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FEATURED Q&A

Are Colombia's Banks Better Positioned to Face the Global Crisis?

Q Earlier this month, Colombia's largest bank, Bancolombia, upped its dividend by nearly 10 percent although the bank's president, Jorge Londono, warned that 2009 would be a tough year due to the current economic climate. What is the outlook for Bancolombia in 2009? Will Colombia's banking sector fare better in the crisis because of what some have called its strict regulation and a focus on credit-worthy investors, or is it as susceptible to the economic downturn as other banking sectors in the region?

A **Guest Comment: Diego Alcazar:** "After several years of steady growth and sound performance, the economic deceleration will likely hinder Bancolombia's growth in 2009. Margins should come under pressure given its rising funding costs and an expected slower growth in higher margin segments that contributed to its past results. Slower growth combined with maturing portfolios—in particular consumer lending—should cause a deterioration of asset quality ratios, hence creating the need for higher provisions for loan losses. As a result, profitability should decline from the flattering levels of the past few years but, we expect—absent a severe deterioration of the current economic scenario—that the bank will still produce moderate profits and sustain its capital levels. As expected, given the rapid economic deceleration, Colombian banks' year-end indicators show some deterioration of consumer and commercial lending from its strong levels of asset quality; further deterioration should be expected during 2009 as growth prospects remain dimmed. This is somewhat mitigated by lower household indebtedness and by conservative mortgage loan to value figures when compared to the last crisis. However, reserves provide decreasing coverage of rising impaired loans and much of the recent growth in regulatory capital came in the form of 'plain-vanilla' subordinated debt which, in

Continued on page 2

US Secretary of State Arrives for Two-Day Visit to Mexico

US Secretary of State Hillary Clinton arrived Wednesday in Mexico where she met with President Felipe Calderon and said US drug policy has been a failure. See 'In Focus' on page 3.

Photo: Mexican Government.

Inside This Issue

NEWS BRIEFS

Two Killed After Crash of Ecuadorean Air Force Jet

Two people were killed Wednesday during a rescue attempt after the crash of an Ecuadorean air force training jet near the Colombian border, the Associated Press reported. The jet, a Strikemaster MK-89 crashed 112 miles east of Quito, according to the air force. The pilot and co-pilot ejected and the co-pilot was rescued after three military helicopters were sent to the crash site. However, the pilot and a rescuer were killed after a cable snapped as a rescuer attempted to bring the pilot into one of the helicopters.

Petrobras Halts Payments to Builder Accused of Overcharging

Brazilian state oil company **Petrobras** on Wednesday said it halted payments to a builder that is carrying out work at a refinery project after a court ruled the builder may be overcharging, Bloomberg News reported. Petrobras said it stopped payments to **Construtora Camargo Correa**, which heads a group working at the Abreu e Lima refinery project. Petrobras said it will honor the court's decision although it does not believe the company is overcharging and plans to contest the ruling. Camargo Correa said it was "perplexed" by a probe conducted by the country's federal police.

Germany's MAN Plans New Investment in Brazilian Plant

Germany's **MAN AG** said today that it is planning to invest 330 million euros ($US 448 million) to increase production at a plant in Brazil, Bloomberg News reported. The investment by MAN, the third-largest truck maker in Europe, will be made over five years, according to spokesman Andreas Lampersbach.

Political News

Mexico Captures Alleged Top Leader of Beltran-Leyva Cartel

Mexican authorities have captured one of the country's most-wanted fugitives, an alleged top leader of the Beltran-Leyva drug cartel, Mexico's army said Wednesday, according to the Associated Press. Hector Huerta was arrested on a Tuesday in a suburb of Monterrey on a homicide warrant, said Gen. Luis Arturo Oliver. Four other men, believed to be Huerta's bodyguards, were also arrested. Soldiers confiscated four hand grenades and assault rifles at the time of the arrests. Huerta is accused of controlling the flow of illegal drugs through Monterrey for the Beltran-Leyva cartel, officials said, adding that Huerta allegedly met with leaders of the rival Gulf cartel to divide the two gangs' territory. "We have information that as the representative of the Beltran-Leyva cartel he held meetings with members of the Gulf cartel with the aim of agreeing on drug distribution zones, in order to avoid clashes between the rival gangs," said federal Deputy Attorney General Marisela Morales, who oversees operations against organized crime. In the past week, Mexican authorities also captured alleged Gulf cartel hit man Sigifrido Najera Talamantes and Vicente Zambada, an alleged leader of the Sinaloa cartel.

