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**The recent evolution of the financial system:**  
**the Brazilian case**

Wagner Soares de Almeida

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## 1. The International Financial System

Since the beginning of the process of globalization when there were great advances in computers and telecommunications, the cost of transferring information fell a lot, the speed of data processing increased fantastically and, then, the access to different financial markets became much easier.

International investments can be done in any part of the world with very similar costs of transaction. This new situation allowed capital market and derivative operations to develop themselves faster and faster.

The process of financial deregulation, and especially in the US during the 80's and 90's, introduced a new impulse and pattern to the international financial market.

Nowadays, the internationalization and the freedom of capital flow is almost a basic condition. Moreover, it involves integration between domestic and off-shore financial and capital markets. The approach between domestic and international regulation is implicit.

The financial globalization made investments in products in different economies possible as secondary markets grew. It extended the opportunities of asset management, arbitrage and speculation.

Other characteristics of globalization were financial markets much more interlinked and the increase in volatility and risk (Cintra, 1998).

In this context, the role and performance of Central Banks have become much more important and complex. Financial companies can earn a lot by bidding in capital market and derivative operations rather than in their traditional activities of financial intermediation as loans. On the other hand, they can lose a lot too.

In spite of the fact that there were great advances in management and technology to create sophisticated systems of risk analysis, the crisis in Russia and the failure of the hedge fund Long Term Capital Management, last year, showed the vulnerability of these control systems. Some criticisms about that situation were:

- as the crisis was widespread, the banks weren't able to change their positions;
- the diversification in portfolios wasn't enough to avoid big losses;
- the volatilities were bigger and longer than the risk models predicted.

Another point is the level of leveraged operations. If a bank has a wrong leveraged position it has to quit it immediately and then the asset prices are pushed down.

Important improvements to prevent risk and systemic crisis have been discussed in the context of the Basle Accord. Last June, the Basel Committee, which is composed by the ten most industrialized countries, permitted banks to reserve less capital in lending operations with high rated banks or companies. The Committee is also studying to permit some prime banks to use

their own credit risk systems. However, these changes haven't finished yet and the big international banks go on pressuring to reduce some requirements.

Another important point refers to an international standard of account information. This procedure would bring more transparency and better evaluations by investors and regulators.

Beyond the intrinsic risk in many operations, financial companies are becoming bigger. They form conglomerates composed by commercial banks, investment banks, brokers, insurance companies, pension funds, etc. In many countries, it involves financial and non-financial companies.

There is a process of mergers and acquisitions in the financial industry and, of course, it isn't an isolated process. Other sectors of the economy illustrate the same trend.

It should be noted that very big companies from different countries compose some of these new groups or conglomerates. Many of them have operations all around the world and their assets or market value are bigger than important national economies (Cintra e Freitas, 1998).

In the US, for example, banking has consistently ranked in top five of all industries in the number of merger transactions year after year. More than 6.000 banks have been absorbed via merge since 1980.

The motives behind the rapid growth of bank mergers (as noted by Rose, 1999) are:

- it reflects the expectation of stockholders that profit potential will increase once the merger is completed. Bank revenues may increase as markets are more fully exploited and new services developed. New management could be better trained, resulting in more effective control over operating expenses;
- mergers can help to diversify the combined banking organization's sources of cash flow and earnings, resulting in a more stable banking firm able to withstand wide fluctuations in economic conditions and in the competitive environment of the industry;
- many bank mergers have been encouraged by regulatory agencies as a way to conserve scarce insurance reserves and avoid an interruption of customer service when a bank is about to fail;
- many mergers arise from expected tax benefits specially where the acquired bank has earnings losses that can be used to offset taxable profits of the acquirer. There may also be market-positioning benefits, in which a merger will permit the acquiring bank to acquire a base in a completely new market;
- more recently, large-scale staff reductions and savings from eliminating duplicate facilities have followed in the wake of megamergers. In a survey by Lausberg and Rose (in Rose, 1999) about the massive merger wave occurring in European banking during the 80s and

90s, the most important merger motivation was the desire to reduce operating costs, followed by a plan to diversify into new markets as part of an internationalization strategy;

- in a study by Prasad and Prasad (in Rose, 1999), senior executives from 25 of the largest banking firms in US were asked what factors they consider in choosing target banks to acquire. The most prominent feature mentioned was quality of management. Several officers of leading banks said they preferred merger partners whose managements were compatible with their own. Other key factors mentioned in identifying desirable banks to acquire were profitability (specially return on assets), efficiency of operations, and maintenance of market share.

Other reasons were pointed in an article in the magazine The Banker:

“In the next decade, the financial services industry will change beyond recognition. Industry consolidation and convergence are blurring the worlds of banking, insurance and asset management and, today, of retailing and manufacturing as well, reducing the numbers of players competing for market dominance.”

“Despite the recent spate of high-profile mergers within the industry, all developed economies are, to a greater or lesser extent, both over-banked and over-branched at a time of deepening competition, intensifying cost pressures and substantial technological transformation.

Ambitious banks are seeking acquisitions to consolidate market position and enter new markets – hopefully not confusing market share with profitable market share. Along with this consolidation is the now well-established process of convergence; there are few wholesale banks now which do not have retail arms, largely for the distribution of asset management/long-term savings products.

The fact that a major insurer such as Zurich has rebranded itself as Zurich Financial Services or that many banks are now dominant players, either directly or through major stakeholdings, in the insurance sector, and that both banks and insurers are seeking to build or develop asset management and other long-term savings vehicles are the clearest evidence of how far this trend has advanced.” (“Bad Old Days for Bankers”, In: The Banker, September, 1999).

The merger between Citicorp and Travelers created the biggest financial service conglomerate in the US whose services include traditional banking operations, consumer credit, credit card, investment banking, broker, asset management and insurance (The Economist, 1999).

The North Carolina National became NationsBank and, after several acquisitions, took over the Bank of America, creating the second biggest American financial group and ranking first in deposits (7% of insured deposits).

Another important merger was between Bank One and First Chicago/NBD last year.

This kind of conglomerate is an example of the process of deregulation in the financial industry in the US. In other developing countries, there is the same process of service diversification. The main differences are in the legal form or way chosen to create these new conglomerates.

Moreover, banks seek to enlarge their number of customers and their business opportunities. This is part of the process of dynamic competition in the financial industry after all and it drives to concentration and centralization.

In the US, with the Glass-Steagall Act, commercial banks particularly have been losing business, on the assets side, to the capital market where big companies raise cheaper money. On the liability side, they compete with money-market funds, mutual funds, and so on. The US is at higher stage in this change to capital markets where banking loans represent just 25% of overall financial assets. In Europe, despite a bigger ratio – 55% in Great Britain and 75% in France and Germany -, there is also a slow downward trend.

For two decades, American lawmakers have struggled to pass legislation that would eliminate barriers that have made it difficult and costly for banks, securities firms and insurance companies to enter one another's business. In October 22<sup>nd</sup>, the White House and congressional negotiators struck a deal, virtually ensuring legislation will pass the House and Senate and then will be signed into law by President Clinton (Washington Post, October, 23<sup>rd</sup>, 1999).

Other important example of merger is Chase Manhattan, a merger between Chase and Chemical Bank and Manufacturers Hanover, which has saved some \$ 2.5 billion a year, partly by getting rid of overlaps in the three banks' business and branches. In metropolitan New York, their combined network of 1,000 branches has been reduced to 500. Its chairman, Walter Shipley, said that "Ten years ago I asked how many people went to branches. It was 30% - 40%; now almost no one does except to go to an ATM machine". In the American banking industry the number of branches remained largely unchanged although the number of banks fell. However, they are much cheaper to run because of the new technology.

The number of employees increased to 1.6 million people, more than ever before. The revenues are also higher.

Nevertheless, scale economies in operational areas are channelled into administrative areas. It seems that financial conglomerates have had difficulties to increase their efficiency.

Citicorp, for example, faced this situation. Citicorp had to manage several different accounts and their particular burden criteria and 28 computer systems related. Citicorp introduced a project to reduce this control to just one or two computer systems. ("Complex equations", In: The Economist June, 5<sup>th</sup>, 1999).

The consequence of the mergers and acquisitions process is the increase in the banking concentration. In the 70's, the ten biggest American banks had 50% of the assets. Today, they have 66% of the assets. (The Economist, 1999)

Regional factors can explain another part of the banking concentration process. In Europe, the unification of financial and monetary markets brought some necessary adjustments. In Germany, in particular, two mergers in 1997, Bayerische Vereinsbank and Bayerische Hypothek- und Wechsel-Bank raised them to second in the banking ranking, and another merger between Ankn Gesellschaft Berlin (a previous merger of three state banks) and Norddeutsche Landesbank Girozentrale created the third biggest German bank. Dresdner Bank fell from second to fourth place, and Commerzbank fell from third to fifth (Cintra e Freitas, 1998). Deutsche Bank remained in first place and tried to strengthen itself by purchasing the American Bankers Trust, a business of around \$ 10 billion ("Lucro do Deutsche Bank salta 37%", In: Gazeta Mercantil, May, 5<sup>th</sup> 1999).

In the beginning of this year, there was a merger between two of the biggest Spanish banks, Santander and Central Hispano-americano, creating the Banco Santander Central Hispano-americano.

Last year, commercial banks led the business of mergers and acquisitions in Europe, merging banks, insurance companies, fund management and so on. The total amount of money was \$ 102 billion ("Obstáculos à Consolidação Bancária na Europa", In: Gazeta Mercantil, translated from The Economist, March, 18<sup>th</sup>, 1999).

Other comments about this issue were written in The Banker's article:

"It is not only banks which are converging, economies are as well. This is clearly the case with the European Union. However artificial some of the political and specially fiscal structures may appear now, the longer term objective is to make these structures uniform and genuine.

But even beyond Europe's boundaries, there are similar calls for currency harmonisation in regions as diverse as Southeast Asia and Latin America. We have become a much more global world, and because trade is now understood as essential to ensure sound economic growth in the global marketplace.

One of the costs of trade has always been the costs of currency conversion – which is why foreign exchange was often one of the main sources of profitability for banks in second-tier economies. Banks were – and many still are – the only institutions to profit from lack of

currency convergence. The loss of this business will boost the drive towards consolidation in several markets.”

“A single European market – specially as tax and regulatory regimes begin to converge – will undoubtedly drive out many marginal players, and even some of the largest domestic ones.” (“Bad Old Days for Bankers”, In: The Banker, September, 1999)

Nowadays, financial innovations are created faster and faster as a consequence of globalization. Central Banks should be up-to-date. They should develop a supervision system to monitor the risk in banking operations and to adopt preventive measures to avoid failures and, even worse, systemic risk. The process of concentration can bring another risk to the financial market: too big to fail.

In Brazil, in particular, the Central Bank has to be sure about when to allow mergers and/or the advantages and disadvantages of opening the financial market and bringing in international banks into the market.

Therefore, this paper will discuss the main changes in the Brazilian financial system during the last years. We will analyze the banking adjustment and the monetary stabilization since 1994 and the Real Plan: the significant fall in ratio of financial system in GDP from 12% to 4,7%; the loss in public banks’ market share and the gain in foreign banks’ share; the improvement in regulation by the Brazilian Central Bank. We intend to understand these changes and try to identify trends and improvements that would be necessary yet.

## 2. The Brazilian Financial System

### 2.1 Some Background Information

The Brazilian financial system’s current structure is based on the financial reform made in 1964 as part of an economic program (PAEG - Programa de Ação do Governo) administered by the ministries Otavio Bulhões and Roberto Campos. As Yoshino (1994) said, the federal laws 4595/64 (Banking Reform) and 4728/65 (Capital Market) improved the system by creating longer maturity deposits and loans. Both public and private sectors took advantage of the new instruments of financial funding. Savings increased and the system as a whole became more efficient.

