THE CUBAN CAPITAL MARKET

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The spectacular business boom in Cuba since 1940 has not been paralleled by a corresponding development of the financial organization of the Island. On the one hand, the value of Cuban exports increased from $143 million in 1939 to $770 million in 1947; during the same period, money in circulation increased from 60 to 466 million pesos and bank deposits from 63 to 474 million dollars/pesos. In addition a sizeable amount of U.S. paper currency is held by Cuban individuals. Gold and foreign exchange holdings of the Cuban Treasury, banks and individuals increased from $25 million in 1939 to $916 million as of July 1948. On the other hand — and in the face of this very large amount of available financial resources — commercial banks increased their loans from $69 million to only $174 million, letting their total cash and cash items in Cuba and abroad grow from $159 million to over $450 million. Typically, most banks do not pay any interest on their demand or saving deposits. The absence of savings, mortgage, agricultural or investment banks, the very narrow securities market of La Habana and the present inability of the Cuban Government to raise any funds in the internal market are all the more conspicuous in the face of the wealth and the favorable "cash position" of the Island.

The reasons for this unbalanced situation have been sought in many directions. The absence of a central bank, although a deterrent to a good credit policy, cannot be considered as having been the main factor in the case of Cuba; its creation by a law of December 1948, which also provides for the establishment of an agricultural bank in the near future, will in any case remove any obstacle which could have been traced in that direction. The same law also ends as of 1949 the dual currency system, dollar-peso, which had often been criticized as a factor of instability. Foreign banks, which control the largest part of the commercial banking in Cuba, have been accused often of voluntarily contracting their credit. Although these banks have in fact followed a conservative policy (often justified by the 1920-39 events) it seems that the real cause of the absence of investment outlets for Cuban capital in the private or in the public field lies in the traditional preference for real estate investments, and mostly in the lack of confidence in the general situation on the part of potential investors. As a result, large sums of capital have fled from Cuba to the U.S.
THE CUBAN CAPITAL MARKET

Introduction

Business prosperity in Cuba has been spectacular from 1939 to the present time. Although no reliable estimates of the national income are available, the increase in foreign trade, which largely determines the national income of Cuba, has, however, been significant; exports rose sharply from $143 million in 1939 to $770 million in 1947 and imports from $106 million to $520 million. The accumulation of foreign trade surpluses largely contributed to the increase in gold and foreign exchange holdings of the Cuban Treasury, from $1 million in 1939 to $357.5 million \(^1\) in July 1948; at the same time holdings of banks and individuals increased from $24 million to $559 million, and this last figure is certainly underestimated. \(^2\) Total holdings of gold and foreign exchange in July 1948 were therefore upward of $916 million.

The purpose of this study is to try to determine whether the general economic expansion of Cuba has been paralleled by a similar development of the money and capital market organization of the Island, such as might be reflected in the evolution of the commercial banks, on the one hand, and the investment channels and institutions, on the other.

I. Structure of the Monetary System and Commercial Banking Organizations in Cuba

From an institutional point of view the main characteristics of the Cuban banking system, before the enactment of a law creating a central bank in December 1948, were 1) the fact that both the U.S. dollar and the Cuban peso were legal tender in the Island, 2) the absence of a central bank and, consequently, 3) the absence of any practical government supervision and control, and 4) the predominance of the foreign banks as a group.

1) The dual currency system

Up to the present, both the peso and the U.S. dollar have been unlimited legal tender. Until 1932, dollar notes had been the effective

\(^1\) Includes $12.5 million of gold contribution to the International Monetary Fund.

\(^2\) These figures do not include holdings of corporations other than banks, which are believed to be substantial. They also exclude holdings of foreign securities (and foreign real estate) by Cuban citizens. The latest estimate of U.S. securities held by Cubans is $66 million in 1941. Since that date such investments should have increased greatly. The bullion value of silver pesos of the Treasury, which constitute backing for the silver certificates in circulation, is not included either. It represents roughly $40-50 million.
currency of the country, supplemented by a small amount of silver pesos. After 1932, the Cuban Government issued silver peso coins and silver certificates backed by 100% silver pesos. This situation accounted for the creation of an internal foreign exchange market where dollars were purchased and sold against pesos. Actually from 1936 to 1942 the peso was sold at a discount, averaging from 1 to 10%, the latter for a short period only in 1940. In 1942 the Cuban Government initiated, on the advice of a U.S. technical mission, a program of purchasing gold as backing for new issues of certificates guaranteed as to 98% in either gold or dollars. The idea behind the program was to create a monetary reserve which subsequently might be assigned to the projected central bank. Since 1942 the peso has been at par by reason of an ample supply of dollars. But the demand for dollars increased dangerously in 1948, mostly because of a widespread flight of capital, and, as a result, a shortage of dollars did occur in the first part of October, when banks accumulated large amounts of Cuban pesos as against U.S. dollars.

