Monthly Report on Banking and the Mexican Financial System

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Banking and the Financial System

Private sector credit closed the first half of the year with growth of 13.8%

In June 2017, the balance of performing loans granted by commercial banks to the private sector grew at a nominal annual rate of 13.8% (7.1% in real terms), 0.5 pp higher than the previous month (14.3%) and 2.4 pp below June 2016 (16.2%). At the close of 2Q17, the three credit segments recorded a slightly slower growth rate than in May. Consumer credit dropped from 10.5% to 10.3%, while credit to firms fell back from 16.8% to 16.1% and housing loans from 10.0% to 9.8%. This more sluggish credit performance could be associated with the downturn in employee purchasing power, which has hit internal demand, including consumer and housing credit. As far as credit to firms is concerned, slower growth may be related to the weak performance shown by investment. In April, the Gross Fixed Investment Index recorded a drop of 8.6% against April 2016. One of the items showing the most marked weakness was the construction sector, which coincided with the slow growth in credit to this sector.

Bank deposits lacklustre due to slower growth in term deposits

In June 2017 the nominal annual growth rate in traditional bank deposits (sight + term) was 10.8%, 0.8% below the previous month's figure and 3.6% below the same month of the previous year. The traditional bank deposit balance has been sluggish due to a slower growth in term deposits, recording a nominal annual growth rate of 10.2%, 3 pp below May level. Sight deposit balances showed an annual variation of 1.2%, 0.5 pp higher than previous month. This lacklustre performance in term deposits might be related to the deceleration in economic activity momentum, which has impacted on corporate earnings, as shown by the Global Indicator of Economic Activity, which in June recorded an annual variation of -0.9%, 3.3 pp below that reported for the previous month. There has also been a greater preference for other instruments showing stronger performance (such as those offered by debt investment funds), due to lower interest rates forecast for traditional term deposits derived from the end of the tighter monetary policy cycle imposed by Banco de México (Banxico). The more dynamic showing reported by sight deposits may be due to a transfer of resources from balances maintained by the non-financial public sector in traditional term deposit instruments, as has been seen since the close of 1Q17. This has probably had the aim of addressing higher current expenditure over this period, which in June showed an annual variation of 10.4%, 9.9% higher than that seen the month before.

Housing prices rise 6.88% in the second half of 2017

Last month, the SHF (Sociedad Hipotecaria Federal, the Federal Mortgage Company) published the housing price index for the second half of 2017. As this indicator suggests, the value of housing in nominal terms increased 6.88% when compared to 2016 levels. In terms of segments, average and residential housing continue to perform best, up 7.84%; while the social housing segment increased 5.74% over the same period.

Given where we currently are on the real estate cycle, with the slow-down in demand for housing, this increase is due to the increase in input costs. Producer prices for residential construction materials rose by 12.5% in the second quarter of 2017. However, this may prove to be the highest increase in the cycle. The cost of plant hire only rose by 4.8% over the same period, reflecting a downturn in the number of ongoing building projects, which according to figures from the National Register of Housing have fallen 28.0% in annualised terms to 258,000, down from 359,000 projects undertaken in 2016.

As a result, we are maintaining our forecast of an increase in the price of housing of 7.0% for the average and residential segment, similar to the consumer inflation rate, which in August stood at a year-on-year level of 6.7%.

The Bank of Mexico announces a slow-down in the economy's financing sources and uses

Banxico's inflation report for the second quarter of 2017 warns of a deceleration in financing sources for the period, with a real annual variation of 0.6% – lower than the 1.7% recorded in the previous quarter. This was the result of slower growth in financing sources (real year-on-year growth of resident M4 down from 3.7% to 1.9% from 1Q17 to 2Q17), with foreign sources also continuing to fall (real YoY down 1.3% in 2Q17). As far as domestic sources are concerned, we should highlight the slowdown in financial saving, both voluntary and obligatory. In the latter case, this has been a consequence of a change in the way in which Specialized Retirement Fund Investment Companies (SIEFORES) hold securities, exchanging debt instruments (which constitute a part of monetary aggregates) for foreign or equity securities. According to Banxico, the deceleration with regard to domestic sources also highlights the performance of economic activity and the effect of a higher inflation rate on real financial savings balance growth rates. As far as foreign sources are concerned, banking resources continue to shrink, with similar downturns in the foreign markets that finance Mexican firms.

