Banks

Monthly Report on Banking and Financial System

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Banking and Financial System

Credit to the private sector maintains moderate growth in September

In September 2016, the balance of outstanding credit granted by commercial banks to the private sector grew at a nominal annual rate of 15.6% (12.2% in real terms), representing a decline of 0.3 percentage points (pp) from the rate observed in August 2016. The average credit growth during 3Q-16 was 16.1%, which compares favourably with the growth of 15.8% and 14.6% observed in the first two quarters of the year and the 12.5% increase of 3Q-15. However, in comparison to the end of the period, less growth was seen than in the previous quarter (16.0% in June 2016) owing to more moderate performance in all three credit segments.

Consumer credit grew at a nominal annual rate of 13.2% (9.9% real), virtually unchanged from the rate in August (13.3%), as a result of mixed performances of the various credit segments. These may be evidence of mixed developments in some components of domestic demand and employment. For example, growth in Credit Card balances may be the result of an increase in cards issued by banks and by greater use by cardholders. On the other hand, the moderation in payroll credit growth and personal loans may be the result of slower growth in real wages of formal workers (IMSS), as well as of lower consumer confidence. Credit to companies grew at a nominal annual rate of 18.1% (14.7% in real terms), representing a decline of 1.1 percentage points (pp) from the rate observed in August 2016. This behaviour seems to be related to the weak performance of investment and exports.

Mortgage financing will grow more than the economy

The mortgage market of commercial banks has maintained growth during 2016 and will have performed better than the total economy at the end of the year. In September, the funding provided in cumulative figures grew 2.9% in real terms. Intense competition in mortgage products has kept interest rates at historically low levels, reaching 9.5% in September, with limited transmission of only 10 bp from the minimum of 9.4% in June.

Employment, the main determinant of housing demand, has continued to grow annually at close to 4% on average, so we expect that in 2016 the mortgage market served by commercial banks will close the year with around 6% growth in real terms, in line with the effect of seasonal increased demand during the last quarter. If the trend in employment continues, even at a slower pace, we can expect growth in mortgage lending of 2% in real terms.

Bank deposits keep up moderate growth through the mixed performances of their components

In September 2016, the nominal annual growth rate in traditional banking deposits (sight and term) was 12.8%, almost unchanged from the previous month and 3.5 pp below that seen in the same month of the previous year. Thus, the nominal annual growth rate of traditional deposits moderated its growth in the third quarter as a result of mixed performances by both its components. The annual nominal percentage variation in sight deposits was 13.1%, 0.6 percentage points below that registered the previous month, while time deposits recorded a nominal annual growth of 12.4%, an increase of 1.5 pp over the previous month. The lower momentum of sight deposits was mainly due to the slowdown in the corporate segment, associated with lower growth in economic activity recorded during the period. On the other hand, it is likely that the improved performance of term deposits results from an increase in precautionary saving by households, as a precaution against negative impacts on their income. To the above we must add the growth in balance from companies possibly associated with an increase in demand for low-risk assets, owing to the increased level of volatility observed in the period. Finally, recent increases in reference interest rates have provided an additional incentive for holding such assets.

Banco de Mexico points out that more financial resources were channelled to the private sector during 3Q-16

In its quarterly inflation report, the Bank of Mexico said that in 2016 the sources of financial resources have grown more moderately than in previous years, but they have been channelled into the private sector at a higher rate, partly because the public sector has reduced its use of loanable funds. In 3Q-16 sources of financial resources from the economy grew at a real annual rate of 3.9%, higher than the previous quarter (3.1%), although lower than that observed in previous years (6.3% between 2014 and 2015 , for example). The rebound was due to an acceleration of internal fund sources (5.9% real annual rate in 3Q-16 vs 4.8% in 2Q-16), mainly caused by increased domestic voluntary savings; external sources grew only by 1.0%, as a result of lower external financing for Mexican private companies. This was offset by an increase in financial savings of non-residents through increased investments in short-term government securities.

Regarding the use of financial resources, moderation in the growth of public sector financing continued, while financing to the private sector maintained a high growth-rate, although slightly lower than the previous quarter. For example, company funding went from an annual real rate of 9.0% in 2Q-16 to 8.1% in 3Q-16, as a result of lower growth in both bank lending and the debt market. Borrowing costs also increased, in line with the increase in bank funding interest rates. Still, delinquency rates remained at low levels, although Banxico warned of some deterioration in the portfolio of development banks. Household credit expanded at a similar rate to the previous month (8.5%), highlighting the expansion of mortgages, which keeps interest rates and delinquency rates stable. With respect to consumer credit, Banxico highlights different behaviours of its components. While payroll and personal loans have moderated the high growth of previous months, credit for the purchase of consumer durables and financing through Credit Cards have grown, with relatively low default rates. This, despite an increase in Credit Card interest rates.

