

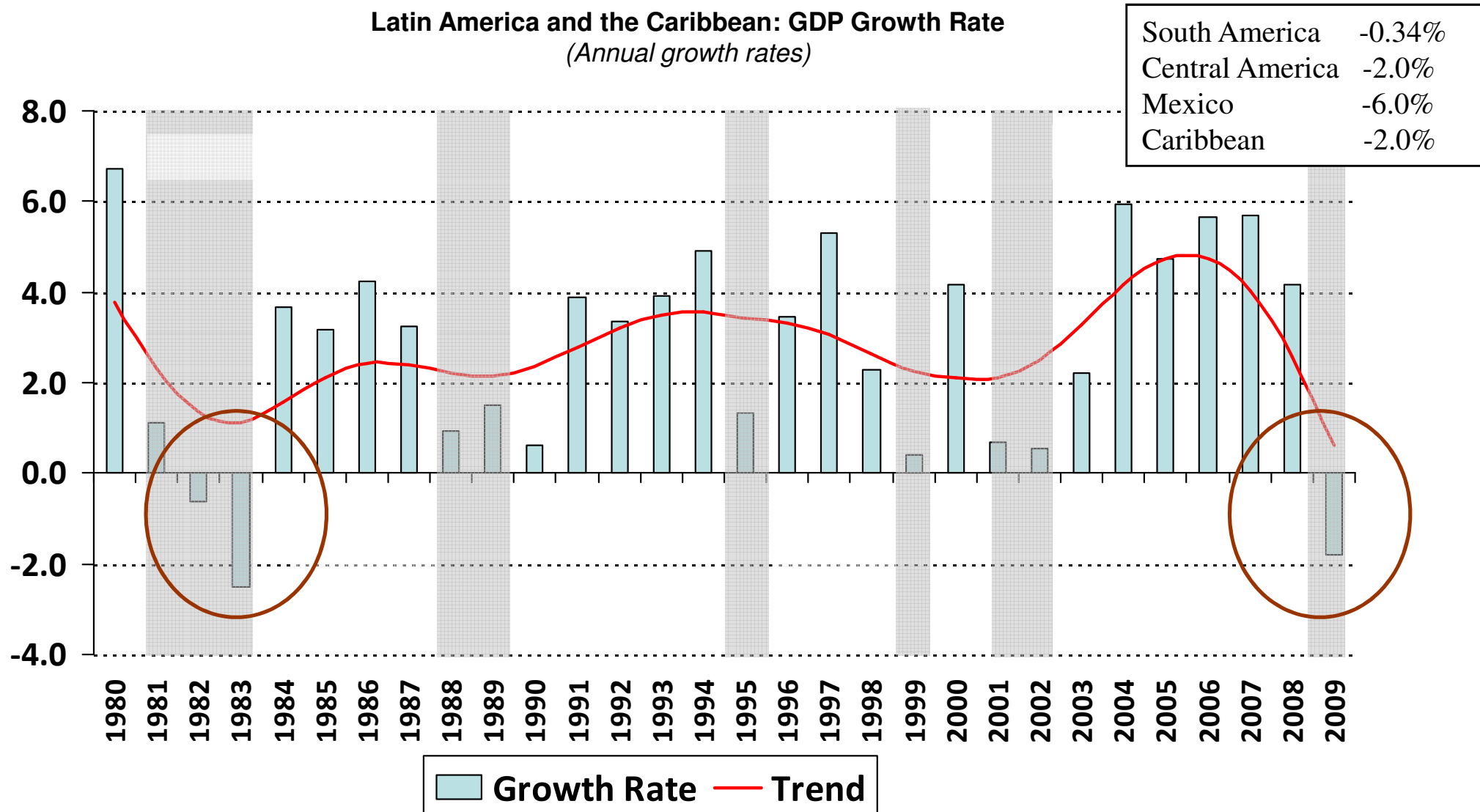
The Challenge of Financing Business in Latin America and the Caribbean

The Future of the Financial Services Industry after the Crisis

14th Caribbean Business Executive Seminar
Port-of-Spain, Trinidad and Tobago
30th April 2010

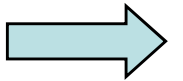
Esteban Pérez Caldentey
Development Studies Section
Economic Commission for Latin America and the Caribbean (ECLAC)

The global crisis caused one of the most severe declines in GDP in over three decades and the sharpest growth deceleration of any past episode since the 1980's



The transmission channels resembled those of other crises episodes

➤ The effects on trade flows have been significant.



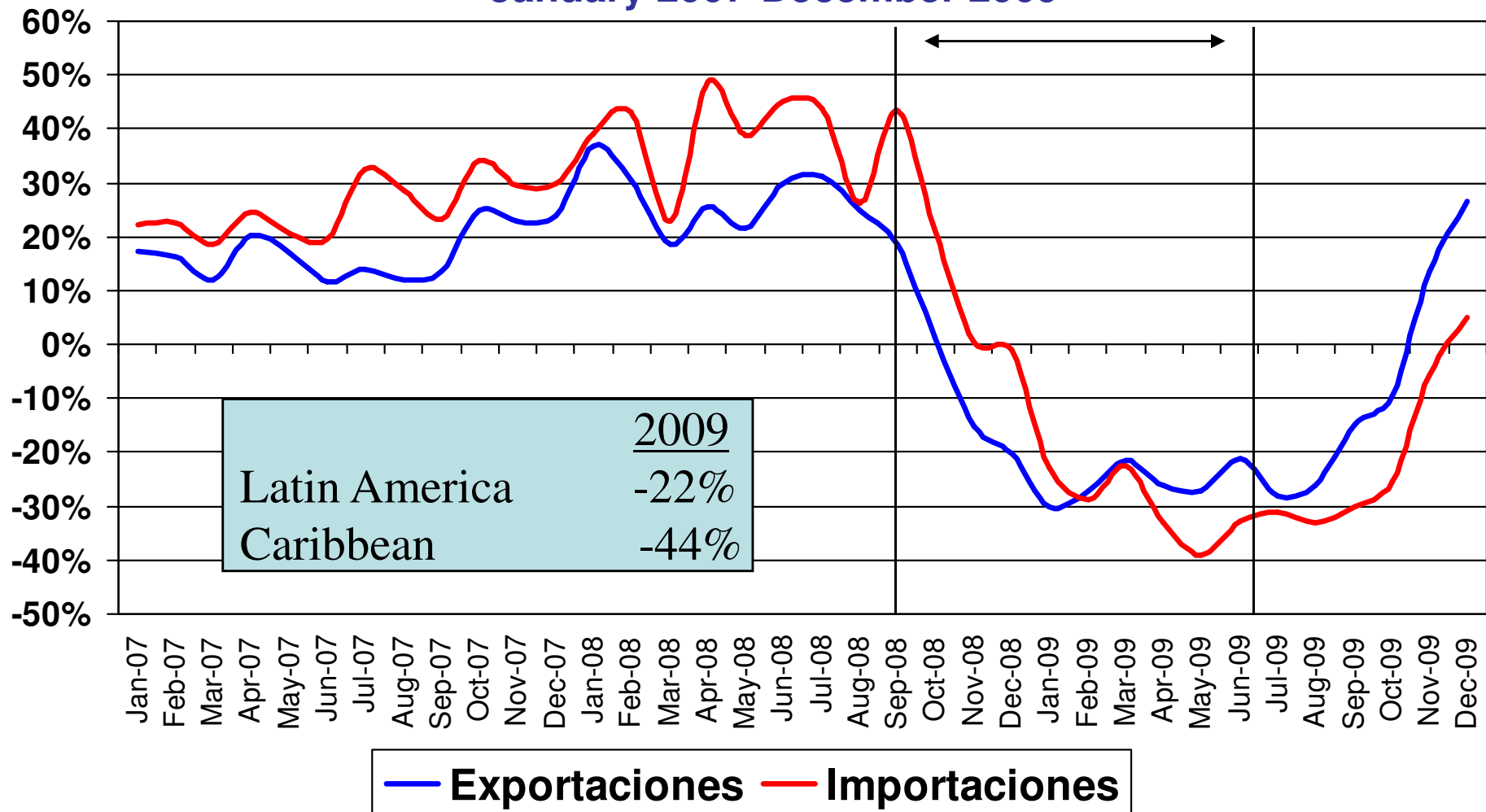
➤ The availability of external finance was severely curtailed

➤ Partly as a result the supply of domestic funding was significantly reduced.



Trade flows contracted by nearly 40%....

LAC-7: Annualized rate of growth of exports and imports January 2007-December 2009



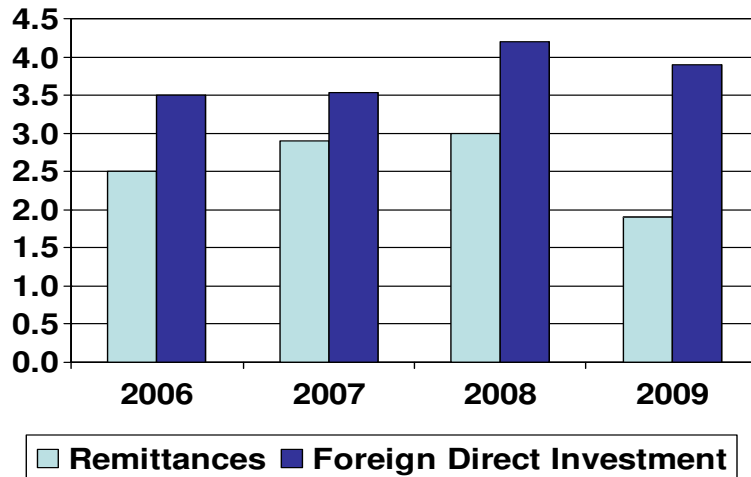
Note: Simple average including Argentina, Brazil, Chile, Colombia, Mexico, Peru.

