BANKS

Monthly Report on Banking and the Financial System

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Banking and the Financial System

Slight recovery in credit to the private sector driven by companies' credit portfolio

In October 2017 the balance of credit loans granted to the private sector by commercial banks grew at a nominal annual rate of 12.5% (5.8% in real terms), 0.3 percentage points (pp) above the rate seen in the previous month (12.3%) and 2.9 pp below that recorded in September 2016 (15.4%). This result was due to a greater dynamism in loans to companies, which went from 14.2% in September to 15.8% in October. In contrast, consumer credit and mortgages continued to reduce their rate of growth. The former went from a nominal annual rate of 8.9% in September to 8.2% in October, while the latter reduced its rate slightly to 9.2%, 0.2 pp from 9.4% in September. This confirms the downward trajectory of credit to households, linked to a moderation in their purchasing capacity due to the effect that inflation has had on real wages. On the other hand, the advance in credit to companies could be linked to the substitution of foreign financing for bank loans, as well as the 5.6% increase in the exchange rate registered in October, which increased the value in pesos of the balance of firms' portfolio in foreign currency. For the following months, a more moderate momentum in credit could be observed, in line with what was observed in recent indicators of economic activity.

The figure for banking deposits picks up supported by the dynamism of its two components

In October 2017 the nominal annual growth rate for traditional banking deposits (demand + term) was 13.2%, 2.0 percentage points (pp) higher than that seen in the previous month and 0.6 pp higher than the rate reported in October 2016. The two components of traditional deposits recorded improvements: demand deposits reached a nominal annual growth rate of 14.0% (vs. 12.3% in September), while term deposits achieved an annual nominal growth of 11.9% (vs. 9.4% in September). The greater dynamism in sight deposits was the result of the momentum of the segments of non-banking financial intermediaries (NBFIs) and of the non-financial public sector (NFPS), which was sufficient to offset the moderation in the growth rate of deposits of companies and individuals. This result was originated, in part, by a base effect, since in October 2016 the deposits of NBFIs registered an atypically small amount with respect to those observed in other months, while in October 2017 an unusual upswing was recorded. In the case of NFPS deposits, the greater momentum could be associated with the growth observed in budgetary revenues of public agencies and companies. For term deposits, the recovery was driven by deposits of private companies and NBFIs. In the case of private companies, the observed increase could be associated with the accumulation of availabilities awaiting more favourable conditions to undertake investment projects.

Banxico has updated its report on housing loan indicators

Banxico updated its report on Basic Indicators of Housing Credits, with data as of May 2017 (May17). At the end of that month, the housing loan portfolio of consolidated commercial banks was made up of 1.6 million loans, with a balance of 711 billion pesos (bp), which represented 19.3% of total loan portfolio. The above implied an annual real growth rate of 3.0% in the balance of this type of loans, significantly lower than the 8.2% reported in the same month of 2016. Meanwhile, the delinquency rate (IMOR) was at 2.6%, while the adjusted IMOR (IMORA) was at 3.9%, maintaining the downward trend that began in 4Q14. The most significant type of loan within the mortage portfolio is that for buying new or second-hand homes (83.4% of the balance granted between July 2016 and May 2017). In the most recent 12 months this exhibited a weighted average lending rate of 9.6% over 19 years and was for an average sum of 1.3 million pesos. The second type of loans in terms of importance in the mortgage portfolio were those used to pay off debt, which accounted for 8.0% of the balance granted between June 2016 and May 2017 due to customers switching their mortgages between lenders as the market became more competitive.

