

# THE MEXICAN STOCK EXCHANGE: A NEW FINANCIAL POWER

The October stock market crisis in the world's major financial capitals caused distress on the Mexican exchange. With that, the debate surrounding the Mexican Stock Exchange and its role in the country's economy began to heat up. Opinions on the matter are diametrically opposed. But what is true, independent of the discussion, is that the stock market here has become an essential force in the country's life. To get an insider's point of view, VOICE'S reporter Jorge Luis Sierra interviewed a major protagonist on the Mexican exchange: Eduardo Legorreta Chauvet, President of the Administrative Council of the Operadora de Bolsa, the country's largest brokerage firm.

*In 1982 the Mexican banking system was nationalized. Private bankers were displaced from the country's financial heart, and Mexico experienced what the government and business community have liked to call "a loss of confidence."*

*No one could have imagined then that those same executives, taking refuge in the still-young stock brokerage houses, would be the lead actors in the spectacular growth of a new, alternative financial power. Five years later, what was once a distant glimmer of hope for those ex-bankers, has become one of the world's most prosperous stock markets. At the head of their own strong, efficient and hi-tech brokerage firms, they have achieved a ten-fold increase in the dollar-value of the stocks traded over the past four years.*

*No one doubts the role they've played in the repatriation of large sums of money, taken out of the country as part of the capital flight following nationalization in 1982. Nonetheless, they have also managed to get the State out of stock market operations and to totally privatize what they now call the investment banking system.*

*Having been able to recover 34 percent of bank shares, purchase "Operaciones Bursátiles Somex", once the most important brokerage firm in the nationalized system, and limit the government's role to simply regulating and promoting investment, these financiers now form a sector with the power to dialog, exert pressure and win new privileges.*

*Eduardo Legorreta Chauvet is one of these actors in the stock market boom, perhaps the most important. His friendly and unpretentious manner contrast sharply with his social position. He belongs to one of Mexico's wealthiest and most powerful families. His brother, Agustín Legorreta, was the owner of the National Bank of Mexico (Banamex) until 1982 and is now the head of the Business Coordinating Council (Consejo Coordinador Empresarial, CCE), a leading private sector*

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association. The two brothers have established a veritable financial and industrial emporium.

The brokerage house "**Operadora de Bolsa**", founded and owned by Eduardo Legorreta, leads the Mexican Stock Exchange. Its capital value is 10 percent higher than Inverlat, owned by his brother and the country's second-most important exchange house.

VOICES interviewed Eduardo Legorreta ten days after October 19th, that "Black Monday" when the Mexican market plummeted as never before. Yet he believes that the stock market here will continue to be one of the world's most prosperous, as well as the only financial force capable of driving industrial production up and creating the one million new jobs the country needs each year.

For him, there is no recession in Mexico. He is confident that brokerage houses will play a vital role in the country's immediate future. That is, they will become Mexico's second financial heart, beating stronger and growing wealthier despite inflation, the foreign debt and the fall in consumer purchasing power. This is his point of view:

**Now that five years have past since the banks were nationalized, what do you think of the balance that's been created between the nationalized credit companies and the kinds of financial operations carried out in the private brokerage houses?**

I think both the nationalized banks and the brokerage houses have developed in important ways. And I think the banks need us, just like we need the banks. We provide financial services to our clients. Obviously, what we do is convert savings into investments, so there can be credit. That's what banks do in general, turn savings into credit. We need firms with lots of capital that can do the converting, demand credit, healthy credit, and ultimately pay it back. So I believe they are congruent points of view. Both kinds of businesses are needed for any country's economy to function adequately, and Mexico is no exception. Obviously, brokerage houses had already developed considerably before 1982; the capital market had been showing significant growth.

**What caused that growth?**

I think it's due to two major factors. One is confidence; in other words, the capital



The October crisis also affected the Mexican Stock Market. (Photo by José Fuentes Salinas)

market hadn't had time to develop before, since prior to 1970, the country's economic model of stabilizing development did not contemplate the growth of a capital market. Promotion of such a market only really began in 1970, when people began to acknowledge the country's size and its great needs for capitalizable savings. That's how the market got started. Later, however, unfavorable conditions developed; that is, people lost confidence in things, and there was not enough investment. Investment remained stable, or perhaps grew a bit during the oil boom. But by 1979, before the oil problems had really evolved, investment started to drop because people didn't believe the market was solidly backed by Mexico's economic conditions. The market is nothing more than the confidence of Mexicans in Mexican business and the Mexican economy. People invest in stocks when they think business is good and the country's economy is strong.