Source: Development Studies Section on the basis of official information.

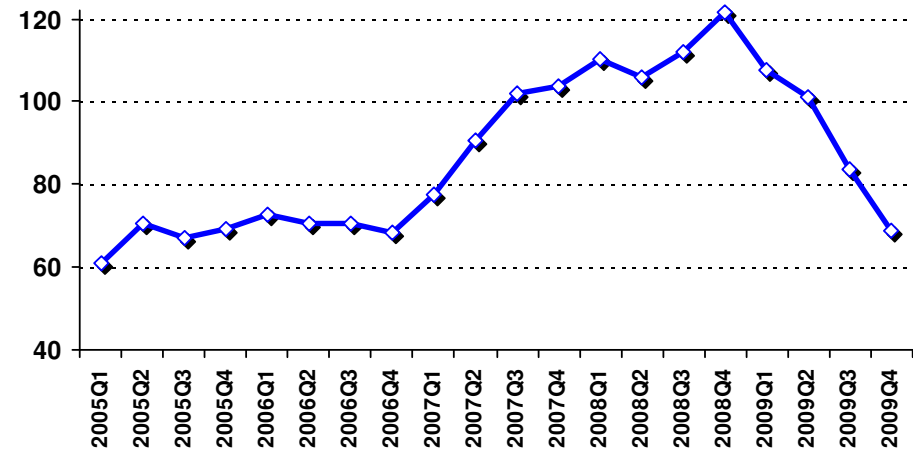


The region witnessed restricted access to all external sources of finance due mainly to higher international risk aversion and global deleveraging...

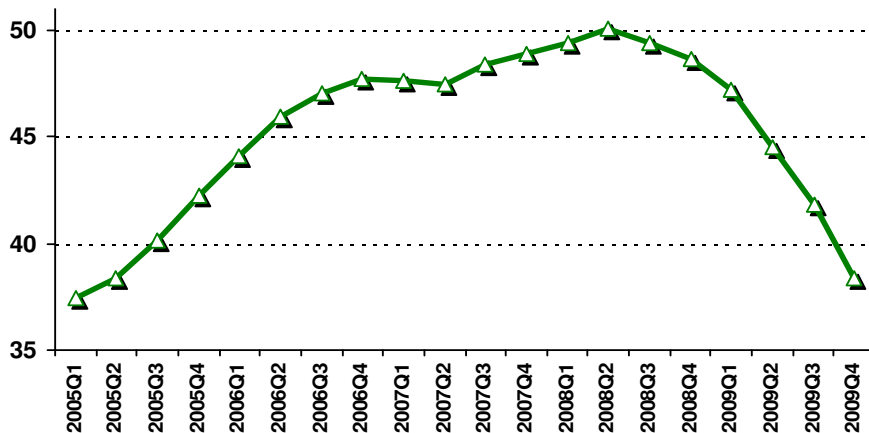
Caribbean: FDI and Remittances (US\$ billion)



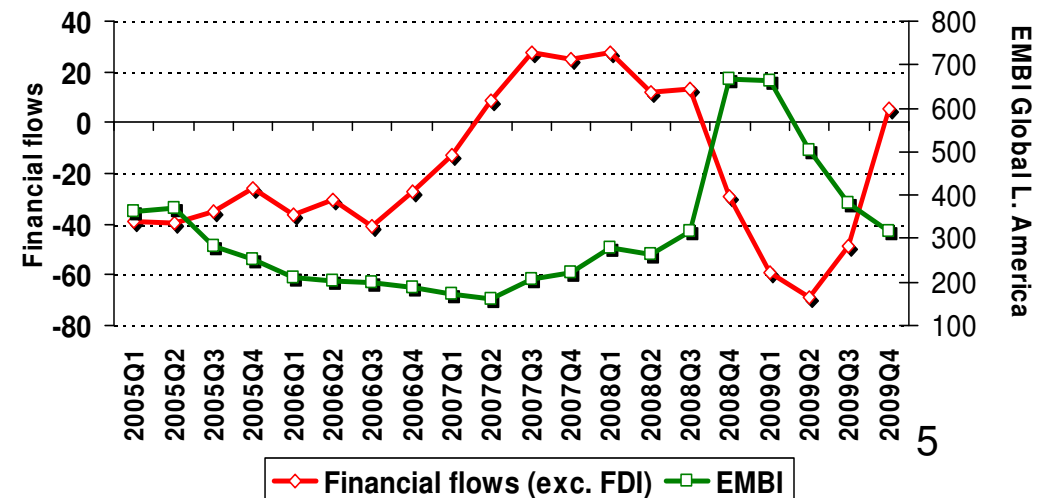
LAC-7: FDI (US\$ billion)



LAC-7: Remittances (US\$ billion)



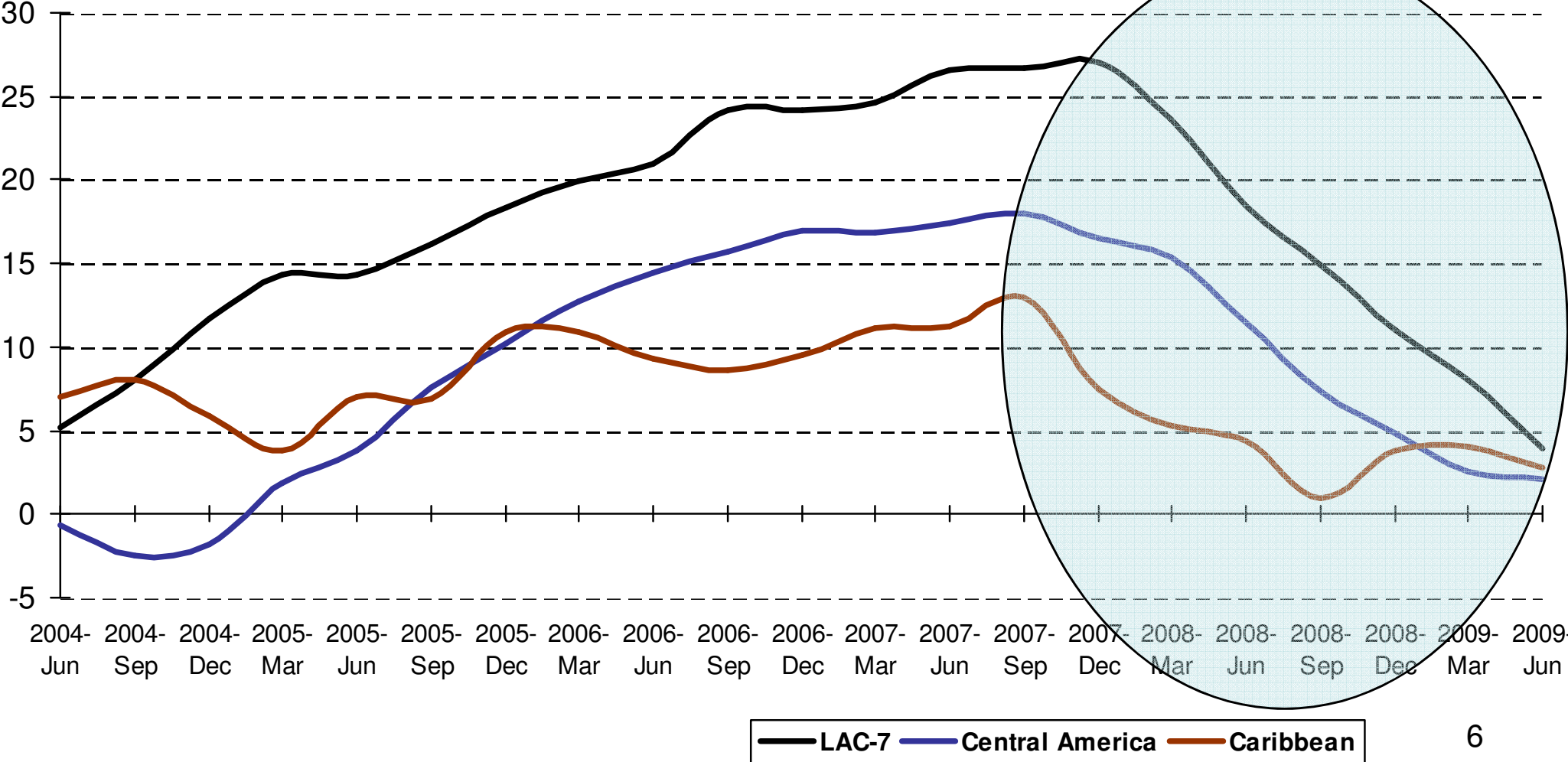
LAC-7: Non-financial flows (US\$ billion) and EMBI



Source: Development Studies Section on the basis of official information.



