

because they feel that governments are following poor economic policies. When speculators looked at the economic fundamentals behind the economy of Thailand in 1997, they felt that the government was making poor choices and that the Thai baht could not continue to trade at its existing level. So they sold Thai baht on the assumption that the currency would have to fall. Is there anything wrong with that? Was the subsequent fall in the Thai baht because of evil speculators, or was it because the speculators profited on the inevitable? As long as markets are free and information is available, traders ought to be able to make some money on their predictions of the future.

The key is that currency speculation is a different way to invest money and allows investors to diversify their portfolios from traditional stocks and bonds. Just as foreign exchange can be traded for speculative purposes, trading in shares is also speculation. Even though we call such trades "investments," they are just another form of speculation hoping to gain a return that is higher than the market average and certainly higher than what a CD can yield. ►

losses in excess of \$1 billion, and the bank eventually was purchased by Dutch bank ING.¹⁹

Since the collapse of Barings, measures have been put into place in banks to prohibit such consequences, yet negative outcomes of rogue trading continue to happen. Leeson's record losses were surpassed in 2008 by Jérôme Kerviel of French bank Société Générale. Kerviel, a one time employee in the back office of Société Générale (the part of the bank that processes transactions), became a trader in 2005 in the relatively unimportant Delta One trading unit. In his new position, he began trading futures on the bank's own account. His role was to take opposite positions on the direction of the market in order to earn money on the spread. However, he began to take one-way positions to earn even more money for the bank and hopefully earn a bigger bonus. The problem is that he bet that the European markets would rise, but instead they fell rather sharply in early 2008. Through a variety of actions that went against the internal controls of the banks as well as outright lies about what he was doing, he was able to fool bank insiders while he was hoping to cover his positions. However, the bank eventually found out what he was doing, and they discovered that Kerviel had exposed the bank to a €50 billion risk. By the time they had unwound all of their trading positions, the bank had lost €1.5 billion or \$2.22 billion. Unlike Leeson, Kerviel was not using the bank's money to trade on his own account, but like Leeson, he created serious problems for his bank, which lost a lot of money.²⁰ ◀

The Global Economic Crisis: Banking on Argentina

In the first half of 2007, HSBC Holdings PLC saw profits soar to new records as it expanded aggressively in Asia, Latin America, and other emerging markets.²¹ HSBC is counting on its investments in emerging markets—especially China, Brazil, Argentina, and Vietnam—to pick up market share and increase profits. However, the year did not end well, as weaknesses in the U.S. real estate market hammered HSBC Finance Corporation in the United States. The challenges continued into 2008, as financial market turbulence and the collapse of the global economy created stresses in the entire banking industry. The bankruptcy of Lehman Brothers in the United States on September 15, 2008, sent a shock wave throughout the banking industry worldwide, resulting in mergers, more bankruptcies, and the unprecedented bailout of troubled banks and intervention by the U.S. and other governments, including the U.K., the home government of HSBC. What about HSBC? Will they be able to weather the storm? Is their bet on the emerging markets as future areas of growth the right strategy as they move into the future in an increasingly volatile world?

A Little Background on HSBC

London-based HSBC derives its name from its founding member, the Hong Kong and Shanghai Banking Corporation Limited, which was established in 1865 to permit trade between China and Europe. Until the early twentieth century, Hong Kong and Shanghai



Banking Corporation set up offices and branches mainly in China and Southeast Asia—but also in India, Japan, Europe, and North America.

Acquisitions and Diversification

After World War II, Hong Kong and Shanghai Banking Corporation expanded and diversified its business with acquisitions and alliances. Through the 1980s, it expanded into Canada, Australia, and the United States; and in the 1990s, it moved into Brazil and Argentina. In 1991, its member companies came together to form HSBC Holdings PLC.

HSBC pursues a balance of opportunities in developed economies and emerging markets. And it now has over 9,500 offices in 86 countries and stock market listings in London, Hong Kong, New York, and Paris. Its main lines of business are global banking and markets, private banking, commercial banking, and personal finance services. Its foreign-exchange operations fall under the markets organization.

