LATIN AMERICA

Limited risk of currency mismatches in the corporate sector in Latin America

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In a scenario of exchange rate strength and copious liquidity in the international market in the wake of the 2008 financial crisis, the emerging nations, and among them those in Latin America, stepped up fund-raising in overseas markets, especially in the non-financial corporate sector[1].

The risk, and consequently concern, regarding a potential currency mismatch in the corporate sector is greater at times such as now[2,3], when the weakening of commodity prices and the prospect of monetary normalisation in the United States place mounting pressure on the exchange rates of LatAm countries. Compounding this is the fact that there is far less information available on the financial position and exposure to foreign currency of the non-corporate private sector than there is, for example, as regards either the state or the financial system.

It should in any case be pointed out that there are four factors which should diminish the currency depreciation effect: i) unlike what happened in 2008, the current weakening has been evident for some time now, which has allowed companies to ready themselves for it; ii) the countries have been able to learn from the 2008 experience and in certain cases, particularly in Mexico and Brazil, where the corporate sector took a notable battering from the Lehman Brothers fall-out owing to their foreign currency exposure, regulatory changes have been brought in to curtail the risk of a major currency mismatch; iii) the region's economies have considerable foreign currency liquidity from building up reserves in recent years, which could be channelled into the private sector if required (as was done in certain countries in 2008-09 and is even now taking place); and iv) some companies which have issued bonds in foreign currencies could have natural cover if their revenues are linked to the exchange rate, for example by being exporters or direct suppliers to the export sector.

To what extent is the non-financial corporate sector in Latin America exposed to exchange rate fluctuations? This economic watch describes the findings from studies conducted by the region's central banks, which have examined the degree of currency mismatch of non-financial companies, thus affording us an overview of the situation in the region.

Argentina

After the traumatic collapse of the currency board in late 2001 and early 2002, and the subsequent learning process regarding the risk of currency mismatches, the Argentine private sector's external debt was steadily brought down to 12.4% of GDP in 2Q14 from 31% at the close of 2001. This figure is not only low but additionally: i) 50.3% of this debt involves companies in various tradable goods sectors (industry, mining and agriculture, among others) that have a large portion of their revenues in foreign currency, which provides them with natural cover; ii) 43% of the private sector's external debt is with companies in the same group, which would manage to refinance themselves without too much trouble in the event of an episode of currency depreciation. On this basis, only a small fraction of the private external debt in foreign currency is exposed to a significant risk of a currency mismatch. With respect to the dollar debt within the local financial

1: For further details on this process of rising fund-raising abroad, see, for example, the 2014 Latin America and the Caribbean Macroeconomic Report, IDB. "Global recovery and monetary normalisation".
2: See, for example, Global Financial Stability Report, 2014. International Monetary Fund
3: See, for example, Bank for International Settlements, "Chapter IV - Debt and the financial cycle: domestic and global", 84th BIS Annual Report, 2013/2014.

system, this was also reduced from 13.9% at the end of 2002 to 0.7% of GDP in 2Q14, with the additional qualification to note that loans of this kind in foreign currency are arranged for export firms (under a regulatory change made by the central bank after the currency board crisis), which means that the risk of a currency mismatch is even less.

Brazil

According to a study recently published by the central bank[4] using data on access to bank credit, external debt, credit instruments and currency derivatives, total corporate debt was 49.2% of GDP in 2014. Of this amount, 17.1% of GDP was foreign currency denominated, of which 6.1% of GDP was accounted for by export companies (which have natural currency cover, as we have mentioned earlier), 3.0% had currency cover in local markets, 5.1% was where the company's parent or part of its assets were abroad, and only 2.9% of GDP had no known kind of currency hedging. The study thus supports the contention that the currency mismatch problem is limited in Brazil. Although funds raised by subsidiaries of Brazilian companies abroad are not included in the central bank figures, the monetary authority argues that these are not significant volumes. Finally, all the requirements for greater information on the holding of currency derivatives, that were established after the problems that arose with the exchange rate depreciation in 2008, such as the central bank's currency swap selling programme which began in 2013, among other measures, are factors which mitigate the potential impact of exchange rate depreciation.

