Banks

Monthly Report on Banking and the Financial System

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Banking and the Financial System

At the beginning of the year, the perception of a less favourable environment is moderating the dynamism of lending to the private sector

In January 2017, the outstanding balance of credit facilities granted by commercial banks to the private sector grew at a nominal annual rate of 13% (7.9% in real terms), less than the rate observed in the previous month (15.3%) and in January 2016 (16.3%). This result is explained by the moderation in the nominal pace of growth of all three components forming the aggregate: lending to businesses showed a nominal growth rate of 13.6%, compared with 18.4% in December 2016, while the rate associated with consumer credit was 11.6%, compared with 12.2% in the previous month. Housing loans showed the smallest reduction, with a nominal growth rate of 10.5% compared with 10.8% in December. This moderation reflects the perception of a less favourable environment for investment and consumption, with expectations of increases in both inflation and interest rates and uncertainty about the effect that the new US administration's economic policies would have on the national economy, leading to greater caution in households' and businesses' decision taking.

Both components of growth in banking deposits showed greater dynamism

In January 2017 the nominal annual growth rate in traditional bank deposits (sight + term) was 14.1%, 0.8 percentage points (pp) more than that seen in the previous month and 2.9pp above that recorded in the same month of the previous year. Thus traditional bank deposits balance improved its performance in the first month of 2017 as a result of greater dynamism in both its components. Sight deposits (63.7% of total traditional bank balances) grew at a nominal annual rate of 15.4%, 0.9pp more than the 14.4% posted in the previous month. Term deposits (36.3% of total traditional bank balances) grew at a nominal annual rate of 11.9%, representing a 0.7pp increase on the 11.2% seen in the previous month. It is possible that the greater growth seen in the sight segment is associated with reduced public sector spending, as suggested by the nominal annual percentage change in actual net public spending – 6.3% in January, 25.4pp less than that observed in December. As for the improved performance of the term deposit segment, it may be associated with increased caution on the part of businesses in terms of their investment plans given the moderated expectations of economic growth.

New housing stock holds steady

The slowdown in demand for mortgage financing which started to be visible in the second half of 2016 has lead to reduced dynamism in activity on the part of home builders. This should be seen as positive, since a balance between supply and demand sustains not only the rate of appreciation of the guarantees but also the health of the construction lending portfolio, since it is aligned with the capacity of absorption determined by the market.

According to data from the Single Housing Registry (RUV in the Spanish abbreviation), at the end of 2016 the number of projects for home construction was down by 13.1% in annualised terms relative to year-end 2015. The stock of ready-to-occupy homes for its part was down by 12.5%, from 302,000 units at the end of 2015 to 264,000 at the end of December 2016. This trend looks set to continue down to 250,000 units, which could be the equilibrium number to place on the market in annual terms.

In view of the foregoing, we consider that the gradual reduction in the number of construction projects is a positive sign that market saturation will be avoided and in line with the reduction of more than 30% in subsidies for home acquisition in 2017; as well as the transmission of monetary policy to the construction lending market.

Less dynamic personal lending portfolio, despite better financing conditions

On 28 March the Central Bank updated the Basic Indicators of Personal Lending, with information at the end of August 2016. According to this report, between August 2015 and August 2016, personal loan outstanding increased at a real rate of 14.4%, the lowest seen in this segment in 2016. At the end of August 2016, personal loans represented 20.8% of the total portfolio of consumer credit granted by regulated entities. This type of financing totalled 7.5 million loans, with a total balance of 133.5 billion pesos.

As at August 2016, loans granted in the previous twelve months represented 82.7% of total lending (72.9% of total portfolio outstanding), with a weighted average interest rate of 32.6%, 80 basis points less than that of loans granted in the previous twelve months (September 2014 to August 2015). The average amount of a personal loan granted last year was 18,900 pesos; this figure rose by 7.5% in real terms between August 2015 and August 2016. As for the term of the loans, 34.3% of loans were granted last year for terms ranging between 12 and 18 months.

The rate of growth in lending to finance the purchase of vehicles reached an all-time high with figures to October 2016

On 29 March, the Bank of Mexico published an update on the Basic Automotive Lending Indicators, with information to the end of October 2016. In that month, this credit segment posted a real annual growth rate of 13.6% relative to the same month of the previous year, the highest seen since 2010. The share of car loans in the consumer portfolio was 11%. The NPL rate was 1.5%, still the lowest of all types of consumer lending. In October 2016 a total of 656,993 loans were reported outstanding, of which 267,641 had been granted in the past year (55% of outstanding balance). Outstanding balance of these facilities totalled 79.08 billion pesos. The average amount outstanding was 177,800 pesos, at an average term of 51 months, and a weighted average interest rate of 11.8%.