At the same time, there was a marked reduction in the rate of expansion of the flow of domestic credit...

**LAC-7, Central America and the Caribbean
Annualized rate of growth of credit in real terms to the private sector**



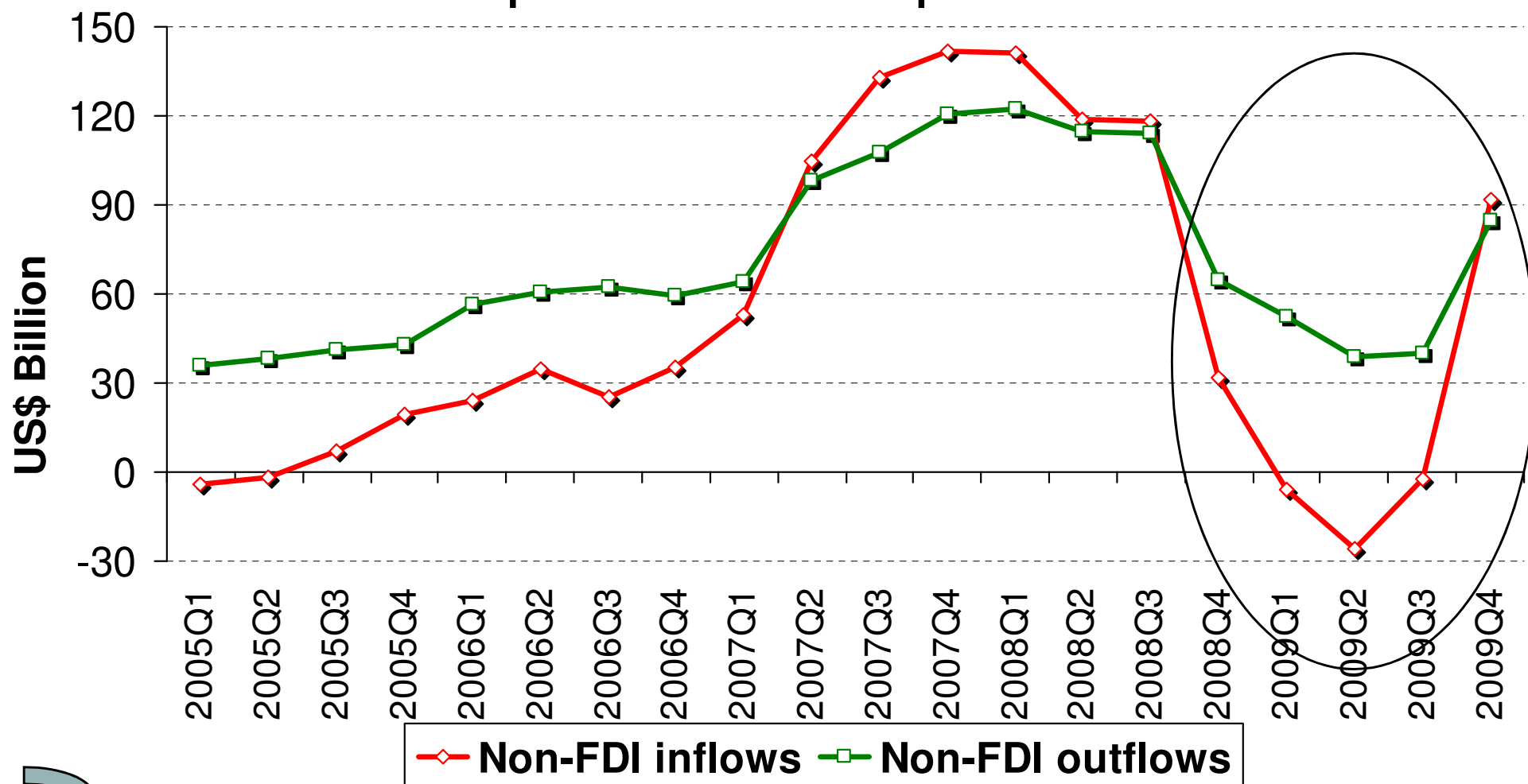
Source: Development Studies Section on the basis of official information.

The countries of the region implemented a range of different policies to mitigate the effects of the crisis on real and financial activity

- Countries stabilized their external financial position during the crisis. 
- Countries confronted the effects of the liquidity crunch on domestic markets through a range of countercyclical policies:
 - Fiscal stimulus packages (0.5%-6% of GDP).
 - Lean against the wind monetary policies. 
 - Active public credit interventions.

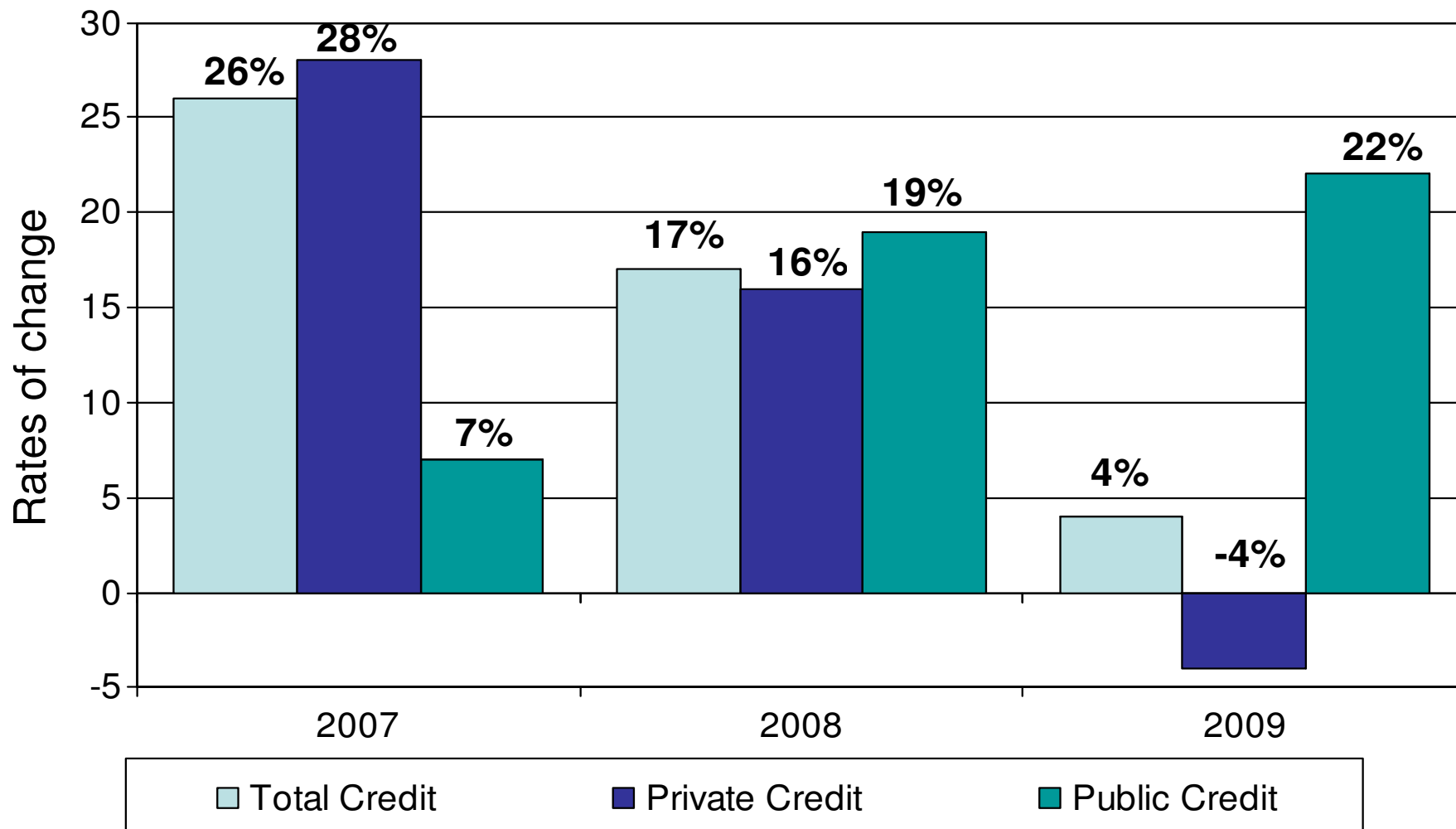
During the crisis the decline of gross outflows acted as buffer stock partly offsetting that of gross inflows

LAC-7: Gross non-FDI inflows and outflows (US\$ billion)
First quarter 2005-Fourth quarter 2009



Public sector credit played a fundamental role in offsetting the decline in private sector credit ...