Chile

In Chile, a central bank study[5] highlights the sound position of Chilean companies with regard to any depreciation. According to the data provided, the currency mismatch as measured by dollar liabilities less dollar assets, less the net derivatives position, as a percentage of total assets (asset-weighted average) came down from 1.8 to 0.8 between 2009 and 2013. Similarly, the proportion of company assets with a mismatch percentage of over 10%, measured as a percentage of overall assets, dropped by 60% in 2008-13. Even though companies have been stepping up external bond issues to the detriment of local bonds since the middle of 2013, they have generally gone hand-in-hand with currency hedging. Chile's currency mismatch risk is thus limited.

Colombia

In Colombia, a recently published central bank study[6] notes that currency mismatch levels rose in 2005-12. On average, 28% of foreign debt in this time was currency-hedged, although this figure could be underestimated as no information is available on hedging by Colombian companies with foreign counterparties. On the other hand, 84% of the debt in foreign currency is in companies with foreign capital, so they could be less affected by exchange rate fluctuations. It should also be noted that the information used in this study does not address the universe of companies with foreign currency debt, and the figures provided are the average for 2005-12 and do not necessarily represent the true current situation.

Mexico

A central bank study[7] draws on information on all of the companies listed on the Mexican Stock Exchange which publish their financial statements quarterly. These companies have issued around 88% of the sum total of bonds placed abroad, so this is therefore highly representative of the universe in question. The study concludes that, on aggregate, losses would be limited given a 30% currency depreciation, as they would equate to little more than 15% of equity, or only around 5% if we take into account the hedging that

4: Box "Performance of non-financial corporate borrowing following the 2008 international crisis", from the central bank's September 2014 Financial Stability Report
5: Box III.1 "Currency mismatch in the non-financial corporate sector" from the del BCC Financial Stability Report, Second Half of 2014
6: Angel, S., Niño J., Montes "Currency mismatches of non-financial firms in Colombia". Economics Notes 805-2014
7: Report on the Financial System. Central bank. October 2014. pp: 52-56

companies have made. The comparatively small impact of such a depreciation relates to the significant reduction in exposure using FX options since 2008. On top of this, issues have been placed with long terms and at fixed rates, so companies do not appear to have taken on sizable refinancing and interest rate risks. Notable too are the regulatory changes brought in over recent years in connection with the derivatives market, both domestically and internationally, which have helped to limit risks.

Peru

In Peru, a study[8] by the central bank of non-financial companies examines a set of 84 companies (listed on the Lima stock exchange) from March 2011 to December 2013. To measure mismatch risk they use gains or losses produced by exchange rate fluctuations as a proxy. The results indicate that these companies showed considerable and rising losses in 2013, due to higher dollar borrowings which entailed high exchange rate losses. With respect to progress in the regulatory environment, at the end of 2012 the banking and insurance watchdog (SBS) established higher capital requirements for currency credit risk exposure and more demanding (i.e. lower) benchmark loan-to-value ratios for dollar mortgage loans. Moreover, in 2013 the central bank stipulated an additional reserve requirement for financial institutions which exceed a limit set on dollar-denominated vehicle and mortgage loans. Here it should be mentioned that in early 2015 the central bank toughened up the previous measure by imposing a further reserve requirement that will apply to those financial institutions that do not comply with the obligation to cut down the balance of their dollar loans (excluding foreign trade lending) by 5% as of June and 10% up to December this year.

Conclusion

The information on the degree of exchange rate exposure in the non-financial corporate sector is very thin in Latin America, as it is in the other emerging economies. Based on sparse studies by the region's central banks, it could be concluded that the individual corporate sectors are in most cases prepared to face up to the costs of a sharp depreciation in the exchange rate, as the increase in external liabilities in the last few years has been accompanied by a rise in foreign assets and currency hedging.

This said, we should be mindful that the lack of information, especially in certain countries, such as Peru and Colombia, rules out making a more emphatic and widely applicable conclusion. We therefore think that the central banks and supervisory authorities should pursue efforts to gather and disclose data conducive to more ample analysis, which would remove uncertainty over the risks attaching to any depreciation of LatAm currencies.

8: Box 2 "Currency risk at non-financial companies" Central bank Financial Stability Report. May 2014

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