Payroll credit slows despite improvement in its granting conditions

Banxico published an update of the Basic Payroll Loan Indicators, with information up to June 2017 (Jun17). At the end of that month, the balance of payroll loans represented 23.6% of total consumer credit. The real annual change registered was -3.0%, showing a contraction for the first time since the balances of this portfolio have been published (Feb12). Payroll loan delinquencies stood at 3.0%, lower than the figure for consumer credit in general (4.4%). However, the IMORA of payroll loans in the reference period was 12.4%, very close to that observed for personal loans (12.8%), which do not have any type of guarantee. Of the 4.3 million payroll loans in place at the end of 1Q17, 58.1% were granted in the past year, equivalent to 68.4% of the total balance. The average weighted interest rate on payroll loans granted was 24.6%, lower than the rate reported in June 2016 (25.5%). The average loan amount granted over the last year was 63,100 pesos (2,900 pesos more than the average for the previous year) while the average term increased to 44 months, two months more than the average term reported in the portfolio of the previous year.

Alert from the authorities about participation in “Initial Coin Offerings” schemes (ICO)

The Bank of Mexico, the Ministry of Finance and Public Credit (SHCP) and the National Banking and Securities Commission (CNBV) issued a preventive warning on the risks associated with the use of the Initial Coin Offerings scheme (ICO), a new method of raising funds with the objective of financing projects and activities. To date, the authorities have not registered any ICOs in Mexico, but there are some abroad, upon which various international financial authorities and agencies have expressed their concern, since the complexity and variety of these schemes increases the risk of fraud. In the case of Mexico, the authorities warned that some ICOs could violate the Securities Market Law and constitute a financial crime.

Likewise, they reiterate the risks inherent to the use of virtual assets, since these do not constitute a legal currency in Mexico and are not foreign currencies, and no foreign monetary authority issues them or supports their power to make payments. These assets show high volatility, so they also emphasise that those who decide to invest in them lack a special regime for resolving disputes and the people who administer them are not regulated by Mexican financial authorities. Therefore, the Mexican authorities recommend that those who decide to invest in an ICO should be experienced investors and have full knowledge of the project being financed, the systems that support the virtual assets and the legal framework applicable to the ICO. These alternatives should be considered high risk investments, so users should be alert to any signs or indications of fraud.

The Financial System Stability Council (CESF) updates its balance of risks

At its regular session on 19 December, the members of the CESF agreed that global economic activity is improving, in both advanced and emerging economies. However, the Mexican economy has been impacted by the uncertain environment derived from the future of the renegotiation of the North American Free Trade Agreement (NAFTA) and the US proposal for implementing an expansive fiscal plan. Both the foreign exchange market and economic activity have reflected this greater uncertainty. Added to this is the presence of new shocks that have recently affected the behaviour of inflation.

Bank credit to the non-financial private sector has continued to increase, although its momentum has moderated with respect to previous years. The delinquency rates are at historically low levels, although in some credit lines such as consumption and small and medium enterprises, a slight increase has been observed. The CESF emphasises that the Mexican banking system is well capitalised and with adequate levels of liquidity, so it is in a position to face adverse scenarios.

In October credit to housing developments grew 12.4% in real terms

According to data from the CNBV, the total balance of the bridge loan portfolio increased 9.5% in real terms as of October 2017, compared to the same month of the previous year and reached 45.6 billion pesos.

The current component of the loan portfolio increased 12.4% in real terms; while the overdue balance recorded contractions throughout 2017 at double-digit rates and in October, contracted by 38.2% in real terms. As a result, the delinquency rate went from 5.6% in October 2016 to 3.2% in October 2017.

Although the current balance has continued to grow, the health of the portfolio is due more to the contraction of the past due portfolio and not to an acceleration in the growth of new loans. In fact, investment in housing construction, although it continues to grow, does so at ever lower rates and in September increased by only 1.5% according to Inegi figures. On the other hand, the business confidence index of the construction sector barely registered positive growth rates after two years of being in negative territory, due to the successive increases in short-term interest rates, which temporarily stabilised in 2017.

In spite of the above, the contraction in mortgage financing could be reflected more strongly in the coming months, as the confidence of construction producers is already starting to slow down again. This lower confidence of construction producers appears to be influenced by the lower demand that they observe.

