Banks

Monthly Report on Banking and the Financial System

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Banking and the Financial System

Private sector credit is recovering, being driven by business loans

In August 2017 the balance of performing loans granted to the private sector by commercial banks grew at a nominal annual rate of 13.2% (6.2% in real terms), 0.6 percentage points (pp) higher than the rate seen the previous month (12.6%) yet 2.8 pp below the reading in August 2016 (16.1%). This result was due to an upturn in business loans, which climbed from a nominal annual rate of 14.5% in July to 15.8% in August, whereas consumer credit growth continued to ease off the pace, down from 9.9% in July to 9.5%. On the other hand, housing credit growth rate held unchanged at 9.5%. The rally in business loans could be linked to improved investment prospects for companies.In turn, they might be due to a stronger exchange rate, chances of achieving an encouraging NAFTA agreement, successful auctions of oil fields in Round 2 of the energy reform, and the expectation that Banxico makes a pause in its monetary policy decisions. Regarding household credit, there are mixed domestic demand indicators, such as a rise in formal and stable employment (a higher number of permanent workers registered with the Social Security system) and greater consumer confidence, but stability in domestic consumption and high levels of inflation, which keep undermining household purchasing power. These factors suggest a more stable performance on the demand for consumer and housing credit.

Mild recovery for bank deposit-taking, driven by the demand deposit segment

In July 2017 the nominal annual growth rate (AGR) for traditional banking deposits (demand + term) was 11.0%, 0.2 percentage points (pp) above the rate seen the previous month, but 1.4 pp below the reading in July 2016. This rate shows a more stable trend for traditional banking deposits, after a mild performance since February this year. Demand deposits exhibited a slight recovery, with a nominal growth rate of 11.8% (vs. 11.2% in June). Such improvement was the result of a stronger growth in demand deposits by the non-financial public sector and by companies. At the same time, it could be associated to a greater liquidity preference and more inflows from the business sector, due to a higher level of activity in the export sector and to the extraordinary foreign currency deposits made by companies as part of the capital repatriation programme. On the other hand, term deposits stuck to a trend of lower growth, posting a nominal annual variation of 9.7% (vs. 10.2% in June). This decline was due to a weaker performance for term deposits by the non-financial public sector and companies. The lower growth rate in term deposits by companies might be associated with the loss of buoyancy that economic activity continues to show.

Update of the risk assessment by the Financial System Stability Council (CESF)

On 18 September the Stability Council published its risk assessment update. On the external stage, global economic activity has seen a moderate improvement and US monetary policy normalisation is still expected to take place gradually. Even so, risks persist, and come from the advanced economies implementing their monetary policy normalisation faster than expected, potentially more protectionist stances around the world, and geo-political uncertainties.

On the domestic front, the Stability Council makes the point that Mexican financial markets have shown less volatility and asset prices have performed favourably, driven by a higher risk appetite from international investors. Meanwhile the forex market has seen lower volatility in the pricing of the Mexican peso, which has also traced a substantial appreciation. The Stability Council considers that the exchange rate performance can be attributed to policy actions taken by Banxico, consolidation efforts implemented by the Secretariat of Finance and Public Credit (the SHCP), the progress made in the rounds of renegotiation of the North American Free Trade Agreement (NAFTA) and an international environment conducive to investors seeking returns. Added to this, it notes that the growth seen in the Mexican economy has been driven by both export recovery and lively consumption, which are conditions that have allowed credit to continue to grow, albeit at a slower pace. Domestically, the Stability Council identifies latent risks in the form of potential new bouts of financial volatility and stumbling blocks in bringing NAFTA up-to-date.

Regarding the impact to the financial system, the Stability Council concludes that, in general, banking institutions have the ability to withstand any deterioration in the country's financial and economic conditions that could emerge in case any such risks materialize. It also underlines that the adoption of the Basel III standards has helped the institutions to raise their liquidity levels and to maintain adequate levels of capital, which boost loss-absorbing capacity.