**My question was really focused on its growth after the nationalization.**

Fine, things didn't grow much in the beginning because plans were just being announced. And only when people really felt that the Mexican government was going to create satisfactory conditions for investment did the market begin to show significant growth. That's when the repatriation of capital really started; people brought their money back, they began to make considerable investments, they bought shares in banks, and so on. Mexican investors have regained their confidence, which is just natural, right. I think that for all Mexicans, the country we like and the country we're from is Mexico. Investors didn't leave, it's just that they took their savings elsewhere for reasons obviously related to confidence, and even to economic factors. That was when the cheapest thing in this country was the dollar, so people bought dollars. Obviously they were the object of terrible propaganda, called *sacadólares* (those who take their dollars out) and unpatriotic. But people, and not only Mexicans, but from all over, tend to protect their capital. It's a natural tendency. So the tremendous reactivation of the stock market is due to the fact that the people willing to invest in Mexican industries have regained their confidence in the country.

**Do you have any idea about the amount of resources generated for business by the stock market?**

This year more than a trillion pesos entered for new investments. So new businesses, as well as already existing ones have been able to increase their capital. This is a record figure in Mexico's history.

**Until "Black Monday", it was said that the Mexican Stock Exchange was a bull market, one of the most prosperous in the world. Is that an overstatement?**

No. It's true. Over the entire year, to date, the Mexican market continues to be the most prosperous. And there are two reasons for that. One, the market started out very low. With 1982 and the lack of confidence, shares were going for ridiculously low prices. So with the readjustment in the market, growth parameters have been enormous. The other reason is that the Mexican economy is beginning to recover from its difficulties and the recession of 1984, 85 and part of 86, caused by a second round of oil problems. So business profits have shown impressive growth. The initially undervalued shares, then, combined with the increased profits, have pushed the stock market way up in 1987.

**One of the most important things to happen in this field is the institutionalization of the brokerage houses. You explained that a few months after the nationalization, the *Operadora de Bolsa* became institutionalized. That was the reason for the company's growth. What does that institutionalization consist of? And was it a generalized process for all of the brokerage firms?**

No, it's still not become a general trend. But I can say that we were probably the first, and today there are many others. The idea is that before 1982, brokerage firms, for all practical purposes, were corporations with very few associates. In 1982, and in our case due to a shortage of capital, we invited a number of industrialists and merchants, among others, from Mexico to support us with their

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capital, so we could buy computers and open new offices. That's how we were able to institutionalize our operations, since we were no longer dependent on just two or three associates. *Operadora de Bolsa* now has 10,000 associates nationally, and no one person controls it. The business is run by its administrative bodies, by its Administrative Council, named by the firm's assembly and where the directors make our reports. That makes it a highly professional corporation. Here decisions aren't made by a single person.

**Within that process, have there been any advantages from decentralization?**

Decentralization has been very important for us. I think people in Mexico City think there's nothing more to the country than the capital. We've discovered a much more credible Mexico, with many more opportunities. We felt that Mexico's wealth was to be found in the provinces, and we haven't been wrong. There are two cities, perhaps the country's most important ones, with really major problems, Mexico City and Monterrey. Besides them, really, the rest of the country is doing quite well. There's an incredible boom along the northern border and in all the tourist resorts. Things have even gotten much better in rural areas; we've had years with good rain, etc. I would say that besides Monterrey, which has a large debt, everything is looking up in the rest of the country; it's impressive. Here, in Mexico City, there are so many people, all packed together; everything's so expensive, everything is

## CRITICS: GAMBLING WITH THE ECONOMY

Investment banking is complementary to national banking, according to the non-banking financial groups. Nevertheless, the relation between the Mexican government and the stock brokerage houses has not been tension-free. The ex-bankers demand that the stock market operate freely, and constantly press for the removal of governmental interference.

