

# Peru's banking crisis: just the beginning

by Manuel Hidalgo

Peru's banking crisis escalated in November and December of 1998, exactly as occurred in Argentina, Ecuador, Mexico, and Chile. The "Russian phase" of the international financial crisis has caused, since August, a drastic decline in the flow of dollars toward Ibero-America's financial markets, dollars that had been financing the supposed economic successes of the "opening" and the bubble of the region's "emerging markets." This has combined with the collapse of incomes in the region caused by the fall in raw materials prices, including oil. In the case of Peru, the dollars of the foreign banks and of income from raw materials, which accounted for 70% of the money in circulation, are no longer coming into the country.

This sudden cutoff of the flow of dollars has produced serious liquidity problems in dollarized economies, flight out of local currency into dollars, and great difficulties in the banking sector, which have accumulated short-term foreign debt in unheard-of amounts, in the midst of a nearly 50% decline in the value of their stocks over the past 12 months.

On Nov. 24, the Banco República was taken over and liquidated. On Dec. 9, the Peruvian state bought the Banco Latino, the country's seventh-largest bank, when all plans to sell it collapsed, threatening its main creditors, ING Baring and Peru's number-two bank, Banco Wiese, with huge losses. The government justified its action by arguing that otherwise, the bank would have had to liquidate itself, triggering a domino effect. Days later, a wave of rumors that Banco Wiese had been taken over by the authorities nearly caused that bank to lose a subscription for expanding its social capital by \$50 million, an expansion urgently needed to refloat the bank, whose stocks have fallen 55.5% in value since early 1998.

The bank crisis comes in the midst of the recession and liquidity crisis afflicting the entire Peruvian economy. The Alberto Fujimori government has dealt with the fall in mineral (export) prices, and with the decline in agricultural and fishing exports because of El Niño, by implementing recessive policies of reducing the availability of the Peruvian currency, the sole, out of fear of a devaluation crisis. Although the foreign-exchange gap is under control for the moment, because of a recession, even Economics Minister Jorge Baca has stated that the "Russian crisis" had not been foreseen.

In just the past eight months, the government lost more

than \$600 million in reserves through its efforts to prevent a devaluation and to avoid massive capital flight. The banks, in turn, are holding onto the dollars in the economy (70% of money in circulation is in dollars), in their efforts to prevent a moratorium on their short-term foreign debt, which totals an average of \$3.7 billion. The banks have begun to plead with the government to hand over reserves—whose use in creating infrastructure was specifically combatted by the banks—to provide them liquidity instead. Meanwhile, the interbank market remains paralyzed, with interest rates at nearly 30%. In all, the recessive prescriptions are proving worse than the disease: Delinquency in payments rose nearly 7.32%; non-performing loans have grown 52.3% since October 1997.

## Rescue of the banks begins

On Dec. 7, in an effort to calm the crisis of confidence and alleviate the mass withdrawal of bank deposits, President Fujimori went on television to announce that the government, for the first time in many years, would issue Treasury bonds, up to as much as \$1 billion worth, to buy up the non-performing bank portfolios. The government has expanded the Deposit Security Fund, but it is still not clear how to make that expansion effective. In fact, it is known that shortly before intervening against the Banco Latino, the government had made large deposits in the bank, in addition to reducing the reserve ratio three times in succession. More money to the bankers, more indebtedness, more hot air to inflate the speculative bubble.

In the meantime, the physical economy is in free fall, reaching the extreme of a generalized deflation and massive losses in the food and beverage industries. In November, the GNP fell by 1.8%, and it is expected that sales at Christmas—which for many sectors is the only period in which sales can be made—will be 25% less than the previous year. In November, manufacturing collapsed by 6%, and the National Industrial Society warned that by mid-1999, if there are no major changes in policy before then, as many as 30-40% of its members will have shut their doors!

A spokesman for Standard & Poor's rating agency said that the only salvation for the small and medium-sized banks is merger or sale. And if the mergers don't work out? Already, the Darwinian battle among the banks has begun; according to the press, the rumors of a supposed state intervention against Banco Wiese are part of a deliberate strategy by a competitor bank—whose name is not mentioned—for a hostile buyout. Banco Wiese lost 400 million soles in deposits, and fell from second largest bank in Peru to third place.

How much time remains for the bubble? Actually, not even enough time to cover the problems up: Juan Francisco Raffo, banker and president of the Society of Foreign Trade, declared on Dec. 19 that the government should be prepared to burn up still more reserves, in case the Brazilian program should fail.