Monthly Report on Banking and Financial System

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Banking and Financial System

Credit to the private sector in July was driven by credit to companies

In July 2016 the balance of outstanding credit granted by commercial banks to the private sector grew at a nominal annual rate of 16.9% (13.9% in real terms), representing an increase of 1.3 pp relative to the rate seen in June 2016. This result was due to a further expansion in lending to companies, while growth in consumer credit and credit for housing maintained a similar pace to that of the previous month. In turn, the acceleration of credit to businesses seems to be motivated by a greater preference of companies for credit from commercial banks compared to other non-bank sources of internal financing or from abroad.

Bank deposits lost momentum because of slower growth in their components

In July 2016, the nominal annual growth rate of traditional bank deposits (sight + term) was 12.5%, 2 pp lower than that seen in the previous month. This slowdown was driven by the slower growth of its two components: the percentage change in nominal annual sight deposits was 14%, 2.8 percentage points lower than the previous month, while term deposits grew by an annual nominal 10%, 1 pp below that seen the previous month. It is possible that the lower momentum of sight deposits is associated with an increase in spending of public sector agencies and companies, which in the period recorded an annual nominal growth of 22.8%, 11.9 pp above that seen in June. On the other hand, the poor performance of term deposits may be associated with a restructuring of companies' financial assets, towards holding investment funds, helped by lower risk aversion as a result of positive employment data, industrial production and retail sales in the US, which were published in July.

The 4th Report of the Federal Government highlights progress of financial reform

In early September, the head of state presented its 4th Government Report. Among the findings related to financial reform is the increased domestic financing to the private sector, from 25.7% of GDP in 2012 to 32.3% of GDP in the third quarter of 2016. It also highlights the gradual reduction of interest rates on consumption, firms and housing loans by 2.8, 0.7 and 0.8 percentage points respectively between 2013 and June 2016. It should be noted that the aforementioned increases are calculated relative to 2012 or 2013, years in which the financial reform had not yet come into force (it did until 2014 and had deadlines for the implementation of various measures) so that the results attributable to the same might be overestimated.

The report also documents the increase in mortgage refinancing arrangements, which in December 2015 amounted to 16,311 (an increase of 10.5 times compared to the 1,547 refinancing arrangements seen in 2012). In addition, in December 2015, it was recorded that banks, in order to hold on to their customers, offered improvements in the conditions of 6,524 mortgage loans.

Regarding the entrance of new participants in the financial market, the document mentions the evolution of the Savings and Loan Cooperative Companies (SOCAPs for its acronym in Spanish), the incorporation of the Mexican Stock Exchange into the Latin American integrated market and the inclusion of a chapter on financial services in various international treaties.

Related to the promotion of competition, the report highlights the implementation of the Guidelines for the Evaluation of Performance of Banking Institutions, whose final resolution was issued in July 2016, in which all commercial banks running for more than five years to 2015 obtained satisfactory results.

While strengthening the system of guarantees to increase lending and improve credit conditions is mentioned, the document does not mentioned any achievements aimed at expediting the process (reducing the number of procedural stages or waiting times for procedures), or specific measures to provide greater legal security for the granting and implementation of guarantees.

Regarding measures to promote access to and the responsible use of financial products and services, it was reported that the Bureau of Financial Institutions, with data accumulated to March 2016, contains information on 25 sectors, 4,044 Financial Institutions and approximately 273 million contracts.

In addition, the Report also contains information on the evolution of commercial and development bank loan portfolios, domestic savings and the review of the main actions carried out between 2015 and thus far in 2016, to promote both financial inclusion and the proper functioning of the Mexican financial system.

The Financial System Stability Committee (CESF for its acronym in Spanish) highlights the importance of fiscal consolidation to maintain macroeconomic stability

In its statement the main risks the CESF highlights are the volatility in financial markets stemming from the uncertainty about the electoral process in the United States (US) and the normalization of its monetary policy. Other factors that may influence volatility are further falls in oil prices and doubts about the capital needs of some European banks. Nevertheless, it maintains its view that banks in Mexico maintain adequate levels of capital and liquidity to face adverse scenarios. Credit growth has also been accompanied by lower Non-Performing Loans. However, given the current environment of higher interest rates, exchange rate depreciation and sluggishness in domestic and external demand, we consider it important to monitor the evolution of credit segments such as business and payroll.

CESF members considered that the fiscal consolidation measures proposed in the economic package are appropriate and relevant, since a primary surplus as well as stability in the public debt to GDP ratio is expected to be achieved from 2017. In our opinion, achieving these goals will be crucial to strengthen the confidence of the markets and rating agencies. Otherwise, it is likely that the sovereign rating will be revised downward, which might result in an outflow of capital and increased funding costs for financial institutions.