LAC-7: Total credit growth in real terms (2007-2009)

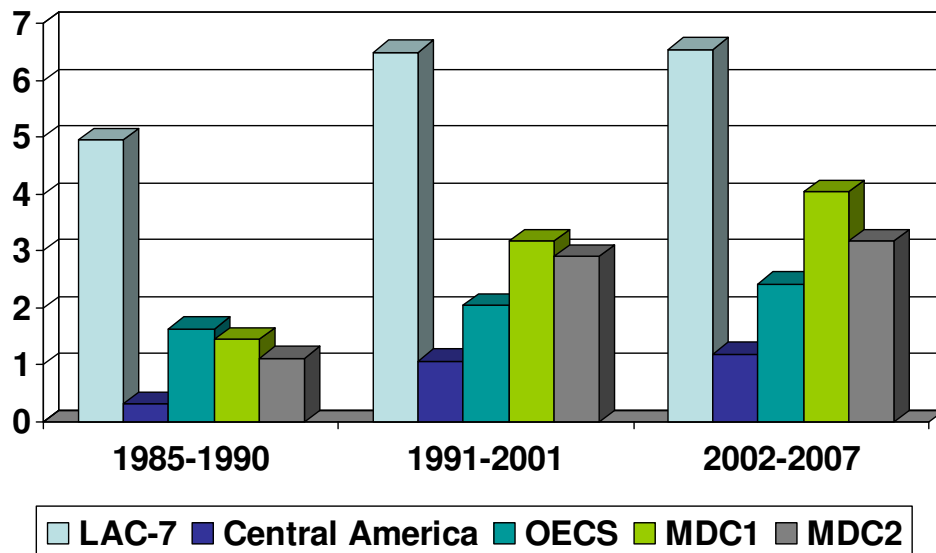


Countries capacity to confront and mitigate the negative effects of the crisis was determined by stock (balance sheet) positions

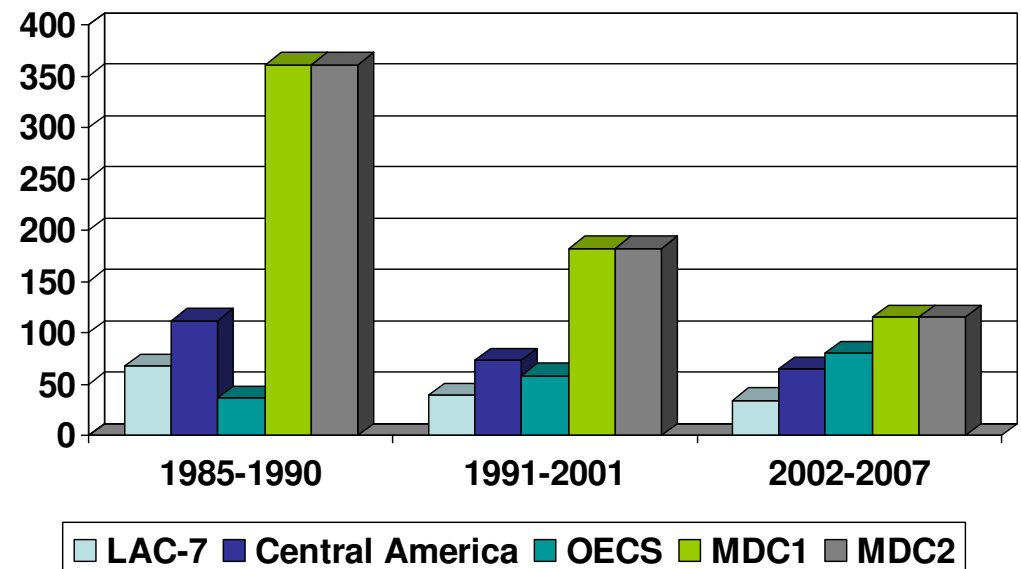
- Balance sheet positions were with some exceptions stronger than in the past.
 - Countries increased their reserve coverage.
 - Countries (with exceptions notably in the Caribbean) reduced their debt levels.
- Nevertheless, regional comparisons show that balance sheet positions were stronger in South America than in Central America or the Caribbean.
 - Due to an exceptionally favorable macroeconomic performance in 2002-2007 that served to consolidate their stock positions.

International Reserves in months of imports and external debt as percentage of GNI (1985-2007)

International Reserves in Months of imports
By Country Groupings (1985-2007)

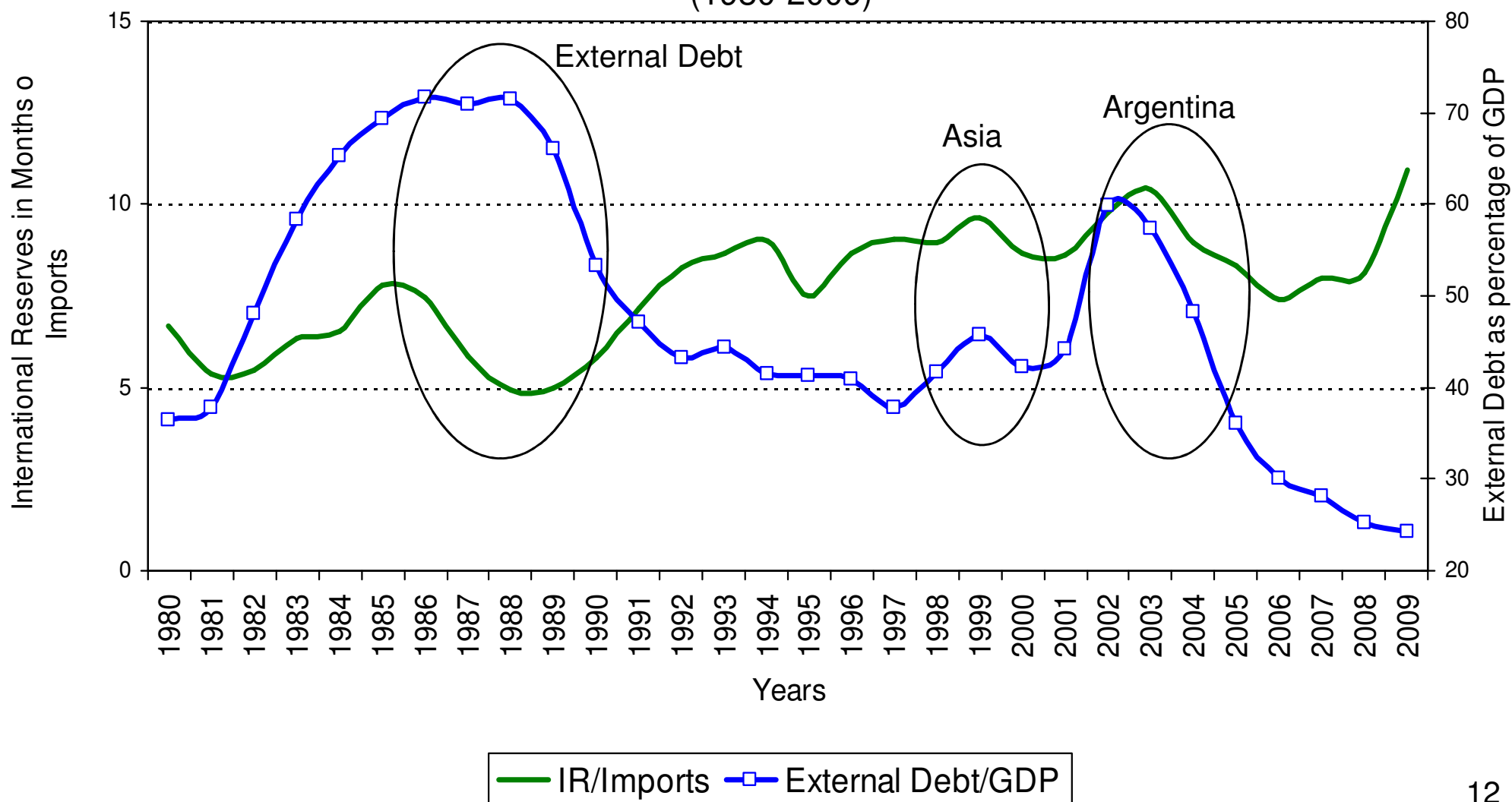


External debt as percentage of GNI
By Country Groupings (1985-2007)





For LAC-7 the dynamics of reserve accumulation and debt stocks behaved differently in relation to past crisis episodes

LAC-7: Months of imports covered with international reserves and external debt as percentage of GDP (1980-2009)



