms are getting shorter than the hairs on an iguana's back. "When you have interest rates as high as we've had them, investment terms shorten," said Guillermo Guemez, executive vice-president at Banamex, which in mid-January introduced a new seven-day deposit certificate. "It is a young product, so we have no figures available yet. "But it has been very popular."

Bancomer, which is offering a similar "seven-day promissory note," viewed the short-term deposit instruments as a magnet to regain some of the funds that slipped away in recent years to the *casas de bolsa*, or brokerage houses. "Over the last eight years, the brokerage houses have increased their share of the nonstock savings in Mexico from 4% to 30% reported Tim Heyman executive vice-president at Estrategi Borsatil, a Mexico City securities house. "The Mexican banking system doesn't fear competition—we like it," Guemez added gamely.

Admittedly, the belt-tightening the banks were forced to undertake on the asset side of their balance sheets wasn't accomplished without some pain. . "Our commercial lending, as well as that of the other banks, has been severely restricted,"said Robert Lyon, executive vice-president of Bancomer's international group.

The 15% trimming of the bank's portfolio of commercial and consumer outstandings of P5 trillion translated into a cutback of P750 billion. "The restrictions limit our ability to lend, but we assume they will be lifted in the near future," Lyon added.

Clients approaching the bank for credit are not turned away immediately, he said. "We try to meet their needs through one of the areas of lending that are exempted, such as exports, if at all possible. But just because we are under some temporary restrictions, I don't think our clients are going to suddenly stop doing business with us."

Guemez of Banamex said the calling in of loans and limits on issuing new loans were difficult measures, but added that the moves had caused to bank to look for business elsewhere. "Banks are becoming more efficient and creative in Mexico. The reduction in credit by the Bank of Mexico and the resulting squeeze on liquidity means that we are looking more closely to lend to clients for their export/import business, and for businesses such as housing. But it is always difficult to cut back on loans."

One significant piece of business to come the bankers' way in 1988 is the handling of investment banking for the government's stepped-up privatisations programme. On the block for divestment by the state will be scores of companies, among them Telefonos de Mexico; Cananea, a copper mining firm with a heavy debt burden; a sugar mill; Dina, the ailing truck, bus, and engine maker; and Mexicana, the national airline. Just as debt-equity swaps and the stock market were the hot tickets last year, the byword in 1988 will be privatisation, Castillo predicted.

Some, the parastatals, are no prizes. Cananea, for instance, has nearly $800 million of debt. Mexicana desperately needs an infusion of cash to buy some new jets so it can stay in the air. Dina is in terrible shape, according to a senior accountant in Mexico City. ▶

A further negative for buyers of the privatised firms is the prospect of dealing with Mexico's militant unions. Efforts to prune waste and eliminate unnecessary or redundant positions would no doubt kindle fierce opposition among Mexican unions.

None the less, IFI de Mexico's Castillo thinks many of the parastatals to be sold will draw plenty of investor interest. "These are not all bad companies. There are some good ones and some bad ones."

Cananea is a case in point. "There are 20 parties that have expressed interest in the company," Castillo said. They include industrial copper users, other mining firms, and companies looking for investment opportunities. "The government wants the best price, but it wants to be careful about who it sells to. It doesn't want a monopoly situation, yet it wants a buyer who has some expertise, at least in a related field." Castillo believes the government could raise between $1 billion and $2 billion this year through the sales of parastatals, depending on how many go on the block. Bidders are likely to include both Mexican and foreign companies, as well as some private investors. The latest rumour is that Japan Airlines will bid for Mexicana.

. . . just because we are under some temporary restrictions, I don't think our clients are going to suddenly stop doing business with us.

