Banking

Monthly Report on Banking and the Financial System

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1.1. Banking and the Financial System

Growth in lending to the private sector slows somewhat due to reduced dynamism in the business and housing segments

In March 2018 the outstanding balance of credit granted by commercial banks to the private sector grew at a nominal annual rate of 11.1% (5.7% in real terms), 1.0 percentage points (pp) below the rate seen in the previous month (12.0%) and 3.9 pp below the March 2017 reading (15.0%). This result was due to a slower rate of growth in business and housing loans, while consumer credit grew at the same nominal annual rate as in the previous month (8.2%). Lending to businesses grew at a nominal annual rate of 14.5%, 1.1 pp less than the rate seen in February (15.6%), although it was the highest rate of the three segments. Growth in housing loans meanwhile slipped from a nominal annual rate of 8.2% in February to 7.9% in March. The stable growth rate of the consumer segment could be associated with the improved performance of domestic consumption and real wage indicators. In the business segment, we continue to see an increasing local demand for loans in foreign currency, associated with tightening credit conditions abroad. Lastly, it seems that housing loans are still being affected by the fall in real wages seen in 2017, although consumer confidence data point to a certain degree of recovery.

Commercial banks keep up the pace of their deposit gathering, largely thanks to the performance of sight deposits

The nominal annual growth rate in traditional banking deposits (sight plus term) in March 2018 was 10.5% (5.2% in real terms), practically unchanged from February (10.4%) and barely 0.5 pp below the nominal rate posted in March 2017. The dynamism seen in traditional banking deposits came largely from the performance of sight deposits, which contributed 5.7 pp to the growth rate for March, while term deposits accounted for 4.8 pp of the overall growth rate in traditional banking deposits. In March, the nominal growth rate in sight deposits continued to accelerate (increasing by 1.3 pp relative to February), underpinned mainly by the dynamism of private individuals' deposits. This in turn was associated with the increase in household disposable income because of the falling trend in inflation. In contrast, growth in term deposits was less dynamic, with the nominal growth rate falling by 1.8 pp relative to the previous month, in spite of the increase seen in companies' foreign currency term deposits.

Domestic sources of financing supported the non-financial private sector

In its report on the first quarter of 2018, Banco de México (Banxico) points out that the economy's sources of financial resources showed sluggish growth of just 2.3% in real terms in the first quarter, more than the real growth rate of 1.2% in 2017, but less than the annual average of 4.9% seen in the period 2013 to 2016. This slackening growth was mainly due to the slowing of external financing sources, which contracted by 2.2% in annual real terms in 1Q18, less than the 3.0% fall reported for 2017.This reduced availability of external financial resources was a consequence of, among other factors, the uncertainty associated with the renegotiation of NAFTA and the impact of the process of U.S. monetary policy normalisation. In contrast, domestic sources of financing increased gradually, as a result both of the increase in reference interest rates, which encouraged savings, and the recovery in economic activity. In particular, there was an increase in holdings of term instruments, while at the same time, savings in housing and retirement funds were favoured by the dynamism of formal employment. As a result, domestic sources showed annual real growth of 5.1% in 1Q18, more than the real growth rate of 3.8% posted in 2017.

The report also records that the application or use of financial resources showed equally sluggish growth. On the one hand, financing of the public sector grew by 0.8% in annual real terms in 1Q18, after contracting by 4.1% over full-year 2017. Meanwhile total financing of the non-financial private sector grew at an annual rate of 4.9% in real terms in 1Q18, in excess of the 3.3% real rate posted in 2017. This dynamism was seen overwhelmingly on the domestic side, while external financing, although apparently having ceased to contract, still showed a low rate of real annual growth (0.8% in 1Q18).

It is worth pointing out that domestic financing to the non-financial private sector has shown a rising trend. In the first quarter of the year, we saw an uptick in private debt issuance, as well as an increase in demand for financing from commercial banks, reflecting the fact that companies have been replacing external sources of financing with domestic ones. As regards lending to households (housing and consumer), in 1Q18 the annual real increase was 4.2%, more than the 2.5% posted in 2017. This performance may be associated with the revival in economic activity and the recovery in real wages. A notable development in 1Q18 was the stabilisation of NPL rates for business lending and housing loans, averaging 1.74% and 2.72% respectively. These are close to the lowest levels of the past three years. Meanwhile the NPL rate for consumer credit in 1Q18 averaged 4.51%.