The banking reform was based on the American structure (Glass-Steagal Act and Regulation Q, both issued in 1933) and its market segmentation.

The arguments in favor of banking reform were: 1) to isolate the banking system from the risks of the capital market; 2) to be more efficient by the specialization; 3) to reduce the conflict of interests.

The new structure defined by the banking reform in 1964

financial institution	Kind of funding	destination	maturity
Commercial Bank	Demand deposit	loan and bond discount	short and medium term
Investment and Development Bank	Deposit certificate and transfer	investment and working capital	medium and long term
Finance Company	bill of exchange	consumer credit	short and medium term
Building Societies	Saving, mortgage bond	real estate	medium and long term
Leasing	Debenture	investment	medium and long term
Broker Company and Securities Dealers	Intermediation	stock market	medium and long term

Other important instruments created:

- federal bonds with indexation (Law 4357/66);
- open market improvements;
- incentives to get money in foreign markets (Law 4357/66, Resolution 289 (SUMOC) and Resolution 63 (Central Bank));
- incentives to open new branches abroad;
- new public funds to grant long term loans: FINAME, FNRR, FUNDAG and FRE;
- incentives to the capital market: mutual fund, stock market.

This law also created the Central Bank. Since that, Banco do Brasil lost part of its activities, although remained with special functions up to 1986: control of required reserves, clearance and issue of money. Banco do Brasil's history is marked by granting loans at very special rates (lower than the market's rate).

We can say that the changes in the reform of the system were impressive. Until the 60's, demand deposit and other liquid assets were almost 90% of all financial savings. Then in the 70's, they were just 33%.

This model of specialized banks intended economies of scale. Therefore, the reforms decreased the number of commercial banks, from 328 to 176, between 1964 and 1970. The biggest banks purchased the small ones, receiving fiscal incentives from the government (Moura, 1998). However, as Mário Henrique Simonsen said (Yoshino, 1994): "economies of scale in that specialized financial system didn't work".



In practice, this model wasn't compatible with the size of the Brazilian market and commercial banks increased control over other kind of institutions. Commercial banks became almost universal banks. Holding companies were created but regulation demanded separate accountability.

Another important aspect related to the Brazilian economy and its financial system was the high level of government intervention in the market. The government was responsible for building a modern infrastructure in the economy and for granting loans and other incentives in several sectors.

However, external shocks (the oil crises, the increase in the international interest rate and external debts' crises) drove the economy to a huge unbalance. In the 80s, revenues decreased and expenditures and inflation increased very much, the economy grew little, the government started running larger and larger deficits, the public bond's maturity became shorter. (Carlos Luque, in Yoshino, 1994). There was also the collapse of the National Housing System.

Despite all of these negative factors, which could have destabilized the financial system, an index process spread over the whole economy was created. Investors tried to protect the assets' value against the consequences of inflation.

The Brazilian Constitution issued in 1988 allowed the entrance of new institutions in the financial system, basically Brazilian ones. The number of banks in the system was fixed prior to 1988. Article 192 of the Constitution determined that a new Law would redefine the structure of the financial system. Despite the tradition of non-segmented companies, in this article, the separation between banking companies and non-banking companies (insurance, pension and capital market) was established. However, it won't be implemented until the new structure is defined and voted upon.

After the new rules established by the Constitution, there was a rapid increase in the number of banks. A lot of Brazilian brokers and securities dealers became universal banks (Moura, 1998).

## 2.2 The Adjustments in the Financial System since 1994

The following analysis is based on the Brazilian Central Bank's report (BACEN, 1999) and on BNDES's paper (Puga, 1999).

### 2.2.1 The Adjustments in Private Banks and Regulation Improvements

As the main aims of the Real Plan were achieved – lower and more stable inflation -, financial companies couldn't keep their high floating revenues any longer (Cysne e Costa, 1997). The consequence was a strong adjustment in the financial system's ratio in the economy.

#### FINANCIAL SYSTEM RATIO IN GDP

%

	1990	1991	1992	1993	1994	1995	1996
<b>PUBLIC</b>	8.05	6.17	6.22	5.92	4.64	3.21	
<b>PRIVATE</b>	4.62	4.28	5.85	8.51	6.88	3.59	
<b>SUBTOTAL</b>	12.67	10.45	12.07	14.43	11.52	6.79	
<b>TOTAL (*)</b>	12.78	10.53	12.13	15.61	12.37	6.94	4.70**

source: IBGE

(\*) Statistical adjustments to avoid identification of company

(\*\*) ANDIMA's source

Mendonça de Barros (Barros et alii, 1998) identifies 3 general phases in this process of important changes: 1<sup>st</sup> phase: from the beginning of the Real Plan up to the middle of 1996: merger and acquisitions in the private financial industry, regulation and improvements in supervision and the creation of PROER's program (program of incentives to restructure and to strengthen the financial industry) ; 2<sup>nd</sup> phase: from middle of 1996 up to the adjustment of public financial industry and new acquisitions by foreign banks; 3<sup>rd</sup> phase: changes in the administration of Brazilian banks.

Before the Real Plan, when there was very high inflation and indexation of assets and liabilities, a lot of banks just operated for the short run. They made a kind of arbitrage over the floating of currency's value. Then, when the inflation fell, they had to search for other opportunities to get revenues or they went out of business by themselves, or by failure.

Another serious point concerns banks that accounted non-real operation in their balance sheet in order not to show a negative net worth (this was, for example, Bank Nacional's case). These banks also did illegal operations with companies (non-financial) of their own group (Banks Bamerindus and Econômico's cases). All of these irregularities were favored because: 1) the inflation process made the analysis of the balance sheet more difficult; 2) there were failures in the financial regulation and its supervision; 3) independent auditings weren't rigorous enough in checking the banking accounts.

In short, it was clear that some banks would have difficulties to adjust itself. Some would fail without represent a risk to the financial system. However, the bankruptcies of others, as three of the biggest private banks - Econômico, Nacional and Bamerindus – and the public banks, would cause a systemic risk. So the government had to create special programs to avoid that situation.

The first step was to adopt the Basel Accord recommendations. New financial regulations followed those principles and some laws were approved to manage the grave situation and the necessary improvements.

I will show the most important changes in the regulations.

The Resolution<sup>1</sup> 2099, August/94, (changed by Resolution 2607 - May/99) defined new capital limits to create financial companies and additional limits to asset risks<sup>2</sup> and the number of branches.

#### Minimum Paid-in Capital and Net Equity - R\$

Financial Institutions	Res. 2099/94	Res. 2607/99
commercial banks and commercial activity of universal banks	7,000,000.00	17,500,000.00
investment banks, development banks and related activities of universal banks	6,000,000.00	12,500,000.00
financial companies, building societies, leasing companies and related activities of universal banks	3,000,000.00	3,000,000.00
mortgage companies	-	3,000,000.00
broker companies and securities dealers that operate in the open market	600,000.00	1,500,000.00
broker companies and securities dealers that don't operate in the open market	200,000.00	550,000.00
exchange brokers	200,000.00	350,000.00

Obs.: According to Res. 2607: 1) The limits will be reduced in 30% if the headquarter and 90% of branches are in other states but São Paulo and Rio; 2) deadlines: up to 06.30.2000, 50% of the new requirements and up to 06.30.2001, 100 % of the new requirements.

Therefore, beyond these limits, financial companies had to keep a capital reserve (11%) of their assets weighted by risk. Risks and weights to each kind of asset operation were defined:

- Zero risk: 0% = cash, deposits in Central Bank, federal public bonds;
- Reduced risk: 20% = bank deposit, gold and available foreign currency;
- Reduced risk: 50% = investments in foreign currency abroad, state and local bonds, private bonds and credits in the housing system (credits without payment delays);

<sup>1</sup> All the Resolutions referred were issued by Central Bank.

<sup>2</sup> The Res. 2399, June/97, introduced additional requirements over swap operations (current bracketed is 20%). The Res. 2606, May/99, defined additional requirements of 60 % over operations related to volatility risks in exchange rate and gold.

- Normal risk: 100% = other operations as loans and debt financing, debentures, commercial leasing, exchange rate, stocks, and all operations of aval and guarantees.

Nevertheless, some problems appeared in the economy. Consumers increased their consumption basically by contracting debts. Banks and retail companies didn't seem to be prepared to correctly analyze credit risk. Banks were seeking other sources of funding, as they didn't have floating revenues any more. Then they increased their credit operations. On the otherhand hand, the government adopted a tight monetary policy and opened the economy in order to keep inflation in check. But some industries weren't competitive enough to face cheap and better import products. Firms failed and delinquent credits increased.

The Mexican crisis in the end of 1994 forced the government to raise the interest rate. The decrease in the growth of the economy affected the banks even more: delinquent credits increased substancially. The situation became worse when Banco Econômico was liquidated in August 1995. People looked for security and transferred resources from small banks to the big ones. Several small Banks failed.

Then, in November, 1995, the government introduced several regulations in order to restructure and to strengthen the Brazilian financial system:

- Medida Provisória (MP)<sup>3</sup> 1179 (Law 9710/98): it offered fiscal incentives to stimulate acquisitions of unbalanced financial companies;

- MP 1182 (Law 9447/97): it gave power to the Central Bank to intervene in unbalanced financial companies if they didn't follow its recommendations. This new kind of intervention allowed Central Bank to restructure and sell financial companies. This Law extended to majority stockholders the legal responsibility over bad management;

- Res. 2211 and 2197: they created a Credit Insurance Fund referred to demand deposit, deposit certificate, savings, bill of exchange and mortgage bonds;

- Res. 2212: it increased the ratios of capital risk required during the first 5 years of a new financial company. Beginning with 32% of assets weighted by risk, then decreasing up to 8% in the sixth year (modified to 11% by Res. 2399, Circ. 2784 and Res. 2607). It also changed the evaluation of economical capacity of a financial company and it extended the analysis over the group that it belongs to. Incentives to mergers and acquisitions were created. The supervision area of the Central Bank could decide whether to approve a proposed merger or acquisition;

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<sup>3</sup> It is a constitutional instrument that allows the executive (the president of the country) to issue a temporary Law. This temporary Law has to be approved by the Congress.

- Res. 2208: it issued the PROER's Program. It was a kind of discount window loan offered to restructure the management and operating controls of unbalanced financial companies. The necessary condition was to transfer the ownership or to become a non-financial company. The banks which decided to acquire unbalanced companies could defer the expenditures for 5 years. The unbalanced company would be dispensed temporarily to comply with the limits of the Basel rules.

MAIN PURCHASED BANKS IN PROER'S PROGRAM

BANK	PURCHASER	DATE
Banco Econômico S.A	Banco Excel S.A	04.30.96
Banco Mercantil S.A	Banco Rural S.A	05.31.96
Banco Banorte S.A	Banco Bandeirantes S.A	06.17.96
Banco Nacional S.A	Unibanco S.A.	11.18.96
Banco Bamerindus do Brasil S.A	Grupo HSBC	02.04.97

SOURCE: D O - DEORF/COPEC

The PROER's cost, according to Bank Bozano-Simonsen, was \$ 21 billion (3.8% of GDP) which provided credit to acquisitions of the following private banks: Econômico (\$ 6.8 bi), Nacional (\$ 6.1 bi), Bamerindus (\$ 5.9 bi), Banorte (\$ 1.3 bi) and Mercantil de Pernambuco (\$ 0.5 bi). Other small banks were also acquired by this program: Bank Antônio de Queiroz and Bank Martinelli.

The federal bank Caixa Econômica Federal collaborated in the program by purchasing unbalanced companies' mortgage portfolios.