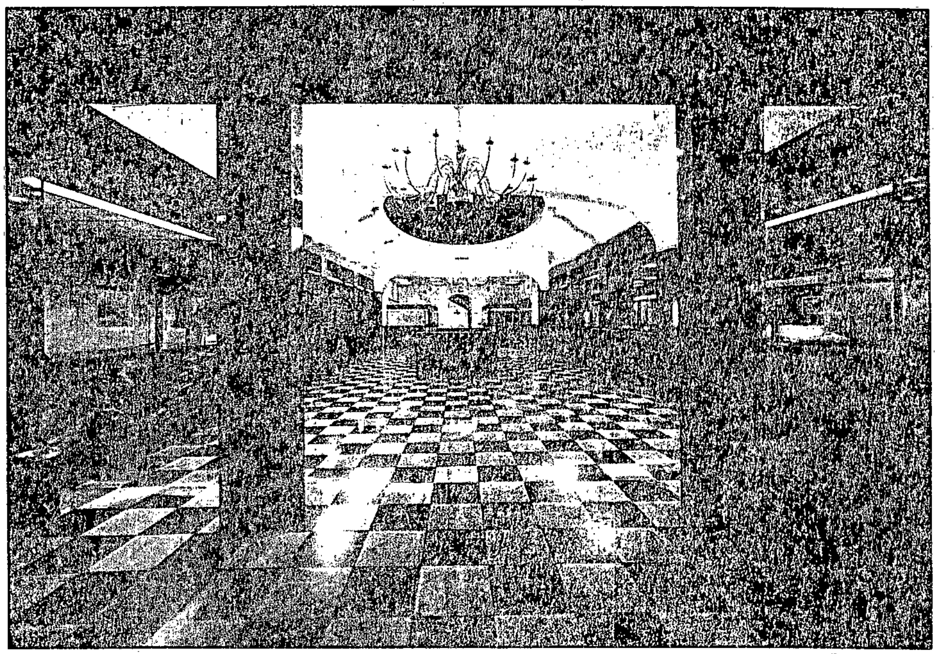
Robert Lyon, Bancomer

The government has brought down the auction gavel three times already on scores of lesser enterprises, including some petrochemical firms, its interest in Renault, a cement maker, and the national soccer team. Other parastatals sold last year were Accioniones Bursatiles Somex, the brokerage unit Banco Somex and the El Presidente hotel chain.

Castillo, for one, believes the privatisations could boost the economy. "The government must give large subsidies to many of these companies, because of their huge debts and losses. If they can get out from under this, it will be an important step. The capital can be used to pay back foreign debt or to reduce the need for new debt. If the privatisations are successful, you could have a leaner state by the end of the year.

Although no one confuses last year's sale of 34% of the Mexican banks to the public with privatisation Castillo thinks they could be next in line in a year or two. "It will not happen with this administration," he said. "Maybe next year." □

CRUCIAL ROLE OF COMMERCIAL BANKS



Banco Venezolano de Credito's Caracas HQ: though not one of the "Big Banks", it outstrips most others in terms of profitability and productivity.

Venezuelan commercial banking is modernising, becoming better managed and more competitive within the stricter limits imposed by the government. But negative interest rates and tight liquidity are hurting the banks. Some critics warn that an orderly restructuring process must be made. And service to customers should be updated. By Joseph Mann

Venezuela's commercial banking system is in far better shape today than it was five years ago. Commercial banks, which make up the most important segment of Venezuela's financial system, successfully weathered a huge capital outflow in 1982, a major devaluation of the Venezuelan bolivar in 1983 (plus subsequent devaluations), and learned to cope with a seven-year recession that lasted through 1985.

"The commercial system is more solid today," said José Maria Nogueroles, executive vice-president and general manager of Banco Provincial, the country's largest commercial bank. "Banks have been able to manage a variety of problems."

Venezuela's economy improved in 1986-87, and the banking system's health also recovered thanks to a series of government-imposed takeovers, mergers and liquidations. To cope with problems that developed over the last several years, commercial banks increased capital, set aside large reserves for bad loans, restructured their foreign debts and adopted stricter norms for granting new commercial credits. Banks also have changed to keep pace with new business. "Commercial banks in Venezuela have become modernised and are now much more competitive," said Oscar Garcia Mendoza, president of Banco Venezolano de Credito. "This can be seen in some of the new services they offer: guaranteed payment of cheques, payments and balance statements made by telephone, automatic teller machines and the enormous efforts made to finance the country's imports," he said.

"Venezuela is one of the leading countries in Latin America with the capacity to offer modern banking services," Nogueroles said.

While private banks built up reserves for loan losses, the government was also obliged to swallow huge losses. Especially ▶