From a strategic point of view, HSBC is aligning its global presence because of three major trends in the global economy: (1) Emerging markets are growing faster than developed countries, (2) world trade is expanding faster than GDP, and (3) longevity is increasingly virtually everywhere. As part of its strategy, HSBC is reshaping its focus on the fast-growing economies in the emerging markets, including Mexico, Brazil, and Argentina in Latin America.

Foreign-Exchange Trading

HSBC is involved in a wide range of banking activities and ranked as the number three global financial institution by market capitalization from 1999 to 2009. In addition, it is one of the top banks in the world in foreign-exchange trading. HSBC trades foreign exchange in 75 of its treasury sites worldwide in 60 countries and territories. The bank provides market information, trades, and consulting in the area of risk exposure and how to minimize the impact of market volatility on its clients.

As we note in Table 9.3, it is the seventh-largest bank in the world in market share in foreign-exchange trading. However, it is in the top five in terms of most currency trades, and it ranks third in trading Latin American currencies after Citi and Deutsche Bank. In addition to being the third-largest foreign-exchange trader in South America, HSBC is ranked number one for trades in Asian currencies, holding the number-one position for trading Chinese yuan.

HSBC Ventures into Argentina

HSBC's entry into Argentina began in 1997 when the bank acquired Roberts S.A. de Inversiones, changing its name to HSBC Argentina Holdings S.A. Along with the banking arm, HSBC bought into a general insurance agency with the purchase of Roberts. In 1994, HSBC united with New York Life to form a life and retirement insurance company, so the acquisition of Roberts was a strategic fit in both banking and insurance. HSBC Argentina has also acquired companies in pension fund management and medical care, thus creating a diversified portfolio in Argentina.

The outlook for HSBC in Argentina looked good when it entered the country. In 1998, its first full year of operations, the bank had a pretax loss of \$13 million but earned a profit of \$67 million in 1999 and expected profits to continue growing at 100 percent.

Argentina: A Little Economic History

To understand the problems facing HSBC in Argentina, we must take a look at Argentina's economic history. Argentina's economy flourished in the beginning of the twentieth century, growing at an annual rate of 5 percent for three years. It attracted a flood of British and Spanish capital and was rated as one of the world's 10 richest countries—even ahead of France and Germany.

However, it has been downhill since then. When Juan Perón ruled the country from 1946 to 1955, he instituted protectionist measures and printed money to finance generous benefits

for workers. State intervention in all sectors led to poor productivity and structural weakness in the economy. Inflation plagued the country; there were two bouts of hyperinflation in the 1980s and two banking collapses. As a result, Argentines lost trust in the peso and invested in U.S. dollars or shipped their capital abroad.

The Advent of the Currency Board

In 1989, Carlos Menem took control of the country and set out to implement free market reforms and to restructure monetary and economic policies. He privatized many state-run companies, tightened fiscal management, and opened up the country's borders to trade. Probably the most important policy he established was the Convertibility Law, which pegged the Argentine peso 1:1 with the U.S. dollar and restricted the money supply to its hard-dollar currency reserves. This monetary arrangement, called a *currency board*, was established to impose discipline on the central bank.

Successes The new currency board accomplished what it set out to do: It halted inflation and attracted investment. Investors felt there was little risk now in investing in the peso because it was pegged to the dollar. The sentiment that "the peso is as good as the dollar" was strong throughout the country. Because there was a stable money supply, this reduced inflation to nearly 0 percent through the rest of the 1990s and kept the exchange rate at a constant value. Real GDP grew by 6.1 percent from 1991 to 1997, compared with 0.2 percent from 1975 to 1990.

Shortcomings In spite of these positive developments, the currency board also had its drawbacks. It reduced the Argentine government's ability to respond to external shocks by allowing its exchange rate and monetary policy to be determined de facto by the United States. Interest rates were, in reality, set by the U.S. Federal Reserve; plus there was a risk margin for investing in Argentina.