In March, 1996, the MP 1334 increased the responsibilities of independent auditings in case of irregularities in a audited company.

In June, 1996, the Res. 2283 determined that financial companies had to account all investments superior to 25% in capital of offshore subsidiaries in their balance sheet.

In July, 1996, the Res. 2302 altered the regulation of new branches abroad.

In that same month, Res. 2303 deregulated the charges of fees by the banks.

**RATIOS BANKING FEES OVER ADMINISTRATIVE EXPENSES AND OVER OPERATING REVENUES**

%

BANKING FEES / ADMINISTRATIVE EXPENSES										
DEC/93	JUN/94	DEC/94	JUN/95	DEC/95	JUN/96	DEC/96	JUN/97	DEC/97	JUN/98	DEC/98
6.07	6.02	13.32	16.31	18.35	19.03	20.49	13.81	23.94	26.1	27.03
BANKING FEES / OPERATING REVENUES										
DEC/93	JUN/94	DEC/94	JUN/95	DEC/95	JUN/96	DEC/96	JUN/97	DEC/97	JUN/98	DEC/98
0.46	0.37	2.41	2.88	3.91	5.12	5.88	6.74	5.19	6.22	6.26

source: COSIF - DEORF/COPEC

The table clearly shows the increase of fees as source of revenue.

In May, 1997, Res. 2390 created a Risk Information Center. The main objectives of the Center were: to make available creditworthiness of the major debtor, to increase the efficiency, to reduce costs of overall credit system and, therefore, to reduce the spread. There is a proposal of new regulation over the allowance for possible loan losses. The borrower would be classified according to their associated risk: normal (risk 1), potential (risk 2), effective (risk 3), high (risk 4) and too high (risk 5). Allowance would be demanded in operation from risk 2 clients and so for. It's important to note that the utilization of rating agencies in Brazil is small.

In May, 1998, Res. 2493 allowed a company to sell its credit portfolio, including non-paid credit, to Securities Companies. These companies could issue bonds guaranteed by these credits.

At last, Central Bank got a \$ 20 million loan to spend in training and to introduce a new accounting information in the Brazilian financial system in order to achieve a international standard. This program is called PROAT (Programa de Aperfeiçoamento dos Instrumentos de Atuação do Banco Central junto ao SFN).

### 2.2.2 The adjustment in public banks

Before the Real Plan, there was a consensus that state banks would have problems when inflation stabilized at a low level and there was a monetary tightness. As a rule, the banks had very high fixed costs, as personnel and administrative. Beyond the rigidity in most of these expenditures, particularly concerning public companies, there was political interference in order to avoid closing branches or to save bank of failures. In fact, most of the state banks almost failed. They lent to their major stockholders – state governments or their public utilities companies – beyond the legal limits and when the state governments already had very high

debt burdens. Then, state banks became illiquid. There wasn't an alternative to Central Bank except to save these banks to avoid a systemic failure.

At the same time, the federal government encouraged the reduction of state banks in the financial system. It was created a special program (PROES - Programa de Incentivo à Redução do Setor Público Estadual na Atividade Bancária), by MP 1514, August, 1996 and MP 1556, December, 1996<sup>4</sup>. The government would lend money in two situations:

ALTERNATIVES	CONDITIONS
the federal government would lend 100% of the necessary funds to save the bank =>	in privatization or change into development agency or liquidation
the federal government would lend 50% of the necessary funds to save the bank =>	if the state government decided to keep the public bank

The state governments would receive a 30-year federal loan to pay their debts with their state banks. If a state government decided to keep its bank then it should pay half of the debt by its own resources and to guarantee a professional administration.

It is estimated that just 6 state banks will remain after the PROES's program. The following state banks were already liquidated: Mato Grosso, Alagoas, Amapá, MinasCaixa, Rio Grande do Norte, Rondônia and part of Banerj ("Banco Central reforça empenho para reduzir rede de bancos estaduais", In: Gazeta Mercantil, 06/14/99). The following table was elaborated when it was expected that 9 state banks would remain. We decided to keep the table to show the evolution in the adjustments.

Number of State Banks			
Kind of Bank and Situation	Situation in		Estimate
	Aug/96	July/98	After Proes
Commercial Banks	23	19	9
Saving and Loans Banks	1	1	0
Development Banks	4	4	0
Commercial Banks in Intervention (RAET)	3	1	0
Commercial Banks in Liquidation	1	5	0
Saving and Loans Banks in Liquidation	2	1	0
Development Banks in Liquidation	1	0	0
<b>Total</b>	<b>35</b>	<b>31</b>	<b>9</b>

Source: Boletim Macroeconômico, da SPE (May, 1998), and Banco Central do Brasil.

In: Puga, 1999

<sup>4</sup> Renewed by MP 1773-32 12.14.98; Res. 2395 and Circ. 2742; Res. 2347 and 2574; Res. 2365, 02.28.97.

Among all the 26 banks that chose not to continue as a state bank, 10 chose to be privatized, 5 were abolished and 11 became a development agency.

Until the end of 1998, 4 banks have been privatized:

- Banerj (June/97), part was purchased by Itaú;
- Credireal (August/97), purchased by BCN, which was purchased by Bradesco in October/97;
- Bemge (September/98), purchased by Itaú;
- Bandepe (November/98), purchased by ABN-AMRO

According to Bank Bozano-Simonsen, \$ 48 billion (6% of GDP) were issued in federal bonds in exchange of state bonds related to the following banks:

- Banespa – \$ 26 billion (as part of the negotiations, was federalized in Dec/1997)
- NossaCaixa – \$ 8 billion
- Banestado – \$ 4 billion
- Banerj – \$ 3 billion
- Banrisul – \$ 3 billion
- Bemge – \$ 1.5 billion.

Banespa will be privatized soon. It has been created a big dispute among the biggest banks in Brazil. Banespa will be sold in a block of 67% of its common stocks. The federal share is 51% and São Paulo State's share is 16%. This total of stocks represents around 32,8% of capital stocks. The biggest national private banks are discussing whether it would be advantageous to purchase a bank with a very similar branch net. Whoever purchases it will initially face high costs to integrate the management systems or to adjust the overlaps.

It should be noted Banco do Brasil's situation. The recognition of some credits as losses in 1996 stabilized one of the biggest banking losses in the world: R\$ 7 billion. The National Treasury increased its capital share in R\$ 8 billion by issuing bonds. In the first semester of 1999, Banco do Brasil had a negative result of R\$ 926 million in its financial intermediation. There was an allowance of R\$ 1,688 billion to face risk agricultural credits. Due to the Real devaluation, its assets and investments in associated companies and subsidiaries abroad valued and yielded a revenue of R\$ 2,923 billion. Its directors said it was just a conservative strategy. ("BB lucra R\$ 574 milhões de janeiro a junho", In: Folha de S.Paulo, July 27th, 1999).

The other big federal public bank, Caixa Econômica Federal (CEF), also has important credit problems and their solutions were complex and involve the failure of the National Housing System and its burdens: a fund of clearance of wage variations (Fundo de Compensação das Variações Salariais - FCVS) (Barros e Almeida Jr., in Puga, 1999).



### 2,2,3 The increase in foreign banks

According to the Brazilian Constitution (1988), new branches and increase in capital of foreign banks are forbidden. However, it could be allowed in some situations: by bilateral agreement, by reciprocity or by Brazilian government interests.

In August, 1995, a Ministry of Finance's request (Exposição de Motivos 311) was approved by the president, allowing the entrance or the investment in the capital of companies of the Brazilian financial system.

The arguments to defend that decision were:

- the national capital would be scarce;
- the foreign banks would be more efficient and would have more creditworthiness. This could have a positive impact over the price of services and the available resources to society;
- the foreign banks would have easier access to get money in the international market;
- it would introduce new technologies and management, offering new products and services.

The Brazilian government has allowed new foreign banks to solve banking failures and to introduce international patterns of management and products in our system.

As many foreign banks wanted to invest in the Brazilian financial system, the government charged a fee to permit it. However, some banks didn't have to pay that fee because they invested in unbalanced banks. This was the HSBC's case, which purchased Bamerindus.

Main acquisitions:

- March, 1997: HSBC-Hong Kong Shanghai Banking Corporation (England) purchased Bamerindus;
- August and October, 1997: Santander (Spain) purchased Geral do Comércio and Noroeste;
- September, 1997: InterAtlântico (controlled by the portuguese Espírito Santo, by the French Credit Agricole and by the Brazilian group Monteiro Aranha) purchased Boa Vista;
- January, 1998: Caixa Geral de Depósitos (Portugal) purchased 79% of voting capital of Bandeirantes;
- March, 1998: Sudameris (France) purchased América do Sul;
- August and October, 1998: Bilbao Viscaya (Spain) purchased Excel-Econômico (first, purchased a share of 55,5% and then, 100%);
- November, 1998: ABN-AMRO (Holland) purchased Real, becoming the biggest foreign bank in Brazil, considering total assets or number of branches.

In 12/31/98, foreign capital participated in 233 companies, and in 155 their ratio was over 50%. The ratios of foreign banks in the total of the financial system were: 15% in the number of branches, 25% in net equity and 46% in overseas funding in banking area.

**FOREIGN OWNERSHIP INTEREST IN BRAZILIAN FINANCIAL COMPANIES  
VOTING CAPITAL**

**12.31.94**

RATIO	KIND OF COMPANY										
	BC	BM	BI	SCTVM	SDTV	SAM	SCFI	C.H.	SUBSIDIARIES	TOTAL	%
00 -----20 %	1	8	1	10	9	6	2			37	20%
20 -----50 %	1	20	7	12	21	5	3			69	37%
50 -----80 %		3				1				4	2%
80 -----100 %		17		4	15	21	3		17	77	41%
<b>TOTAL</b>	<b>2</b>	<b>48</b>	<b>8</b>	<b>26</b>	<b>45</b>	<b>33</b>	<b>8</b>	<b>0</b>	<b>17</b>	<b>187</b>	<b>100%</b>

**12.31.98**

RATIO	KIND OF COMPANY										
	BC	BM	BI	SCTVM	SDTV	SAM	SCFI	C.H.	SUBSIDIARIES	TOTAL	%
00 -----20 %	1	12	3	7	6	7	2			38	17%
20 -----50 %	1	13	2	2	12	7	3			40	17%
50 -----80 %		3	2	1	6	4	1			17	7%
80 -----100 %	1	40	3	26	21	27	2	2	16	138	59%
<b>TOTAL</b>	<b>3</b>	<b>68</b>	<b>10</b>	<b>36</b>	<b>45</b>	<b>45</b>	<b>8</b>	<b>2</b>	<b>16</b>	<b>233</b>	<b>100%</b>

source:DECAD-

DEORF/COPEC

Obs.: BC=Commercial B; BM=Universal B; BI=Investment B; SCTVM=Broker.; SDTV= Securities Dealer; SAM=Leasing; SCFI= Finance Cia.; CH=Mortgage Cia

Unfortunately, these figures don't show yet the purchase of Real by ABN-AMRO that was very significant. Therefore, the ratio of foreign banks is undervalued.