Similarly, various sectors of the economy have seen a fall in the in the use of resources, particularly the public sector, in which financing as a consequence of the Federal Government's fiscal consolidation strategy has shrunk, with a greater revenue collection and lower actual spending than scheduled. Elsewhere, private sector financing grew at a relatively slow rate (1.5% to 2Q17 compared to 1.7% in 1Q17), with mixed performance reported by its various components. Credit to firms continued to grow despite higher funding costs, partly as a result of large companies moving from foreign credit to domestic financing. This domestic financing mainly comes from commercial banks and, to a lesser extent, from the Mexican stock market, given the relaunch of debt issues. Meanwhile, household credit is continuing its downward trend, with annual real growth at 3.5% at the close of 2Q17 compared to 5.0% in 1Q17. As far as home loans are concerned, a deceleration has been noted both in the granting of credit by commercial banks and in the level of Infonavit financing, while interest rates have increased in comparison to 2016 and delinquency rates have kept stable. In the area of consumer credit, restraint is the watchword in all segments, except in terms of the purchase of consumer durables, due to the ongoing dynamism in car loans. Costs have stayed relatively stable, although there have been some increases in credit card and car loan fees.

Delinquency rates are also largely unchanged, apart from an increase when adjustments are made for write-offs, due to a certain deterioration in payroll credit.

The rate of growth of the personal loan portfolio continues to slow

The Bank of Mexico updated its Basic Indicators of Personal Loans, with information from the end of February 2017. Such loans represented 20.7% of total consumer credit portfolio, the third largest segment after credit cards (39.4%) and payroll credit (24.4%). At February 2017, personal loan balances recorded a real growth of 9.2% compared to the same period from the previous year, confirming the downward trend we have noticed since the second half of 2016. Elsewhere, the adjusted delinquency rate was 12.5%, 14.3% below the same month of the previous year. Over the past year, 6.3 million loans were granted, 83% of the total number of loans and representing 70.4% of the balance. Among the loans granted in the previous year, we should highlight an increase in the participation of short-term loans repayable over a maximum of 24 months for sums between Mex$5,000 and Mex$25,000. As a result, the average loan went from Mex$23,454 in February 2016 to Mex$25,708 in February 2017 (4.5% real growth), while the average repayment period increased from 20 to 22 months over the same period. The average rate per balance dropped off slightly from 32.9% to 32.7% between February 2016 and February 2017.

Credit card financing consolidated its recovery in 2016

Pursuant to the updating of credit card core indicators published by Banxico, the credit card portfolio balance increased to a real annual rate 5.7% at 2016-year end, twice the recorded amount for the previous year. This represents a recovery when compared to the lacklustre panorama between 2014 and 2015. While the adjusted delinquency rate associated with credit card financing fell in 2016 (14.4% in December 2016 compared to 15.2% in December 2015), this segment continues to present an adjusted delinquency rate that is higher among the various consumer credit products.

As of December 2016, a total of 17.8 million credit cards were up-to-date with payments, an increase of 6.3% with regard the figure at the close of 2015. Within this figure, 48.3% correspond to customers who pay in full each month, up from 47.3% in December 2015. The balance associated with customers paying in full each month showed a real increase of 7.5% compared to December 2015, remaining virtually unchanged in terms of the share of the total balance compared to the previous year (24.5%). Meanwhile, as at December 2016 the balance set aside for promotions of interest-free months came to 59 million pesos, a reduction of 0.3% compared to the amount in December 2015. The share of the balance set aside for interest-free months fell from 21.0% of the total balance in December 2015 to 19.5% in December 2016.

National Corporate Financing Survey (ENAFIN 2015)

The National Securities and Banking Commission (CNBV) and the National Institute of Statistics and Geography (INEGI) published the results of the ENAFIN National Corporate Financing Survey 2015 (Survey). Among main ENAFIN 2015 goals are that of identifying needs, sources and financing access and use conditions, as well as gathering information on the use of other finanical services by companies.

As wel as the National Survey of Company Competitiveness, Sources of Financing and the Use of Financial Services (ENAFIN 2010), ENAFIN 2015 is also representative of companies employing six or more people, in towns and cities of over 50,000 inhabitants and which belong to the building, manufacturing, commercial and private non-financial service sectors (including transport)[1.]