The value of construction companies' activity fell 2.7% in July 2017

According to data from the Monthly Survey of Construction Companies (ENEC) carried out by the National Institute of Statistics and Geography (INEGI), the total value of annualised construction output in July fell 2.7% in real terms with respect to the like period in 2016. The building activity sub-sector, which accounts for 46.3%, began to take a decelerating course since January, with an average growth rate of 1.7% in the seventh month of the year.

Within building activity, housing construction showed annualised growth of 0.8% in July, whereas construction for industrial and commercial buildings and facilities grew by 3.4%, both with respect to 2016. The slowdown began in house building due to the gradual decrease in the amount for housing subsidies, and the rise in short term interest rates last year is already reflecting a lower productive activity.

On the other hand, transport and urban development construction, which represent 25.7% of the overall output of construction companies, could see growth restored in the second half, after two years of languishing in negative territory. The reactivation of such construction work will become more evident in the fourth quarter of 2017 and the first half of 2018. For this reason, there could be a greater demand for housing development credit given that private sector investment has offset the contraction in public investment in the construction industry.

Financial Markets

Losses for Emerging Market assets on investor expectations factoring in an additional hike by the Fed towards year end

The shift of tone in the communication strategy of the Federal Reserve (Fed) has altered the monetary policy expectations of investors and given rise to losses in financial assets of Emerging Markets (EMs). At its September meeting, besides announcing the imminent start on the unwinding of its balance sheet, the Fed made it clear that a further rise in the federal funds rate in December is a genuine possibility given the strength of the US labour market. This prompted substantial asset price movements, since investor expectations reflected in market prices had not factored in any great likelihood of such a hike. T-Bond rates reacted with rises across virtually all maturities, which led the 10-year yield to maturity (YtM) to rise by 17bp in September and close the month at 2.33%. The greater demand for US assets in the light of higher yields consequently took its toll on EM assets. The dollar firmed against currencies generally, but especially against those of the EMs. In fact the benchmark index for the performance of EM currencies against the dollar (MSCI EM) slipped by 2.0% in September, while the comparable figure for developed country currencies was only off by 0.3%. It is worth pointing out that the dollar has been generally falling back since March, which left it in a relatively weak position.

In stock markets the performance was similar, and whereas the benchmark for assets of this kind globally (MSCI World) moved up 1.77% in September, that for the EMs dipped by 0.9%. In the case of the Mexican market the fall was 1.44%.

Almost all sovereign risk indicators registered a rise. In Mexico's case, the rise was to 17bp after the Fed meeting, but further toward the end of the month the gain fell back to 10bp. Greater sovereign risk, combined with higher liquidity risk owing to the commencement of the Fed's balance sheet unwinding process, were influential in a rise in the maturity premium. That led the YtM of the 10-year Mbono to close the month in September at 6.87%, up from 6.76% a few weeks earlier.

The process of harmonisation between market expectations and those of the Fed with regard to monetary policy normalisation will continue to be one of the key catalysts in financial markets, even more so when major divergences are still observable with respect to 2018. Overlying this from Mexico's standpoint, the NAFTA renegotiation will bring bouts of volatility with it. All this in an environment in which global risk aversion remains at historically low levels, especially considering the current conditions of political uncertainty.

Regulation

Financial Technology (FinTech) Bill

On 19 September, the project for the "Law Regulating Financial Technology Institutions" (FinTech Law) was made officially public. The proposed law would see the creation of two types of Financial Technology Institutions (FTIs): those engaging in Crowdfunding and those associated with E-Money. Likewise, it would include the so-called innovative models, which would allow FTIs, financial institutions and other legal persons (Start-ups) to provide their services in a manner that differs from that prevailing in the market, on a temporary basis and benefiting from exceptions to the applicable regulation (Regulatory

Sandbox). In addition, the recognition of virtual assets (cryptocurrencies) for use by the FTIs and other financial institutions, subject to recognition and regulation by Banxico, is also noteworthy. Finally, the project includes an obligation for financial institutions and FTIs to set up Application Program Interfaces (APIs) for the distribution of open, aggregate and transactional data (the latter subject to prior authorisation from the client).

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