BANKS

Monthly Report on Banking and the Financial System

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Banking and the Financial System

Moderation in lending to all three segments of the private sector

In September 2017 the balance of performing loans granted to the private sector by commercial banks grew at a nominal annual rate of 12.2% (5.5% in real terms), 1.0 percentage points (pp) lower than the rate observed the previous month (13.3%) and 3.4 pp below the reading in September 2016 (15.6%). This result was due to a reduced growth in the three segments of the portfolio, in particular lending to businesses, which fell from a nominal annual rate of 15.8% in August to 14.2% in September. For its part, the pace of expansion of consumer lending continued dropping, going from 9.5% in August to 9.0% in September, and housing loans showed a marginal drop in growth from 9.5% in August to 9.4%. This new setback in lending to businesses could be a consequence of the moderate growth prevailing in a number of economic sectors such as services and construction, as well as of the slow growth in interest rates, which in turn reflects the monetary policy actions implemented by the Central Bank in order to keep inflation expectations anchored. In the case of consumer lending, its performance may be a delayed effect of the moderation in domestic demand observed at the beginning of the third quarter. However, within the consumer portfolio the payroll segment and, for its part, the housing portfolio are showing a stabilisation in their growth, probably linked to a similar performance in employment.

Slowdown across bank deposit segments

In August 2017 the nominal annual growth rate for traditional banking deposits (demand + term) was 9.9%, 1.1 percentage points (pp) less than that seen in the previous month and 2.7 pp less than the rate reported in August 2016. Thus, the dynamism of traditional banking deposits continues to slowdown. Demand deposits showed a nominal growth of 10.3% (compared with 11.8% in July) while term deposits growth rate fell slightly, with an annual nominal variation of 9.4% (compared with 9.7% in July). The reduced dynamism in demand deposits was the result of a slowdown in the corporate segment, while the performance of the other segments improved. The reduced growth in companies' demand deposits is associated to a decrease in their foreign currency balances, due to an outflow of resources coming from the capital repatriation programme that were later invested in other types of securities. Term deposits improved their performance, especially corporate and private savings, probably associated to an increase in the interest rates offered by this type of deposits. However, this improvement was not enough to offset the slowdown in other segments, which also reflect a rebalancing in portfolios due to flight-to-liquidity movements.

The global financial system faces lesser risks, but vulnerabilities and regulatory challenges persist

On October 11, the International Monetary Fund (IMF) announced the updating of its Global Financial Stability Report (GFSR). This report highlights the strength of the global financial system resulting from the stimulus of economic policies, regulatory improvements and reactivation of growth. However, sustained monetary expansion in a number of economies (necessary for fostering economic activity and inflation) has increased the value of financial assets and leverage. Therefore, financial stability risks have been transferred from the banking system to the market and non-banking sectors. Consequently, the IMF recommends normalising monetary policies in order to prevent greater accumulation of financial risks outside the banking sector, and deal with any still existing difficulty inherited from the worldwide financial crisis.

However, an acceleration in monetary policy normalisation would eliminate the support of a sustained economic recovery. The expansionary monetary policies implemented over the past few years encouraged significant adjustments on an international scale in portfolios of the private sector, so sudden or untimely changes in these policies could generate turbulences in financial markets, which could spread to other countries and markets. On the other hand, a longer lasting expansionary monetary policy in some economies could favour the accumulation of financial excesses (for example, in some markets financial assets are overvalued). Furthermore, the leverage of the non-financial sector in the G-20 economies is higher than before the worldwide financial crisis, making this sector more vulnerable to a tightening of financial conditions or a weakening of the economy. This means economic authorities are facing the challenge of containing the accumulation of vulnerabilities and supporting the reactivation of the world economy. Elsewhere, it is necessary to finally resolve the problems inherited following the crisis via an effective implementation of measures such as a resolution framework for international banks, tackling the risks associated with deficient business models, and fully comply and implement the Basel III agreements.

In September house prices rose less than inflation

The Federal Mortgage Company (SHF in the Spanish abbreviation) recently announced the housing price index for the third quarter of 2017. For the first time since 2014 house prices rose at a slower pace than consumer prices (INPC). At the end of September, the SHF index showed a nominal yearly rate of 5.0% with respect to the same month of 2016, while the INPC came in at 6.4%.

In our September report, we mentioned that residential construction costs could have reached the top of their appreciation cycle during the first quarter of the year and that they would begin to reflect the slowdown in the housing market. This has ocurred in the third quarter, since the construction costs index is already growing at a single digit pace (9.5% in year-on-year terms).

The middle income and residential segments grew by 6.0% during the period, while the social housing segments grew by just 3.4%, their lowest rate since the second quarter of 2014. In Metropolitan Areas, we can also appreciate greater diversity. In the centre region, the Valle de México, Toluca and the Puebla-Tlaxcala area, yearly rates of 4.3%, 3.8% and

4.6% respectively were reported. On the other hand, the cities of Guadalajara and Monterrey reported increases of 5.9% and 5.6% respectively.

Financial Markets

Negative differentiation of domestic assets due to uncertainty caused by the renegotiation of NAFTA

Following a shift of tone in the communication of the US Federal Reserve, which altered investors' monetary policy expectations and gave rise to losses for financial assets of emerging markets, the increased risks of a breakdown of NAFTA resulted in a negative differentiation of Mexican assets. This is because, after the fourth round of negotiations, the trade delegation put on the table a series of proposals contrary to free trade, thereby making it unlikely that an agreement will be reached within the expected time frame. The most notable result of this was an exchange rate depreciation, which fell by 5.1% in October, a far greater fall than that suffered by emerging countries currencies, which fell back by 1.8%. After being the currency that appreciated the most during the first half of the year, the Mexican currency is now after the Turkish Lira, the second most depreciated since the start of NAFTA renegotiation process on August 16. It is worth highlighting that in response to this depreciation, Banxico increased the number of currency hedging auctions payable in pesos from one to four billion dollars.

On the other hand, country risk measured by the spread of five-year CDS, increased by 15 bps in mid-month following the fourth round of NAFTA negotiations, later falling slightly to stand at 107 bps at the end of October. Although this increase was significant, its level is far below its long-term mean, which stands at around 130 bps, given the prevailing appetite for risk in global markets. The increase of country risk and the Federal Reserves' starting to reduce its balance sheet, which brings the liquidity risk back down to levels more in line with those prior to the crisis, influenced the increase in long-term interest rates. The yield to maturity of the ten-year government bond rose by around 43 bps in October to end the month at 7.3%. The recent rises in medium- and long-term rates have reversed the downward slope shown by the government curve since last June.

Negative differentiation was also observed in the Mexican stock market. The CPI fell 3.0% in October while emerging markets' benchmark continued growing at a rate of 1.6%. The remaining stock markets continued showing significant gains supported by better than expected economic data and positive corporate earnings reports. Both the benchmark of this type of global assets and the S&P 500 posted new record highs following rises of 1.7% and 2.1% respectively. In the case of the S&P 500, the increase was influenced by the expectation of a possible approval of the tax reforms announced by the Trump administration.

Regulation

Adjustments to the risk diversification rule

On 25 October, the CNBV published changes to its Banking Rulebook making the large exposures regime applicable to states and municipalities more flexible. The rule already exempted exposures guaranteed by, or with sources of payment made up of, federal budgetary contributions provided the existence of irrevocable instructions to apply them to the payment of said exposures. The recent amendment extends this treatment to those exposures guaranteed using unstructured public trusts constituted by states and municipalities as long as their sources of payment are the aforementioned federal budgetary contributions and a mandate has been granted for their use as source of payment for the exposures in question.