**NUMBER OF BRANCHES BY FOREIGN OWNERSHIP**

DATE	FOREIGN BANKS	TOTAL OF BANKS	% RATIO
1988	247	16,228	1.52%
1993	384	17,972	2.14%
1994	378	18,760	2.01%
1995	360	17,798	2.02%
1996	403	16,686	2.42%
1997	1.610	16,383	9.83%
1998	2.395	16,060	14.91%

SOURCE: CADINF - DEORF/COPEC

**RATIO IN NET EQUITY AND OFF-SHORE FUNDING - BANKING AREA**

	1993	1994	1995	1996	1997	1998
<b>% IN NET EQUITY</b>						
<b>DOMESTIC BANKS</b>	86.89	83.46	75.73	81.53	72.50	73.01
<b>BANKS WITH FOREIGN CONTROL</b>	7.28	9.57	13.08	10.29	14.29	15.50
<b>BANKS WITH FOREIGN INTEREST</b>	5.33	6.26	9.75	6.92	11.66	9.69
<b>% IN OFF-SHORE FUNDING</b>						
<b>DOMESTIC BANKS</b>	67.63	76.09	69.14	68.23	57.99	53.70
<b>BANKS WITH FOREIGN CONTROL</b>	24.40	15.96	22.79	25.13	26.50	27.25
<b>BANKS WITH FOREIGN INTEREST</b>	7.97	7.96	8.07	6.64	15.51	19.05

SOURCE: COSIF - DEORF/COPEC

**BANKS WITH FOREIGN CONTROL**

RATIO IN TOTAL ASSETS

%

	1988	1994	1998
3 BIGGEST BANKS	57.06	36.86	27.57
10 BIGGEST BANKS	93.17	74.95	61.13
20 BIGGEST BANKS	99.62	92.21	83.73
TOTAL OF B. FOREIGN INTEREST/ CONTROL	100.00	100.00	100.00

SOURCE: COSIF - DEORF/COPEC

The concentration among foreign banks decreased as it is showed in the table above. The entrance of new banks (that weren't established or had a small share in the market) explains this situation.

In July 1999, the Central Bank's director (regulations and organization of the financial system) declared that new rules to the entrance of new foreign capital was approved by the Board of Directors. The government wouldn't charge fees any longer. On the other hand, foreign companies interested in entering the financial system will have to look for associations or acquisitions. This will be the only way to enter in the system. A guarantee of a minimum level of overseas funding, capital increase after the association or acquisition, to assure commitments of negotiation of Brazilian foreign debts, transference of technology and have a minimum rating in the international market will be also demanded.

**2.2.4. The evolution of the market – data analysis**

A characteristic of the Brazilian financial system is its low leverage. The banks didn't

focus on lending but on creating products to minimize the devaluation of financial assets. This conservative policy decreased the risk of credit crisis in the system.

#### RATIO IN CREDIT OPERATIONS IN GDP - %

	1993	1994	1995	1996	1997	1998
Banks with Foreign Control	1.78	1.44	1.46	2.07	2.41	2.40
Private Banks	8.55	9.80	8.14	7.83	7.28	6.59
Public Banks	5.40	5.25	6.01	5.61	2.12	1.46
Caixa Econômica Federal	6.19	5.64	5.80	5.74	6.37	6.65
Banco do Brasil	5.19	5.51	4.09	2.54	2.26	2.48
Credit Cooperative	0.05	0.09	0.11	0.13	0.15	0.19
<b>Banking Area</b>	<b>27.17</b>	<b>27.73</b>	<b>25.61</b>	<b>23.92</b>	<b>20.60</b>	<b>19.76</b>
<b>Financial System</b>	<b>30.88</b>	<b>30.28</b>	<b>27.79</b>	<b>26.60</b>	<b>23.54</b>	<b>23.69</b>

Source: COSIF - DEORF/COPEC – IBGE

The following tables show an increase in foreign banks and a fall in public banks. Nevertheless, they also show the influence of federal banks (Banco do Brasil and Caixa Econômica Federal) in the system.

#### RATIO IN THE TOTAL ASSETS – BANKING AREA - %

	1993	1994	1995	1996	1997	1998
Banks with Foreign Control	8.35	7.16	8.39	9.79	12.82	14.15
Private Banks	40.67	41.21	39.16	39.00	36.76	38.15
Public Banks	13.41	18.17	21.90	21.92	19.06	10.79
Caixa Econômica Federal	14.51	14.98	16.40	16.47	16.57	17.98
Banco do Brasil	22.93	18.28	13.91	12.52	14.42	18.41
Credit Cooperative	0.13	0.20	0.24	0.30	0.37	0.52
<b>Banking Area</b>	<b>100.00</b>	<b>100.00</b>	<b>100.00</b>	<b>100.00</b>	<b>100.00</b>	<b>100.00</b>

Source: COSIF - DEORF/COPEC

#### RATIO IN THE TOTAL DEPOSITS – BANKING AREA - %

	1993	1994	1995	1996	1997	1998
Banks with Foreign Control	4.83	4.58	5.40	4.36	7.54	8.34
Private Banks	38.8	39.35	36.40	34.07	32.85	33.66
Public Banks	17.25	16.45	16.07	18.66	17.09	12.32
Caixa Econômica Federal	27.92	24.35	24.33	26.58	24.05	24.45
Banco do Brasil	11.08	15.11	17.59	16.00	18.00	20.53
Credit Cooperative	0.12	0.16	0.21	0.34	0.47	0.70
<b>Banking Area</b>	<b>100.00</b>	<b>100.00</b>	<b>100.00</b>	<b>100.00</b>	<b>100.00</b>	<b>100.00</b>

Source: COSIF - DEORF/COPEC

The non-banking companies keep having a small ratio in the system.

#### RATIO OF NON-BANKING COMPANIES IN THE FINANCIAL SYSTEM -

<b>ASSETS</b>						
	1993	1994	1995	1996	1997	1998
BI	3.08	3.10	1.24	1.67	1.53	0.90
SAM	2.43	2.90	3.33	3.36	4.17	5.24
CFI	0.33	0.56	0.29	0.59	0.52	0.41
CTVM	2.38	2.77	1.58	1.50	1.16	0.91
DTVM	1.55	1.24	2.02	2.94	1.33	1.26
TOTAL	9.77	1.57	8.46	10.06	8.71	8.72
<b>NET EQUITY</b>						
	1993	1994	1995	1996	1997	1998
BI	3.38	3.60	4.05	3.50	2.73	1.82
SAM	3.94	4.47	6.25	5.49	5.87	5.63
CFI	0.90	1.00	1.38	1.34	1.20	1.08
CTVM	2.46	3.02	3.74	3.33	3.62	2.70
DTVM	1.22	1.45	1.74	1.38	1.27	1.25
TOTAL	11.90	13.54	17.16	15.04	14.69	12.48

Source: COSIF - DEORF/COPEC

Obs.: BI=Investment B; CTVM=Broker.; DTVM= Securities Dealer; SAM=Leasing; CFI= Finance Cia.

As we will see in the next table, the number of financial companies fell 24% between Dec/93 and Dec/98 without considering credit cooperative. It is really an expressive fall.

It is important to note the fall in the number of securities dealers ( -53%) and securities brokers ( -20%). Despite that, their ratios in the overall net equity of the financial system kept the same. Resolution 2099/94 increased their minimum capital required in a bigger proportion than it was required to other kinds of financial companies.

Different from others sectors, the number of leasing companies increased (+19%) and finance companies kept almost the same.

In December, 1998, the total number of credit cooperative was divided basically into two kinds of cooperatives: mutual funds (64%) and agricultural credit funds (34%).

## NUMBER OF FINANCIAL COMPANIES

KIND OF INSTITUTION	Dec-93	Dec-94	Dec-95	Dec-96	Dec-97	Dec-98
<b>BM</b>	206	210	205	191	179	173
<b>BC (1)</b>	35	34	35	38	36	28
<b>BD</b>	7	6	6	6	6	6
<b>BI</b>	17	17	17	23	22	22
<b>SCFI</b>	41	41	42	47	48	42
<b>SCCTVM (2)</b>	285	280	271	255	237	228
<b>SDTVM</b>	378	367	323	281	235	207
<b>SAM</b>	67	72	78	74	78	80
<b>C E</b>	2	2	2	2	2	2
<b>SCI/APE</b>	27	27	23	22	22	21
<b>C H</b>	-	-	-	3	3	4
<b>SUB-TOT 1</b>	1,065	1,056	1,002	942	868	813
<b>COOP (3)</b>	877	946	980	956	1,015	1,088
<b>SUB-TOT 2</b>	1,942	2,002	1,982	1,898	1,883	1,901
<b>F. INV. (4)</b>	839	1,279	2,195	2,765	3,500	3,615
<b>ADM</b>	485	490	462	446	433	422
<b>REG. ESP. (5)</b>	82	87	98	82	89	89
<b>TOTAL</b>	3,348	3,858	4,737	5,191	5,905	6,027

(1) Include Subsidiaries of Foreign Banks

(2) Include Exchange Broker

(3) Exclude, since dec/97, cooperatives that haven't been working

(4) Include Funds that have been working

(5) Include companies in liquidation and intervention

Source: CADINF-DEORF/COPEC

Obs.: BC=Commercial B; BM=Universal BI=Investment B; SCTVM=Broker.; SDTVM= Securities Dealer; SAM=Leasing; SCFI= Finance Cia.; CH=Mortgage Cia; COOP=Credit Cooperative; F.INV.=Mutual Funds

### UNIVERSAL BANKS – NUMBER OF ACTIVITIES

	ACTIVITIES						TOTAL
	COMMERCIAL	INVESTMENT	DEVELOPMENT	C I	C F I	A M	
Jun/95	189	111	18	76	167	1	562
Dec/95	184	111	18	75	163	7	558
Jun/96	181	110	18	77	160	10	556
Dec/96	176	108	18	76	156	9	543
Jun/97	170	104	19	74	145	13	525
Dec/97	163	103	17	71	141	14	509
Jun/98	159	104	16	66	141	13	499
Dec/98	157	106	15	65	145	20	508

Source: CADINF-DEORF/COPEC

Obs.: CI=Building Societies; CFI=Finance Companies;AM=Leasing

In the table before, we showed the universal banks' activities. We notice a decrease in all activities except leasing.

### Number of Branches and Other Smaller Structures

KIND	12.31.94	12.31.95	12.31.96	12.31.97	12.31.98
BRANCH	18,760	17,798	16,686	16,383	16,060
PAB-Banking Unit	10,125	9,075	8,268	7,787	7,211
in cities with branch	9,775	8,780	7,987	7,513	6,987
in cities without branch	349	295	281	274	224
PAE-Eletronic B. Unit –Individual Net	2,874	3,922	4,841	6,015	6,709
PAE-Eletronic B. Unit –Associated Net	572	674	696	744	1.010
PCO-Unit of Gold Purchase	216	213	190	96	93
PAC- Cooperative Unit	48	305	361	445	600
UAD-Administrative Unit	456	476	420	412	412
PACRE- Agricultural Credit Unit	10	9	8	7	7
PAP-Pay-roll units	1,786	1,643	1,340	1,164	942
PAA-Advanced Unit	-	-	-	52	334
<b>TOTAL</b>	<b>34,847</b>	<b>34,115</b>	<b>32,810</b>	<b>33,053</b>	<b>33,378</b>

Source:CADINF-DEORF/COPEC

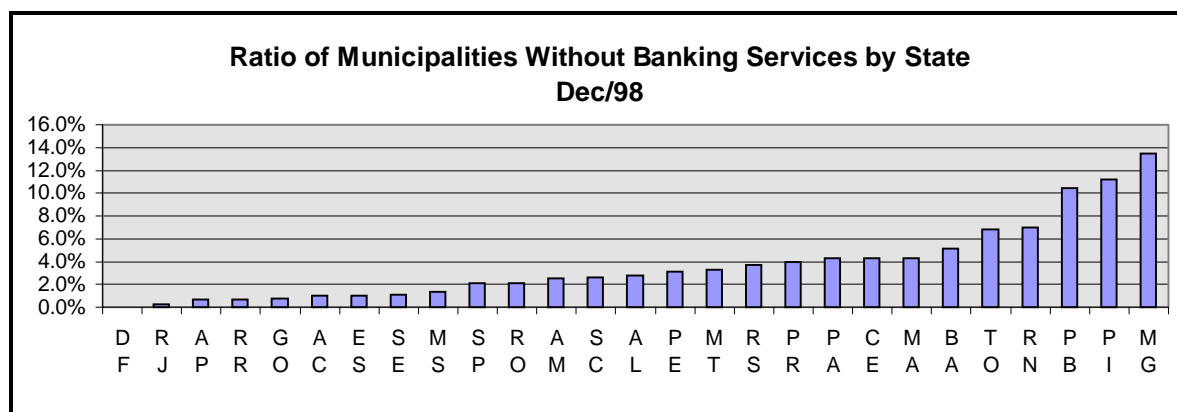
The total number of banking branches and PAB (a very small office – linked to a branch) decreased: branches, from 18,760 in Dec/94 to 16,060 in Dec/98 (-14%); PAB, from 10,125 to 7,211 (-29%). The biggest decreases were in the poorest regions. The decreases of banking branches by region were: North (-24%), Northeast (-20%), Middle West (-20%), South (-13%) and Southeast (-12%). Most of these branches ran deficits. Therefore, most were closed because of the process of adjustment in public banks or in privatized banks or, simply, the bank was liquidated or, yet, the bank was transformed into a development agency.