In these years when "confidence" has been undermined, there has been a privatization of a third of the nationalized bank and the two main Exchange institutions which were still in Government hands: the *Indeval* (Institute for Deposit of Stocks) and *Somex* Stocks and Shares. The existence of state-owned stock companies is now prohibited by law, while the profits from the Stock Exchange are tax exempt.

Nevertheless, the government itself maintains its Mexican Stock Commission as an institution promoting investment, and also regulates and vigilates this finance market. In October 1987, for example, the Commission suspended the historic session of Monday 5 October, when the Exchange had an incredible rise of more than 25 thousand points in the index of prices and quotations. Although this action gave rise to the immediate protest of the Stock Exchange authorities, the government refused to budge, considering that the quotations were rising beyond the real value of the business enterprises.

In the opinion of Carlos Acosta, reporter in an important Mexican weekly, nothing appears to deter the proprietors of the brokerage houses. Acosta wrote the following during the Stock boom: "The ex-bankers see how, day by day, their profits and those of their clients grow in a scandalous manner, without any impediment whatsoever, and what's more, with the approval and even the help of the government".

Three days after October 19, "Black Monday" in the memory of the investors, some criticism was made by Lorenzo Peón, President of the National Committee on Stocks and Shares, when he appeared before the Exchequer Committee of the Chamber of Congress: "The problem we have with the Stock Exchange —said Congressman Jorge Alcocer— is that the Mexican economy, through some pernicious influence, has run along the same lines as a casino where what is important is profit gained, not on the long term, but on as short a term as possible."

Alcocer demanded why the volumes negotiated in the Exchange are so voluminous, when there are only some 200 business enterprises involved and the amount of shares offered there has scarcely changed in 10 years.

"What has grown —he added— is the speed with which these papers change hands and this reflects the fact that the Exchange in general is not for investment for medium or long term returns; even less so when the Stock houses inform their clients of returns such as! *Operadora de Bolsa*, 4127% profit in the course of this year; *CAP S* of *Banamex*, 3264%; *Inverlat*, 2648%. Faced with these returns, would anyone be interested in investing in the productive sphere?"

One month before, another Congressman had proposed a tax on the profits from Stock Exchange activities. Humberto Ramirez Rebolledo, representing the parliamentary section of the National Action Party (PAN), expanded on this in the Chamber of Congress: "The tax exemption on Stock Market profits is an example that does most damage to the equity and justice of the law on that subject".

The representative of the PAN understood that this tax privilege was established as a promotional measure for the Stock Exchange, in order to stimulate its function of attracting national savings so that this would be channelled into productive investment. At that time —he explained— there were few people investing in the Stock Market and it was necessary to give a fiscal stimulus to increase this participation. "The situation today has gone to the opposite extreme", he added.

The legislative proposal is based on the fact that the number of saving and investing participants in the Stock market has now reached 400 thousand and their operations reached 16 billion pesos. In 1983 all the Mexican brokerage houses together had a capital of only one thousand million pesos, while it is calculated that, by 1988, every brokerage house will be able to count on a minimum of 10 thousand million pesos for its operations.

During the sequels of "Black Monday", the presidential candidate for the Mexican Socialist Party (PMS), Heberto Castillo, stated his position as to the possibility of a Mexican Stock Exchange crash! "The speculative spiral unloosed in the Stock Exchange —completely unconnected from the productive apparatus— is an act against the people of Mexico."

Castillo stated that, with the appearance of the Exchange, as government compensation for the nationalization of the bank, productive investment ended, no new business enterprises were begun, employment figures fell, and, in the field of speculation, the most powerful were those who took advantage of the circumstances.

The PMS proposals went even further than the PAN: "What is needed, —said the presidential candidate,— is the total nationalization of the bank, an impetus to small and medium industry, a stimulus to the productive areas and an end to money speculation".

The business sector have the opposite opinion. Agustín Legorreta Chauvet, owner of the Stock company, *Inverlat* and president of the Council for Coordinating Enterprises, demanded fair taxes from the government, low charges to promote investment and saving, as well as a reduction in governmental spending.

