

# ECONOMY

Banking sector  
in the spotlight

THINK STRATEGICALLY:

## Banks Fight Reversing Development

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There is widespread agreement that Puerto Rico's problems began with the elimination of section 936 of the federal tax code, whose phase-out began in 1996 and finally ended in early 2006, with the first government on the island shared by the mayor parties. As May 2006 began, the government, led by Popular Democratic Party Gov. Aníbal Acevedo Vilá, declared a partial government closure—allegedly due to the inability to approve the first design of the Sales and Use Tax, along with a Loan Rescue Package. The New Progressive Party majority House of Representatives, led by then-Speaker José Aponte, and Senate, headed by then-President Kenneth McClintock, had been evaluating the proposal for the governor of a 7 percent Sales and Use Tax, aka IVU, by its Spanish acronym; in comparison, the legislature favored a 4 percent rate.

This initial saga was only the beginning of the use of many quick-fix solutions, instead of dealing with the broader issues of our “reversing development” and the array of excesses in government spending.

Between 1976, when section 936 began, and as its elapsing period began in 1996, Puerto Rico's economy expanded by 2.5 percent annually, while the U.S. economy grew by 3 percent annually. Even with 936, over these 20 years, the U.S. economy grew 17 percent more than the Puerto Rican economy, so it should have been evident that without 936, the Puerto Rico economy would fall into a reversing development mode.

Since 2006, Puerto Rico's economic engine began to sputter, and our reversal of fortunes started. However, in my view, while the elapsing of section 936 was a hard blow, in reality, it should have been a 10-year wake-up call to allow Puerto Rico to reshape its economic engine and transform

its dependency on section 936. Our leaders then, and many who followed, continued to focus on maintaining our bloated, inefficient government model.

As we further expand our discussion, we want to focus on a critical sector that faced a magnitude of problems: the Puerto Rico banking sector. Among the headwinds it has faced is losing as much as 42 percent of its deposit base with the elimination of section 936. The industry also lost a key source of cheap funding to finance mortgages, consumer and commercial loans, and various financial services. The year 2006 was ushered in with a local banking crisis involving the infamous Interest Only Strips, or IOs, from Doral Financial that impacted several banks; the global financial crisis followed this and the bursting of the real estate bubble that made the real estate sector collapse.

During this period, several local banks received capital infusions from the Troubled Assets Relief Program.

Next came the failure in April 2010 of Westernbank, a \$16 billion financial institution; RG Financial, a \$10.2 billion bank, and Eurobank, a \$3 billion institution. The three banks were absorbed through Federal Deposit Insurance Corporation-assisted transactions as follows: Westernbank was acquired by Popular Inc.; RG Financial by Scotiabank and Eurobank by OGF Bancorp. Further consolidation occurred as OFG Bancorp acquired BBVA Puerto Rico in June 2012, followed by Popular Inc.'s acquisition through the FDIC of Doral Financial in 2015.

Then in June 2019, Scotiabank Puerto Rico was acquired by OFG Bancorp, immediately followed by Banco Santander, selling in October 2019 its Puerto Rico operations to Firstbank Puerto Rico.

In only 16 years, Puerto Rico saw its banking sector shrink from 15 banks to mainly three local publicly traded banking institutions and one branch of a Florida bank.

As we begin to show how these critical members of the Birling Puerto Rico

Stock Index have performed during 2022, we thought it essential to discuss how we got here and how much the sector has evolved since 2006.

### The leading US vs. Puerto Rico Banks

We begin our analysis by examining the top nine U.S. and Puerto Rico bank holding companies, part of the Birling Capital U.S. Bank Stock Index or the Puerto Rico Stock Index. We reviewed how each Bank holding company's stock performed from 1/01/22 to 10/14/22 and compared it to the Dow Jones Industrial Average, S&P 500, Nasdaq composite, Birling Capital U.S. Bank Index and Birling Puerto Rico Stock Index.

### The returns of the five indices are ranked by performance:

- Birling Puerto Rico Stock Index: -6.94 percent.
- Dow Jones: -18.45 percent
- Birling Capital U.S. Bank Index: -24.01 percent
- S&P 500: -24.82 percent
- Nasdaq: -34.03 percent

### The Birling Puerto Rico Stock Index is ahead by 245.96%

The Birling U.S. Bank Index has a return of -24.01 percent year to date (YTD), while the Birling Puerto Rico Stock Index has a return of -6.94 percent.

### Let's see how each holding company has performed individually and against these five indexes:

**1. Firstbank Corp. (FBP):** Achieved a total return of 9.94 percent, beating the Dow Jones, S&P 500, Nasdaq, Birling U.S. Bank Index, and Birling P.R. Stock Index handsomely. The stock price on 10/14/22 closed at \$15.15 and had a price target of \$17.80. The company reports its third-quarter 2022 (3Q22) earnings on October 25.

