

## Banks

# Monthly Report on Banking and the Financial System

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## 1.1. Banking and the Financial System

### Private sector lending remains dynamic, driven by business financing

In May 2018 the annual nominal rate of growth in the outstanding balance of [credit granted by commercial banks to the private sector](#) was 12.6% (7.7% in real terms). Although this growth was greater than in the previous month (10.8%) it was less than in the same month of 2017 (14.3%). The most dynamic category of bank lending in May was lending to businesses, which reached a nominal annual growth rate of 17.4% (12.3% in real terms), greater than the previous month's rate (14.3%) and greater than that of the same month of 2017 (16.8%). Growth in consumer credit was 7.7% (3.1% in real terms), below that of the previous month (7.8%) and that of the same month of 2017 (10.5%). Growth in housing loans was 8.3% (3.6% in real terms), similar to the rate seen in the previous month (8.2%) and less than that of the same month of 2017 (10.0%). Contributions by components to total growth in private sector lending in May was as follows: lending to businesses contributed 9.5 pp of the 12.6 pp total growth for the month, consumer credit contributed 1.9 pp and housing loans 1.6 pp. Thus, the most dynamic component, and that which made the biggest contribution to overall growth in lending in May, was lending to businesses. This is related to businesses replacing sources of financing and reducing external financing in favour of domestic bank borrowing. For as long as this replacement of financing sources persists, we can expect the rate of growth in total lending granted by banks to the private sector to continue to grow at a double-digit nominal rate.

### The rates of growth in sight and term deposits converged in May

In May 2018 the annual nominal rate of growth in [traditional commercial bank deposits \(sight + term\)](#) was 11.3% (6.5% in real terms). The growth rate for May was greater than in the previous month (9.0%) and similar to that of the same month of 2017 (11.2%). Also, in May both sight and term deposits posted the same 11.3% nominal annual rate of growth. Although both kinds of deposits grew at the same rate, sight deposits contributed 6.9 pp to the 11.3 pp growth in total deposits, whereas term deposits contributed 4.4 pp, reflecting the fact that sight deposits account for a larger proportion (61.1%) of total traditional bank deposits than term deposits (38.9%). The annual average nominal growth rate in traditional bank deposits from January to May 2018 was 10.1% (4.9% in real terms), less than that recorded in the same period of 2017 (12.6% nominal and 6.9% real). The lower average dynamism of traditional deposits in the first five months of 2018 is not associated with the pace of growth in economic activity, since the average annual growth rate of the global economic activity indicator (IGAE per the Spanish acronym) from January to April 2018 (latest available data) was 2.1%, the same as it was in the first four months of 2017. However, between January and October 2017, the Ministry of Finance and Public Credit (SHCP by its Spanish acronym) implemented a capital repatriation programme which favoured growth in bank deposits. The temporary nature of this programme may be the main factor explaining the lower average level of dynamism seen in traditional bank deposits during the first five months of 2018.

## New stock exchange begins trading

BIVA, [Mexico's new stock exchange](#), began trading on 25 July. In August 2017 the SHCP granted Bolsa Institucional de Valores, S. A. de C. V. (BIVA) the concession to set up and operate a stock exchange. At the end of July 2018 the CNBV (National Banking and Securities Commission) authorised BIVA to begin trading. The BIVA's start of operations allows companies and government institutions to access non-bank sources of financing on more competitive terms, while at the same time giving investors more alternatives to channel their savings. In this way, and according to the press release issued by the CNBV, with two stock exchanges operating in the country it is hoped that more SMEs will be able to get listed on one or the other.

## Results of the performance evaluation of commercial banks

On 31 July 2018 the SHCP published the "[Final resolution of the performance evaluation for 2017 of the institutions forming the commercial banking sector](#)". This resolution presents the result of the evaluation carried out by the SHCP of a total of 48 banking institutions. Of this total, 39 institutions had been in operation for more than five years, and three of these received the evaluation "unsatisfactory", two of these three in turn being in the process of liquidation. The other nine banking institutions had been in operation for less than five years. Only two of them were evaluated as "unsatisfactory". The SHCP guidelines on the evaluation of banking institutions establish that for banks that have been in operation less than five years, the evaluation is purely for indicative and monitoring purposes.

We should also mention that in December 2014 the SHCP published the criteria on which the annual evaluation of each commercial bank would be based. These criteria fall into two groups. The first, of a quantitative nature, is the bank evaluation index. This index is based on three sub-indices: a) intermediation (lending portfolio, NPL ratios and deposits growth); b) infrastructure (facilities and services through which institutions carry out their banking transactions); c) quality of services provided (based on the customer service indicators published by CONDUSEF, the National Commission for the Protection and Defence of Users of Financial Services). The second index is a questionnaire on each banking institution's strategy. The index evaluates the bank's plans and actions, the extent to which they support and promote the development of the country's factors of production; promotion of savings; decentralisation of the system and channelling of resources at the regional level, as well as other relevant activities, such as market makers or participants in the placement of securities issues. The five institutions marked "unsatisfactory" must submit to the SHCP for its approval a plan for remedying the deficiencies within 45 business days of publication of the evaluation