On his part, Bernardo Ardavin Migoni, president of the Mexican Employers Confederation, declared to the national press that Mexico has to undergo a profound change that will stimulate investment and growth. He emphasized that re-privatization is the only way to develop the country.

shipped in. It's become a real problem; we're all suffocating here. Without a doubt, decentralization is vital for the country, and the same goes for business. There's great opportunities to be had by moving businesses out of Mexico City.

### What role have small and medium sized investors played?

There haven't been many so far. The mark of a healthy capital market is the participation of small and medium-sized investors. Here, many people are just beginning to find out about this kind of investment. They are just beginning to see the possibilities of investing in the market. With time, the opening of more branch offices, changing investments, publicity and advertising, people will get to know the stock market better and make their investments there. In the developed countries, millions of people own corporate stock. General Motors, for example, is the largest shareholder corporation, with some 1.3 million shareholders. That's true democratization of capital. We want to reduce the concentration of wealth and distribute it via a capitalist market.

### Why do you place more importance on the capital market than on the money market?

As financial advisors we need to have all kinds of products to suggest to our clients. For example, if someone has 10 million pesos, it's not a good idea for them to invest all of it in the stock market. They should invest part of it in stocks and another part in the money market. What then is the brokerage firm's main role? It's to take the money that's been entrusted in us and channel it to businesses through the stocks they issue. That doesn't mean we won't buy Treasury Certificates or Petrobonos, because clients also need liquidity. But stocks aren't high liquidity instruments. Companies aren't like banks that pay interest every month. A company may take several years to begin producing dividends. That's why they are not instant investments. But it's been proven that a productive investment will generate greater returns, in due time, than if you had your money invested in a bank. Fifteen years ago, a person with a million pesos in the bank could live stupendously on the 120,000 pesos in monthly interest. But that same person spent the interest, and now those million pesos aren't enough to live on. But you can't eat stocks, either; you need money. That's why the liquidity provided by fixed return instruments, combined with the profits generated from stock holdings, are both important elements in the portfolio of the sensible investor.

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**A crack in the U.S. financial system would affect Mexico because we're part of a global system**

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Stock Brokerage House. (Photo from Novedades archive)



Eduardo Legorreta Chauvet. (Photo by Laura Cano)

**How has the government's economic policy influenced the stock market, and in particular the brokerage houses?**

Two actions were taken. In 1975 a law was passed regulating the stock market. Before that, there was no legal framework for operating brokerage firms, or for the capital market. Another very important thing was done in 1984; the commercial banking system was separated from the investment banking system. Previously, banks could also own brokerage houses. It was essential to separate them because they follow very different courses. This division exists in practically all the developed countries: the commercial system on one side and the investment system on the other. Banks try to attract resources in order to make loans; brokerage firms do it to make investments.

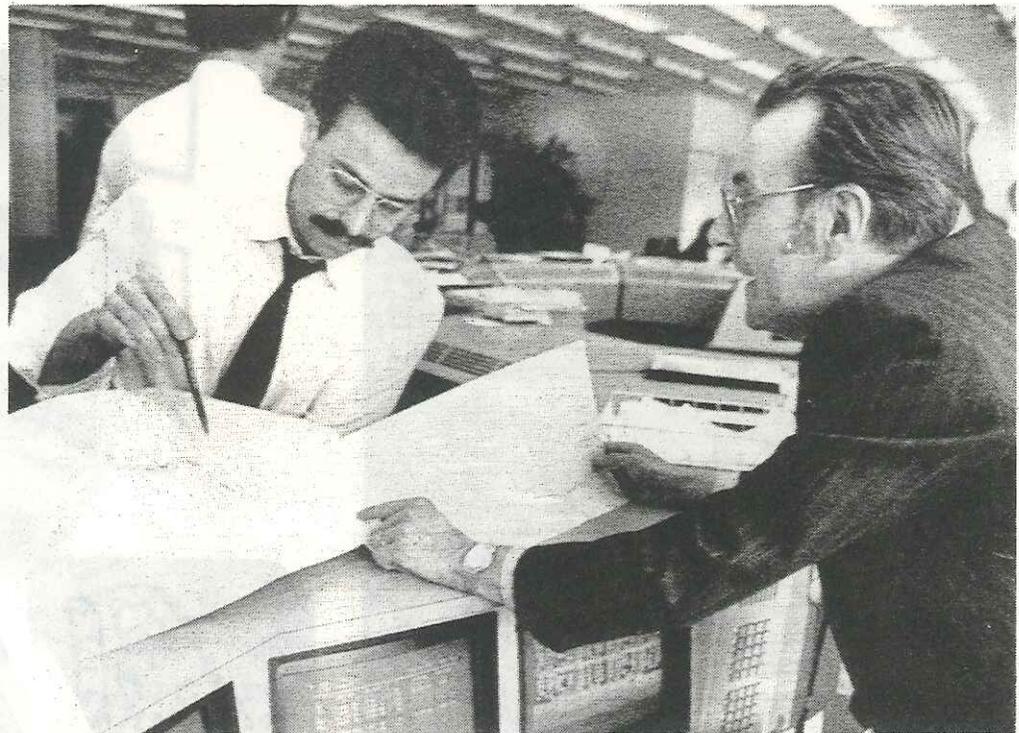
**What is responsible for the stock market's enormous growth in a country which, since 1982, suffers from a serious economic crisis, with open recession, inflation rising and real wages falling?**