The new monetary and banking law of December 30, 1948 provides for the elimination of the dual currency system and establishment of the Cuban peso as the only legal currency in the country. It fixes the par value of the Cuban peso at its present rate of exchange with the U.S. dollar, i.e., 1 peso to 1 dollar. The dollar will continue to have legal tender status for a period of one year, which may be extended for an additional year. After this period, the Cuban peso will be the sole legal tender and all obligations and contracts will be settled in pesos, with the exception of specified international transactions.

A Monetary Stabilization Fund has been created by the same law of December 1948 in order to operate in the exchange market to support the pegged rate and carry out the exchange policies of the government and the central bank. It will normally finance its purchase of foreign exchange with local currency resources arising from non-interest-bearing loans granted by the central bank. However, if an inflationary surplus in the balance of payments should develop, the central bank may refuse further credit to the Stabilization Fund, in order to neutralize an inflow of gold and foreign exchange. In this case, the Fund would have to finance its future purchases of foreign exchange with local currency resources borrowed from the public.

3/ However, the law which authorized this program made provision for buying gold and dollars but not for selling them. Therefore, the country was left without adequate machinery to support the pegged rate of the peso.

4/ This flight of capital was aggravated by rumours of pending action on the proposals for monetary and banking reforms.

2) The creation of a central bank

The absence of a central bank in Cuba has been the subject of political agitation over the last 25 years. Its creation was persistently opposed by foreign bankers lest it should make the peso the only currency of the Island and for fear that the establishment of exchange control would be the logical consequence sooner or later, which, in turn, could lead to a devaluation of the peso under less favorable economic conditions. It was also feared — and the better-established Cuban bankers concurred in this respect — that a central bank would be used by the Government to pursue unsound policies. The larger banks, moreover, over, did not want to see their prudently accumulated reserves mobilized in favor of the weaker in case of a banking crisis.

According to the law of December 30, 1945, the central bank is created under the name of "Banco Nacional de Cuba". It will be organized as a mixed corporation owned jointly by the Government and the commercial banks operating in Cuba. The initial capital will be 5,000,000 pesos, of which 2,500,100 pesos are to be subscribed by the Government and 2,499,000 by the commercial banks, the Government thus having a controlling majority. The Bank will have the usual functions and powers of modern central banks. It will act as a bankers' bank and fiscal agent of the Government. Its lending functions are rather conservative. It is authorized to rediscount short-term commercial and agricultural paper. It may grant advances to the Government to be repaid within the fiscal year, provided they do not exceed 8% of the average Government revenue during the preceding five years. It is authorized, however, to buy long-term Government securities in the open market provided that they have been issued at least one year earlier. Open market transactions in private securities are not mentioned.

Many Cuban businessmen believe that the success of a central bank will depend largely upon economic conditions during the first years of its activity; a pronounced business recession would submit it to heavy pressure for extension of credits.

3) Government supervision of the commercial banking system

In the absence of a central institution the commercial banking system has been regulated up to now by general provisions of the Code of Commerce or special decrees. The banks' transactions are limited to 90-day maturities and the bills discounted must have the guarantee of at least two responsible signatures. In actual practice, one signature is generally considered sufficient provided the bank's assets remain sound, and the 90-day limit applies only to funds originating in demand deposits. A bank's capital and reserves may be invested in longer maturities including bonds. Another regulation requires a minimum 25% ratio of cash reserves against deposits — which is by no means high considering the absence of a lender

As of June 30, 1946, over 20% of outstanding loans of the main 13 commercial banks had maturities of over 180 days.
of last resort. This reserve requirement has been insisted upon by the
government only since 1938. Over the last five years the main banks have
been over 50% liquid because of the favorable economic situation.

The new law of December 30, 1948 contains provisions concerning the
structure and functioning of commercial banks. It establishes minimum
fixed capital requirements to open a bank (from 25,000 to 250,000 pesos
according to the importance of the bank), and commercial banks will be re-
quired to maintain at all times a capital stock of not less than 7-1/2% of
their demand deposits. This last provision will affect mostly foreign
banks, which will have to increase their capital. The new law also es-
tablishes a variable system of reserves against deposit requirements, where-
by such reserves may be fixed by the central bank at between 8 and 40% for
local currency deposits already deposited in the banks at the time of the
decision, but may be boosted to 100% for any further increase of deposits.
The reserve requirements against foreign currency deposits may be fixed
by the central bank at between 25 and 100%. The new law does not contain
any provision as to the operations themselves of the commercial banks, but
a general banking law is expected to cover that subject soon.