The increase of PAE (automatic machines' unit) from 3,446 (Dec/94) to 7,719 (Dec/98) couldn't compensate the decrease in the number of branches and PABs as they provide

different services.

Other important aspect is the concentration of branches and PAEs in the southern and southeastern capitals: 23% of overall branches and 40% of overall PAEs.

In short, concerning services, there is growth in the biggest cities and decrease in small cities. The increase is in the better-supplied places and the decrease, in the worst supplied places.



Among the southern and southeastern states, the richest in the country, Minas Gerais appears as a exception, 13.5% of its municipalities don't have banking services.

<b>RATIO IN TOTAL NET EQUITY - %</b>						
	<b>1993</b>	<b>1994</b>	<b>1995</b>	<b>1996</b>	<b>1997</b>	<b>1998</b>
3 BIGGEST BANKS	43.77	38.08	42.60	33.21	33.01	32.46
10 BIGGEST BANKS	64.24	60.37	80.23	59.54	62.58	59.89
20 BIGGEST BANKS	75.88	73.49	96.36	70.80	74.96	74.41
<b>RATIO IN TOTAL ASSETS - %</b>						
	<b>1993</b>	<b>1994</b>	<b>1995</b>	<b>1996</b>	<b>1997</b>	<b>1998</b>
3 BIGGEST BANKS	44.07	41.15	40.72	40.01	39.99	44.82
10 BIGGEST BANKS	65.57	63.38	64.22	62.33	62.91	68.10
20 BIGGEST BANKS	76.31	76.27	76.32	74.22	77.56	81.24

SOURCE: COSIF - DEORF/COPEC

The banking concentration didn't vary significantly, rather the ratio in total assets or the ratio in total net equity.

On the other hand, as we can see in the next table, the increase in the number of branches owned by the 20 biggest banks relatively to the others banks is clear: their ratio jumped from 76.7% in 1994 to 85.3% in 1998.



**RATING OF BANKS – BY NUMBER OF BRANCHES**

	BANKS	KIND (2)	NÚMERO OF BRANCHES				
			12.31.94	12.31.95	12.31.96	12.31.97	12.31.98
1	BANCO DO BRASIL	B.C.	3,124	3,004	2,933	2,926	2,828
2	BRADESCO	B.M.	1,846	1,856	1,895	1,960	2,090
3	CAIXA ECONÔMICA FEDERAL	C.E.	1,784	1,699	1,642	1,566	1,602
4	ITAÚ	B.M.	1,010	1,023	1,013	993	1,019
5	HSBC – BAMERINDUS	B.M.	1,352	1,371	1,206	1,200	991
6	UNIBANCO	B.M.	786	809	714	686	684
7	REAL	B.C.	546	552	534	562	588
8	BANESPA	B.M.	612	611	610	569	571
9	NOSSA CAIXA NOSSO BANCO	B.M.	494	493	482	483	485
10	BEMGE	B.M.	490	518	500	472	472
11	BANESTADO	B.M.	392	393	394	391	391
12	BANRISUL	B.M.	302	309	314	392	370
13	BESC	B.C.	254	254	255	255	256
14	MERIDIONAL	B.M.	256	256	256	222	224
15	BILBAO VIZCAYA (1)	B.M.	284	284	232	222	223
16	MERCANTIL DE SÃO PAULO	B.M.	198	215	216	217	218
17	MERCANTIL DO BRASIL	B.M.	179	179	179	179	177
18	NORDESTE DO BRASIL	B.M.	180	180	180	174	174
19	BANCO DO ESTADO DA BAHIA	B.M.	174	174	169	169	170
20	BANDEIRANTES	B.M.	118	120	169	177	164
<b>SUB TOTAL</b>			<b>14,381</b>	<b>14,300</b>	<b>13,893</b>	<b>13,815</b>	<b>13,697</b>
			76.7%	80.4%	83.2%	84.3%	85.3%
OTHER BANKS			4,379	3,498	2,793	2,568	2,363
			23.3%	19.6%	16.2%	15.7%	14.7%
<b>TOTAL</b>			<b>18,760</b>	<b>17,798</b>	<b>16,686</b>	<b>16,383</b>	<b>16,060</b>
%			100%	100%	100%	100%	100%

(1) Include branches of Excel-Econômico purchased by Bilbao Vizcaya in 10.09.98

(2) BC=Commercial Bank; BM=Universal Bank

Source: CADINF - DEORF/COPEC

The headquarters of the financial companies (except credit cooperative) were distributed in the following way: São Paulo, 51% of the total companies; Rio de Janeiro, 20%; Rio Grande do Sul, 6%; Minas Gerais, 5%; others states, 18%.

Now, we will present indicators of leverage, quality of assets and profitability to the Brazilian financial system (the tables are presented in the end of the paper and they were extracted from Puga, 1999). We will point out some aspects and then we will make some comments:

- the main Brazilian banks operate less leveraged (credit/ net equity) than banks from others countries. The only exception is Banco do Brasil;
- the domestic private banks have a lower index of delinquent accounts than banks from others countries (overdue credits plus delinquent accounts/ total credits); this is not the case of the public banks. Most of the agricultural credits are supplied by Banco do Brasil and they have a high level of overdue credits and delinquent accounts. However, there is a correct allowance for possible loan losses;

- the profitability of the Brazilian banks (net profit/ net equity) has been negatively affected just in periods of high increase in the interest rate (in the end of the years 1995 and 1998);
- the net margin (revenues of financial intermediation – expenses of financial intermediation)/assets) of the Brazilian banks is bigger than banks from others countries. One reason to this is that the spread charged in Brazil is much bigger than in other countries; in an article in the Brazilian newspaper Gazeta Mercantil (“Por que os juros demoram a cair no crediário”, June, 1<sup>st</sup>, 1999), it was asked why the interest rate of consumer credit takes too long to decrease despite the fall in the prime rate and the decrease in overdue credits. The article cited the following reasons:
  - inefficiency of the Brazilian banks, that is, they don't have experience in retail credit analysis and the operational costs are high;
  - there are too much taxes and contributions: PIS, COFINS, IOF;
  - the reserve requirements are high;
  - there are few borrowers due to the recession and the high rate of unemployment;
  - uncertainty about the future: variations in interest rate are faster upward than downward; banks prefer being absolutely certain about the tendency downward before lending for a long period; If interest rate goes up again they can lose money in the long run;
  - the ratio services revenues and result of financial intermediation shows that banks increased fees to compensate the floating revenues that they don't gain any more.

In a McKinsey's report (in Puga, 1999), there is an evaluation about the labor banking productivity in Brazil versus in US. The productivity of the Brazilian banks is: just 29% of the American one, in public banks; and 52%, in private banks. Some possible reasons are: in the US, a considerable amount of bills are paid by post service and call centers offer centralized services; in Brazil, people go to a branch to pay bills or to check their account. The report also shows the need of automating the grant of credit by Brazilian banks.

In this way, Brazilian banks have invested in technology in order to reduce cost and offer easier and better services to their customers. A McKinsey's consultant, Alejandro Picos, thinks that “automation challenges the current banking model. Branches are expensive and they can't achieve everything for all the potential customers”. Another consultant, Fernando Henrique da Silveira Neto, thinks that if banks want to expand their business they should invest in modern equipment, have a high level back-office service and simplify the systems used by customers.

Let's show some practical information. The investments in technology done in 1998 by

some banks were: Itaú, \$ 317 million; Banespa, \$ 85 million. Banco do Brasil is going to invest R\$ 460 million this year. Most of available banking services can be done by consumers using computers or machines: 70% of total services in Banco Itaú and 62% in Banco do Brasil. The number of customers that sign up for home and internet banking and the number of transactions done this way are: Itaú, 800 thousand customers and 7 million transactions/month; Banespa, 195 thousand customers and 1.4 million of transactions/month; Banco do Brasil, 800 thousand customers and 2.3 million de transactions/month. According to Banco do Brasil, the unit cost of a transaction in a branch is R\$ 1.08 and by Internet is around R\$ 0.12 (“Banco usa tecnologia para atrair cliente”, In:Gazeta Mercantil, June, 21th, 1999).

Some of the bigger retail Brazilian banks (Banco do Brasil, Itaú, Unibanco) will start selling stocks by Internet in the next months. Bradesco has already introduced this (“Bancos de varejo prontos para a corretagem virtual”, In:Gazeta Mercantil, June, 1<sup>st</sup>, 1999).

Bradesco has been changing all their customers' cards - around 15 million – to make available both debit and credit functions in the same card, even to lower income customers (Gazeta Mercantil, “Bradesco terá débito e crédito no cartão”, July, 12<sup>th</sup> 1999).

Brazilian banks have been introducing complex programs (called global sourcing) to reduce costs and to review supply contracts. For example, Unibanco, one of the pioneers, contracted an American consultancy (A.T.Kearney), and saved R\$ 105 million in 12 months, which represents 25% of the profit's group in the last year. The relationship with its suppliers has changed. Nowadays, there is a contract (Xerox do Brasil) to print all the check book, forms, account statement and to distribute mails and check books outside the bank (“Bancos baixam custo com fornecedores”, In:Gazeta Mercantil, July, 12<sup>th</sup>, 1999).

In order to evaluate the impact of Real devaluation in the Brazilian financial system in the beginning of this year, we present The Banker's analysis about this issue:

“A survey of results for 15 top banks conducted by the Brazilian consulting firm Austin Assis reveals a remarkable surge of 1,216% in net profits from year-earlier levels to a cumulative R\$ 2.56 billion (\$1.42 billion) in the first half of 1999.

Private sector banking leader Bradesco realised a healthy 6.9% gain year-on-year in net income, to R\$ 460.7 million; its leading Brazilian-owned rivals posted more dramatic earnings growth, with Banco Itaú reporting a 17.2% advance in recurring net income and Unibanco boosting net profits by 21.5% for the first semester. Major foreign players in the Brazilian financial sector enjoyed equally strong first-half income. A case in point is the Brazilian subsidiary of US-based Bank Boston, which posted a record \$60 million profits in the first half.

Even more impressive is the fact that these earnings performances were achieved in a recessionary environment that has taken its toll on credit demand and loan portfolio performance. Itaú boosted loan-loss provisions to more than R\$1 billion even at its past-due

loan portfolio shrunk by 7.6% during the first semester, resulting in an increase in the coverage ratio to 348%.

Bradesco has pursued a similarly conservative policy, sustaining loan-loss provision coverage at a comfortable 284% at the end of June.

A closer analysis of bank results for the first half suggests that the industry has preserved and bolstered its profitability through a combination of careful risk management, favourable interest margins, enhanced service-fee income and lucrative capital market operations.