I only agree with you on two points. Inflation is high, that's obvious, and purchasing power has also dropped. But that doesn't necessarily go along with the rest of what you've said. The country is in the midst of a clear economic recovery. It's just that we don't realize it, or we don't want to acknowledge it. What happens is that Mexico has a high population growth rate and needs a million new jobs a year, but enormous numbers of new positions are being created. The crisis has not gotten out of hand. Clearly all of us got poorer in 1982, with the demagoguery of redistributing what didn't exist. But all of the current programs have helped the country to develop in important ways. The GNP dropped, but that was due to the fall in international oil prices. The decision to promote exports of manufactured products was good for the country, it diversified the economy. The weight of oil in gross national production has dropped to about 30 percent, while it used to be more than 70 percent. People are investing because of these conditions, and that's what makes the market rise. A stock market is moved by two factors: people's confidence and the performance by business. And business here is producing more. So I don't believe in the recession; it doesn't exist. Yes, there has been a reduction in spending, in consumption, at all levels. Obviously the middle-class has been most affected. Workers understand things well because of their unions, and with these new measures, they understand even better.

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Experts in foreign exchange quotation. (Photo from Novedades archive)

**How is the Mexican Stock Exchange affected by the international situation, with the falling dollar, its impact on U.S. companies and the possibility of increased protectionism?**

The Mexican Stock Exchange doesn't have anything to do with stock exchanges in other countries. But clearly we live in the world, although at times we Mexicans are like the Chinese and like to think we're isolated. And we just saw that. The big drop in the New York market affected Mexico. That's not because Mexican shares dropped there, but rather it was a simple reaction, in which people said, "Well, if the world's most important market just plummeted, and in Tokyo, Germany and England they're also falling, then why won't the Mexican market fall, too?" Right? It was a purely psychological reaction, and if people's psychology isn't right, they won't invest. Our starting point is that Mexico forms part of a global system, whether we want to or not. I also think the crack in the U.S. financial system will, in fact, affect us. It's not over yet, and if the U.S. doesn't correct its budget deficit or its problems with the dollar, then the situation will get worse. It's the same thing that happened to us: we spent too much and borrowed more than we should have. The difference is that they can't run out of dollars because they print them; we did run out because they didn't lend us their press.

**What role will the stock market play in the country's immediate future?**

I think we need tremendous investment in order to be able to generate a million new jobs a year. It takes 200 million pesos for each employee. We need to create a huge amount of investment, and the only way to do that is through a capital market. The only way to create jobs is through investment; there's nothing else that will do it. That's the role we must play. The capital market needs to be the most important part of the country's financial system.

**Will the Mexican market continue to be one of the most prosperous in the world?**

I believe it will because the country is becoming more prosperous. Between 1950 and 1970 we grew so much that we outstripped the Japanese and the Koreans. Current conditions in Mexico will allow us to do that again. □

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