A regional lynchpin

Alexander R. Malaket explores the state of trade and trade finance in Mexico at a time when the country's two Nafta partners are each dealing in their own way with the consequences of the crisis.

Juan Ignacio Garcia Merino at BBVA Bancomer in Mexico City

Luiz Simione at HSBC in Mexcio City

Mexico is accustomed to crisis and has learned under difficult conditions, to manage its financial system and its economy. The Mexican financial sector is heavily influenced by the presence of foreign based international banks which inevitably influences the trade financing landscape in the country.

An exploration of the state of the Mexican trade and trade finance market elicits a variety of views from those who know the market best: on one level, Mexico is described as having suffered from the 'symbiotic relationships' facilitated and engrained between Mexico, the United States and Canada under the North American Free Trade Agreement (Nafta). On the other hand, commentators point out that Mexico knows about crisis, and has faired better than some would have expected – indeed, comes out in a better position on a go-forward basis than the one in which it entered the crisis.

In pre-crisis days, Mexican businesses and financial service providers were actively engaged in the evolution of open account and supply chain finance solutions – driven in part by shifts in the business approaches of US business partners and counterparties. Overall, the sense is that while there has been a shift back to traditional instruments – partly as a result of demand from Asian partners and partly a reflection of requirements to secure US-based payment undertakings through confirmations – the consensus is that the shift is temporary and Mexico will return to trade based primarily upon open account and supply chain finance mechanisms.

State of the market

Mexico has been and remains heavily dependent on the US consumer market – a market which partly provides inputs to production, which Mexican business, concentrated in the states bordering the US, the well-known Machiladora, assembles and re-exports primarily to the American market.

In addition to sourcing from the US and re-exporting, Mexico also serves as a major entry-point for parts and manufactured goods from mainland China to the US. By some estimates, 90% of imports from China to Mexico eventually transition to the US, with the remaining 10% for local consumption. Public policy in the form of negotiated tax agreements with various jurisdictions in Asia, has been instrumental in positioning Mexico as a credible and commercially viable gateway to the US market.

The continuing challenge for Mexico has been to develop and sustain value-added activities in the export sector, and the crisis brought into focus the need to diversify interests and business activities to other markets. While there has been some effort to increase trade flows with Canada, the primary focus has been on Asia and Europe. The effective disappearance of the US consumer market, coupled with a near concurrent impact from the H1N1 Flu outbreak, resulted in a loss of GDP of about 7% year-over-year.

Overall, about 85% of Mexico's export flows are concentrated on the US and Canada. Despite best efforts and the most optimistic projections of success, it is simply a reality that Mexico will not be able to develop new markets overnight, and that the recovery in the US remains fragile at best – with 'Buy American' provisions in US stimulus packages further exacerbating the anxiety of trading partners such as Mexico and Canada.

The Mexican trade environment is characterised by significant inter-company trade, either with China-based parent companies or Mexican owned, US-based subsidiaries serving, effectively, as distribution centres for goods re-exported from Mexico. Given the nature of the trade flows, about 60% of imports are facilitated through bank guarantees and documentary credits, while the remaining volume of imports are concluded based upon open account or purchase-order based transactions.

A significant portion of intra-company or intra-group trade relates to the hard-hit automotive sector, and the implications of the crisis in this sector remain unclear across North America and beyond.

The Mexican financial market has proven to be fairly resilient and robust despite other challenges in the country, and it is worth highlighting that – like India – Mexico has had the opportunity to offset some of the impact of the crisis through domestic consumption powered by a large market and significant demand.

Financial liquidity is adequate at the moment, with capital markets and funding sources having rebounded relatively well in comparison to the worst moments of the crisis in late 2008 and early 2009, when financial and capital markets all but shut down. At the same ➤

➤time, an appreciation of the peso against the US dollar, nearly 50% at its peak, had significant impact on trade flows,

Valentino Gallo managing director and Americas head, export and agency finance at Citi in New York observes: "Mexico exhibited a significant bifurcation in the market, with top-tier corporates having access to capital markets and funding, while other organisations had no access to speak of. The market offered abundant credit in some segments, while concurrently constricting credit to the SME segment."

