Same country, same currency, new plot

Mexico has earned the respect of every comfort-loving industrialized nation by surviving the rigors of a 43% inflation rate, a 39% treasury-bill rate and a set of mortgage interest rates that range as high as 100%. In the United States, any one of these privations might cause J.P. Morgan & Co. to finance a Bernie Sanders presidential campaign.

The ordeal continued Monday in Washington as the Mexican people were subjected to the praise of the Clinton administration for producing less, buying less and eating less. A U.S. official, who would not be named, declared: “The damage has been contained.” An official who did speak for the record, Larry Summers, deputy Treasury secretary, congratulated the Zedillo administration on its timely repayment of some $700 million to the Treasury, part of the $12.5 billion loan that the Zedillo government had taken out earlier this year. Mexico, although allegedly in possession of adequate reserves, borrowed the $700 million as it had earlier borrowed the $12.5 billion, but this time the capital markets lent freely (in the form of 1 billion deutschmarks). Summers congratulated the Mexicans on the loan, which was not a sign of need but “really a reflection of the markets’ increasing confidence in Mexico, which, in turn, has been earned by the convincing policies that the Mexicans have pursued.”

The truth of the matter, we think, is that markets increasingly lack confidence. On Tuesday morning, even as President Clinton was congratulating President Zedillo on the belt-tightening prodigies that Zedillo wishes he had never achieved, the peso was sold down to a seven-month low; it has fallen almost 8% in the past month. The bolsa, despite some recent strength, is down by 11% or so from its highs of last month, and the predicament of the Mexican banks (and, of course, their clientele) has continued to deteriorate. It is true, just as Summers observed, that the bond markets have reopened to Mexico, but that is less a reflection on Mexico than it is on the markets. The bond markets also promptly reopened to Orange County, Texaco, Marriott, RJR Nabisco, Hospital Corp. of America and other debtors, public and private, that offended against the canons of law or taste in their dealings with lenders. When the sovereign state of Colombia set out to raise $200 million in a new syndicated loan the other day, the world's banks would hear of nothing less than $225 million (there were commitments, all told, of $365 million). The interest rate, over five years, was 1.25 percentage points over the wholesale cost of dollar deposits, the lowest pricing for a Latin American sovereign borrower in more than a decade, according to the Financial Times.

Markets can change their minds, of course, and the bolsa and the Chicago Mercantile Exchange (where a futures contract in pesos is now traded) might yet come to agree with Clinton. On Tuesday, a trader declared that Mexican stocks were cheap; others have pronounced the peso a bargain. What we think is so telling about the current bearish market mood, however, is that it has passed almost unnoticed. According to a Dow Jones bulletin from London by Gene Colter on Tuesday, most European investors are oblivious to it; what was front-page news in The New York Times in July is today barely noticeable. It is true, just as Summers observed, that the bond markets have reopened to Mexico, but that is less a reflection on Mexico than it is on the markets. The bond markets also promptly reopened to Orange County, Texaco, Marriott, RJR Nabisco, Hospital Corp. of America and other debtors, public and private, that offended against the canons of law or taste in their dealings with lenders. When the sovereign state of Colombia set out to raise $200 million in a new syndicated loan the other day, the world's banks would hear of nothing less than $225 million (there were commitments, all told, of $365 million). The interest rate, over five years, was 1.25 percentage points over the wholesale cost of dollar deposits, the lowest pricing for a Latin American sovereign borrower in more than a decade, according to the Financial Times.
York Times the other day was not that Mexico had borrowed the money with which to make a partial repayment, but that it had made a partial repayment.

The investment lesson we take away from the Mexican crisis of 1994 (predicted in these pages, if we may be indulged in remembering, by our friend Gert von der Linde) is that a developing country should always be valued with an eye to calamity. Thus, we think, Russia is the quintessential emerging market because it is so wild, so woolly and so cheap. According to New York-based Firebird Fund, which invests in it, Russian stocks—growth companies by definition, unless the country blows up—change hands at multiples of one, two or three times earnings. Repeat: earnings.

In Mexico, of course, there are hardly any earnings for stock prices to multiply. Mexican exporters, basking in the devaluation, have fared well enough, according to Eduardo Uribe, a Standard & Poor’s industry analyst in Mexico City. “But then you have the medium-size and small-size companies—the interest rates are killing them,” says Uribe. “All the money they are making is being paid to interest expense, if they make any money, because demand is still very, very low. Sales are down significantly from last year.”

Interest burdens have climbed, naturally. According to S&P’s Credit Week International, debt service has doubled in relation to pre-devaluation income. While reported past-due loans at the major Mexican banks reached 12% of total loans at June 30, S&P goes on, “this figure understates the true extent of substandard credit, which should be over 30% when adjusted to U.S. accounting standards and including distressed reschedulings and loans that do not pay cash interest.”

Every investor must choose between bullish political rhetoric and bearish price action. For ourselves, we would be short the peso—and short the administration, too, if that were possible, as a show of solidarity with the long-suffering Mexican people.

Grant’s® and Grant’s Interest Rate Observer® are registered trademarks of Grant’s Financial Publishing, Inc. PLEASE do not post this on any website, forward it to anyone else, or make copies (print or electronic) for anyone else. Copyright 1995 Grant’s Financial Publishing Inc. All rights reserved.
Subscribe to Grant’s

and get TWO FREE ISSUES added on to your subscription...
AND a signed copy of Jim Grant’s latest book:*