In particular, wide spreads between funding and lending rates have provided critical insulation against recessionary damage to loan portfolios, and extraordinary gains on treasuries trading and foreign exchange positions have more than compensated for less substantial profits from traditional bank services.

The serendipitous earnings boost from post-devaluation foreign exchange gains clearly has dissipated in the second semester but aggressive development of bank automation and mini-branch networks is providing fresh competitive impetus to broaden deposit-taking and improve operational efficiency" ("Surprise, surprise - Brazilian banks have reported surprisingly good results, setting the stage for a rebound in 2000", In: The Banker, September/1999).

### 3. Conclusions

Could we say that, nowadays, the Brazilian financial system is stronger and solid and, therefore, there is no risk of a systemic crisis? Or yet, could we say that our financial system is modern and good enough for the development of the Brazilian economy?

About the first question, we believe that we were able to demonstrate the important changes made in the Brazilian financial system. Therefore, our system is much more stable than it was five years ago. After the introduction of PROER's and PROES' programs, the liquidations of some banks and others that went out of financial business by themselves, the entrance of foreign banks and improvements in regulation by Central Bank, it would be fair to say the risk of crises decreased.

Nevertheless, we identified in the process of globalization how interlinked the financial markets all around the world are. Thus, if an instability in a specific market occurs the risks of affecting other markets are considerable. Despite the increase in products and models to protect banks from losses in their operations, banks can be seriously affected depending on their bets or strategies. And even the expectatives over the economic performance of emerging countries and their governments can bring again instability to a financial system. The growing

volatility and, perhaps, a special situation in the financial and capital market could drive high losses to a financial company and, therefore, somehow affect the whole financial system.

We have to mention as a negative aspect the high concentration of agricultural credits and housing credits in two federal financial companies. The risk of losses in these operations are considerable.

Concerning our second question, if our financial system is modern and good enough for the development of the Brazilian economy, we can say that the entrance of foreign companies has helped a lot and it has driven the modernization at the Brazilian companies and at the system as whole. However, we are in a period of transformation.

The banks have charged fees and they have been able to face their administrative expenses. They have invested a lot in automation and it brings lower transactions costs. As a rule, the main banks are performing well and they have sound management.

The trend of financial conglomerates offering a great variety of products is a fact in the Brazilian market. This is a characteristic of the formation of the Brazilian financial system. Universal banks have already existed for several years.

On the other hand, continuous advances in the economic globalization and in the sophistication of some financial markets demand banks be very efficient in order to be competitive. Banks should quickly offer products that fit the customers' need. Therefore, banks should increase investments in technology, management systems and training. Then, perhaps, scale represents a condition to be efficient.

An important question to be answered is if the big private banks, strong as commercial banks, will be able to extend significantly their business into investment banking areas, for example, which is identified as potentially profitable. The insurance and pension fund industries could also be sought by the banks. Late July, Central Bank's director, Sérgio Darcy, identified some sectors that could grow in the future: finance companies and leasing companies. He said that there were foreign companies interested.

The mergers and acquisitions can bring more stability and strength to the financial system, scale economies and productivity. Although they can also increase the concentration in the system if there is not a limit.

We would like to finish this paper with The Banker's analysis about the present and future of the banking system. We quite agree with this analysis and we think it can indicate some trends or concerns to the Brazilian financial market:

"In almost every major economy, there has been a wave of new entrants to the market from outside the financial services sector. AT&T, the US telecoms giant, went from being ousted from its dominance of the US phone market to becoming the largest issuer of credit cards in the world.

General Electric went from being a respected manufacturer of appliances to a global financial powerhouse. Virgin went from being a record company to an airline to a provider of pension and investment products. Carrefour, the French retailer, entered the banking industry, as did Safeway, Tesco and Marks & Spencer, the UK food retailer.”

“Established financial institutions have no choice but to respond to these challenges. This, as much as any other factor, is going to drive a substantial reshaping of all areas of operations, from the front through the back office and particularly at the vital customer face.”

“Financial institutions, if they are to succeed, must develop a deeper understanding of what their customers want, and imaginative, user-friendly ways to reach them.

The age of the Internet has arrived, and few would argue that e-commerce is simply the most efficient distribution channel from the standpoint of both access and cost. Yet it remains relatively underexploited in the financial industry, despite these advantages – and this is specially true in Europe.”

“Few institutions have taken on board the dramatic change that becoming a full e-business means, not only in creating an interface with customers but also in realigning every aspect of their operations and processes behind this front end. This is, however, changing.”

“E\*trade and Charles Schwab helped revolutionise the US share market, and they are bringing their expertise and ambitions to Europe and internationally.

E-commerce will be the back-bone of the new global economy in the next century, a marketplace which can be entered from anywhere, which can take its users anywhere, which can give access to an unimaginably diverse range of products and services. Household as well as corporations will be able to access and purchase financial or any other kind of services from the most cost-effective, efficient or attractive provider. For companies seeking to diversify their market presence, the need to create new distribution channels or create new physical operations will be erased.”

“In the financial markets until very recently, control of market knowledge was restricted to market professionals, enabling great profits to be made on market imperfections or through curtailing access to products, services and financing structures.

Access to market knowledge is clearly no longer a restricted franchise. The knowledge revolution – via the Internet as well as traditional media – has directly fed the sophistication of the financial industry’s customers on the retail and wholesale levels. In consequence, the market imperfections that created enormous potential profits for the financial sector have been eroded.”

“It is at the vital customer interface that we can see the potential of knowledge management. More intensive and intelligent use of client data, including the identification of a bank’s most profitable customers, will enable financial services companies to shift from less

productive mass marketing to the development and customised marketing of products and services to individual customers or better defined customer groups.”

“The other side of this increased market power is that it is neither exclusive – potentially every financial services company or new entrant can access and deploy these techniques and the supporting technology – nor a one-off process. Information that is not clean, accurate and fresh may not only be useless, it can harm customer relationships. As with risk management, knowledge management is a dynamic process and must be continually monitored, updated and enhanced, ideally by data users. The “care and feeding” of the knowledge management system must be part of the normal operation of business. The ideal system enables users to modify the information or access it on a real-time basis and in support of customer relationships.”

“Transformation is inevitable; it is not painless but it is not to be feared. The most successful companies are those which can adapt, because the future is not a straight line, any more than the past has been” (“Bad Old Days for Bankers”, In: The Banker, September/1999).

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## Appendices

Indicators of Leverage and Quality of Assets – Universal and Commercial Banks										
	(%)									
	Jun/94	Dec/94	Jun/95	Dec/95	Jun/96	Dec/96	Jun/97	Dec/97	Jun/98	Dec/98
<b>Leverage (Credits/Net Equity)</b>										
Federal Banks	3,5	5,4	7,9	6,7	2,6	5,1	4,8	4,0	4,0	4,1
State Banks	4,7	8,6	9,4	11,3	15,1	8,9	9,5	6,2	5,5	3,3
Domestic Private Banks	2,9	3,1	3,2	5,6	5,7	2,9	2,9	2,7	2,5	1,7
Foreign Banks – Subsidiaries	3,4	2,5	2,7	2,9	3,1	2,6	2,7	2,9	2,8	2,9
Banks with Foreign Control	3,4	2,6	3,0	3,7	4,3	4,7	4,4	3,6	3,1	2,3
Banks with Foreign Interest	3,0	2,1	2,0	1,9	2,4	2,7	2,6	2,7	3,0	3,2
Total of Unoversal and Commercials	3,4	4,0	4,4	5,8	4,7	4,1	4,1	3,2	3,1	2,5
Financial System	3,3	3,6	3,8	4,5	4,1	4,0	4,1	3,6	3,6	3,2
<b>Quality of Assets (Overdue Credits and Delinquent Accounts/ Total Credits)</b>										
Federal Banks	12,5	11,0	15,6	14,3	21,5	18,3	18,5	21,5	24,2	33,2
State Banks	1,4	2,6	4,0	5,2	5,0	5,1	4,8	9,6	10,8	17,0
Domestic Private Banks	1,1	2,1	3,9	15,6	16,6	4,8	3,6	4,5	5,1	4,2
Foreign Banks – Subsidiaries	2,4	5,6	6,6	7,5	8,8	9,6	8,9	8,0	6,9	7,1
Banks with Foreign Control	1,2	2,3	4,7	5,0	3,5	3,4	4,6	4,5	5,7	5,8
Banks with Foreign Interest	1,4	2,6	3,3	5,2	5,9	4,7	4,1	3,1	4,5	6,5
Total of Unoversal and Commercials	4,4	4,8	7,3	11,7	13,3	7,5	6,9	9,4	11,2	14,6
Financial System	3,8	4,3	6,6	10,3	11,5	7,1	6,4	7,6	8,7	10,3
<b>Quality of Assets (Allowance to Overdue Credits and Delinquent Accounts / Overdue Credits and Delinquent Accounts)</b>										
										(Em %)
Federal Banks	10,4	18,5	37,9	77,7	119,5	117,8	150,0	148,0	132,4	90,3
State Banks	276,4	142,0	113,3	104,9	113,6	124,0	125,3	119,6	197,9	192,0
Domestic Private Banks	150,2	141,0	123,1	104,0	108,4	110,2	119,3	116,5	144,9	184,2
Foreign Banks – Subsidiaries	97,7	78,7	81,5	85,0	91,9	96,7	97,8	100,3	107,5	106,3
Banks with Foreign Control	141,4	126,1	101,9	109,5	109,9	104,1	89,6	95,9	89,6	108,2
Banks with Foreign Interest	114,2	91,9	107,0	94,6	111,0	113,9	118,5	240,3	156,6	121,3
Total of Unoversal and Commercials	45,3	57,8	69,0	95,9	112,8	115,7	132,4	138,2	135,5	106,8
Financial System	50,9	61,2	73,1	95,3	109,3	108,6	126,0	137,6	136,1	117,4
Source: Sisbacen. IN PUGA, 1999										







**Some Indicators to the 20 Biggest Universal and Commercial Banks (June 1998)**

	Assets (US\$ Million)	Credits (US\$ Million)	Deposits (US\$ Million)	Net Equity (US\$ Million)	Credits/Net Equity	Delinquent Acc./ Credits (%)	Allowance/ Delinquent A (%)	Capital Adequacy (%)	Profit/Net Equity (%)	Net Margin (%)	R.Serv./ RS+RFI (%)	Eficiency (%)
Brasil	111.913	46.957	52.423	5.433	8,6	20,1	126,3	10,3	13,5	2,9	39,8	134,3
Bradesco	59.253	26.532	23.075	5.441	4,9	2,1	172,2	17,1	15,5	7,3	25,6	74,4
Itaú	45.165	16.571	16.028	4.066	4,1	0,9	506,2	19,8	17,3	6,9	36,1	72,7
Unibanco	27.002	14.012	5.988	2.754	5,1	1,7	301,2	14,0	17,6	7,5	35,9	83,1
Banespa	23.229	4.499	10.596	3.438	1,3	29,9	105,0	36,9	(2,5)	4,8	30,4	104,4
Real (Group)	18.762	9.708	7.058	1.590	6,1	1,7	221,5	14,8	12,4	4,7	37,3	95,1
Safra	14.789	4.227	3.244	752	5,6	1,3	100,2	12,2	17,6	3,6	24,1	72,4
Meridional	14.209	3.448	2.763	882	3,9	0,8	320,2	17,0	0,0	1,8	44,6	84,5
BCN	13.993	6.019	2.712	627	9,6	3,5	170,2	17,1	20,1	4,0	17,1	75,1
Nossa Caixa	13.437	1.251	8.695	792	1,6	8,8	101,6	31,6	8,7	5,8	13,5	79,3
HSBC Bamerindus	12.144	3.077	5.939	954	3,2	1,1	153,5	23,3	10,1	5,5	46,8	100,5
Bozano	11.557	2.370	995	400	5,9	0,5	409,0	17,0	0,0	(0,6)	246,7	162,0
BankBoston (Group)	9.145	3.006	1.295	643	4,7	0,4	171,1	16,1	19,5	6,6	17,9	57,0
Citibank (Group)	8.699	5.152	1.311	922	5,6	3,0	116,4	13,9	12,2	5,4	33,5	62,2
CCF Brasil	8.645	1.573	230	308	5,1	0,8	89,0	14,7	26,3	1,1	34,4	61,1
BBA	7.479	2.598	1.843	520	5,0	0,3	202,0	13,3	24,4	1,6	21,4	52,4
Sudameris	6.870	3.275	1.676	499	6,6	5,6	66,0	11,3	12,1	5,4	17,2	89,2
Excel-Econômico	6.411	2.321	1.965	(503)	(4,6)	18,3	159,4	**10,8	8.536	(13,8)	(9,9)	(71,1)
Mercantil Finasa	6.209	2.424	3.448	1.041	2,3	3,0	82,4	26,2	8,9	5,7	18,9	86,3
Boavista InterAtlânt.	5.171	2.283	1.497	340	6,7	11,4	124,5	11,9	8,2	4,7	13,8	90,0
Source: Bozano Simonsen, Atlantic Rating and balance sheets												
*Exchange Rate: R\$ 1,16 / US\$.												
**In dec./97. Not Available to June 1998. However, according to Atlantic Rating, the bank's index was below 11%. IN PUGA, 1999												

