Banking penetration in Uruguay[1]

Santiago Fernández de Lis, Adriana Haring, Gloria Sorensen, David Tuesta, Alfonso Ugarte

December 2012

Abstract

In recent years, financial depth ratios in Uruguay have trended upwards, although without reaching the levels seen prior to the crisis at the start of the century. The ratio of credit to GDP in 2010 was near 18%, while the ratio of deposits exceeded 33%. However, Uruguay is still lagging behind the regional average, above all in the ratio of credit to GDP, and it is even behind a number of countries with lower levels of per capita income.

By segments, credit for household consumption in Uruguay falls far short of the levels observed in more developed countries like Chile (11% of GDP) and Brazil (15% of GDP), as such credit amounts to only 3% of GDP. The segment of mortgage loans is a bit more developed - although still at low levels - at 7% of GDP. A more significant lag can be seen in corporate credit, which amounts to only 12% of GDP, whereas in countries like Chile or Brazil, it amounts to 52% and 26% of GDP, respectively. Moreover, although access to financial services in Uruguay stands at approximately the regional average, banking infrastructure - particularly in terms of ATMs and POS - is below the average of Latin America, as is the use of electronic means of payment.

The underlying thesis of this study is that banking institutions must assume the role of leading a serious process of increasing banking penetration in the country. From a broad technical perspective, an understanding exists of the role played by certain non-bank financial institutions, such as savings banks, mutual societies, cooperatives and non-governmental organisations, in reaching specific population segments. **However, such non-bank institutions face a number of structural limitations in becoming agents for change in a banking penetration process, such as the financing capacity and cost, economies of scale, development in risk management, professional staffing and broad supervision by regulatory bodies, among others.**

Our report discusses cases such as those of **China, Bangladesh and India**, where significant efforts have been made to develop non-bank institutions to deepen the coverage of financial services, but which ultimately face a number of obstacles. **Nor should we forget the financial failures of such non-bank institutions in Latin America. Even recent experiences in Europe (such as Spain and its savings banks) show that the risks of such institutions always make themselves felt when they become too large.**

Hence, this analysis has sought to provide recommendations for driving deepening banking in Uruguay, focusing on both institutional factors and those inherent to the banking sector that condition the development of savings and credit markets.

With regard to the institutional environment, two measures are identified that would benefit the banking penetration process of the country: strengthening the scope of information to which risk centres have access and reducing the time and cost of registering properties and guarantees. Development of the institutional pillar is essential for assuring creditors that borrowers will repay loans.

Factors intrinsic to the banking sector include measures to boost access of lower income segments to financial products and services. Options are considered to enable individuals to

1: This document was discussed on November 14, 2011 in a banking seminar organized by the Central Bank of Uruguay. The authors are grateful to Adolfo Albo, Alicia Garcia Herrero, Hugo Perea, Jorge Sicilia and Ana Rubio, for the detailed comments and suggestions as part of the review committee of this work. Special recognition to the support of BBVA Uruguay through Jose Manuel de la Cruz, Rafael González Moya and his staff directors who helped make this work possible. The work was valuable feedback through interviews with Julio de Brun of the Association of Private Banks of Uruguay, Bruno Gilli, Alejandro Pinto, Rafael Rodriguez Diego Mantero and CPA-Ferrere, Martin Vallcorba of the Ministry of Economy, Pablo Bazerque of the Commission, Pablo Roselli and Florencia Carriquiry of Deloitte Uruguay and Jorge Ottavianelli and Rosario Patrón of the Superintendent of Financial Services, also appreciate the comments and suggestions of Diego Torres and Javier Alonso at different stages of this research. The views expressed in this study are solely those of the authors and in no way subscribe to the position of the institution to which they are affiliated.

deepen their use of the banking system to meet their transactional needs, such as making it **mandatory for employers to pay wages through the financial system** or implementing "**low cost *automatic enrolment* accounts"**. Both measures would be strengthened by proposals for tax incentives for **payments made with debit cards through VAT discounts,** and by promotion of the **banking correspondent model.**

Given the wide margin for expanding corporate credit, it is important to incentivise the penetration of loans to MSMEs, as the vast majority of the 114,000 enterprises in Uruguay are small and medium-sized and nearly a third of them do not use banking services. Bank financing could enhance enterprises' productive capacity and help grow their business and profitability, thus incentivising greater formalisation. One way of beginning to provide financing to these enterprises might be factoring, as financing through discounts on trade invoices is commonly known.

One important item to be discussed as part of a comprehensive reform is the **high costs borne by the banking sector in Uruguay,** as the consequence of regulations that directly affect it. Several studies - particularly, a recent one by the International Monetary Fund (2011) - indicate that labour costs have the largest impact on the banking sector's financial results. The same report points out that this factor has limited the potential for growth of the banking sector in Uruguay and incentivised the appearance of non-bank financial intermediaries that are subject to less stringent regulation than the banking sector. Thus, it is important for the country's lawmakers to bear in mind these problems and be aware of the risk that such "extra costs" will limit the capacity of the banking sector to expand its services to broader segments of the population.

According to the estimates of BBVA Research based on a statistical model of credit growth and potential economic growth, if Uruguay makes no reforms, the level of credit would increase from 18% of GDP[2] in 2010 to 32.5% of GDP in 2020, owing to the demand generated by growth of the economy and to factors of convergence in financial development. The recommendations set forth in this study are conceived to be implemented jointly. It is estimated that in a conservative scenario, implementation of the proposals will lead to banking penetration, measured as the credit-to-GDP ratio, of 53.9% of GDP in the next ten years, whereas in a more optimistic scenario, it could exceed 68.4%. **The foregoing is without taking into account the impact of other measures that could contribute to reducing informality in Uruguay. Hence, the impact could surpass 76% in a best-case scenario.**

Keywords: banking penetration, financial inclusion, banking coverage.

JEL: B26, G2, G21, G28, G32.

2:. The model of estimation used in the study is based on the credit-to-GDP ratio of 2009 owing to the availability of information on other variables used in the methodology described in the appendix.