They also considered that the decision of the Bank of Mexico, to increase by 50 basis points the target for the monetary policy rate contributes to strengthen the country at a macroeconomic level and to ensure financial stability. We believe that rather than trying to influence the level of the exchange rate, the increase in rates announced by the Bank of Mexico seeks to reduce the possibility of an episode of portfolio outflows, and in that sense we think the decision was correct.

Financial markets

US elections spark an increase in market volatility

During September, volatility in domestic financial markets increased significantly in the light of a closer US election campaign. The increase in voter preferences for the Republican candidate was reflected particularly in a significant depreciation of the Mexican peso. Also, after a summer of low risk aversion and the dissipation of speculation about a possible rise in the benchmark rate in September, polls for the Republican candidate in some key states (e.g. Ohio) and news about the health of the Democratic candidate had a decisive influence on the increase in the price of the dollar. It went up from 18.8 to 19.9 pesos in the period from 12 to 26 September and, with this, the Mexican peso reached a new record low. After the debate between the candidates for the US government the peso appreciated, which was also supported, although to a lesser extent, by the OPEC agreement to cut oil production. The peso therefore ended September as the second most depreciated currency after falling 3.1%, and also remains the second most depreciated currency in 2016, with a loss of 11.2%. On the Mexican stock market, both speculations about a possible rise in the Fed as well as the US election acted as negative influences, leading to the CPI losing up to 3.7% by the middle of the month. However, in a similar way to the exchange rate, losses were reduced and closed at 0.62% in September. This monthly figure compares unfavorably with the performance of stock markets in emerging countries (as measured by the MSCI EM), which recorded a rise of 1.09% in the month in question. At the global level, stock markets registered a marginal increase of 0.3%.

Meanwhile, in the first nine months of the year the performance of Mbono 10-year averaged 6.01%, similar to the observed average level in 2015 (5.94%), but marginally lower than that observed in 4Q15 (6.10%). This 2016 average highlights the stability of long term interest rates despite the persistent pressure on the peso, in a more adverse context regarding the appetite of foreigners for Mexican bonds, and the three monetary rate increases (50 bp each) so far this year. Thus, while the 10-year Mbono rate averaged 6.12% in 1Q16, during 2Q16 it decreased to 5.99% and recorded a further decline to 5.93% in 3Q16. Despite Banxico's additional 50 bp increase in the monetary policy rate on the 26th, the performance of the 10-year Mbono had barely picked up to 6.05% by the end of September. Also, the downward pressure on long-term rates in US has contributed to the good performance of long term rates in Mexico. The ten-year Treasury Note rate started the year at 2.2% and in 3Q16 averaged 1.56%, fluctuating between 1.4% and 1.7% depending on market expectations of the Federal Reserve's monetary policy. We believe the decline in bond issues in domestic currency has also contributed, which translates into a slower increase in the supply of bonds in the market, which puts upward pressure on their prices, i.e. downward pressure on interest rates. Moreover, while the monetary rate in Mexico began the year at levels far from the neutral rate (i.e. 5.0-5.5%), the 10-year bond rate was not so far from a long-term equilibrium, which would imply a slope of around 100-150 bp with the monetary rate. So, it was predictable to expect a flattening of the yield curve when the increase in the monetary policy rate was starting from very accommodative levels.

The increase in the monetary policy rate during September, plus the additional 25 bp which we expect for December, have led us to revise our forecast for the 10-year Mbono interest rate upwards, from 5.9% to 6.2% by the end of 2016. For 2017, we are still anticipating an increase of only 30 basis points, which would yield 6.5% at the end of that year. Qualitatively, significant increases will hardly be expected in long-term rates in the US, while the process of fiscal consolidation in which the Mexican federal government is already immersed continues to limit the supply of long-term bonds. The main upside risks are related to an increased perception of country risk, if fiscal targets are not met and/or additional pressures on Mexican assets are observed.

Regulation

Adjustments to the CNBV's banking handbook

On September 19, the CNBV amended its provisions in order to facilitate the dispersion of resources through ATMs via pay orders. On the other hand, adjustments were made allowing for the customer's consent to be given through agreed upon electronic means in the context of consumer credit contracts; the changes also include the possibility of simplified credit files with documentary requirements commensurate to this mode of contracting. These changes align the CNBV's rules with the content of the Law for Transparency and Regulation of Financial Services.