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FEATURED Q&A

What Is Driving Profits in Mexico's Banking Sector?



Mexico will continue being an attractive market for U.S. and other foreign banking firms, Bryan S. Bloom says below. An office in Chetumal of Mexico's largest bank by assets, BBVA Bancomer, is pictured above. // File Photo: holachetumal via Creative Commons.

Q **Citigroup on Oct. 12 reported a slight gain in profit for the third quarter, due in part to strong performance in its Mexico business. The New York-based bank has been investing heavily in the unit. What is driving profits in Mexico's banking sector, and can banks with operations in the country expect continued gains in the quarters ahead? How is uncertainty surrounding the future of the NAFTA negotiations affecting Mexico's banking sector, and how important is the accord to the country's banks? What emerging trends in Mexico's financial services sector will most likely shape the future of the country's banks over the next decade?**

A **Bryan S. Bloom, chief financial officer at ENODO Global:** "Foreign direct investment is the primary driver of current profits and future growth. Since 2016, Citigroup, BBVA and Santander have pledged investments of more than \$1 billion, \$1.5 billion and \$700 million, respectively. Investors are attracted to the unrealized synergies from their acquisitions and the potential of the Mexican market—namely its untapped consumers. Only half of Mexico's adult population have bank accounts, which presents incredible upside to sell both basic and complex financial products to drive future growth. NAFTA negotiations have had no significant impact. However, if the new NAFTA regulations inhibit U.S. banks from conducting business in Mexico, others will fill the gap. Despite that risk, Mexico will still continue to be an attractive investment for both U.S. and other foreign banking firms. It is the second-largest Latin American country by population and GDP, with limited market penetration. Analysts estimate that Citibanamex delivers

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THE DIALOGUE

TOP NEWS

INSURANCE

SwissRe Estimates Claims Burden From Disasters at \$3.6 Billion

The world's second-largest reinsurer said the claims from the recent hurricanes in the Caribbean and earthquakes in Mexico are subject to a higher-than-usual degree of uncertainty.

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PENSIONS

Principal Acquires MetLife's Mexico Pension Unit

Principal Financial Group announced that it has acquired full ownership of the unit, known as MetLife Afore. The financial terms of the deal were not announced.

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FINANCIAL SERVICES

Banorte Buying Interacciones in \$1.4 Bn Deal

The deal will create Mexico's second-largest bank. Banorte CEO José Marcos Ramírez Miguel said the acquisition will make Banorte a leader in financing Mexico's infrastructure needs.

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Ramírez Miguel // File Photo: Grupo Financiero Banorte.

FINANCIAL SERVICES NEWS

Banorte Buying Interacciones in \$1.4 Billion Deal

Grupo Financiero Banorte has agreed to acquire Grupo Financiero Interacciones in a \$1.4 billion deal that will create Mexico's second-largest bank, Bloomberg News reported Oct. 25. Banorte will pay for the bank, which is

The deal would make Banorte the second-largest bank in Mexico.

controlled by billionaire Carlos Hank Rhon, in a 50-50 combination of cash and stock. The acquisition still must be approved by shareholders of both banks as well as regulators in order to proceed. "With this deal, Banorte positions itself as a leader in the financing of the enormous infrastructure necessities of our country, which represents a unique opportunity to propel competitiveness, attract investment and improve quality of life for Mexican families," said Banorte's chief executive officer, José Marcos Ramírez Miguel. Banorte and Interacciones, both of which have ties to the Hank family, are believed to have been in merger talks since at least 2014, Bloomberg News reported. Carlos Hank Rhon chairs Interacciones, while his son, Carlos Hank González, was Interacciones' chairman but then joined Banorte's board in 2014. Hank González's maternal grandfather chaired Banorte between 1992 and 2011. Banorte's merger with Interacciones is expected to close in next year's second quarter. The deal would make Banorte the second-largest bank in Mexico just after BBVA Bancomer and ahead of Citibanamex. The deal also would make Banorte Mexico's largest infrastructure lender.