Evaluation of Financial Indicators among Brazilian, American and Emergent Countries' Banks												
	Assets (US\$ Million)	Credits (US\$ Million)	Deposits (US\$ Million)	Net Equity (US\$ Million)	Credits/Net Equity	Delinquent Acc./ Credits (%)	Allowance/ Delinquent A (%)	Capital Adequacy (%)	Profit/Net Equity (%)	Net Margin (%)	R.Serv./ RS+RFI (%)	Efficiency (%)
<b>Brazil (1° Semester 1998)</b>												
Banco do Brasil	111.913	46.957	52.423	5.433	8,6	20,1	126,3 <sup>v</sup>	10,3	13,5	2,9	39,8	134,3
Bradesco	59.253	26.532	23.075	5.441	4,9	2,1	172,2 <sup>v</sup>	17,1	15,5	7,3	25,6	74,4
Itaú	45.165	16.571	16.028	4.066	4,1	0,9	506,2 <sup>v</sup>	19,8	17,3	6,9	36,1	72,7
Unibanco	27.002	14.012	5.988	2.754	5,1	1,7	301,2 <sup>v</sup>	14,0	17,6	7,5	35,9	83,1
Banespa	23.229	4.499	10.596	3.438	1,3	29,9	105,0 <sup>v</sup>	36,9	(43) <sup>Δ</sup>	4,8	30,4	104,4
<b>United States (1° Semester 1998)</b>												
Chase	366.995	165.076	207.091	22.610	7,3	0,7	2,2 <sup>o</sup>		17,0	1,9	47,7	53,0
Citicorp	330.751	186.084	215.982	21.717	8,6		3,3 <sup>o</sup>		20,9	2,9	38,6	49,0 <sup>+</sup>
Nations Bank	307.985	179.755	169.238	26.670	6,7		1,8 <sup>o</sup>		14,8	3,0		34,0 <sup>+</sup>
Bank America	263.885	163.104	178.094	20.039	8,1		2,2 <sup>o</sup>		18,0	2,8	37,7	
BankBoston	70.499	42.520	45.196	4.980	8,5		1,7 <sup>o</sup>		20,2	3,0	33,1	46,0 <sup>+</sup>
<b>Argentina (1° Semester 1998)</b>												
0De la Nación Argentina	17.659	8.276	11.604	2.065	4,0	21,7 <sup>+</sup>	47,3 <sup>v+</sup>		6,7	2,3	43,9	86,3
Río de la Plata	14.182	4.900	4.262	953	5,1	3,3 <sup>+</sup>	106,5 <sup>v+</sup>		12,6	2,3	39,8	80,0
De la Prov. de Bs. Aires	12.856	7.615	9.225	1.263	6,0	16,5 <sup>+</sup>	51,2 <sup>v+</sup>		6,5	2,0	60,7	104,5
De Galicia y Bs. Aires	11.425	6.441	6.449	1.089	5,9	5,2 <sup>+</sup>	70,9 <sup>v+</sup>		10,5	2,9	37,3	79,8
Frances S.A.	11.235	4.888	5.012	748	6,5	2,2 <sup>+</sup>	98,5 <sup>v+</sup>		11,5	2,2	49,0	92,4



	Assets (US\$ Million)	Credits (US\$ Million)	Deposits (US\$ Million)	Net Equity (US\$ Million)	Credits/Net Equity	Delinquent Acc./ Credits (%)	Allowance/ Delinquent A (%)	Capital Adequacy (%)	Profit/Net Equity (%)	Net Margin (%)	R.Serv./ RS+RFI (%)	Efficiency (%)
<b>Chile (1997)</b>												
Santiago	10.797	7.531	5.245	936	8,0	0,7	143,7 <sup>v</sup>		14,7	2,9		
Del Estado	10.780	5.669	6.031	647	8,8	2,3	81,1 <sup>v</sup>		9,9	3,3		
Santander	9.922	5.492	4.780	700	7,9	1,2	102,9 <sup>v</sup>	10,7	10,3	2,3	16,3	61,5
De Chile	7.646	5.109	4.136	771	6,6	0,8	208,6 <sup>v</sup>		21,1	3,7		
De Credito e Inversiones	6.019	3.386	3.367	310	10,9	0,9	114,8 <sup>v</sup>		22,0	3,1		
<b>Mexico (1997)</b>												
Banamex	31.154	16.963	21.607	2.749	6,2	20,5	55,4 <sup>v</sup>	13,7	13,0	2,2	32,1	100,0
Bancomer	27.116	20.089	19.194	2.351	8,5	13,7	57,5 <sup>v</sup>	12,7	6,0	2,9	22,4	69,9
Serfin	17.930	12.220	12.928	1.002	12,2	10,8	61,1 <sup>v</sup>	11,3	(216) <sup>Δ</sup>	2,3	22,7	
Bitel	9.181	6.302	6.457	748	8,4	14,9	53,7 <sup>v</sup>	12,6	(19) <sup>Δ</sup>	2,9		
Santander Mexicano	8.019	5.563	5.643	351	15,9	2,8	135,1 <sup>v</sup>	10,5	(16) <sup>Δ</sup>	3,1		
<b>South Korea(12 Months up to June 30th 1998)</b>												
Korea Exchange Bank	41.881	27.999	26.031	1.408 <sup>+</sup>	11,9 <sup>+</sup>	7,8	100,0 <sup>v</sup>	6,8 <sup>+</sup>	(393) <sup>Δ</sup>		12,1	
Chohung Bank	37.394	24.950	26.413	1.242 <sup>+</sup>		10,4	100,0 <sup>v</sup>	6,5 <sup>+</sup>	(667) <sup>Δ</sup>			
Hanil Bank	36.349	24.810	24.825			7,0	100,0 <sup>v</sup>	6,9 <sup>+</sup>	(587) <sup>Δ</sup>			
Commercial Bank of Korea	32.421	20.149	23.421			6,9	100,0 <sup>v</sup>	7,6 <sup>+</sup>	(398) <sup>Δ</sup>			
Korea First Bank	28.152	16.058	18.903			16,3	100,0 <sup>v</sup>	-2,7 <sup>+</sup>	(976) <sup>Δ</sup>			
<b>Hong Kong (June 30<sup>th</sup> 1998)</b>												
HSBC Holding PLC	484.367	241.100	344.297	27.540	8,8	2,2	110,3 <sup>v</sup>	9,3	18,2	2,3	33,7	56,2
Hang Seng Bank	52.581	26.020	44.409	6.034	4,3	0,9		22,0	16,9			
Bank of East Asia	17.216	11.097	12.411	1.805	6,1	1,3		15,3	10,5			
Dao Heng Bank	15.829	8.360	12.878	1.433	5,8	0,6		17,9	15,3			
Wing Lung Bank	6.607	3.738	5.236	778	4,8	4,8		14,3	12,7	2,1		

	Assets (US\$ Million)	Credits (US\$ Million)	Deposits (US\$ Million)	Net Equity (US\$ Million)	Credits/Net Equity	Delinquent Acc./ Credits (%)	Allowance/ Delinquent A (%)	Capital Adequacy (%)	Profit/Net Equity (%)	Net Margin (%)	R.Serv./ RS+RFI (%)	Efficiency (%)
<b>Indonesia</b> (1997, see exceptions)												
Bank Negara Indonesia	9.758 <sup>#</sup>	7.036 <sup>#</sup>	5.095 <sup>#</sup>	375 <sup>#</sup>	18,7 <sup>#</sup>	10,5 <sup>#</sup>		6,0 <sup>#</sup>	4,7 <sup>#</sup>	3,5 <sup>#</sup>		
Bank International Indonesia	5.031	3.357	2.897	521	6,4	33,6	4,0 <sup>∇</sup>	11,7	9,6	4,1		
Bank Lippo	2.640	2.075	2.282	204	10,2	10,0	27,4 <sup>∇*</sup>	10,4	12,4	4,0	23,0	
Bank Bali	2.565	469 <sup>*</sup>	1.596			55,0		10,8				
Bank Panin	1.607	283 <sup>*</sup>	846			20-25		17,4				
<b>Tailand</b> (1997, see exceptions)												
Bangkok Bank	31.281	22.818	21.029	2.292	10,0	29,7	18,9 <sup>∇</sup>	13,0	4,1	3,2		
Krung Thai Bank	19.200 <sup>*</sup>	15.253 <sup>*</sup>	14.989 <sup>*</sup>	1.221 <sup>*</sup>	12,5 <sup>*</sup>	32,4	25,9 <sup>∇*</sup>	7,7	(305) <sup>Δ</sup>	(2,4) <sup>*</sup>		
Siam Commercial Bank	15.839	12.367	12.831	921	13,4	19,9	16,3 <sup>∇</sup>	9,1	7,7	3,4		
Bank of Ayudhya	10.905	8.900	8.593	579	15,4	17,3	15,7 <sup>∇</sup>	9,2	7,5	3,0		
Bank of Asia	3.456	2.892	1.769	218	13,3	25,9	9,8 <sup>∇</sup>	8,6	0,4	2,7		
Exchange Rates: 1,16 reais/US\$ (Br.); 1,00 pesos/US\$ (Arg.); 439,81 pesos/US\$ (Ch.); 8,055 pesos/US\$ (Méx.); 1484,08 won/US\$ - 31.12.97 e 1.397,77 won/US\$ - 30.6.98 (Cor.); 7,744 HK\$/US\$ (H.K.); 4.909 rupiah/US\$ - 31.12.97, 8.669 rupiah/US\$ - 30.3.98, e 14.621 rupiah/US\$ - 30.6.98 (Ind.); 45,28 baht/US\$ - 31.12.97 e 42,33 baht/US\$ - 30.6.98 (Tai).												
*First semester 1998, # : .3.31.98; + : 12.31.1997; Δ : US\$ million; ∇ : Allowance/Overdue Credits and Delinquent Accounts; ∠ : Allowance/Total Credits.												
Source: Atlantic Rating, Bozano Simonsen, Banco Central de la República Argentina, <i>Latin Finance</i> , <i>Far Eastern Economic Review</i> e balanços dos bancos. IN PUGA, 1999												