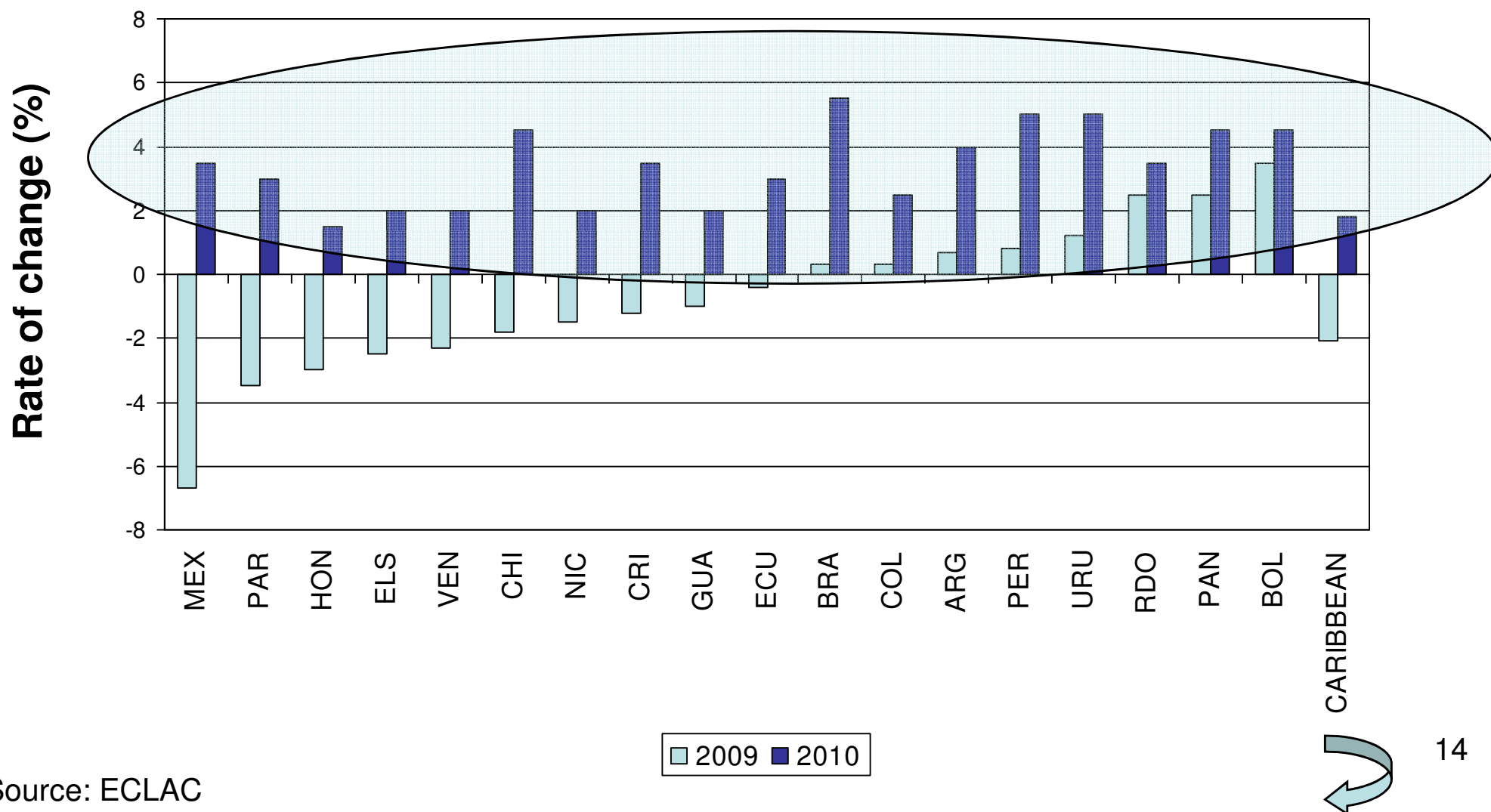
Source: Development Studies Section on the basis of Official Information

The combination of policy activism and more favourable conditions in external markets point to a rebound in economic activity in 2010

- The rebound is generalized throughout the region.
 - All countries are expected to show positive growth rates in 2010. 
- However it is not homogenous throughout the region.
 - South American countries and Mexico are expected to show the more pronounced recoveries partly as a result of favorable commodity prices.
 - ✓ This has strengthened the capacity of commodity exporting countries to expand domestic demand through higher consumption and investment.
 - The rebound is expected to be very modest for Central America and Caribbean countries. 

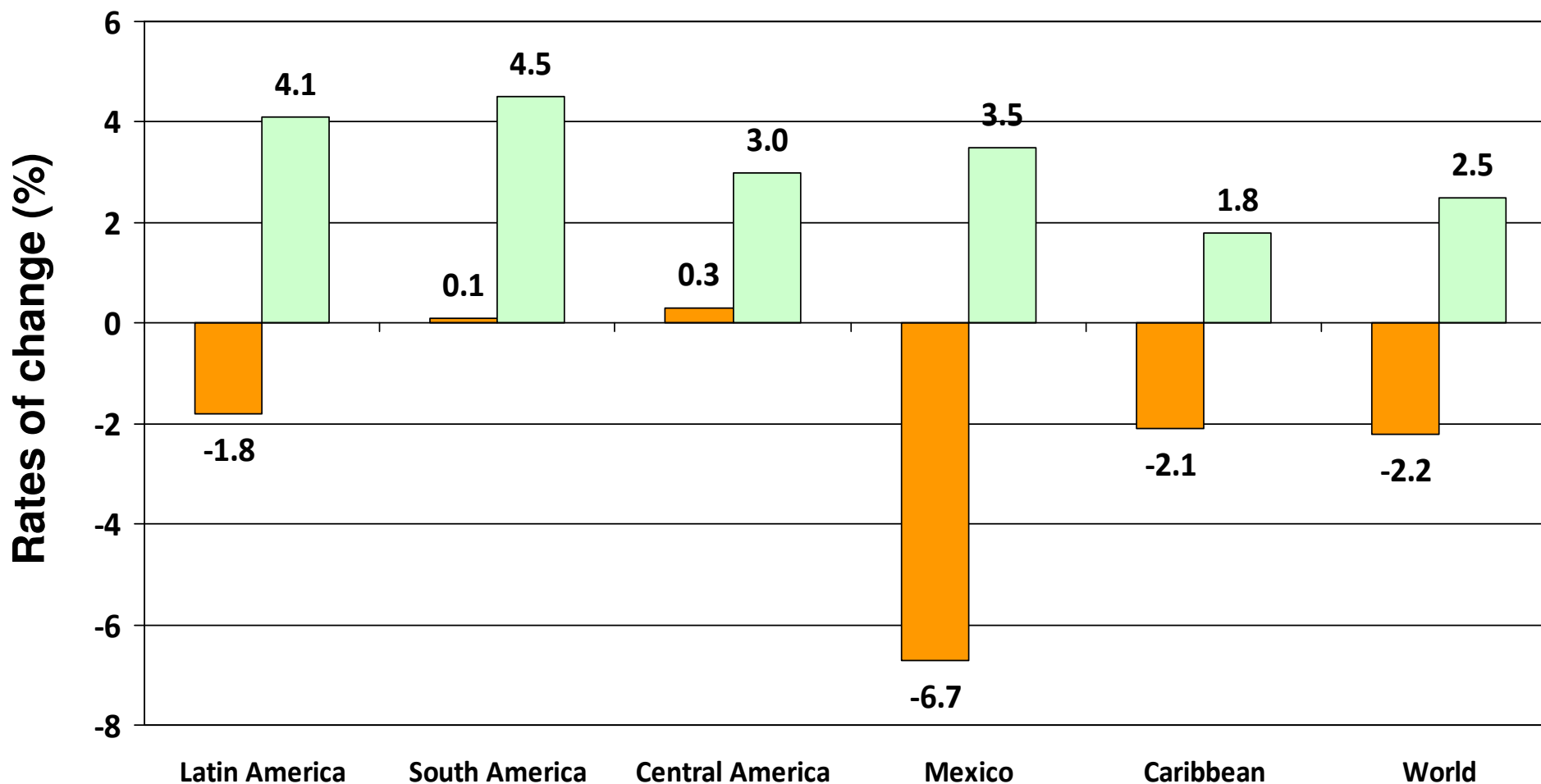
Latin America and the Caribbean

Rate of change of GDP in real terms 2009-2010

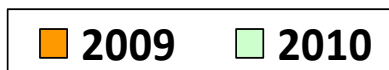


The rebound is much stronger in the larger Latin American economies...

Rebound	<u>LA</u>	<u>South America</u>	<u>Central America</u>	<u>Mexico</u>	<u>Caribbean</u>	<u>World</u>
	5.9	4.4	2.7	10.2	3.0-3.9	4.4