While it is true that the questionnaires from the two surveys differed in terms of the level of detail applied to the credit used by companies, taken as a whole, both studies can be used to better understand how the use of credit evolved in the interim between the two, drawing on earlier work done by the CNBV, INEGI and BID. It should be noted that, unlike the 2010 survey, ENAFIN 2015 included information which classified credit based on currency (domestic vs. foreign), as well as detailing intention to apply for credit and use of invoicing and financial leasing services. It also featured a section on customer acceptance of payment methods (and not only their use by companies).

The main results from ENAFIN 2015 survey related to corporate financing include: 1) 40.0% of the companies surveyed had been granted or had requested credit. 2) Of the companies that had requested credit, the main source was commercial banks (76.5% of the companies receiving credit), followed by suppliers (in 31.7% of the cases). 3) Among the main reasons given as to why credit was sought from commercial banks was that the bank in question had previously provided them with some kind of service. As far as the companies who had not been granted credit were concerned, the survey revealed: 1) 51.1% of the companies had not applied for credit because they were not interested or did not need it. 2) Among the companies that had requested credit but not been granted it, the main reasons for the decision was said to be their bad credit history and the difficulties they would face in repaying the loan.

As far as the use of other financial services was concerned, the banking service most commonly used by companies was the business account with chequebook (55.9%) and internet banking (47.9%). Moreover, 32.5% of companies also accepted payment by bank cards from their customers and clients.

Analysis of the information from ENAFIN 2015 may offer a template for preparing strategies that contribute to promoting corporate credit. It will therefore be important in the future to ensure continuity and maintain comparability in order that the effort of gathering the information might serve as an instrument that can be used to outline courses of action regarding the attention given to businesses and better assess the results obtained.

Financial Markets

The Fed and the renegotiation of NAFTA have had a bearing on the performance of domestic markets

Movements on financial markets in August continued to be influenced by monetary policy forecast by the main central banks around the world, as well as geopolitical tension and uncertainty. July inflation in the US was below forecast levels (1.8% compared to 1.7%), reducing the implicit probability in the futures market of a hike in the federal funds rate at the September meeting to below 15%. In fact, the markets have assigned a probability of only 50% that there will be a federal funds rate rise until the June 2018 meeting. While it is well known that these forecasts fluctuate continuously, it is nevertheless relevant to point out that there is a significant contrast between them and the forecasts made by the Federal Open Market Committee,

1: ENAFIN is representative of 233,155 companies with these characteristics identified through the 2014 Economic Census, which is to say that the results are representative for 5.5% of all economic units in the private and para-public sectors which were active in 2014 (according to the 2014 Census, in that year there were 4,230,745 economic units in total).

which expects to see a rate rise this year and three or four in 2018. Given this lower probability of monetary normalisation in the US, the dollar continued to be weak. In August, the dollar lost 0.78% against emerging currencies and 0.1% against currencies in developed countries. We should nevertheless highlight the strength of the euro, given the comments that were made of “reflationary forces” by the president of the ECB. The euro is close to the level of $1.20, a level not seen since the start of quantitative easing. Despite the trend toward gains in emerging currencies, the Mexican peso performed poorly. After a number of months in which the peso was among the most appreciated currencies, the start of NAFTA renegotiations created volatility in the currency. The dollar reached a high of 17.97 pesos during the month, although at the close it stood at 17.71 pesos. As renegotiation progresses and US policy results in episodes of risk aversion, there will be a real possibility that we will see lower exchange rates.

As regards as equity markets, the tension between North Korea and the US led to periods of risk aversion. During August, the international equity market benchmark fell 0.7%, while the S&P500 dropped by 0.5%. Despite this, emerging markets were up 2%, while the Prices and Quotes Index of the Mexican stock market rose 0.36%.

Regulation

Amendments to the Circular Applicable to Credit Institutions to combat identity theft

On 29 August the amended resolution of the Circular Applicable to Credit Institutions which seeks to tackle identity theft was published. This project defines the identification methods used for the conclusion of contracts and the request for means of payment, as well as for cash withdrawals and transfers. It also establishes verification measures, especially biometric validation and consultation with the electoral credentials database of the National Electoral Institute. The rule also provides for the possibility of non-face-to-face identification (digital onboarding).