This arrangement was put to the test in 1995 when the Mexican peso devalued. Investors got nervous about Latin America in general and pulled investments out of Argentina. Its economy shrank by 4 percent, and many banks collapsed. The government responded by tightening bank regulation and capital requirements, and some of the larger banks took over weaker ones. Argentina increased exports and investment, and the country returned to 5.5 percent growth.

Unfortunately, the government was not so lucky with its results at the end of the 1990s. Commodity prices, on which Argentina relied heavily, declined; the U.S. dollar strengthened against other currencies; Argentina's main trading partner, Brazil, devalued its currency; and emerging economies' cost of capital increased. Argentina soon fell into a recession, with GDP falling to 3.4 percent in 1999 and unemployment increasing into the double digits. Argentina, because of its hard link to the dollar, was unable to compete internationally, especially in Brazil, because of its high prices.

One way to correct this problem would be to devalue the currency to bring the value closer to its fundamental value. Argentina could not devalue unless it canceled the currency board, a move it did not want to make because of the currency board's popularity and past success. The only way for Argentina to become more competitive was for prices to fall. As deflation set in, the government (and some private companies) found it difficult to pay off debt because it was not collecting as much revenue. Banks had been lending dollars at 25 percent interest rates even though the risk was supposed to be low.

The Burden of Debt Argentina was acquiring a burgeoning public debt. When the recession hit, tax revenue fell and spending increased to pay for such things as higher unemployment. Tax evasion is extremely high in Argentina, but the government did little to tackle the problem. The budget went from a surplus of 1.2 percent of GDP in 1993 to a deficit of 2.4 percent in 2000. Increased interest rate payments also added to the increasing budget deficit. From 1991 to 2000, the amount of interest rate payments increased from \$2.5 billion

to \$9.5 billion annually. This drained the economy even more, as most of this money went to overseas investors. This currency “mismatching”—meaning most of the debt is taken out in one currency but assets are held in another—was large in Argentina and would later prove disastrous.

Political Perplexities and Monetary Problems Politicians found little they could do to help the struggling economy. They fiddled with tariffs and finally the currency board. They pegged the peso half to the dollar and half to the euro for exporters. The idea of devaluation scared investors and caused interest rates to rise even more. Unable to pay its interest payments and unwilling to declare a debt default, the government turned to the banks.

The Menem government had strengthened the banking system, particularly the central bank, but Menem's successor, Fernando de la Rúa, sent a crushing blow to the sector. He strong-armed the banks into buying government bonds. This triggered a bank run, and Argentines withdrew over \$15 billion between July and November 2001. In a desperate attempt to save the industry, de la Rúa imposed a ceiling of \$1,000 a month on bank withdrawals on December 1. Within days, the country defaulted on \$155 million in public debt, the largest such default in world history. As rioters and looters took to the streets, de la Rúa resigned.

Argentina struggled to find a president who was fit for the job. It went through a total of five presidents in four months, ending finally with Eduardo Duhalde. The government abandoned the currency board in January 2002 and let the peso float against the dollar. The peso began falling quickly, so the government spent around \$100 million a day—to a total of \$1.2 billion—to prop up the value. More money was leaking out of the banking system too (around \$50 million a day), because the courts had overturned the freeze on withdrawals.

To repair its economy, Argentina sought help from the International Monetary Fund (IMF). However, the IMF continued to turn down Argentina's requests for help until it implemented some sweeping changes in its exchange-rate policy, fiscal policy, and banking system. In an attempt to find someone to blame, President Duhalde started criticizing foreign-owned banks, such as HSBC, for not infusing more cash into the system from their headquarters.

The Peso Crisis The central bank printed pesos to keep banks solvent, but this led to increased inflation. The national and provincial governments also used bond notes, quasi currency, to pay many of their debts. This note was swapped in everyday transactions and surprisingly held its value against the peso. Almost a year after the initial freeze on bank deposits, the government lifted the remaining restrictions on withdrawing cash from banks, further easing the financial strain on the banking system.