4) Foreign banks in Cuba

Foreign banks have largely dominated the Cuban banking structure since
the crisis of 1920, which ruined the most important Cuban houses and ham-
pered the credit of those that survived. At the present time, six of the
thirteen main commercial banks are foreign-owned; in addition, there are
around 45 small Cuban-owned credit institutions. The total assets and
liabilities of foreign banks, as of December 31, 1946, represented some
$408 million as against $189.3 million for the Cuban banks. Cuban banks,
however, have developed rapidly during the war years and seem to be on the
way to regaining an important role, partly through the development of branch
offices and partly because of the voluntary policy of the foreign banks.

II. Activities of the Commercial Banks

1) Deposits

The general economic expansion of Cuba is reflected in the activities
of the commercial banks. Their total assets rose from $156.4 million as of
December 31, 1939 to $762.4 million as of December 31, 1947, while bank
clearings rose from $663 million in 1939 to $2.3 billion in 1947. Deposits
in banks increased during the same period from $128 to $586 million. It
should be noticed, however, that while "current account deposits" increased
from $79 million to $440 million, "saving account deposits" only increased
from $41 million to $90 million. This is due to the definite policy of
most banks during the last few years of discouraging savings deposits in
the face of the plethora of available funds and the lack of outlet for
them. Most of the banks do not pay interest on saving accounts, particu-
larly on dollar saving deposits and peso deposits have increased more than
dollar deposits over the last ten years. As of January 1948 peso deposits
represented 58% of the total deposits of the fifteen main commercial banks.
2) **Portfolio**

In view of the large increase in deposits, the limited development of the lean portfolio of the commercial banks has been most striking. Outstanding loans and discounts increased from $669 million in 1939 to only $174 million in 1947. The rise in loans has been noticeably less than the increase in the value of exports (from $1,413 to $770 million), while the increase in deposits is very close to the increase in exports.

Loans to the sugar industry, which were predominant until the war, have constantly diminished in relative importance since that date; from roughly 50% of total loans in the 1936-41 period 7/ they decreased to only 28% in the 1942-46 period and to 20% for the first six months of 1947, while commercial trade loans increased from 33 to 58 and 66% during the same period. This change can be attributed to a somewhat more diversified economy but mostly to the much improved cash positions of the sugar businessmen and to the Commodity Credit Corporation's advances on loading or carryovers. Loans relating to industrial and agricultural activities other than the sugar industry are conspicuously absent or very small, although some industrial borrowers may have been able to finance themselves through loans on securities and credits listed as commercial in spite of the 90-day limitation. Because of the limited credit facilities, foreign banks have often been accused by Cubans of voluntarily contracting their credit. This affirmation does not seem entirely justified; 8/ there has been most of the time a very conservative policy. It is also indicated that the percentage of sugar loans is higher with foreign than with Cuban banks; this is due to the business connections of the former with the largest sugar mills and also to the minimum credit risks involved. In addition, often because of the strict directives of their head offices, foreign banks in Cuba will have nothing to do with credit operations in which there is the slightest doubt about the moral character of the borrower no matter how good his security. The better-established Cuban banks are as conservative as foreign competitors, at least since the crisis of 1929, knowing the slender reserves they have to fall back upon. Only smaller Cuban banks are more enterprising but the risk involved is generally so great that their interest rate is correspondingly high. While foreign banks charge an interest rate ranging generally from 3 to 8%, Cuban banks are lending at rates anywhere between 3 and 12%. Not infrequently, the maximum legal rate of 12% is exceeded.

On the whole, although most commercial bankers insist that they can meet all needs of Cuban business, there is obviously a lack of credit facilities, with the exception of the best risks for which there is severe competition between banks. A change in the banking laws, probably action by the new Cuban central bank and the creation of an agricultural bank, would be required to remedy this situation. Besides, commercial bankers would have to accept greater risks.

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3) **Other Assets**

Because of Cuban banking regulations, stocks and bonds held by commercial banks amounted to only $17.4 million as of the end of January 1949, mostly held by one Cuban bank. Foreign banks avoid investments in domestic securities either as a result of the directives of their head offices or because of the regulations of the countries where they are incorporated.

Deprived of investment outlets for their funds -- unwilling to take risks -- commercial banks have seen their cash and cash items rise from $159 million in 1939 to $469 million in 1946.

On the whole, commercial banks which, until the war, had lost money or had just broken even, have since that date been able to make substantial profits without, however, really participating in the general economic boom. Not the least of their worries, at the present time, is the attitude of the bank workers' federation, which has prevented them from importing managerial or accounting personnel and has enforced a virtual closed shop and rigid seniority rules for all but a few managerial posts.

**III. The Medium and Long-term Capital Market**

A description of the commercial banking system virtually ends a survey of Cuban banking activities. There is only one savings bank, which is closely connected to Spanish interests; its deposits amount to less than 2 million pesos. Government postal savings amount to 5.5 million pesos of deposits, plus 18 millions of postal saving stamps outstanding. More important is the "Caja de Retiro y Asistencia Social de Obreros de la Industria Azucarera". Its purpose is to provide a pension fund for retiring employees of the sugar industry and also to provide for all employees at present working certain social and medical services. It has accumulated $40 million in a few years and there has been repeated criticism of the management of the Caja for having these funds entirely idle without any earning whatever.