Brazil Earnings Help Boost Profits of Spain's Santander

Spain-based Banco Santander saw a jump in earnings in Brazil in the third quarter, benefiting the lender as it took a hit from one-off restructuring costs as it absorbed Banco Popular Español, Bloomberg News reported Oct. 26. The net income of Spain's largest lender fell to 1.46 billion euros, or \$1.7 billion, from 1.7 billion euros during the same period a year before, the bank said. Putting aside the 515 million euros in charges Santander saw in the third quarter, underlying profit rose 17 percent to 1.98 billion euros, and Brazil contributed to about a third of the profits. Profit in Brazil rose 35 percent to 659 million euros in the third quarter, up 4 percent year-over-year. "The numbers came in better than expected in most of Santander's divisions," said Daragh Quinn, an analyst at Keefe Bruyette & Woods.



Álvarez // File Photo: Banco Santander.

The bank, headquartered in Santander, Spain, raised its profitability target this month. It cited a more positive outlook in Latin America and positive trends in Europe, as well. Analysts at Deutsche Bank said eight of Santander's 10 core markets saw revenue growth in the three months through September, Reuters reported. Positive results for the bank are expected to be overshadowed by the independence standoff between the Spanish government and Catalonia, where the lender has a 13 percent market share of deposits. Santander CEO José Antonio Álvarez said the situation in Catalonia was not good for business throughout Spain, though he added that it was too early to assess the impact on activity.

NEWS BRIEFS

Amazon Offers Cash Payment Service in Mexico Amid Fraud Concerns

Seattle-based retail giant Amazon on Oct. 24 launched a cash-payment program in Mexico in a bid to lure customers who are worried about credit-card fraud and often earn a living in paper currency, Reuters reported. Amazon is the third-largest online retailer in Mexico. The company's 2016 sales of \$253 million lag far behind the country's top online retailer, Argentina's MercadoLibre, and are only slightly higher than Wal-Mart de México's online sales.

Eight Guyanese Bank Directors Released on Bail

Eight directors of the Guyana Bank for Trade Industry were released on bail after appearing in court on Oct. 23, the Caribbean Media Corporation reported. The directors had been charged with failing to comply with a court order to provide information regarding the movement of \$500 million in the account of the Guyana Rice Development Board. The directors have denied the allegation that they failed to comply with a court order made by the chief justice. Authorities recently launched an investigation into more than \$500 million that the Guyana Rice Development Board had handled.

U.S. Lifts Sanctions on Panamanian Newspapers in Laundering Case

The United States has lifted sanctions on two Panamanian newspapers that are owned by Abdul Waked, who has been wrapped up in a money-laundering corruption scandal, the Associated Press reported Oct. 23. In May of last year, the United States prohibited U.S. citizens or entities from doing business with dozens of Waked-related companies. U.S. Ambassador John Feeley in a statement said Waked had transferred his shares in La Estrella de Panamá and El Siglo newspapers to a foundation.

INSURANCE NEWS

Swiss Re Estimates Claims Burden From Disasters at \$3.6 Bn

Swiss Re, the world's second-largest reinsurer, has estimated that its claims burden for the damage caused by Hurricanes Harvey, Irma and Maria and two earthquakes in Mexico is approximately \$3.6 billion in the third quarter, Reuters reported Oct. 20. The reinsurer said the estimate was before tax, but net of reinsurance, the Financial Times reported. The



Cole // File Photo: Swiss Re.

company added that claims are subject to "a higher-than-usual degree of uncertainty and may need to be subsequently adjusted as the claims assessment process continues." Of that burden, some \$175 million is attributed to damages from the earthquakes in Mexico, Reuters reported. Reinsurers such as Swiss Re are a financial backstop for insurance companies, helping pay out large amounts of money for damage claims after natural disasters in exchange for part of the premiums customers pay. "Swiss Re maintains a very strong capital position and high financial flexibility to support our clients' needs, respond to market developments and execute on our capital management priorities," Chief Financial Officer David Cole said in a statement. The company said the total insured market loss caused by the recent natural disasters is approximately \$95 billion, the Financial Times reported. Analysts have said that the insurance industry may need to adjust risk models amid climate change and storms that are becoming more intense, Reuters reported.

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a 15 percent return on equity, almost double what Citi reported overall last year. Pension reform and consumer acquisition will be the dominant factors that shape the future of the banking sector. Pension reform created a new group of institutional investors and asset managers who provide market liquidity. Bancomext recently offered a first-of-its-kind subordinated capital instrument that was oversubscribed by eight times. To remain attractive, the financial sector will need to prove Mexico's potential to grow into underserved markets is real. One success story is Citibanamex grassroots' partnership with the OXXO convenience store chain to offer new 'Saldazo' cards. More than 8,500 new consumers are signing up for the program daily."

