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Investment Capital Flows, Mexican Economics and Electronic Loan Exchange Project

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Abstract

Private capital flows to emerging markets continue at high levels, but concerns are growing about their sustainability. Direct equity investment slows down, as well as lending by bond investors and private creditors. The potentially global impact of a US economy slowdown, global financial imbalances and geopolitical tensions present motives for cautiousness. Situation in Mexico, the world's ninth largest economy, seems favorable, but confirms written above. Mexico's FDI rises, but slow down is expected: and with more than 40% of the population living below official poverty line, the inequality continues rampant.

Fortunately, there are innovations unseen ever before promising ways how to tackle the lack of investment. Electronic Loan Exchange Network, ELEN Project in development between group of Czech elite bankers, IT specialists and FIPS, prime Mexican microfinance institution. Goal of this ambitious endeavor is to enable tens of millions of small European and US investors to lend for attractive interest rate to poor micro-borrowers in marginalized regions on a massive scale, thus creating an alternative for savings accounts and stock market investments.

Keywords: **capital; investment; emerging; Mexico; risk; missing working capital,; microfinance; private capital; Czech; loan; network; FIPS; internet**

Introduction

Private capital flows to emerging markets are slowing down. However, emerging countries need capital in order to booster their development. Mexico is representing a typical emerging country: while macro-economic indicators may be in a good shape, almost half of the population lives in poverty. There are interesting innovative projects, just as Electronic Loan Exchange Network that may create alternative ways for capital investment.

Investment capital flows, Mexican economics and Electronic Loan Exchange Project

As the Economist quotes him, Richard Bernstein from Merrill Lynch compares emerging markets to popcorn in a microwave. One kernel pops, seemingly in an isolated event: but then another goes up and another, until the entire pack blows up.

Private capital flows to emerging markets continue at near record-high levels. While this is aiding to boost development, it may also be giving rise to an asset bubble. Indeed, concerns are growing about the sustainability of these flows and their effects on asset prices in recipient countries. The commodity boom has allowed yield-hungry investors to pour money into emerging markets: returns on American Treasury bonds and high-grade debt were too low to meet the needs of pension fund managers and voracious investors. Therefore, investors searching for higher yields than those available in advanced markets drove up prices of emerging-market bonds and equities in 2006. Acceleration in net portfolio equity investment in these markets, with continued strong net lending by commercial banks, accounted for the high level of overall flows.

But direct equity investment slows down, as well as lending by bond investors and private creditors. According to the Institute of International Finance (IIF), $502 billion of private capital flowed into emerging markets last year, less than $509 billion in 2005. The IIF predicts $469 billion of capital flows in 2007. Those flows reflect the general perception of a good shape of emerging-market economies, but a slowing trend.

Yet, there are reasons to worry. The potentially global impact of a US economy slowdown, global financial imbalances and geopolitical tensions present motives for cautiousness. Emerging-market equity volatility remains higher than in advanced markets. Another source of concern is the high level of lending by commercial banks to emerging markets. Seemingly benign corporate environment, attracting foreign bank loans, must yet to be tested in the dismay of an economic downturn.

When Latin American debt crisis broke in the 1980s, much of the debt was in the hands of Western banks, tied to a lot of political interest in ensuring the restructuring of the loans. Now that debt, in form of credit derivatives, is widely dispersed among hedge funds, pension funds and it is harder for creditors to discern where the risk is focused in order to consequently retrieve the capital: risk is loosing its form, transforming into shapeless clusters of relationships between non-identified causes and effects. Inflows to Latin America slowed down in 2006. Situation in Mexico seems favorable, but confirms what is written above. Mexico, along with Brazil, remained the largest recipient countries of foreign direct investment, with stable inflows in Mexico and an increase of 6% in Brazil. In 2006, Mexico reported foreign direct investment of US$18.9 billion, the highest since 2001, as manufacturers relocated factories to Latin America´s second-biggest economy. Mexico´s FDI rose 6.4 percent compared with 2005, while the manufacturing industry attracted the majority of foreign investment. Nevertheless the FDI to Mexico is expected to slow down to US$18.5 billion in 2006.

Mexico is the top trading nation in Latin America and the ninth-largest economy in the world. No other country has signed more free trade agreements: 33 in all, including the two biggest markets in the world, the US and the EU. Much of the FDI in Mexico is attracted by the country’s strategic location within the North American Free Trade Agreement, which has positioned it as a springboard to the US and Canada. Other attractions are competitive production costs and a young, skilled workforce, together with political stability and an open economy. As a result, the number of foreign companies established in Mexico has risen to more than 17,000.

Mexico´s proximity to the United States, a stable currency and inflation of 4 percent last year has helped attract foreign investment. Investment in manufacturing accounted for 61 percent of the country´s direct foreign investment: 64 percent of the country´s FDI came from the United States. The Stock Market, Bolsa de Valores, Latin America's second largest exchange, after Brazil's, has grown steadily, with its main indice increasing by more 48% in 2006. Certainly, there is a lot of room to grow in the stock market, which is currently trading mere 37% of GDP. The Bolsa remains small indeed when compared to other North American exchanges, as e.g. The New York Stock Exchange, which is about 100 times bigger institution. Mexico's economy grew 4.8 percent last year: the government expects growth to tail off to about 3.6 percent this year.

Financial markets experience strong growth in Mexico, with consumer credit growing of 400% since 2000, which is signaling a healthy middle class and financial institutions becoming regulated banks in surprising numbers and more institutions waiting in a row in front of the Central Bank for banking license.

These numbers may seem intriguing and promising. Nevertheless, with more than 40% of the population living below official poverty line, one soon realizes that there are two radically different planets existing separately under the umbrella of the Mexican federation – and that inequality is rampant and threatening.

However, new approaches and innovations, unseen in other countries before, may show promising ways how to tackle this issue. One of them is Capital Bridge Project, currently under construction between group of European bankers and Mexican microfinance institution FIPS. Goal of this ambitious endeavor is to enable millions of small European investors to lend their savings for attractive interest rate to poor individuals in marginalized regions on a massive scale, thus creating an alternative for European savings accounts and stock market investment, currently offering low yields or insecure and volatile earning.

The success of the microfinance methodology, abysmal discrepancies between interest rates in developed countries and emerging markets, mammoth, by far untapped gap between offer and demand, pave the way to make this financial dream come true: the positive result could mean more inflows of capital into capital-hungry SME sector in Mexico and later on in other emerging countries, creation of jobs and increase of stability of the Mexican economics, away from speculations and risk dispersion, as feared above. If ELEN project, currently under construction and open for any international collaboration on academic level, should succeed, poorer countries may be entering a new era, with gate of alternative capital bonanzas open to those who didn't have access to financial markets for long centuries.

After all, as Mexican writer Carlos Fuentes said, the health of Latin America is based on three pillars: human capital, jobs and security.

Conclusion

Private investment into emerging markets is expected to slow down. However, need for capital is conspicuous and obvious. New alternatives to traditional foreign investment channels, just as ELEN project, are thus more than necessary.

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