The CNBV publishes a Report on Financial Savings and Financing in Mexico with figures to September 2016

On 3 March the CNBV released the Financial Savings and Financing Report with information up to 3Q16. According to the report, in September 2016 total financial savings represented 100% of GDP, with a real annual growth rate of 6.9%, 2.3pp less than in September 2015. Meanwhile, total financing accounted for 96.3% of GDP, with a real annual growth rate of 4.9%, 7.2pp below that recorded in September 2015.

The sluggishness observed in financial savings was the result of the mixed performance of its components. Deposits from financial intermediaries (32.1% of GDP) recorded an improvement, with a real annual growth rate of 9.7%, 1.6pp above that of September 2015. Holdings of fixed income securities (34.2% of GDP) posted an annual real rate of growth of 5.7%, 4.5pp more than that seen in September 2015. In June 2016 external savings recorded a real annual growth rate of 5.6%, 14.4pp below that observed in the same month last year.

Meanwhile, the slowdown observed in total financing was due to slower growth in all three of its component parts. Domestic debt and trust bond (CBF) issues (41.8% of GDP) showed a real annual variation of minus 2.7%, 7.9ppbelow the change observed in September 2015. External financing (21.8% of GDP) reported a real annual growth rate of 14.4%, 18.3pp lower than in the same month of the previous year. Lastly, the credit portfolio (32.8% of GDP) posted an annual real rate of growth of 9.7%, 1.8pp below that reported in September 2015.

In addition to figures on domestic financing in which the financial system acts as intermediary, the report provides figures on credit granted by non-bank credit cards and supplier financing. The first of these items grew by 10.3% in real terms, an increase of 53.6 pp relative to the same month of the previous year. On the other hand, the balance of supplier credit to issuers on the Mexican Stock Exchange showed annual real growth of 9.5%, 1.6 pp less than in the same month of 2015.

Mexico's central bank highlights moderate growth in sources and applications of financial resources

In its report on inflation for the first quarter of 2017, the Bank of Mexico says that sources and applications of financial resources ended the year at a more measured pace compared with the previous quarter. As regards sources, the central bank mentions that the slowdown in economic activity and the high volatility prevailing in international financial markets led to lower growth than in previous years. In the fourth quarter of 2016 (4Q16) these sources grew at a real annual rate of 4.2%, similar to that of 3Q16, although lower than in other years (for example between 4Q11 and 3Q14 the average real annual growth was 6.3%). This behaviour was due to a smaller increase in external sources (from 1.5% in 3Q16 to 1.2% in 4Q16) as a result of a decline in external resources channelled into financing businesses in Mexico and falling balances of financial savings held by non-residents (-2.7%). Domestic sources grew faster – by 6.3% in 2Q16 as opposed to 5.8% in 3Q16, favoured by the higher interest rate environment in domestic markets.

As regards applications of financial resources, financing of the private sector grew at a more moderate pace, ending 2016 with growth of 3.9% compared with 5% in 3Q16. This was due to a contraction in external financing and more measured growth in domestic financing. Among domestic sources, bank lending to non-financial private sector business ended 4Q16 with a real annual growth rate of 8.1%, less than in the previous quarter (9.2%), although more than the average growth over the past five years. The environment of higher costs due to the increase in the target monetary policy rate has not so far affected the quality of this portfolio, since NPL rates have remained low and tending downwards. Lending to households also saw growth steady (to 7.8% in 4Q16 from 8.5% in 3Q16), although this is still high compared with previous years. In consumer credit the increased dynamism in car loans and credit card facilities stand out, while growth in payroll and personal loans slowed. Relative costs held steady with the exception of credit cards for which rates went up. Even so, NPL rates remain low, although payroll loans deteriorated somewhat in the last two quarters. Lastly, housing loans granted by banks and by Infonavit (*Instituto del Fondo Nacional de la Vivienda para los Trabajadores*, the Mexican federal institute for workers' housing) showed higher rates of growth than in previous years, while their cost remained at historically low levels and their delinquency rates stayed low and stable.

The Mexican Financial Stability Board (FSB) publishes its annual report, in which it highlights the growth in lending with low NPL rates and the solvency of the banking system

In the latest update of the balance of risks for the Mexican economy (30 March 2017), the FSB highlighted a significant reduction in volatility of international financial markets, as a result of the publication of macroeconomic figures pointing to improved performance of world economic activity. Despite persistent uncertainty concerning protectionist economic policies that the new US government might implement, long-term interest rates and the exchange rate in Mexico (pesos per dollar) reversed their upward trend in view of the possibility of reaching a reasonable renegotiation of the North American Free Trade Agreement (NAFTA). Added to this were fiscal policy measures announced by the Mexican Treasury, aimed at strengthening public finances and stabilising public debt as a percentage of GDP, as well as central bank’s monetary policy actions.