Going forward

Prospects for 2010 are focused on moderate growth, ranging from about 2% to over 3%; commentators agreeing that the country's dependence on the US will remain significant for the foreseeable future. While advances may be made in terms of market development, and Mexico will likely continue to have success in positioning itself as a gateway to the still-powerful US economy, the short-term growth achieved by Mexico is expected to be driven primarily by domestic demand, including stimulus measures.

Corporates and midcaps in Mexico will take a more strategic view of trade finance as an element of a broader approach to working capital management. Supply chain finance models will be important to Mexican business, and companies will work to reduce debt within their financing structures. At the same time, as in other markets, Mexican companies will look carefully their banking relationships, seeking stability and responsiveness in tough times. Alternate financing and trade financing options have been and will continue to be vigorously explored – from agency business to direct access to capital markets.

Is the discussion of trade financing options or solutions fundamental? For some, the distinction between 'traditional' trade finance and emerging solutions related to open account and supply chain finance is at the crux of a forward-looking assessment of the market in terms of the future of trade finance. For others, perhaps less so.

Luiz Simione, head of trade and supply chain and receivables finance, Latin America at HSBC based in Mexico City notes: "Our industry seems to be caught up in creating and using fantastic-sounding names to describe simple things. Supply chain finance is a nice concept: financing as much as possible, the entire commercial flow, from seller to buyer or vice-versa. What is the difference between traditional trade finance as opposed to open account or supply chain finance? If a bank is fully engaged as an intermediary – i.e., assumes risk in the transaction, that is traditional trade finance. If not, that is open account. Supply chain finance is effectively, a combination of the two."

While Mexican regulators are described as working in a focused manner on maintaining a strong financial sector, it remains a fact and a reality of the market that most of the major providers of banking and international banking services are foreign-owned – arguably an asset to the country as Mexico seeks to diversify its markets, both for trade and investment flows.

Several providers have been dismissed due to serious challenges faced by their parent institutions, while the lone local provider has been discounted due to the impact of the crisis on an affiliate company in the industrial sector.

For some, the conclusion is that these realities, coupled with conservative practices and selective, limited risk-appetite by even the most solid institutions operating in Mexico, effectively translate to a limit on the ability of the financial sector to accept significant additional risk in support of trade transactions. Others describe a significant increase in appetite across all customer segments, but it is more likely overall, that a cautious approach will prevail for the time being.

It must be noted that the entities owned by foreign firms have a long-standing history and presence in the Mexican market, and one senior banker expressed specifically that the mitigation strategies of the parent company had been deemed acceptable by Mexican regulators.

And the verdict is...?

The Mexican economy is a large economy, and internal demand is sufficiently robust to serve as an offset to an externally-generated crisis. As in many markets, infrastructure development and investment plans are significant – including significant public-private partnerships in the areas of motorway construction and the development of ports and airports, complementing large-scale activities in transportation, infrastructure and logistics.

Key sectors such as hydrocarbons, power generation – including a push in alternative energy, as well as telecommunications, are contributing in large measure to the nation's ability to mitigate the effects of the global crisis.

Mexico will focus on growth despite some continuing tightness in the credit markets, while concurrently, trade and project finance will continue to focus on traditional sectors such as energy and power projects, even as agency-based business remains an important part of the trade finance landscape.

Given the significant role of international institutions in the Mexican trade finance market, the need for support through development banks and international financial institutions such as the World Bank, appears to be limited.

On the short-to-medium term side, the effective facilitation of trade flows will be very tightly linked to financing and the availability of reasonably-priced credit. Mexican companies will seek ways to continue to be able to produce, and will look to extend attractive terms, perhaps even up to 360 days, to their clients. Working capital requirements are expected to take and retain centre-stage for the immediate future, remaining core to the needs of importers and exporters.

Simione at HSBC, and colleague Fabricio Parada, head of trade and supply chain for Mexico, concur: "Mexico has also been strongly affected by the global economic situation. Granted, this is arguably the most global, but it remains that billions of people across the globe need to consume. We have been able to achieve three-digit growth in trade, and we continue to be optimistic about the prospects, despite our consciously conservative approach. In fact, we are well positioned to leverage our global footprint to find new corridors and new trade flows, which we will service end-to-end, through existing relationships."