**2. OFG Bancorp. (OFG)** Achieved a 1.54 percent return, beating the Dow Jones, S&P 500, Nasdaq, Birling U.S. Bank Index, and Birling P.R. Stock Index. The stock closed on 10/14/22 at

\$26.97, with a price target of \$34.25. The company reports its 3Q22 earnings on October 20.

**3. Wells Fargo & Co (WFC):** Achieved a return of -10.03 percent, beating the Dow Jones, S&P 500, Nasdaq and Birling U.S. Bank Index. The stock price on 10/14/22 was \$43.17 and had a price target of \$52.14. The company reported 3Q22 earnings on October 14.

**4. Popular, Inc. (BPOP):** Achieved a total return of -10.85 percent, beating the Dow Jones, S&P 500, Nasdaq, Birling U.S. Bank Index, and lagging the Birling P.R. Stock Index. The stock closed on 10/14/22 at \$73.14, with a price target of \$100.42. The company reports its 3Q22 earnings on October 26.

**5. Goldman Sachs Group (GS):** Has a year-to-date return of -21.58 percent, beating the S&P 500, Nasdaq, and Birling U.S. Bank Index, but behind the rest. The stock price on 10/14/22 was \$299.99 and had a price target of \$387.79. The company is reporting 3Q22 earnings on October 18.

**6. Morgan Stanley (MS):** S year-to-date return of -23.29 percent, lagging behind the Dow and Puerto Rico Stock Index, but beating the S&P 500 and Nasdaq. The stock price on 10/14/22 was \$75.30 and had a price target of \$94.77. The company reported 3Q22 earnings on October 14.

**7. Citigroup Inc. (C):** A year-to-date return of -28.42 percent, lagging behind all indexes except the Nasdaq. The stock price on 10/14/22 was \$43.23 and had a price target of \$56.67. The company reported 3Q22 earnings on October 14.

**8. Bank of America Corporation (BAC):** A year-to-date return of -28.75 percent, behind in all indexes except for the Nasdaq. The stock price on 10/14/22 was \$31.70, with a price target of \$40.68. The company was reporting 2Q22 earnings on October 17.

**9. JP Morgan Chase & Co. (JPM):** A year-to-date return of -29.78 percent, lower than all indexes except for the Nasdaq. Its stock price on 10/14/22 was \$111.18, and price target of \$136.03. The company reported 3Q22 earnings on October 14.

Two of the three Puerto Rico banks that make up the Birling Puerto Rico Stock Index are beating their state-side counterparts, and one of the U.S. banks is in a solid third place. With all the Puerto Rico banks' 3Q22 earnings due between October 20 to October 26, we will have a better sense of their

continued performance and outlook.

### Four U.S. banks report earnings: 2 missed and 2 beat expectations

JP Morgan Chase, Morgan Stanley, Wells Fargo and Citigroup have already reported their 3Q22 earnings, with results that while optimistic, included some missing estimates.

– **JP Morgan Chase (JPM):** Reported 3Q22 revenues of \$32.7 billion, up 10 percent, and net income of \$9.7 billion, down 17 percent. The bank said it is preparing for a slower economy and increasing loan loss reserves by \$808 million.

– **Morgan Stanley (MS):** Reported 3Q22 revenues of \$12.9 billion, down 11.9 percent, and net income of \$2.63 billion, down 28.9 percent.

– **Wells Fargo & Co. (WFC):** Reported revenues of \$19.5 billion, up 16 percent, beating estimates, and net income of nearly \$3.53 billion, down 31.12 percent. Wells Fargo recorded a charge of \$2 billion, operating losses related to legacy litigation and regulatory matters.

– **Citigroup (C):** Reported revenues of \$18.5 billion, up 5.94 percent, beating estimates, and net income of \$3.5 billion, down 23.91 percent. Citi's net income was driven by higher cost of credit resulting from loan growth and higher operating expenses.

These four banks collectively reported revenues of \$83.6 billion, an increase of 3.8 percent over the last quarter and net income of \$19.36 billion, up 3.36 percent from the last quarter.

We think local stocks are worth looking into as part of a well-diversified portfolio of stocks, bonds and other securities that are part of your long-term financial goals.

*Francisco Rodríguez-Castro is president and CEO of Birling Capital LLC. Think Strategically is a publication by Birling Capital LLC that summarizes recent geopolitical, economic, market and other developments. This report is intended for general information purposes only and does not represent investment, legal, regulatory, or tax advice. Recipients are cautioned to seek appropriate professional counsel regarding any of the matters discussed.*