Additionally, the FSB stresses the continuous growth of the Mexican economy in an adverse environment, driven mainly by domestic demand, and more recently by external demand as reflected by the uptick in non-oil exports. In this environment the country’s banking system is well capitalised and with adequate liquidity levels.

As part of its Annual Report, the FSB highlights the fact that in 2016 bank lending to the private sector grew at a similar rate to that seen in 2015, while the NPL rate declined. However, there are significant differences in the quality of the various components of the portfolio, with consumer credit being the most sensitive to the performance of economic activity. Its report also deals with the stress tests carried out by the CNBV (Mexico’s SEC) and concludes that the banking system would remain solvent even in an extremely adverse scenario but that some institutions might have difficulty complying with regulatory minimum capital requirements.

Financial markets

Reduced risk of disrupted trade relations contributes to the improved performance of Mexican assets

In March, several members of the new US administration expressed opinions in favour of a reasonable renegotiation of NAFTA, and this had a positive influence on Mexican assets. These opinions, coming from officials who had identified themselves with the most protectionist wing of the Trump administration, namely Wilbur Ross and Peter Navarro, have had the effect of making the scenario of a breakdown in trading relations with the US seem less and less likely. This is reflected in an improvement in the economic outlook, particularly as regards the exchange rate.

The Mexican peso appreciated by nearly 7% in March and more than 15% since Donald Trump took office on 20 January. Although during February the peso was favoured by the dollar's generalised depreciation, at present it is showing a clear positive differentiation, making it the currency that has appreciated most so far this year, way ahead of the South African rand which comes in second with 9% and of the average for emerging market currencies (3.7%). This appreciation was accompanied by greater stability in the Forex market, reflected in lower levels of implied volatility (which is expected by the markets going forward) and improvements in the levels of liquidity, gauged by the difference between buying and selling rates. Additionally, speculative positions against the peso in the futures market have started to reduce.

Equity markets continued to show gains, albeit at a more moderate rate in an environment in which risk aversion remains below historical averages (VIX 11.9% average in March) and with data from the US generally signalling that the US economy is continuing to strengthen. The S&P500 ended the month with marginal variations, although very close to the all-time high of early March. This behaviour was also observed in the global equities markets' benchmark, the MSCI World, which gained 0.8%. Risk appetite was reflected more intensely in the emerging markets, which advanced on average by 2.35% (MSCI Emerging Markets), and even more so in the case of the Mexican market, which gained 3.6% in March, reaching a new all-time high towards the end of the month, influenced by the less pessimistic prospects compared with what had been expected at the beginning of the year.

As regards interest rates, the US Federal Reserve increased its rate by 0.25% and continued to talk of a gradual approach to monetary normalisation, while at the same time making it clear that it saw solid recovery in employment and in the US economy in general. This was a significant factor in Mexico's central bank's also increasing its reference rate by 0.25 basis points. Nevertheless, Mexico's central bank signalled that, despite the level of inflation and the risks of secondary effects that still lingered, the increases in the monetary policy rate carried out since 2015 might be enough for inflation to return to around 3% by the end of next year.

Regulation

Rules of the Public Entities’ Indebtedness Warning-system

On 31 March the SHCP published the regulation to warnings for the level of indebtedness of Public Entities with financing and obligations inscribed in the Single Public Registry stemming from the Federal Entities and Municipalities Financial Discipline Law published on 27 April 2016.

The system classifies Entities according to their level of indebtedness (Sustainable, Under observation or High) based on an assessment of the following indicators: Public Debt and Obligations over Fully Disposable Revenue; Debt Service and Obligations over Fully Disposable Revenue, and Short Term Obligations, Supplier and Contractor Payables over Total Revenue. In the event of payment default of any financing or obligation, the public entity in question would automatically be classified in the High Indebtedness Level until such time as the default were rectified.

According to this Law, the Level of Indebtedness will limit the annual net borrowing that public entities can undertake: at the Sustainable level a limit of 15% of revenues will apply; at the Observation level, 5% of revenues, and at the High Indebtedness level the limit will be zero.

Assessment of the indebtedness levels for States will be on a quarterly bases and half-yearly for Municipalities and other Public Entities other than the centralised administration of States and Municipalities. The Treasury will publish the results on its website.