A **Alejandro Garcia Garcia, managing director and regional group head for Latin America Financial Institutions at Fitch Ratings:**

"Despite the very negative market mood on Mexico at the beginning of the year, Mexican banks have been outperforming many other emerging market peers during 2017. A confluence of factors has been boosting earnings, including the gradual upward revision of the country's expected economic growth over the near term, as well as the sustained lending growth and well-contained credit costs. More importantly, rising interest rates are boosting net interest margins at the systems level. While the rising interest rate cycle could eventually come to an end when inflation returns to the central bank's target, banks will likely continue benefiting from a relatively benign operating environment and ample room for growth, absent any disruptive scenario at the macro level. Such disruptive conditions could arise from a potential negative outcome of the NAFTA negotiations. Mexico is among the most open economies in the world, and therefore banks are exposed to corporations that are reliant on external trade. However, we do not expect that the potential negative scenario related

to NAFTA talks will have major negative implications in terms of asset quality over the near term. Rather, we expect that challenges under such a scenario will be mostly related



Mexico is among the most open economies in the world, and therefore banks are exposed to corporations that are reliant on external trade."

— Alejandro Garcia Garcia

to weaker economic growth prospects, in view of the potential shock on business and consumer confidence, among others. Beyond the near term, we foresee further consolidation in the Mexican financial sector, since gaining economies of scale and pricing power will heavily determine which entities will benefit more from the ample medium-term growth prospects."



José Carlos Rodríguez Puebla, senior advisor at Monarch Global Strategies: "Limited financial inclusion continues to plague

Mexico, as the country ranks last in financial penetration compared to other OECD countries, with only 39 percent of the population having a bank account. In addition, Mexico also lags behind in the Latin America and Caribbean region, where the average is 51 percent. For the region, a major contributing factor for this low penetration is the lack of infrastructure. For instance, there are only 10.1 access points for every 10,000 citizens on average in Mexico where one can deposit or withdraw money. Thus, there is a vast potential market for traditional banks to increase their presence and revenues in the short and long terms. In addition to improving infrastructure, increasing Internet access and use of fintech may provide the solution to reducing financial exclusion,

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PENSIONS NEWS

Principal Financial Acquires MetLife's Mexico Pension Unit

Principal Financial Group announced Oct. 26 that it has acquired full ownership of MetLife's pension fund management business in Mexico, known as MetLife Afore. The financial terms of the acquisition, which is subject to regulatory approval, were not announced. "As the middle class in emerging markets continues to grow, there is increasing demand for long-term retirement and investing products that enable individuals to retire with the highest pension possible," Roberto Walker, the president of Principal International in Latin America, said in a statement. "This acquisition strengthens our commitment to Mexico's pension market." Principal, based in Des Moines, Iowa, said that the acquisition will give it additional scale as well as a larger distribution network and an increased ability to serve its customers in Mexico. The deal is expected to close in the first quarter of next year, at which time Principal Afore would become Mexico's fifth-largest pension provider in terms of assets under management. Principal has already had a presence in Mexico for 25 years. The investment management company said it is "committed to growing across its mandatory pension, voluntary long-term savings, and mutual funds businesses."

POLITICAL NEWS

Opposition Boycotts December Elections in Venezuela

Three of Venezuela's largest opposition parties announced Oct. 30 that they will not participate in municipal elections scheduled for this December, El Universal reported. "Participation in this process is not viable," Henry Ramos Allup,

ADVISOR Q&A

Is the Panama Canal Expansion Paying Off?

Q The expanded Panama Canal began commercial operations more than a year ago, in June 2016. The Central American country's project to add an additional lane of traffic to the canal cost more than \$5 billion and took nearly a decade to complete. Is Panama's investment in expanding the canal paying off? Are global trade flows robust enough to have made the project worthwhile and competitive with other shipping channels? What will be the long-term impact of the canal's expansion on Panama's economy?