## Appendices

Indicators of Leverage and Quality of Assets – Universal and Commercial Banks										
	(%)									
	Jun/94	Dec/94	Jun/95	Dec/95	Jun/96	Dec/96	Jun/97	Dec/97	Jun/98	Dec/98
<b>Leverage (Credits/Net Equity)</b>										
Federal Banks	3,5	5,4	7,9	6,7	2,6	5,1	4,8	4,0	4,0	4,1
State Banks	4,7	8,6	9,4	11,3	15,1	8,9	9,5	6,2	5,5	3,3
Domestic Private Banks	2,9	3,1	3,2	5,6	5,7	2,9	2,9	2,7	2,5	1,7
Foreign Banks – Subsidiaries	3,4	2,5	2,7	2,9	3,1	2,6	2,7	2,9	2,8	2,9
Banks with Foreign Control	3,4	2,6	3,0	3,7	4,3	4,7	4,4	3,6	3,1	2,3
Banks with Foreign Interest	3,0	2,1	2,0	1,9	2,4	2,7	2,6	2,7	3,0	3,2
Total of Unoversal and Commercials	3,4	4,0	4,4	5,8	4,7	4,1	4,1	3,2	3,1	2,5
Financial System	3,3	3,6	3,8	4,5	4,1	4,0	4,1	3,6	3,6	3,2
<b>Quality of Assets (Overdue Credits and Delinquent Accounts/ Total Credits)</b>										
Federal Banks	12,5	11,0	15,6	14,3	21,5	18,3	18,5	21,5	24,2	33,2
State Banks	1,4	2,6	4,0	5,2	5,0	5,1	4,8	9,6	10,8	17,0
Domestic Private Banks	1,1	2,1	3,9	15,6	16,6	4,8	3,6	4,5	5,1	4,2
Foreign Banks – Subsidiaries	2,4	5,6	6,6	7,5	8,8	9,6	8,9	8,0	6,9	7,1
Banks with Foreign Control	1,2	2,3	4,7	5,0	3,5	3,4	4,6	4,5	5,7	5,8
Banks with Foreign Interest	1,4	2,6	3,3	5,2	5,9	4,7	4,1	3,1	4,5	6,5
Total of Unoversal and Commercials	4,4	4,8	7,3	11,7	13,3	7,5	6,9	9,4	11,2	14,6
Financial System	3,8	4,3	6,6	10,3	11,5	7,1	6,4	7,6	8,7	10,3
<b>Quality of Assets (Allowance to Overdue Credits and Delinquent Accounts / Overdue Credits and Delinquent Accounts)</b>										
										(Em %)
Federal Banks	10,4	18,5	37,9	77,7	119,5	117,8	150,0	148,0	132,4	90,3
State Banks	276,4	142,0	113,3	104,9	113,6	124,0	125,3	119,6	197,9	192,0
Domestic Private Banks	150,2	141,0	123,1	104,0	108,4	110,2	119,3	116,5	144,9	184,2
Foreign Banks – Subsidiaries	97,7	78,7	81,5	85,0	91,9	96,7	97,8	100,3	107,5	106,3
Banks with Foreign Control	141,4	126,1	101,9	109,5	109,9	104,1	89,6	95,9	89,6	108,2
Banks with Foreign Interest	114,2	91,9	107,0	94,6	111,0	113,9	118,5	240,3	156,6	121,3
Total of Unoversal and Commercials	45,3	57,8	69,0	95,9	112,8	115,7	132,4	138,2	135,5	106,8
Financial System	50,9	61,2	73,1	95,3	109,3	108,6	126,0	137,6	136,1	117,4
Source: Sisbacen. IN PUGA, 1999										







**Some Indicators to the 20 Biggest Universal and Commercial Banks (June 1998)**

	Assets (US\$ Million)	Credits (US\$ Million)	Deposits (US\$ Million)	Net Equity (US\$ Million)	Credits/Net Equity	Delinquent Acc./ Credits (%)	Allowance/ Delinquent A (%)	Capital Adequacy (%)	Profit/Net Equity (%)	Net Margin (%)	R.Serv./ RS+RFI (%)	Eficiency (%)
Brasil	111.913	46.957	52.423	5.433	8,6	20,1	126,3	10,3	13,5	2,9	39,8	134,3
Bradesco	59.253	26.532	23.075	5.441	4,9	2,1	172,2	17,1	15,5	7,3	25,6	74,4
Itaú	45.165	16.571	16.028	4.066	4,1	0,9	506,2	19,8	17,3	6,9	36,1	72,7
Unibanco	27.002	14.012	5.988	2.754	5,1	1,7	301,2	14,0	17,6	7,5	35,9	83,1
Banespa	23.229	4.499	10.596	3.438	1,3	29,9	105,0	36,9	(2,5)	4,8	30,4	104,4
Real (Group)	18.762	9.708	7.058	1.590	6,1	1,7	221,5	14,8	12,4	4,7	37,3	95,1
Safra	14.789	4.227	3.244	752	5,6	1,3	100,2	12,2	17,6	3,6	24,1	72,4
Meridional	14.209	3.448	2.763	882	3,9	0,8	320,2	17,0	0,0	1,8	44,6	84,5
BCN	13.993	6.019	2.712	627	9,6	3,5	170,2	17,1	20,1	4,0	17,1	75,1
Nossa Caixa	13.437	1.251	8.695	792	1,6	8,8	101,6	31,6	8,7	5,8	13,5	79,3
HSBC Bamerindus	12.144	3.077	5.939	954	3,2	1,1	153,5	23,3	10,1	5,5	46,8	100,5
Bozano	11.557	2.370	995	400	5,9	0,5	409,0	17,0	0,0	(0,6)	246,7	162,0
BankBoston (Group)	9.145	3.006	1.295	643	4,7	0,4	171,1	16,1	19,5	6,6	17,9	57,0
Citibank (Group)	8.699	5.152	1.311	922	5,6	3,0	116,4	13,9	12,2	5,4	33,5	62,2
CCF Brasil	8.645	1.573	230	308	5,1	0,8	89,0	14,7	26,3	1,1	34,4	61,1
BBA	7.479	2.598	1.843	520	5,0	0,3	202,0	13,3	24,4	1,6	21,4	52,4
Sudameris	6.870	3.275	1.676	499	6,6	5,6	66,0	11,3	12,1	5,4	17,2	89,2
Excel-Econômico	6.411	2.321	1.965	(503)	(4,6)	18,3	159,4	**10,8	8.536	(13,8)	(9,9)	(71,1)
Mercantil Finasa	6.209	2.424	3.448	1.041	2,3	3,0	82,4	26,2	8,9	5,7	18,9	86,3
Boavista InterAtlânt.	5.171	2.283	1.497	340	6,7	11,4	124,5	11,9	8,2	4,7	13,8	90,0
Source: Bozano Simonsen, Atlantic Rating and balance sheets												
*Exchange Rate: R\$ 1,16 / US\$.												
**In dec./97. Not Available to June 1998. However, according to Atlantic Rating, the bank's index was below 11%. IN PUGA, 1999												



Evaluation of Financial Indicators among Brazilian, American and Emergent Countries' Banks												
	Assets (US\$ Million)	Credits (US\$ Million)	Deposits (US\$ Million)	Net Equity (US\$ Million)	Credits/Net Equity	Delinquent Acc./ Credits (%)	Allowance/ Delinquent A (%)	Capital Adequacy (%)	Profit/Net Equity (%)	Net Margin (%)	R.Serv./ RS+RFI (%)	Efficiency (%)
<b>Brazil (1° Semester 1998)</b>												
Banco do Brasil	111.913	46.957	52.423	5.433	8,6	20,1	126,3 <sup>v</sup>	10,3	13,5	2,9	39,8	134,3
Bradesco	59.253	26.532	23.075	5.441	4,9	2,1	172,2 <sup>v</sup>	17,1	15,5	7,3	25,6	74,4
Itaú	45.165	16.571	16.028	4.066	4,1	0,9	506,2 <sup>v</sup>	19,8	17,3	6,9	36,1	72,7
Unibanco	27.002	14.012	5.988	2.754	5,1	1,7	301,2 <sup>v</sup>	14,0	17,6	7,5	35,9	83,1
Banespa	23.229	4.499	10.596	3.438	1,3	29,9	105,0 <sup>v</sup>	36,9	(43) <sup>Δ</sup>	4,8	30,4	104,4
<b>United States (1° Semester 1998)</b>												
Chase	366.995	165.076	207.091	22.610	7,3	0,7	2,2 <sup>o</sup>		17,0	1,9	47,7	53,0
Citicorp	330.751	186.084	215.982	21.717	8,6		3,3 <sup>o</sup>		20,9	2,9	38,6	49,0 <sup>+</sup>
Nations Bank	307.985	179.755	169.238	26.670	6,7		1,8 <sup>o</sup>		14,8	3,0		34,0 <sup>+</sup>
Bank America	263.885	163.104	178.094	20.039	8,1		2,2 <sup>o</sup>		18,0	2,8	37,7	
BankBoston	70.499	42.520	45.196	4.980	8,5		1,7 <sup>o</sup>		20,2	3,0	33,1	46,0 <sup>+</sup>
<b>Argentina (1° Semester 1998)</b>												
0De la Nación Argentina	17.659	8.276	11.604	2.065	4,0	21,7 <sup>+</sup>	47,3 <sup>v+</sup>		6,7	2,3	43,9	86,3
Río de la Plata	14.182	4.900	4.262	953	5,1	3,3 <sup>+</sup>	106,5 <sup>v+</sup>		12,6	2,3	39,8	80,0
De la Prov. de Bs. Aires	12.856	7.615	9.225	1.263	6,0	16,5 <sup>+</sup>	51,2 <sup>v+</sup>		6,5	2,0	60,7	104,5
De Galicia y Bs. Aires	11.425	6.441	6.449	1.089	5,9	5,2 <sup>+</sup>	70,9 <sup>v+</sup>		10,5	2,9	37,3	79,8
Frances S.A.	11.235	4.888	5.012	748	6,5	2,2 <sup>+</sup>	98,5 <sup>v+</sup>		11,5	2,2	49,0	92,4

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<b>Chile (1997)</b>												
Santiago	10.797	7.531	5.245	936	8,0	0,7	143,7 <sup>v</sup>		14,7	2,9		
Del Estado	10.780	5.669	6.031	647	8,8	2,3	81,1 <sup>v</sup>		9,9	3,3		
Santander	9.922	5.492	4.780	700	7,9	1,2	102,9 <sup>v</sup>	10,7	10,3	2,3	16,3	61,5
De Chile	7.646	5.109	4.136	771	6,6	0,8	208,6 <sup>v</sup>		21,1	3,7		
De Credito e Inversiones	6.019	3.386	3.367	310	10,9	0,9	114,8 <sup>v</sup>		22,0	3,1		
<b>Mexico (1997)</b>												
Banamex	31.154	16.963	21.607	2.749	6,2	20,5	55,4 <sup>v</sup>	13,7	13,0	2,2	32,1	100,0
Bancomer	27.116	20.089	19.194	2.351	8,5	13,7	57,5 <sup>v</sup>	12,7	6,0	2,9	22,4	69,9
Serfin	17.930	12.220	12.928	1.002	12,2	10,8	61,1 <sup>v</sup>	11,3	(216) <sup>Δ</sup>	2,3	22,7	
Bitel	9.181	6.302	6.457	748	8,4	14,9	53,7 <sup>v</sup>	12,6	(19) <sup>Δ</sup>	2,9		
Santander Mexicano	8.019	5.563	5.643	351	15,9	2,8	135,1 <sup>v</sup>	10,5	(16) <sup>Δ</sup>	3,1		
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