For some, the relative strength of the Mexican economy and business environment pre-crisis resulted in mitigation of the impact of the crisis itself on Mexico. Had the country not been on relatively solid footing, they allege, things would be far worse today.

Salvador Cruz, executive director, head of global transaction banking Mexico at Scotiabank, comments: "Trade between countries can grow through better communication and through attention to awareness-raising. We have had significant success in facilitating and enabling the development of important relationships between Mexican and Canadian businesses, and will continue our relationship-based approach to what we view as a dynamic and promising market."

Scotia's head of trade finance, Jose Manuel Suarez, continues: "Our approach is also based on actively looking for and leveraging synergies between key parties that support the conduct of trade – including regulators, government agencies and other financial institutions operating in Mexico. The bottom line for us is that Mexico is open for business, and we are committed and enthusiastic about prospects here."

The cost of financing trade continues to reflect a premium in Mexico as it does in other markets, though spreads are down significantly from their peak in the second quarter of 2009. While pricing has not normalized, the reduction in spreads has progressed at a faster pace than some local experts would have predicted.

Also similarly to other markets, Mexico has benefited from increased flexibility and generally appreciated responsiveness among ECA's, with agency finance having provided a welcome and effective alternative for clients that historically avoided dealing with agencies, which were perceived as bureaucratic and expensive.

Juan Ignacio Garcia Merino, head of structured trade finance at BBVA Bancomer in Mexico City says: "Last year was particularly difficult for Mexico, but this is a large and important economy and stakeholders – including the government – learned some tough but key lessons from the Tequila Crisis in 2005, and were therefore better able to react, effectively mitigating the impact of the current crisis as well as avoiding the problems arose in the financial sector in other countries. We have seen the economy show signs of normalising with spreads down significantly since their peak, and with credit and risk appetite returning gradually across all segments, from SME to large corporate."

Merino adds: "ECA support has been critically important for Mexico seeing much more flexibility from their side, yet we continue to observe interest in emerging trade finance solutions related to open account trade and supply chain finance. At BBVA, we see a lot of opportunity for Mexico and for Mexican business, and we are committed to support the success of our clients in this market."

Optimism meets realism: Mexico is working its way through the crisis. ■

Latin America leads the way in the GTFP

Market comment: Antonio Alves, senior regional head of trade finance, Latin America and Caribbean region, IFC.

Latin America is now the most active region for the IFC Global Trade Facilitation Programme (GTFP). In the early years of the scheme the region accounted for approximately 15%-20% of the programme's total, with Africa coming out on top with 40% of the total business volume. This situation has now been reversed with Latin America accounting for 40% and sub-Saharan Africa and MENA each at 17%.

Since its launch the programme has enjoyed exponential growth. Working on a financial year that runs from 1 July to 30 June, the GTFP has grown from guaranteeing $45 million in its first four months to an expected total, for a 12-month period, of between $1 billion to $1.2 billion by June 2010. There has also been impressive growth in the number of participating banks – now totalling 55 banks in 18 countries.

Why has the programme been so successful in Latin America? The financial crisis has seen lines cut to smaller businesses and commodity producers, especially in the agri-sector. Banks have had to cope with strict internal risk management controls under Basel II, and cuts in country limits. However, with a GTFP guarantee, which under Basel II has 0% capital allocation, banks are able to step into the gap and lend to keep trade flowing. This has been especially evident in Central America and outside of the larger regional economies.

Each region also has different requirements, for example Africa requires LC confirmations, but Latin America needs funded pre-export and import finance transactions and the fit between what banks are able to offer, and what IFC is able to guarantee under its remit of aiding South-South trade, works well.

IFC has also adopted a new approach with the confirming banks in which the banks located in developed countries use the IFC guarantee as a facilitator for new business in emerging markets. This helps banks sell the idea internally as it allows them to cross sell other banking products. Spanish and Asian banks are expanding in the region and the Caribbean market looks set to be a new source of transactions. IFC has taken on the role of building bridges between emerging markets and banks appear keen to use them. (NB: Also see p34 for news on the GTLP.)