Finally, Banxico expects that in the future, the fiscal consolidation efforts by the public sector will help to contain the possible pressure on the financial resources available in a context in which increased uncertainty in the international financial markets and fewer external sources of funding are expected.

The International Monetary Fund updated its "Financial System Stability Assessment (FSAP)" for Mexico

On November 4th, the IMF announced the update of the FSAP for Mexico (the last was published in 2012). This is intended to help identify sources of systemic risk to the financial system and increase its resistance to shocks and contagious events.

The study found that overall the financial system is strong, despite some weaknesses to certain adverse shocks. Stress testing of the banking sector indicates that this can tolerate severe macro-financial shocks despite facing significant capital losses. The insurance sector is able to face a combination of interest rate, exchange rate and capital market shocks. Although pension funds are exposed to market risk, they face low liquidity-risk. Finally, large listed companies may face adverse exchange rate, income and interest rate shocks.

The development bank has increased its role in expanding financial inclusion; the challenge is to ensure that its participation is sustainable, thus avoiding market distortions and the displacement of private banking activity. In this context, an adequate pricing policy and the implementation of a process to graduate beneficiaries –so they can be handled by private banks– are crucial.

The evaluation acknowledges that progress has been made in strengthening prudential supervision of the financial system, but believes that there are still challenges to governance. It highlights deficiencies in operational independence, budgetary autonomy, legal protection and the lack of a fully functional consolidated supervisory framework. It warns that these challenges may undermine supervisory effectiveness and are important, given the risks associated with an evolving Mexican financial sector.

Although the financial system's safety net is solid, it can be improved. For example, although deposit insurance generally adheres to international best practices, there are significant gaps that must be addressed, including those related to governance, multiplicity of mandate and size of the resolution fund. It also believes that the crisis resolution and management framework could be strengthened –including its coverage of financial conglomerates– to ensure that the supervisor can adequately manage the risks of the group and that the authorities can require banks to improve their resolution processes. Moreover, a contingency plan to face formal systemic crises that includes simulation exercises has yet to be developed.

Financial markets

The US election result generates a negative differentiation of Mexican assets

The risk scenario has materialized. Donald Trump's victory in the US presidential election has ushered in a period of uncertainty about how bad an effect the newly elected president's proposals will have on the Mexican economy.

After the result, the exchange rate was depreciated by 7.7% and later stabilized at around 20.5 pesos per dollar; this means that depreciation amounts to 15.6% so far this year, the second largest among the emerging currencies. Given this increase in the exchange rate and the uncertainty about inflation in the near future, both the short and medium-term rates rose; this influenced the increase in long-term rates by up to 100bp in the days following the election, which led to the yield to maturity of 10-year bonds to approach 7.50%, something not seen since April 2011. This behaviour is relevant because despite the exchange depreciation observed throughout the year,increases in the long end of the curve had not occurred. In fact, the performance of the aforementioned 10-year government bonds had averaged 6.0% over the past three years.

Negative differentiation was also observed in the stock markets. Expectations of higher public spending by the Trump administration gave a hike to stock markets in developed countries, as opposed to what was observed in Mexico. In the period from 8 to 30 November, the S&P500 registered a rise of 2.8%, 1.2% above the global equity markets benchmark (MSCI World). In contrast, the IPyC index fell by 6.5%, a yield under the -4.39% recorded by the emerging market benchmark.

Regulation

Amendments to the CNBV's General Provisions applicable to securities issuers and other market participants

On 15 November the CNBV published amendments to the General Provisions applicable to securities issuers and other market participants The reform takes place in the context of the forthcoming launch of the country's second stock exchange, making it necessary to adjust regulation to allow, among other things, the possibility that issuers might request the change of their listing on the stock exchange without this involving the cancellation of their registration in the National Securities Register. The reform simplifies the requirements for listing shares with measures like the abolition of the requirement of having made an offer or placement of securities within the last two years for pre-registration of securities to be authorised.

It is also worth noting that the stock market listing requirements of capital and shareholders are now more flexible: the rules provide for the possibility of placements of less than 15% of capital –through the establishment of share repurchase funds and the hiring of a market maker– in the case of placements of above 950 million UDIS and below 12% of the issuer's share capital; meanwhile, the minimum number of investors after placement goes from 200 to 100.

Adjustments to the rules applicable to investment funds

On 17 November the CNBV published a resolution modifying the General Provisions applicable to investment funds and their services providers. Among its amendments are those related to strengthening the open architecture scheme provided for in the Investment Funds Act that was part of the financial reform of 2013. Among other things, the provisions deal with the minimum content of adhesion contracts for distributing investment funds shares by operators and distribution companies, promoting equal conditions for competition in the market; moreover, the rules include additional elements on transparency to the investing public.