Company News

Doe Run Peru Shuts Down 95 Percent of Operations

Doe Run Peru, a unit of **Renco Group Inc.**, has shut down 95 percent of its oper-

Featured Q&A

Continued from page 1

our view, has little loss absorption capacity; the quality of capital is further affected by often significant levels of goodwill. Thus, we view the loss absorption capacity of Colombian banks as tight relative to regional peers, leaving the banks more exposed to potential pressure on asset quality."

A **Guest Comment: Jorge Lara Urbaneja:** "The Colombian banking sector is probably in the best shape possible to face the difficult times ahead in 2009 for two structural reasons. The sector already had difficulty at the beginning of the century when emblematic names such Bancafe, Granahorrar and Banco Superior disappeared from the market. At that point, the tax for financial transactions was created with the main purpose of strengthening Fogafin. The tax was enacted, on a temporary basis, at 2 per thousand on financial transactions taking place in the country. Then it was raised to 4 per thousand and now this tax is here to stay. The second reason is of regulatory nature and refers to strict compliance measures imposed by the Financial Superintendency on the banking system. All these measures remain in place today. On the other hand, we should note that there has not been a 'credit democratization policy' promoted in Colombia, as has happened in other countries. Thus, Colombian banks have remained under a very conservative line of business under the strict supervision of the Finance Superintendency ahead of the crisis. Bancolombia is possibly foreseeing a reduction in credit demand for the remainder of 2009. This being the case, it may reduce the net worth *vis-a-vis* active credit ratio thereby strengthening the share profitability rather than keeping unused resources in its balance sheet. Also, the dividend increase should help the price of the Bancolombia stock, which has decreased substantially."

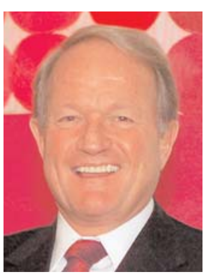
A **Guest Comment: Felipe Carvallo Mendoza:** "Moody's has a positive outlook on the financial strength rating for Bancolombia reflecting its strong franchise in all areas of commercial and retail banking and its leading market shares in

Continued on page 4

ations in Peru because of its difficulty in securing financing, Bloomberg News reported Wednesday. This week, the company's smelter in La Oroya closed down, following last week's shuttering of zinc- and lead-processing operations, the company said. If the company fails to reach agreement with banks and suppliers, the company could shut down completely as early as today, said Luis Castillo, general secretary of Peru's Mining Federation, which represents 28,000 of the country's miners. "Apparently the government is going to provide Doe Run with guarantees," Castillo said. "But it's going to be complicated to regain people's trust in the company." The global financial meltdown has led to plummeting prices for metals, causing more than two dozen mining companies in Peru's central highlands to look for buyers after banks halted financing to Doe Run last month.

McDonald's Restaurants in Latin America See Slowing Growth

Sales at **McDonald's** restaurants throughout Latin America will slow this year as the region grapples with the global financial crisis, said the fast-food giant's largest franchisee, Bloomberg News reported Wednesday. Woods Staton, chief executive officer of **Arcos Dorados**, said he expects a 5 percent increase in sales this year as the recession hurts diners' tastes for Big Macs and Happy Meals. Last year, McDonald's restaurants in Latin America saw a 26 percent sales growth to more than $3.5 billion, a record. Arcos, which is based in Buenos Aires, owns and operates all of US-based McDonald's 1,750 restaurants in 19 countries across Latin America. "If we grow by 5 percent, that will be good," Staton said. "It's a recessive year." This year, Arcos plans to open about 150 new restaurants in Argentina, Brazil, Colombia and Venezuela. Globally, McDonald's said this month that its sales grew 1.4 percent in February.



Staton

File Photo: McDonald's

In Focus

Clinton Arrives in Mexico as Lawmakers Examine Drug Plan

By Matthew Schewel

Secretary of State Hillary Clinton arrived Wednesday in Mexico, where she said a failed US drug policy has contributed to soaring violence. Clinton's trip began the same day as members of Congress expressed support for the Obama administration's plan to address drug-related violence on both sides of the Mexican border, but said more funding for border security is needed.

"Clearly what we've been doing has not worked," Clinton said as she started her two-day visit to Mexico, where she later met with President Felipe Calderon, reported *The Washington Post*. "Our insatiable demand for illegal drugs fuels the drug trade," she added. Clinton said US policies to clamp down on the sale and use of illegal drugs have not been effective and that weapons smuggled across the border have caused the deaths of police, soldiers and civilians in Mexico. President Barack Obama is scheduled to travel to Mexico next month to meet with Calderon.

