BANKS

Monthly Report on Banking and the Financial System

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Banking and the Financial System

Moderation in bank loans to all three segments of the private sector

In September 2017 the outstanding 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 bank loan 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 loans 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 moderation in lending to businesses may reflect the lower growth that prevails in some sectors of economic activity, such as the services and construction sectors, as well as the slow increase in interest rates. The latter reflects the monetary policy actions implemented by the Central Bank to keep inflation expectations anchored. In the case of consumer lending, its performance may be reflecting 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.

Demand deposits boost traditional bank deposits during September

In September 2017, the nominal annual growth rate of traditional bank deposits (demand + term) was 11.2%, 1.3 pp greater than was observed in the previous month. With this result, traditional bank deposits improve their performance after the minimal annual growth recorded in August. Demand deposits showed a nominal growth of 12.3% (compared to 10.3% in August) while the term-deposit growth rate remained practically unchanged, with an annual nominal variation of 9.5% (compared with 9.4% in July). The greater momentum in demand deposits was the result of the impetus from the segments of companies and individuals, which at the same time was related to: 1) the term extension of capital repatriation official programme and 2) the dynamism in retail sales. On the other hand, the boost to individuals' demand balances could come from a greater preference for liquidity destined to finance the purchases associated with the rebound in sales. This also explains the decrease observed in the balances of longer-term savings instruments during September. In the case of term deposits, the slowdown in momentum observed in the savings of companies and individuals was offset by the recovery in the rest of the segments (non-financial public sector and non-bank financial intermediaries). Given the above, the impetus observed in term deposits was the result of the substitution of longer-term balances for more liquid instruments and the effect associated with the extension of the capital repatriation programme.

The total credit balance through cards slows its momentum during 2017

According to the update of the Basic Credit Card Indicators published by the Bank of Mexico, in the year to June 2017 the balance of the credit card portfolio increased at a real rate of 3.5%, which represents a smaller increase than that observed in the year to June 2016 of 3.9%. On the other hand, the IMORA of credit cards (adjusted default rate) in June 2017 stood at 15.1%, slightly higher than that observed in the same month of 2016, when it reached 14.9%. It should be noted that, among the various consumer finance products, credit cards continue to present the highest IMORA.

In June 2017, a total of 18.0 million credit cards were up-to-date with payments, an increase of 3.9% relative to the figure observed in June 2016. Of these cards, 47.7% correspond to customers who pay in full each month, down from 48.3% in June 2016. The balance of cards up-to-date with their payments was 305.7 billion pesos, representing a real increase of 5.6% compared with June 2016. Of that balance, 74.8 billion pesos (24.5% of the total) corresponded to balances of customers paying each month in full, which presented a real increase of 11.3% compared with the previous year, the highest growth registered since the end of 2015. In June 2017 the balance granted through interest-free month promotions amounted to 59 billion pesos, equivalent to 19.3% of the total balance, showing an increase of 0.5 percentage points (pp) with respect to the percentage observed in June 2016.

Car loans accelerated their momentum, offering better conditions as regards amounts and terms

The Bank of Mexico published an update on the Basic Auto Loan Indicators, with information as at the end of April 2017. This credit segment reached a real annual growth rate of 13.6%, higher than the rate of 11.4% observed in the same month of the previous year. The share of auto loans within the consumer portfolio was 11.8%, higher than the figure of 10.9% registered in the same month of the previous year. Meanwhile, delinquency was 1.5%, slightly higher than the 1.4% of the previous year, but remaining the lowest among the various segments of consumer credit. In April 2017 a total of 693,631 loans were reported outstanding, of which 286,957 had been granted in the past year (55% of the balance). These loans accounted for a balance of 87,478 million pesos. The average amount of current loans was 180,500 pesos (6,300 pesos higher than the average amount in April 2016), while the average term was 52 months (two months more than those granted in April 2016). For its part, the weighted average interest rate was 11.8%, similar to the 11.7% recorded in the same month of the previous year.

The International Monetary Fund (IMF) renews Mexico’s Flexible Credit Line (FCL)

On 30 November, the IMF announced the early renewal of the FCL for a total equivalent to approximately US$88 billion. Coverage is again for two years and access to these resources continues to be immediate and without any conditionality. This facility contributes to strengthening confidence that the country is maintaining solid macroeconomic fundamentals. It should be noted that it was renewed early to avoid coinciding with the electoral period. Although the global risk environment has improved, for Mexico the risk persists of an abrupt change in its trade relations or that a resurgence of volatility in financial markets could lead to a reversal in capital flows. In this way, the FCL continues to play an insurance role against external risks. The statement highlights the fact that the Mexican authorities have expressed their commitment to continuing the path of consolidation of their public finances, in order to reduce the ratio of public debt to GDP in the medium term. It is also envisaged, given the soundness of the country's economic fundamentals, that a gradual process of exit from the FCL could be initiated (requesting a reduction in the total level of access after one year), if justified by external conditions and the overview of prevailing risks at that time.

The Mexican financial system has the capacity to face adverse events

According to the updated version of the Financial System Report published annually by the Bank of Mexico, the results of the stress tests indicate that the levels of capital and liquidity in the Mexican banking system are reasonable, which make the system more resilient to different adverse scenarios. The rest of the participants in the financial system, due to their size, the type of operations they perform or the regulation to which they are subject, would not represent a threat to the stability of the system if any of the risks identified were to materialise.

The main risks identified for the country's financial stability are: i) an increase in inflation; ii) a low rate of economic growth; iii) lower oil revenues that could affect the process of fiscal consolidation; and iv) the possibility of a sudden reversal of capital flows. However, the solidity of the financial system contributes to the authorities being in a better position to adjust their monetary policy stance in the face of adverse scenarios and to continue to limit institutions' exposure to credit, market, liquidity and contagion risks.