Financial Markets

Less liquidity in the markets influences the depreciation of the peso

The Mexican peso was the currency in emerging markets with the second highest depreciation in the month of December, after lower levels of liquidity of the season, coupled with some uncertainty related to a corruption scandal forced the peso down to levels of 19.86 pesos per dollar. These movements were influenced by the lower liquidity conditions in the markets derived from the end-of-year holiday period and led Bank of Mexico to increase the amount of foreign exchange hedges to US$5.5 billion.

The long-term interest rates also increased to such an extent that the maturity yield of the 10-year government bond reached levels of 7.80%, a magnitude not seen since 2010. In addition, this movement was influenced by a more restrictive tone adopted by Banxico. In December, the reference rate was increased by 25 basis points and the tone of the official press release indicates possible subsequent increases. With this, market expectations rose and discounted three more movements of the rate during 2018. All this took place in an environment in which the 10-year US Treasury bond closed unchanged during the last month of the year at 2.41%.

Stock markets around the world continued with above-expected increases, supported by economic data and the recent approval of the fiscal reform in the US. Both the benchmark of this class of assets worldwide, and the S&P 500 registered new historical highs after increases of 1.2% and 0.9%, respectively, during December. Emerging markets also recorded a gain of 3.4%, a figure below the 4.8% increase recorded by the Mexican market in the last month of the year.

Regulation

The final package of Basel III regulatory reforms was approved

On 7 December, Banco de México and the CNBV reported that the Basel Committee on Banking Supervision (Group of Governors of Central Banks and Supervisory Authorities, GHOS) endorsed the post-crisis reforms of Basel III that were pending. The statement mentions that among the topics subjets to revision are: the standardised approach for credit risk, the internal ratings-based approach for credit risk, the Credit Valuation Adjustment risk framework, the internal modelling approach for operational risk, revisions to the measurement of the leverage ratio, a leverage charge for global banks of systemic importance and the output floor.

The statement specifies that revised standards will take effect on 1 January 2022 and will be implemented progressively over five years. It also mentions that the date of application of the revision of the minimum capital requirements for market risk was postponed until 1 January 2022 (initially scheduled for 2019). In this way, the implementation date of the framework for market risk will coincide with revisions to standards for credit and operational risk.

Finally, the statement mentions that Basel III reform agenda has been completed, so now the Committee will focus on ensuring that it is implemented consistently throughout the world. Mexico complies with the guidelines approved until 2015, for which Banxico and CNBV announced that they will work for the implementation of these latest reforms within established deadlines.

Extension of deadline to meet operational risk requirements

On 26 December, the CNBV announced the extension of the deadline for operational risk capital requirements for banks with credit portfolios under 30 billion UDIs, subject to certain conditions related to capital sufficiency exercises under supervisory scenarios. With this, the requirement would be enforceable in full in November 2020, instead of January 2018.

Capitalisation adjustments

On 27 December 2017, the CNBV published amendments to the Single Bank Circular in order to make the recognition of capital instruments more flexible, eliminating the restriction applicable to credit institutions not listed on Mexican stock exchanges and by virtue of which the aforementioned instruments were limited to an amount of 400 million UDIs. The adjustment establishes that the institutions may include eligible capital instruments in their Additional Tier 1 (AT1) capital provided they do not exceed 50% of their Core Equity Tier 1 (CET1) Capital as a whole; likewise, the changes include exceptions to this limit when the institution exhibits CET1 capital ratios of at least 10%, or even below it, in those cases when the certificate of issuance of the Capital Instruments, their prospectus and the Minutes of the Shareholders' Meeting that authorises their issuance, all contain an unconditional obligation by the issuing bank to ensure that its capital (as of the date on which the authorisation to issue such securities is requested), will not decrease in absolute terms, by virtue of any mechanism or act that implies a transfer of equity benefits to related persons or due to the payment of dividends, until such capital instruments are fully amortised, or while it continues to maintain a CET1 capital ratio below 10%. Finally, the amendment establishes the issues related to the recognition in Tier 2 capital of those instruments not included in the AT1 capital, where applicable.