Source: ECLAC

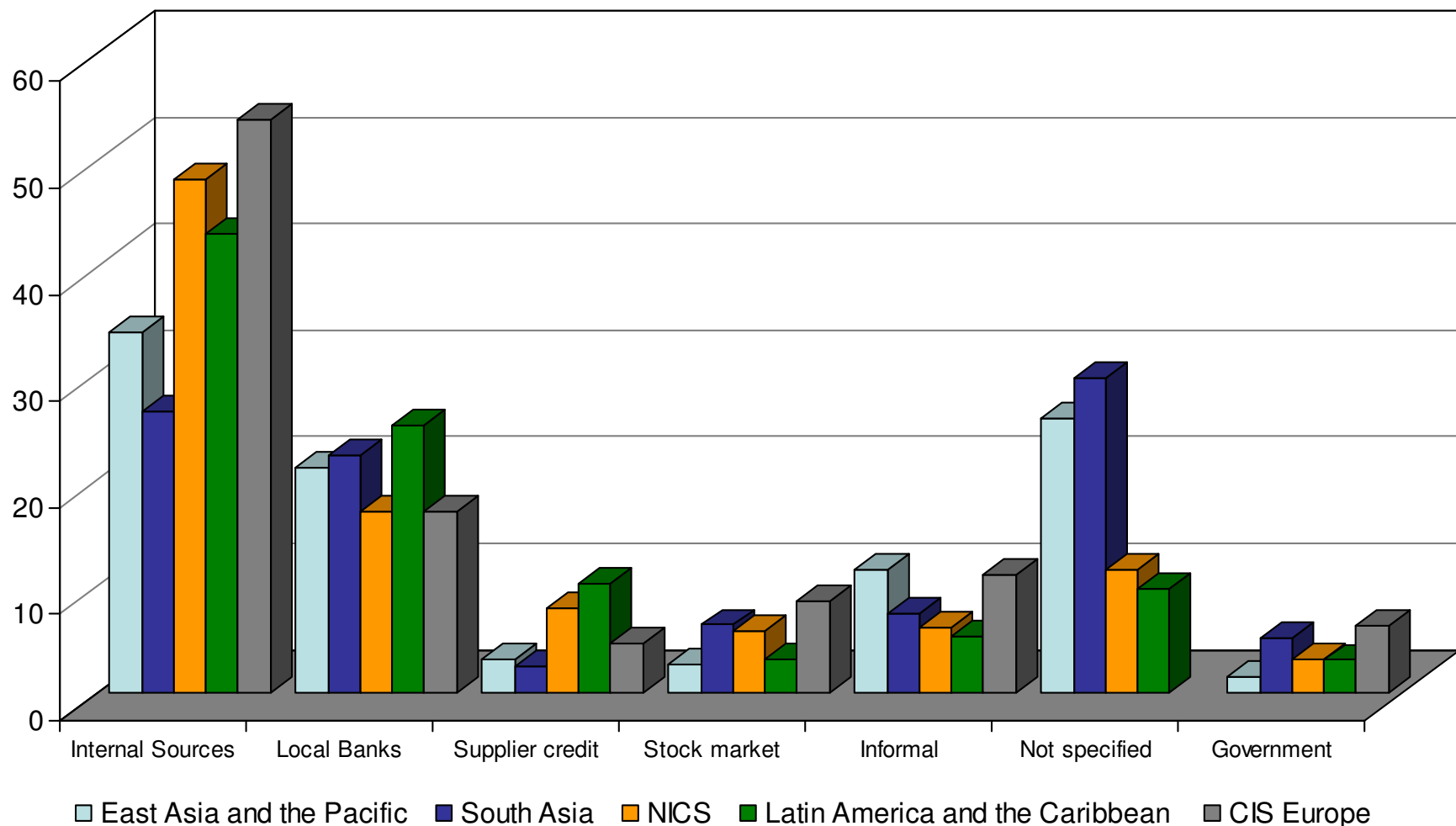


The short-term rebound will face significant obstacles to become a sustained recovery...

- The effects of the current crisis are not limited to short-run factors associated with the economic cycle
 - The magnitude and systemic character of the current crisis indicate that the world will experience structural changes.
- There is a growing perception that world conditions will move towards a ‘**New Normality**’ comprised of three characteristics:
 - **Lower actual and potential growth rates in the developed world.**
 - ✓ Jobless recovery.
 - ✓ Global aggregate demand will be sustained more by the emerging economies.
 - **Limited expansion of international financial markets.**
 - ✓ Massive destruction of financial wealth, tighter regulation and increased financial protectionism.
 - **Reduced volume of commercial flows.**
 - ✓ Growth in world trade will be more sluggish, trade protectionism will increase, and the competition for markets will be more fierce.

In addition to the challenges imposed by the 'New Normality', the financing of business will also face domestic challenges

SOURCES OF FIRM FINANCE BY REGION
(In percent of the total)



The financial system should be an instrument for 'productive development'

- On the one hand financial systems:

- Have low levels of development

- ✓ Low levels of access
- ✓ Short term oriented



- Are highly Concentrated

- ✓ In terms of the ownership of assets
- ✓ In terms of the distribution of loans



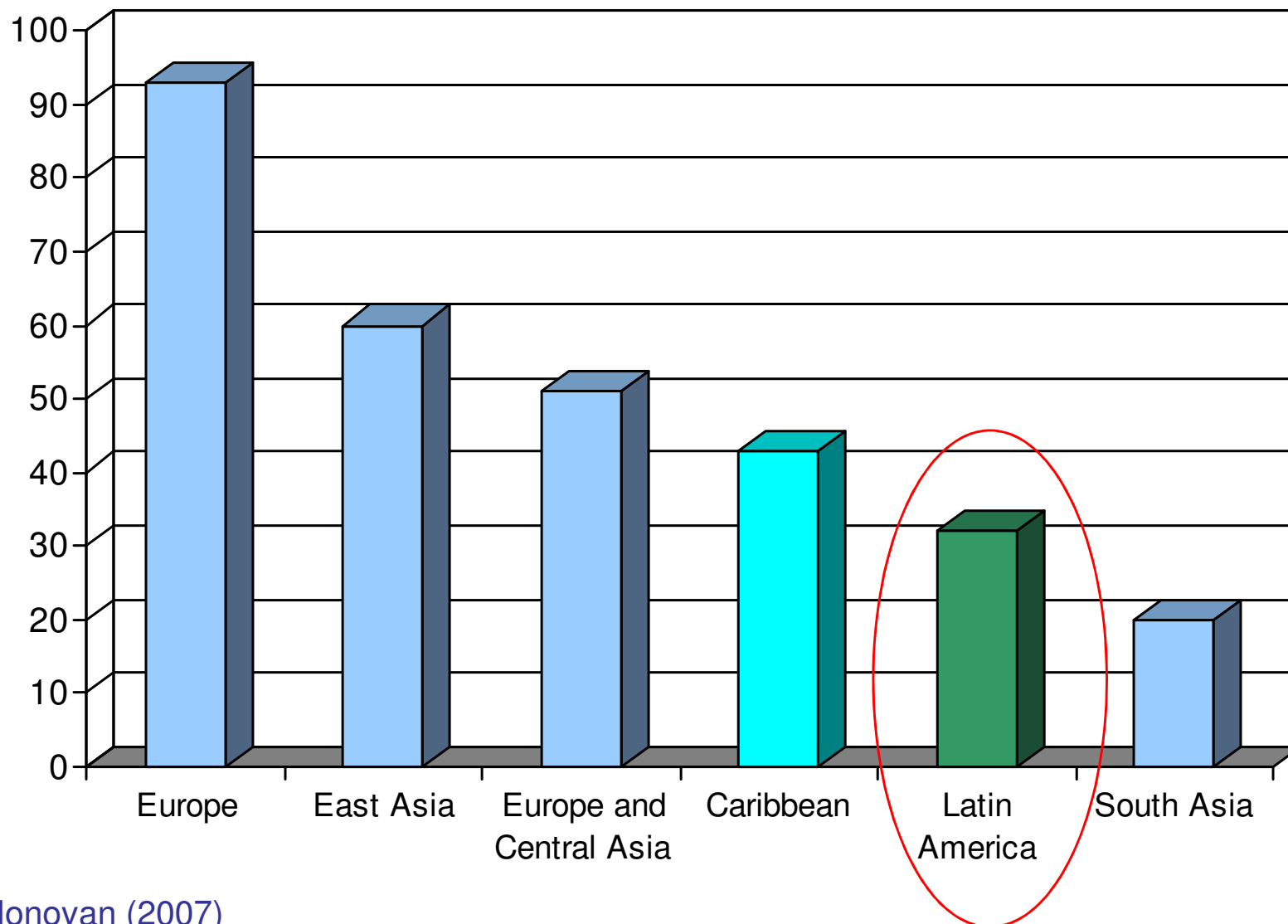
- Are short-term oriented

- Are highly segmented and exhibit high costs



Latin America has lower levels of financial access than other regions...

COMPOSITE INDEX OF FINANCIAL ACCESS BY REGION



And the access to financial services is unequal within the Latin American and Caribbean region and between poor and non-poor households

PERCENTAGE OF HOUSEHOLDS WITH LOANS AND SAVINGS IN FINANCIAL INSTITUTIONS

Country	Year	Total		Poverty				Microfirm activity			
		Credit	Saving	Poor households		Non-poor households		Households with microfirm		Households without microfirm	
				Credit	Saving	Credit	Saving	Credit	Saving	Credit	Saving
Bolivia	2000	7.0	9.9	5.3	4.5	9.7	18.0	6.0	6.0	7.2	15.3
Dominican Republic	2001	10.9	25.1	5.8	9.8	13.1	31.7	12.3	24.3	9.2	25.9
Ecuador	1998	9.8	22.7	4.9	7.9	12.2	29.9	13.9	20.2	4.2	25.5
El Salvador	2002	1.3	n.a.	0.5	n.a.	1.7	n.a.	1.1	n.a.	1.4	n.a.
Guatemala	2000	6.4	16.8	4.2	2.5	8.3	28.9	7.2	14.7	5.6	19.2
Haití	2001	n.a.	11.7	n.a.	3.7	n.a.	23.9	n.a.	9.9	n.a.	19.2
Jamaica	1997	3.8	59.4	1.0	40.2	4.5	61.5	4.3	60.2	3.6	56.9
Mexico	2002	6.2	20.6	5.3	14.8	8.2	32.9	8.2	20.9	5.5	20.5
Nicaragua	1998	10.4	5.6	5.0	0.9	13.8	8.6	15.7	5.4	5.8	5.8
Panama	2003	17.5	35.2	8.4	9.9	20.7	44.0	13.7	27.2	19.7	39.7
Paraguay	2001	3.4	3.7	1.7	0.7	3.1	4.8	2.1	2.7	3.6	6.2
Peru	2001	3.5	4.5	1.5	0.9	5.1	7.6	3.4	3.4	3.6	6.4
Weighted average		6.3	18.0	4.5	10.0	8.3	28.3	7.2	14.5	5.6	20.3

n.a. not available.

Source: Tejerina y Westley (2007)

Commercial bank credit is mainly channelled to big firms...