A Juan B. Sosa, consul general of Panama in Houston and former Panamanian ambassador to the United States: "The expansion of the Panama Canal was undertaken with a high degree of optimism as it became clear that the trend toward bigger ships would limit the canal's possibilities. The results of the first year of the expansion indicate that the vision of Panama's leaders proved correct as the canal has surpassed the estimates. Tonnage has increased by 22 percent, for the first time reaching more than 400 million tons of cargo through the canal. Income grew 12.5 percent, one third generated by the new expanded locks, and Panama's government revenue increased by 60 percent to \$1.6 billion. These are impressive results that bode well for the future. As impressive is the new business that is being created. Transportation of liquefied natural gas, which did not exist with the smaller

the leader of the Democratic Action Party, told reporters. Julio Borges, head of the Justice First party and president of the now disempowered National Assembly, said his party would also pull out because the government of Nicolás Maduro had rigged elections earlier this month. Maduro's allies won the gover-

canal, constituted 9 percent of the NeoPanamax transits, generating new business and making Asia and the west coast of the hemisphere accessible to this U.S. export from the Gulf and Atlantic coasts. But the greatest impact has been in the container traffic that makes up half of the canal's income. This ability to transit large quantities of containers is paving the way to the creation of new trade routes that will also help Panama to become a premier logistics global hub. The expanded canal is reinforcing the traditional strategic partnership between Texas and the Port of Houston and Panama. Today, 51 percent of the tonnage going through the canal comes from the Asia-U.S. Atlantic/Gulf Coast route, with the Port of Houston as the top destination. This makes Houston and Texas' other ports more accessible to Asia and vice versa, creating an opportunity for Texas to become a gateway to the central region of the United States, expanding business opportunities. A change of trade routes takes time, but the expansion of the Panama Canal has already affected trade routes and will have a bigger impact in the future as ports become compatible with the expansion, infrastructure is reinforced and expanded, and companies show even more interest in taking advantage of the economies of scale that the canal brings."

EDITOR'S NOTE: More commentary on this topic appears in the Oct. 26 issue of the Latin America Advisor.

norships in 18 of the 23 states up for grabs, despite polls ahead of the vote showing much stronger opposition support. The deadline for enrolling mayoral candidates for the December 10 vote expired on Oct. 30. Maduro mocked the opposition's decision to boycott the election. "When they lose, they denounce fraud. And

NEWS BRIEFS

Allegations of Attacks Are 'Political Manipulation': Cuban Foreign Minister

Allegations of bizarre sonic attacks that have sickened dozens of U.S. diplomats amount to "political manipulation" that is aimed at undermining relations between the United States and Cuba, Cuban Foreign Minister Bruno Rodríguez said Oct. 29, Agence France-Presse reported. The United States has not formally accused Cuba in the incidents, but U.S. President Donald Trump has said he holds Cuba responsible.

Nicaragua Officially Backs Paris Climate Deal, U.S., Syria Only Outliers

Nicaragua has officially backed the Paris climate agreement, leaving the United States and Syria as the only countries not in support of the global accord, Reuters reported Oct. 23. Vice President Rosario Murillo said Nicaragua's government presented the relevant documents to the United Nations. Nicaragua was the only country to reject the pact in 2015, arguing instead that far stronger measures need to be taken worldwide to combat climate change. The accord seeks to limit the effects of climate change by curbing global emissions of carbon dioxide and other gases.

Colombia, ELN Begin Fourth Round of Talks in Ecuador

The Colombian government and the National Liberation Army, or ELN, rebel group, the last active rebel group in the country, began their fourth round of peace negotiation talks on Oct. 25 in Quito amid a cease-fire between the two sides, Agence France-Presse reported. Representatives from Brazil, Cuba, Chile, Norway and Venezuela also attended the talks. At the end of the third round of talks in September, the two sides agreed to a historic cease-fire that began on Oct. 1 and will last until January.

when they know they are going into an election in an unfavorable position, instead of fighting, they pull out," he said, BBC News reported. The Popular Will party has also pulled out of the election process.

Lula, Bolsonaro Likely to Advance to Brazil Runoff: Poll

Former Brazilian President Luiz Inácio Lula da Silva and right-wing Congressman Jair Bolsonaro would most likely make it to the second round of voting in next year's presidential election if the vote was held today, an Ibope poll showed Oct. 29, Reuters reported. The poll showed Lula winning 35 to 26 percent of the vote in October's election regardless of which other candidates entered in the race. Bolsonaro, who has seen gains in his popularity amid rising crime and violence in large cities like Rio de Janeiro that have been affected by the country's crippling recession, would likely win 15 percent of voters in a runoff against Lula. Lula's former environmental minister, Marina Silva, would take third place with 8 to 11 percent of the vote. Despite Lula's popularity, however, the question remains as to whether he will be able to run in the election. In July, he was convicted of receiving bribes from construction conglomerate Odebrecht in exchange for helping the company win government contracts. In August, he said his Workers' Party might have to put a different candidate on the ballot.