On Capitol Hill Wednesday, members of the Senate Homeland Security Committee expressed both support and doubts about the Obama administration's plan to send more equipment and federal agents to the US-Mexico border.

"The administration's latest response to the southwest border violence represents a significant first step forward," said Sen. Joseph Lieberman (I-Conn.), who chairs the committee. "But I don't think it is enough."

At the hearing, Lieberman told Homeland Security Secretary Janet Napolitano he planned to request an additional $380 million for her department in order to tackle border security issues, $250 million of which would go toward hiring an additional 1,600 customs and border patrol agents.

Napolitano on Capitol Hill Wednesday.

Photo: Latin America Advisor.

Senator John McCain (R-Ariz.) agreed the US could do more to combat drug-related violence, which he said posed "an existential threat to the government of Mexico." When asked by McCain if she saw the threat as "existential," Napolitano paused and then uttered an unequivocal "yes."

Napolitano said the administration's plan, which would require no additional funding, includes doubling the number of agents working on inter-agency border security task forces, hiring 100 new border patrol agents and tripling the number of intelligence analysts at the border. The new initiative for the first time includes monitoring southbound rail and vehicle traffic at the border in order to curb the flow of guns and cash into Mexico.

Napolitano said the $184 million plan would be funded by delaying some equipment purchases and other initiatives, but a number of senators said they were concerned about diverting resources from other needed areas. "I don't think you should have to put off purchases," Sen. Lindsey Graham (R-S.C.) told Napolitano. Graham said that while many items on Obama's proposed new budget are controversial, there is "lots of bipartisan support" for border security issues.

"I can't think of a better use of our time and public dollars," Graham said.

Featured Q&A

Continued from page 2

Colombia. Its broad and deep customer base has provided an important platform for growth and improvement of its financial fundamentals during the past few years. The Colombian banking system is nevertheless challenged as are most banking systems in the region by tough credit and market conditions across the globe as well as a declining domestic economy. Though the uncertainties surrounding the decaying global economic outlook should stress the banks' asset quality, it should be manageable based on an ample capital cushion, supported by high pretax earnings and strong reserve coverage for problem loans. Colombian banks may however also be challenged by their more aggressive tier-one capital levels than those of their Latin American peers particularly when goodwill is deducted and government securities are risk-weighted at Basel II levels. Continued strong expansion of loan portfolios could thus put pressure on capital levels. The Colombian banking system has certainly benefited from a focus on credit-worthy clients, evidenced by adequate asset quality ratios and credit costs thus far. The regulator has comprehensive knowledge of the banking system, with established checks and balances, as well as prudent standards for provisioning and loan classification. During 2008, the regulator sent a wake-up call to the banking system by increasing the policy rate by almost 100 basis points, which, among other things, curbed portfolio expansion, especially for riskier consumer loans."

A **Guest Comment: Carlos Urrutia Valenzuela:** "Unlike banks in the United States and Europe, Colombian banking institutions are in a strong financial position and are well-prepared to weather the potential backlash that the global financial crisis may inflict upon the Colombian economy. To begin with, Colombian banks learned a hard lesson from the near-meltdown of the Colombian economy that occurred between 1998 and 2001. That crisis was likewise triggered by a real estate bubble. Banks engaged in lending to borrowers unable to service their loans. During that period, the Colombian government was forced to step in and provide liquidity to financial institutions. More than half a dozen commercial and mortgage banks were taken over and wound-up, while many others received liquidity facilities provided by FOGAFIN. Additionally, a government-owned institution acquired non-performing credits that were subsequently sold to investors, in many cases at a substantial profit. The Superintendency of Finance, Colombia's financial and securities market regulator, has made a significant effort toward ensuring that its regulations are sound and focused on strengthening the balance sheets of local institutions. The regulations did not permit financial institutions to invest in the types of toxic products that currently plague banks all over the developed world. Colombian banks have recovered from past mistakes. They have built a strong capital base to support aggressive growth and maintained healthy lending and investment practices. Thanks in good measure to the impressive performance of the Colombian economy, local banks have had their best-ever results in terms of profits and solvency ratios. Bancolombia is certainly is a good example. During 2007, it raised more than $670 million in capital in the international markets, by issuing ADR's and subordinated notes due in 2017. The bank's performance in the preceding years supports the decision to distribute 10 percent of its 2008 profits, without compromising its ability to face any difficulties that the Colombian economy might face during 2009. "

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