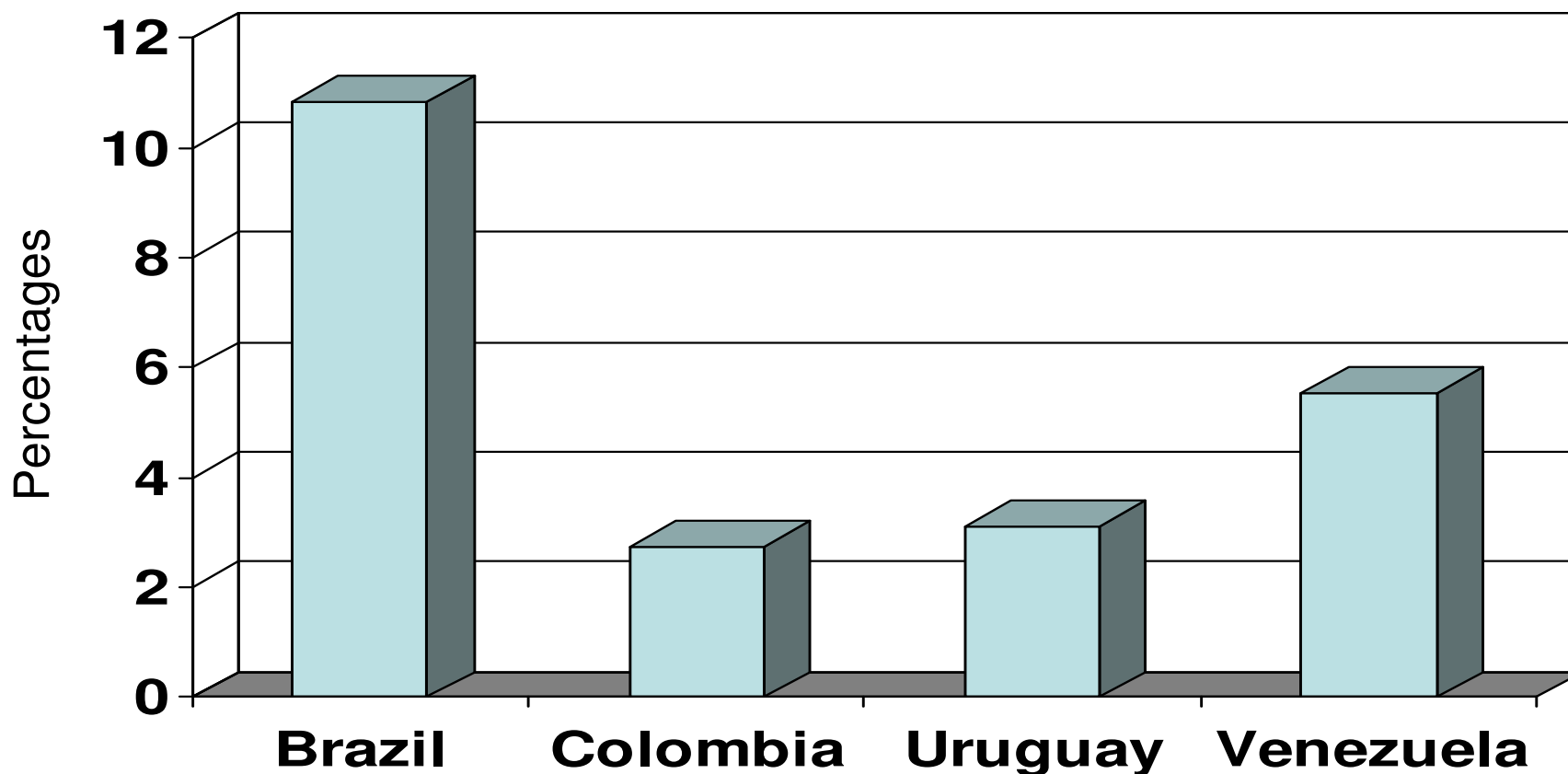
Share of credit by firm size in the case of Mexico (2007)

BANK	SHARE OF CREDIT TO FIRMS IN THE BANK'S PORTFOLIO	SHARE OF THE 100 BIGGEST CLIENTS IN THE BANKS' LENDING PORTFOLIO	SHARE OF SMALL CLIENTS IN THE BANKS' LENDING PORTFOLIO
BBVA	31.9%	56.2%	14.0%
BANAMEX	40.3%	73.5%	10.7%
SANTANDER	46.9%	68.6%	14.7%
HSBC	36.6%	63.3%	13.4%
BANORTE	44.8%	56.5%	19.5%
REST	48.3%	78.0%	10.6%
TOTAL	41.6%	68.0%	13.3%



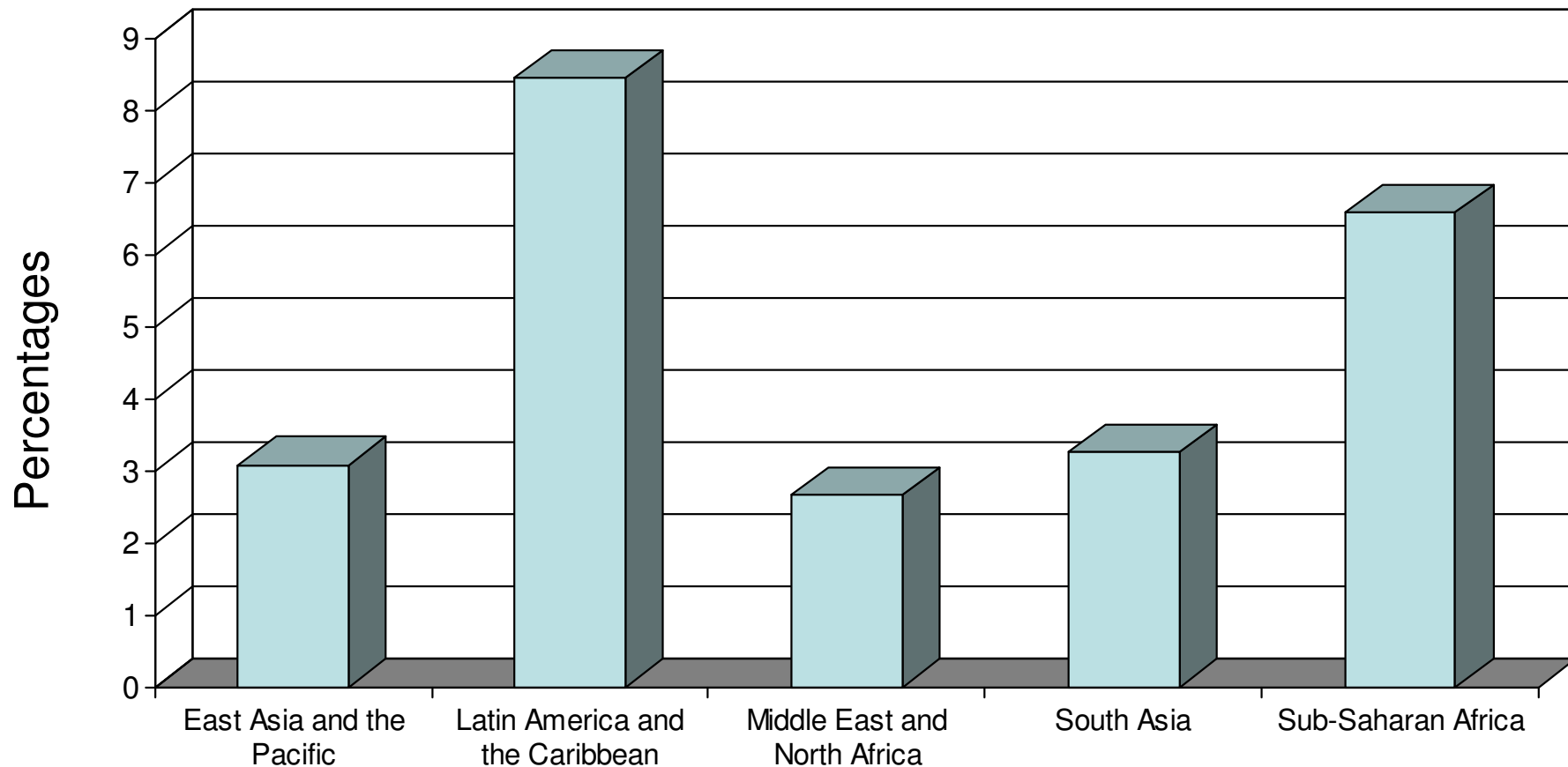
In Latin America the interest rate differential for different size firms can reach up to 10 percentage points

Differential between preferential and ordinary interest rates in Latin America (In percentage points) 2008-2009 (Averages)



And the operating costs are high relative to other regions...