In our opinion, the increase in inflation due to second-order effects is a latent but moderate risk. Apart from this, we share the opinion of Banxico (Banco de México, the central bank) that a possible collapse of NAFTA would not significantly affect trade flows, but could affect economic growth through investment. Finally, although we agree with the adverse effects that an abrupt outflow of foreign capital flows would have, we believe that this is a low-probability scenario, since the monetary policy rate increases that were carried out in the last two years have made Mexico an attractive investment option.

New technologies and financial inclusion in Latin America

The Latin American Federation of Banks (Felaban) published its third Report on Financial Inclusion in Latin America. The report addresses the digital revolution in the provision of financial services, presents the evolution of the variables of access to financial services in the region, and reviews some aspects of public policy related to financial inclusion in Latin America.

The convergence of mobile technologies, the rise of the Internet, the increase in the penetration of mobile telephony and the new habits of the public are trends that have changed bank business models globally and generated areas of opportunity for financial inclusion, by reducing operating costs in the provision of financial services (such as distances, identification of subjects and immediacy). This provides an incentive for new players to offer such services. However, the use of these technologies generates some frictions because, although greater coverage of financial services is required, its provider's should be qualified enough to avoidputing financial stability at risk. In order for banks to overcome this challenge, it will be necessary to design financial products that meet the needs of a changing and more demanding consumer. Coupled with this, it is necessary to build regulation and supervision that provide frames of reference for new players and offer certainty to users. In this area, Mexico stands out as a pioneer in having developed and proposed a Law to regulate financial technology institutions (Fintech Law).

With respect to financial inclusion, the main indicators from the FELABAN Report record significant progress at regional level, despite a challenging macroeconomic scenario. However, the ability of countries in the region to deal with economic shocks of external and/or internal origin varies greatly from one country to another, and this is reflected in the uneven progress made on levels of financial inclusion.

In the third quarter, new mortgage lending by banks decreased by 7.3%

New mortgage loans granted by commercial banks between January and September 2017 decreased by 7.3% in real terms compared with the same period of 2016. The combination of a lower rate of job creation in the segments of workers with incomes of more than five times the minimum wage and the increase in mortgage interest rates generated uncertainty during the first half of the year.

In addition, by increasing the maximum amounts of financing, the official housing institutes have more forcefully entered the market that had traditionally been served by the private sector. The amount granted by the Infonavit grew in September by 8.6% in real terms, with an average amount per mortgage of 354,000 pesos. In contrast, actual financing granted by commercial banks in the same period decreased by 7.3% in real terms, with an average amount per mortgage of 1.2 million pesos.

Financing for new housing remains the main credit product and represents 62% of the total in the third quarter; while that of used housing had a share of 19.8%. On the other hand, loans for payment of liabilities and liquidity, which in 2016 had a share of more than 12%, now account for only 7% of mortgage transactions. This is due to the stability in interest rates and the pause in the competition for these products.

Although we expect that in 2017 the contraction of mortgage financing will be visible in most of the country, at regional level Mexico City, Quintana Roo, Querétaro and other states of the Bajío (West North-Central Mexico) will see growth in sector activity, linked to the momentum in their economic activity.

Financial Markets

A breather for the peso in the absence of any news that makes an imminent breakdown of NAFTA seem likely

During November, pressures on a possible breakdown of NAFTA were reduced, given the absence of new developments in the fifth round of negotiations, which was reflected in less pressure on Mexican assets. The peso appreciated by 3.2% in the month, more than the 0.32% appreciation of the emerging currencies benchmark. However, since the end of September, when the controversial proposals presented by the USA in the fourth round of negotiations began to be discussed, the peso has maintained a negative differentiation, although of a smaller magnitude than previously. Between the end of September and the end of November the peso depreciated by 2.05%, whereas the emerging countries benchmark fell by just 1.4%. It should be noted that the US tax reform and expectations of the US Federal Reserve's monetary policy are among the factors that will influence the global currency market.

With regard to domestic long-term rates, these registered a slight fall during the month, although they remain at levels similar to those observed last June. We must take into account that the market recently changed its monetary policy outlook towards an increase of almost 50 bps during the first half of the year. This, together with the increase in the term premium, has influenced current rate levels. In the USA, the curve is continuing to flatten with the combination of expectations of a higher rate of monetary normalisation, which have increased short-term rates, and doubts about the increase in inflation in the coming months, which is keeping long-term rates well below historical levels, especially if one considers the good performance of the labour market.

In the equity markets we continue to see significant gains underpinned by better-than-expected economic data globally. Both the benchmark of this type of assets on a worldwide level and the S&P 500 posted new record highs following rises of 2.1 and 2.9% respectively. Expectations of approval of the tax reform in the US influence the positive differentiation of the North American stock market. Emerging markets also registered a 0.5% gain, a figure that was well above the 3.6% fall recorded by the Mexican market.

Regulation

Adjustments in the Senate to the bill to regulate Financial Technology Institutions

As part of the legislative process, on 30 November the Mexican Senate approved in general terms the draft bill of the “Fintech Law” and referred it to the Chamber of Deputies. This new version includes several amendments, prominent among which are the inclusion of the protections of the Law for Transparency and Regulation of Financial Services regarding the non-discrimination of Financial Technology Institutions and of the people with whom they operate, the extension of the requirement to establish platforms for the exchange of information (APIs) to people operating “innovative models”, as well as requiring prior authorisation by financial authorities to access data through said platforms. The bill also includes a new criminal definition for the Law of Credit Institutions relating to identity theft in the contracting of financial services or products.