ECONOMIC NEWS

Exports from Latin America, Caribbean to Grow 10 Percent

The value of exports from Latin America and the Caribbean will grow 10 percent this year, reversing five years of decline in the prices of the region's export basket, according to new estimates released Oct. 30 by the U.N.'s

Economic Commission for Latin America and the Caribbean, or ECLAC. The region's imports will also recover after four years of declining values, projected to grow 7 percent in 2017. Economic growth overall in the region is expected to rise 1.2 percent in 2017 and 2.2 percent in 2018 after two years of recession, Santiago-based ECLAC added. Exports in 2017 will be led by shipments to China and the rest of Asia, up 23 percent, while exports to the United States and within the region will expand at around 10 percent, with increases of 6 percent expected to the European Union. ECLAC warned, however, that the region lags behind other parts of the world in the trade in "modern services," such as those that have high value-added and are intensive in the use of information and communications technology, for example. Latin America and the Caribbean has been "a marginal actor" again this year in that category, with its participation in modern global service exports in 2016 comprising just 1.8 percent of global goods exported.

"The region's exporting dynamism depends on implementing active, long-term public policies ... promoting human capital and the digital ecosystem, incentivizing exports and attracting foreign direct investment, as well as for deepening regional integration in services," said Alicia Bárcena, ECLAC's executive secretary, at a press conference Oct. 30.

Renewable Energy Investments Not Very Profitable: BP Chief

The CEO of multinational energy firm BP, Bob Dudley, on Oct. 18 said the company's renewable energy investments have not earned the company much profit yet, CNBC reported. "We love our wind farms in the United States and our biofuels in Brazil and we continue to invest in these businesses and they're profitable, but it's fair to say they don't, as yet, make a material difference to the bottom line," Dudley said. While the company plans to continue to invest in renewable sources of energy, the BP executive said the company would still be committed to its oil and gas business.

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while opening a new market for traditional and nontraditional financial firms. Given the recent trend of collaboration between fintech startups and traditional financial institutions, the most active banks—such as BBVA Bancomer and Banorte—will likely address the current needs of the nonbanked population under a highly competitive but very profitable business of financing. The fintech regulation will define the speed of that expansion, and the level of competition between banks and the newcomers. NAFTA may have an effect through a potential increase of rates if the outcome from the negotiations is negative, but the main banks will continue growing their businesses, given the large market to be served."

A **Jan Smith, partner at KoreFusion in Mexico City:** "Mexico's banking sector is expanding by nearly 10 percent per annum, nearly twice the rate registered 10 years ago. This is spurred in large part by nearly half of the population not being banked, but also by heavy investments in both branch and digital services. These investments cater to the demographics that will propel growth: the oft-maligned millennials and the unbanked. BBVA has invested \$3.5 billion in branch updates since 2013 and has committed an-

other \$1.5 billion. Citibanamex pledged \$2.5 billion and will add nearly 3,000 ATMs this year. Retail banking growth will come from expansion of digital services that replace cash payments and reduce servicing costs. Products such as Citibanamex's prepaid/cash-in Saldazo card aim to capitalize on the rapid growth of e-commerce by becoming a bridge for the unbanked into the digital world. Santander and Gentera reflect a trend by banks of investing in fintechs directly and recently struck a new financing deal with ePesos. Unfortunately, Mexico's recently passed fintech law may limit how fintechs evolve and where they can compete against banks. A discreet motor of growth that is even more compelling will be investments in commercial payments. Mexico's banking system now runs on faster-payment rails, and e-invoicing is mandated. This opens the field for innovation with ERP systems, eProcurement solutions and cross-border payment capabilities. An end to NAFTA would disrupt both consumer and commercial payments by creating rapid inflation, interrupting investment and raising interest rates."

The Advisor welcomes comments on its Q&A section. Readers can write editor Gene Kuleta at gkuleta@thedialogue.org.

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