Negotiations with the IMF Despite the economic growth stimulated by the devaluated peso, Argentina was still burdened by its huge debt to private creditors and the IMF. From the middle of 2002 to spring 2003, Argentina and the IMF disagreed on conditions of IMF aid. Argentina defaulted on debt payments to both the IMF and the World Bank, saying it would not make payments without a guarantee of aid from the IMF. The IMF, however, refused to grant that aid to Argentina without implementation of certain economic reforms, including spending cuts and restructuring in the banking sector. Four months after his victory, President Kirchner and the IMF agreed on a deal that would allow Argentina to pay interest only on its \$21 billion debt over the next three years.

To repay most of its debt, including overdue interest, Argentina proposed a plan to its creditors, asking them to write off 70 percent of the present net value of their government bonds. The majority of creditors reluctantly agreed, and in February 2005, Argentina closed on the biggest debt restructuring in history. However, Argentina still has debts worth nearly 75 percent of its annual economic output, and the country must agree on a new loan deal with the IMF as soon as possible.

HSBC's Reaction

HSBC's reaction to the crisis was similar to that of other banks in the country. It was forced to rethink loans and to decide if the political and economic instability of the country was worth the risk of continued operations. Due in part to the depreciation of the peso, HSBC lost \$977 million in 2001 in Latin America, compared with a profit of \$324 million in 2000. Overall, HSBC Holdings doubled its bad debt charges to \$2.4 billion, and pretax profits fell by 14 percent in 2001.

The Global Economic Crisis of 2007–2009

Just when it looked like things might turn around, the global financial crisis hit. Economic growth worldwide slowed down and was expected to be relatively flat in Latin America in 2009. Capital flows from abroad screeched to a halt. In fact, capital flows to Latin America were down 57 percent in 2009 compared with the prior year. Trade fell as external markets dried up and protectionism began to rise. Given that it is strapped for cash and unable to raise money by traditional means due to the collapse in 2001 and default on debt, Argentina was in a very difficult position, especially compared to Brazil and Mexico. The drop in export revenues, the shrinking of FDI inflows, and the inability to borrow money put Argentina in a very difficult position indeed. Even though the peso was down nearly 30 percent against the U.S. dollar in July 2009 compared with a year earlier, exporters were screaming for an even greater devaluation (the rate was 3.84345 on July 19, 2009, compared with 3.02710 in July 2008).

To make matters worse, the Argentine people had lost confidence in the currency. Following a trend started with the 2001 crisis, a survey of Argentinians in March 2009 showed that 77.233 percent of the respondents planned on withdrawing peso deposits and converting them into dollars.

Where Does HSBC Go from Here?

In addition to being one of the largest banking and financial services in the world, HSBC has the distinction of being one of the few global banks that didn't have to resort to a government bailout to stay afloat. It raised additional capital from shareholders in the largest-ever rights issue in the United Kingdom but at least it survived on the basis of the markets. On July 19, 2009, HSBC was named the best global bank by *Euromoney* magazine due to excellence in providing high-quality products and services across all areas of commercial and investment banking. In its first-quarter 2009 report, it noted that other operating income had increased, partially due to the strong performance in foreign-exchange products, so its strong trading activities continued to provide a good income stream for the company.

In spite of its success worldwide and its desire to focus on emerging markets, HSBC's experience in Argentina was a rocky one. HSBC lost \$1.1 billion in 2001 because of Argentina's problems. At the height of the crisis, the situation in Argentina was so unstable that HSBC employees came to work in casual clothes, entering and exiting their headquarters in Buenos Aires at odd times and using any entrance but the front door to avoid demonstrators and violence. The 2007–2009 crisis wasn't as traumatic for HSBC, partially because the Argentine economy was in a little better position to weather the storm and because it wasn't alone. However, Argentina is a relatively small market compared with faster-growing markets in Asia, including Hong Kong and China. It makes you wonder what Argentina's future is with HSBC. ■

QUESTIONS

1. What are the major factors that initially caused the peso to fall in value against the dollar? What did the government of Argentina do to reverse the decline in the economy?
2. How has the fall in the value of the peso affected business opportunities for companies doing business in Argentina and in exporting and importing? Should the government allow the peso to fall even farther to stimulate exports? Why or why not?
3. What do you think the future of HSBC should be in Argentina?