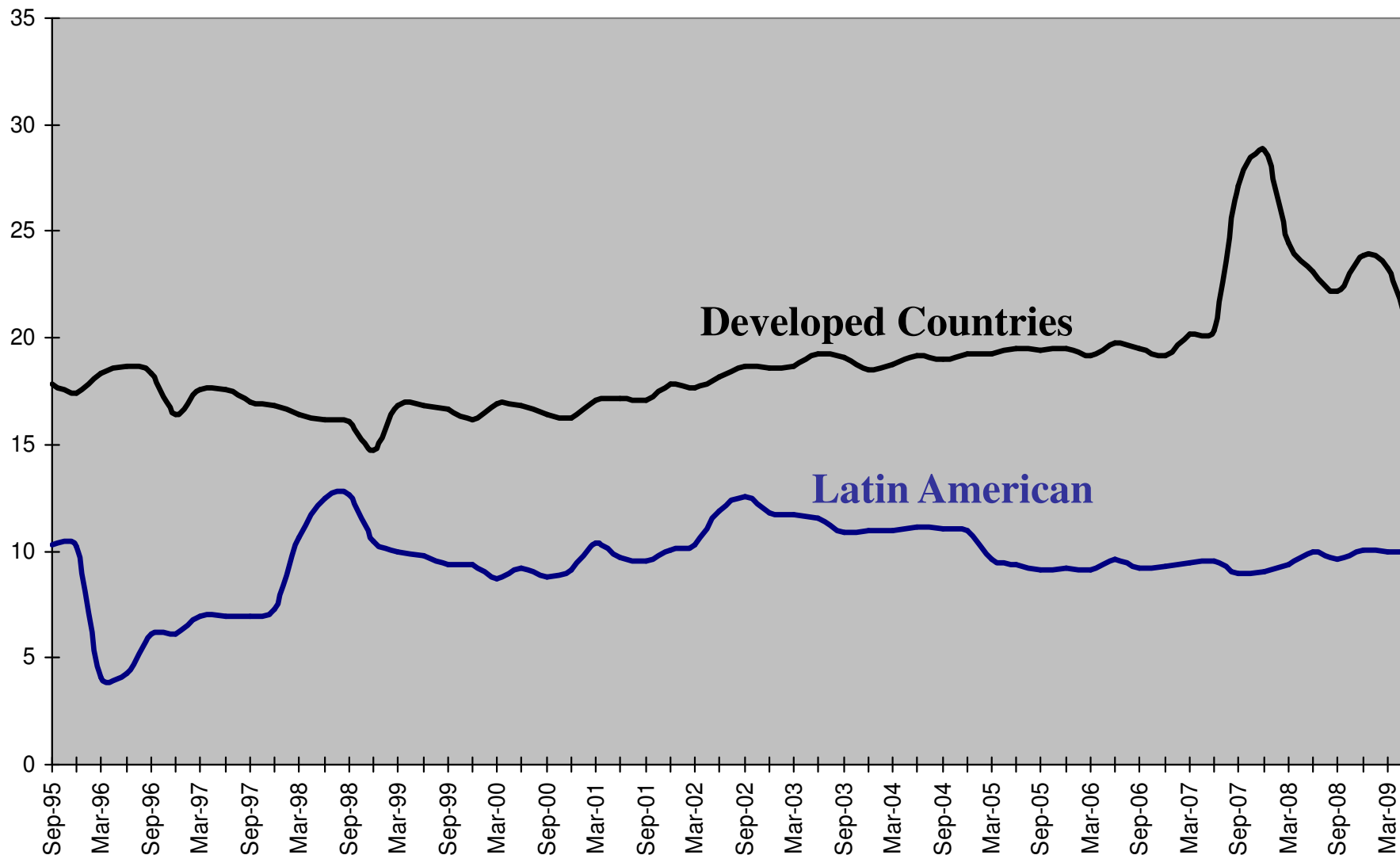
**Non-interest expenses/average assets (%) of commercial banks by region
Average 2006-2008**



Source: On the basis of World Bank Data (2010)

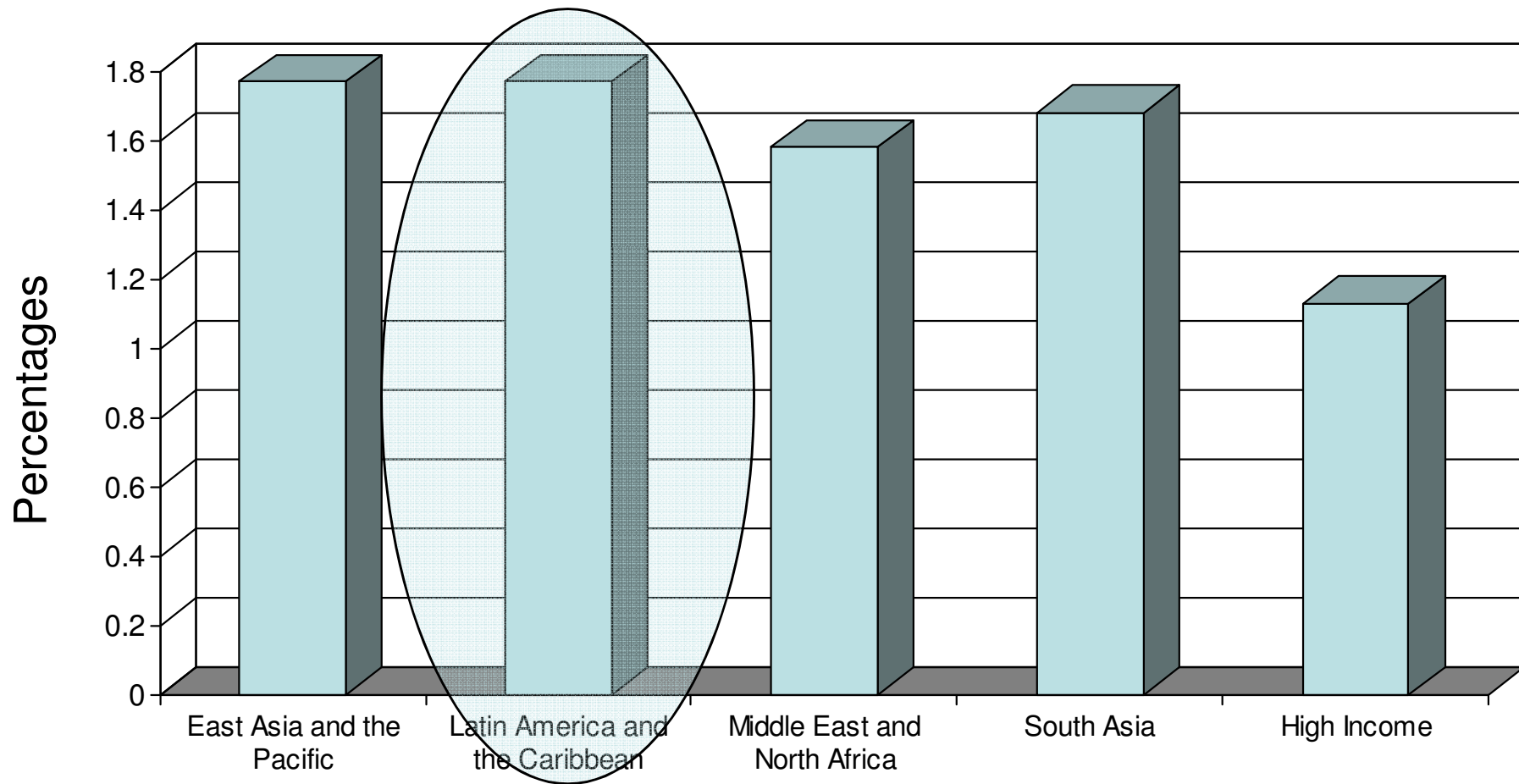
On the other hand financial systems focus on ROA finance rather than leverage...

Leverage in the developed world and Latin America (September 1995-April 2009)



And profit margins are high compared to other regions...

Profit margin (before tax and non-operational items (%)) of commercial banks by region (Average 2006-2008)



Source: On the basis of World Bank Data (2010)

The challenge is to move towards the creation of inclusive financial markets that can improve upon their function of resource channeling and allocation

- To this end commercial banking and financial system activities must be complemented with public policies that promote the role of development banking, and their respective instruments
 - Development banking must focus on market failures.
 - Complementarity with commercial banking.
 - Allocation of resources through financial criteria (maximization of utility).
 - Development of new financial instruments
 - ✓ Guarantee schemes
 - ✓ Venture capital
 - ✓ Securitization
 - ✓ Factoring

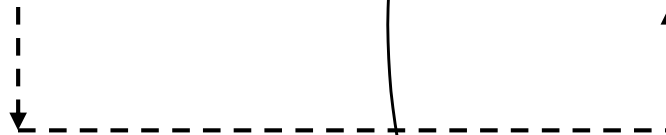
Commercial and development banking

Public bank

Private bank

Second tier banking

First tier banking



Also public policies must promote the role of microfinance and its respective instruments

- Microfinancing institutions provide financial services to low income households and microenterprises, that do not possess the conditions (collaterals or guarantees) to secure loans.
- Multiproduct
 - Financing of working capital.
 - Credit lines: education, family.
 - Health and life insurance.
 - Means of payment: current accounts, cards.
- In order to promote the development of microfinance in the region, it is necessary to design public policies to improve the capacity of the relevant institutions to obtain the required resources to operate.
 - This implies addressing challenges related to administrative and regulatory issues in order to facilitate the monitoring of risk ventures.
 - And requires the application of low cost technologies that are accessible to this type of institution.

Conclusion

- The context within which the financing of business takes place will change.
 - The New Normality
 - √ Implications and effects (regulation, access to finance).
- What is the role and function of the financial sector
 - Who finances is as important as how activity is financed.
 - Intermediation role.
- How to complement private finance with public banking.