The only mortgage bank of Cuba has been in receivership since 1937 and holds only 1.4 million pesos of mortgages at a current rate of 9%. A large part of the mortgage business of Cuba is handled by insurance companies and private individuals.

There are no investment banks in Cuba and, consequently, banking institutions appear definitely undeveloped in spite of the wealth of the island. The Cuban capitalist is, therefore, facing a real problem in investing his funds either in the private or in the public field.

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2/ The proposals of the U.S. Treasury mission in 1942 included the creation of a long and medium-term credit institution for agriculture. The new law creating a central bank provides for the creation of an agricultural bank in the near future.
In the private field, the capital required for establishing or expanding private business enterprises is usually supplied by the owners and their families or, when the undertaking is judged to have exceptionally good chances of success, by small groups of investors; in such cases, brokerage houses have sometimes been used as intermediaries. Shares in Cuban business enterprises are, therefore, usually very closely held. There are, however, a few exceptions of companies, mostly foreign-owned public utilities, whose stock is fairly widely held and is traded on the Havana Stock Exchange. But as of December 31, 1947 the total market value of the common and preferred shares listed on this exchange represented only $167.5 million. 10/ There are practically no private bond issues listed. The market is reported to be dull, a wide spread existing between "bid" and "asked", and it is sometimes difficult to cash securities without a substantial loss. In 1947 a few small capital issues were placed without difficulty on the stock market. There are no restrictions against the holding or flotation of private securities in Cuba. Securities and stock are subject to a few moderate taxes. 11/ 

2) Public securities

There is no domestic market for public securities at the present time. An external market has existed in the past, however, and as of the end of 1947 $35.5 million of the Government's bonded dollar debt of $91.5 million was external debt. Over 90% of this dollar indebtedness is reported to be in Cuban hands and the issues are quoted well above par, reflecting the scarcity of investment opportunities and the good past record of the Cuban Government on these issues, which are generally secured by a lien on specific government revenues and serviced through a fiscal agent. On the other hand, no reduction of the so-called floating debt has been effected; the total amount is estimated at some $80 million. It is generally held that the prevailing conditions prevent the Government from raising any money except through foreign dollar bonds, negotiable on the New York market and administered by American banks. The creation of a central bank and its possible activities in supporting the government bonds may change this picture in the future if the necessary atmosphere of confidence is created.

10/ Boletin Mensual de Estadistica, a publication of the Cuban Government, December 1947.

11/ The issuance of securities is subject to a .9% tax. A tax of .15% is assessed on the market value of bearer shares and payable annually by the issuing company. A tax of .10% is payable once only on the value of registered shares.
In addition, the traditional outlet for investment, real estate, is limited and all possible investments in the sugar industry are reported completed as of the end of 1948. The result of the present situation of the domestic capital market has been a wide-spread flight of capital abroad. Sizeable real estate investments in the U.S. are held by Cuban citizens, mostly in Florida (Miami). Cubans have also shown a considerable interest in the New York Stock Exchange but no figures are available on the value of their holdings. 12/ The flight of Cuban capital to the U.S. has been constant over the last ten years in spite of special taxes 13/ and is reported to have increased during the last three or four months in a more than seasonal movement.

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12/ As of June 14, 1941, date of the last census available, Cuban holdings of U.S. securities amounted to $66.2 million ($20.3 million representing government securities) and interest in Cuban-controlled enterprises in the U.S. to $15.9 million. These figures have certainly increased largely since the census was taken. The New York firm of Merrill, Lynch, Pierce, Fenner and Beane has an office in La Habana, directly connected with the New York office by private wire.

13/ A 2% tax is due on direct and indirect exportation of money or its equivalent, including capital, cash and securities of any kind. In addition, there is a .15% monthly tax on funds invested abroad (with the exception of the balances kept abroad by the banks). A tax of 7% is levied on interest and dividends paid to holders in Cuba of foreign securities issued by public entities or private enterprises which do not operate in Cuba.
APPENDIX I

PRINCIPAL COMMERCIAL BANKS IN CUBA

Foreign-owned Banks

The Royal Bank of Canada
The Bank of Nova Scotia
The Chase National Bank of the City of New York
The National City Bank of New York
The First National Bank of Boston
Banco de China

Cuban Banks

Banco Comercial Pan Americano
The Trust Company of Cuba
Banco Celaya
Banco Popular
Banco del Comercio
Banco de los Colonos y Sucursales
Banco Continental Americano
Banco Agricola e Industrial
Banco Nunez