As regards non-financial private sector companies listed on the BMV, Banxico reports that their leverage, debt servicing and refinancing risk indicators increased slightly, but that the depreciation of the peso and the increase in dollar interest rates in the past few months have not had a significant impact on these companies' risk indicators.

Lastly, the central bank stressed that the country's banks remain solid and solvent. In particular, in March 2018 the Capitalisation Index (ICAP) stood at 16%. The increase seen in this indicator in the past year came from the increase in basic capital, as a result of higher retained earnings. In addition, the leverage ratio stood at around 9.9%, well above the 3% minimum set by the Basel III Accord. The banks' strength is also reflected in their high liquidity ratios, as the great majority of banks post levels above 100%.

Housing prices rose by 8.7% in the first quarter of 2018

At the end of 1Q18, the housing price index of the Federal Mortgage Company (SHF for its Spanish acronym) showed an annual increase of 8.73%. This is the biggest quarterly YoY increase since 2009. Prices in the mid-range and residential segments rose by 9.56%, while in the social housing segment they increased by 7.4% in the same period.

The rise in housing prices was largely driven by general housing construction costs, which increased by an average of 8.5% in the past year. In the first quarter of this year, the increase in these costs began to slow (5.5%). In particular, the price of construction materials rose by an average of 9.5% in the past twelve months. On the other hand, the cost of renting construction machinery rose by just 3.2%, reflecting lower demand for this input in the past year and anticipating lower demand for materials in the coming months. This will be reflected in steadying rates of increase in house prices in the short term.

From a regional perspective, housing in states with high levels of economic activity and in which the major metropolitan areas are located, gained value at a faster pace than the national average. Such was the case of Jalisco and Mexico City, where the SHF index rose by 11% and 10.2% respectively, while in Puebla and Nuevo León it increased by 9.6% and 9.4%.

1.2. Financial Markets

The prospect of a long drawn-out renegotiation of NAFTA leads to negative differentiation of domestic assets

In the absence of agreement in the NAFTA renegotiation process by mid-May, and as the deadline for its approval set by the current U.S. Congress passed, domestic assets posted losses, increasing the negative differentiation relative to their peers.

The Mexican peso depreciated by 6.40% in May, with the dollar ending the month above 19.90 pesos. Even though the global context points to a generalised strengthening of the dollar, this movement was clearly greater than the fall of 3.54% in the EM currency benchmark and the fall of 2.3% in other developed countries' currencies. In the fixed income market, the yield to maturity on the ten-year Mbono increased by 32 bps to 7.81% at the end of May. This came about in a context of higher risk aversion, given the renewed fears in the euro zone related to the political crisis in Italy, which led to the yield on ten-year Treasuries falling by 9 bps.

This negative differentiation was also reflected in the equity markets. Mexico's IPyC stock exchange index fell by 7.64% in May, while equity markets globally rose by 0.71% and emerging markets fell by just 3.75%.

In contrast to recent bouts of volatility, sovereign risk showed a significant uptick. The spread on the five-year CDS increased by 22 bps in the period, ending the month at 136 bps, its highest level since February 2017. At that time, there were still positive prospects of an agreement towards the NAFTA renegotiation process. Negative differentiation was seen in this indicator too: since mid-April, when trade negotiations started to look sticky, Mexico has been one of the five countries in which this indicator has deteriorated most.

In short, in a global environment that is ever more complex for the emerging markets, the delays in the renegotiation of NAFTA have been a source of negative differentiation for domestic assets.

1.3. Regulation

Incorporation of new rating agencies

On 11 May the CNBV (National Banking and Securities Commission) amended the general provisions applying to credit institutions (the "Single Banking Circular") to recognise new rating agencies in the mapping of ratings.

Banco de México: consultation on subordinated bonds

On 4 May Banco de México released for public consideration a draft reform of the "Provisions applicable to transactions of Credit Institutions and of the National Financial Institute for Agricultural, Rural, Forestry and Fisheries Development", aligning the central bank's regulations with the new capitalisation regime derived from the changes in the CNBV's Single Banking Circular of year-end 2017.These amendments made recognition of capital instruments more flexible, which is now reflected in Banco de México's proposal.

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