## Housing construction projects increased by 3% in July

As we anticipated in our May report, the number of housing construction projects showed more visible signs of recovery at the end of the first half of the year. Although the number increased by barely 1% in June in annualised figures, one month later, in July, the number of houses to be built as entered in the RUV housing register (Registro Único de Vivienda by its Spanish acronym) increased by 3%, equivalent to 261,000 homes in annualised terms. Thus, for the first time since November 2015, a positive growth rate was attained. The apparent recovery of construction is also partly due to the extraordinary stability of the housing stock, which at no time showed signs of accumulation during the period of contraction in residential construction. Whereas at the end of 2015 the number of residential units ready for occupation stood at over 300,000, the number fell during 2016, and in the past twelve months the average was 218,000.

Apart from this, the balance of bridge financing for home building, which grew by an average of 2.9% in real terms during the first five months of the year, grew by 7.3% in July relative to the same month of the previous year. This is according to information from CNBV. These data tend to reinforce our assumption of a revival in house building in the second half of 2018, which is also underpinned by favourable financing terms for home purchases, with mortgage loan interest rates remaining at historically low levels.

## 1.2. Financial Markets

### The easing of global trade tensions paves the way for gains for domestic assets given the temporary reduction in idiosyncratic risks

In the financial markets, July was marked by a degree of easing of global trade tensions, the favourable effect of which on domestic assets was intensified by the conciliatory stance of Andrés Manuel López Obrador (AMLO) after he emerged as the clear winner of the presidential elections. In initial speeches by AMLO and his team of associates, they laid emphasis on fiscal discipline, as well as respect for the independence of the central bank and free enterprise. Even though it is not entirely clear how these statements will be reconciled with his social welfare programmes, which were the centrepiece of his election campaign, the markets seem to have given him the benefit of the doubt, with the result that, in the short term, one of the idiosyncratic risks for the country has been neutralised. In terms of magnitudes, the day before the election, the exchange rate stood at 19.90 pesos to the dollar, while a couple of weeks afterwards the dollar was priced at MXN 18.88, making the peso the currency that appreciated the most in the first half of July. Essentially, in a more helpful environment on account of a relaxing of global trade tensions, the swift resolution of the election process and the prudent stance exhibited by the winning candidate produced a positive change for Mexico's currency. Towards the end of July, renewed optimism over the renegotiation of NAFTA took the dollar to below 18.60 pesos, yet so far this appreciation does not seem to have any basis in tangible progress at the negotiating table.

The behaviour observed in the exchange rate was replicated in many of the market variables: sovereign risk as measured by the spread on the five-year CDS went from its YTD high of 152 bps on 12 June to 114 bps at the end of July, once the risks had eased. These movements in sovereign risk influenced movements in long-term interest rates. The yield to maturity of the 10-year M-bond peaked in mid-June, when it touched 8%, then shrank back to 7.76% in late July. This positive differentiation of domestic assets was also reflected in the equities market: in July the IPyC (Mexican stock exchange index) advanced by 4.27%, surpassing the 1.68% increase in the MSCI EM emerging markets benchmark and even beating the 3.05% gain in the worldwide equities benchmark.

One variable notable for its performance over this recent period of volatility was foreign holdings of Mexican medium and long-term bonds. Even given the uncertainty associated with renegotiation of NAFTA and the election, flows into bonds have stayed in positive territory since March after falling off slightly at the beginning of the year. Although there were dips in holdings in reaction to escalating trade tensions and in line with outflows from most emerging markets, the recovery in the last two weeks was enough for the change in holdings to marginally top US\$1 billion at the end of the month. This performance becomes more significant if we bear in mind that, from March onwards practically, there have been outflows from emerging markets on the back of the rise in yields in the United States and greater risk aversion due to trade uncertainty. The fact is that with Banco de México's restrictive policy and the recent reduction in both the peso's implied volatility and the country risk, Mexico offers attractive risk-adjusted returns in comparison with its peers. This has led holdings of M-bonds by foreigners to increase to nearly US\$4 billion during the first half of the year.

### 1.3. Regulation

#### Adjustments to the rules for payments in foreign currency with debit and credit cards

On 18 July Banco de México published Circulars [8/2018](#) and [9/2018](#) amending Circulars 3/2012 and 34/2010 on payments in foreign currency by means of debit and credit cards respectively. Among other things they establish mandatory use of a price vendor authorised by the CNBV to obtain the price of any currencies other than the US dollar; they also reduce the factor by which the exchange rate may be multiplied for converting US dollar transactions into pesos, from 1.01 to 1.005.

#### Strengthening of risk management for participants in the Interbank electronic payments system

On 27 July Banco de México issued Circular [10/2018](#), amending the general provisions applicable to participants in the Interbank Electronic Payments System (SPEI per the Spanish abbreviation), as regards risk mitigation. The changes address the additional risk posed by clients other than financial institutions that habitually and professionally offer to exchange, buy or sell virtual assets. They require such clients and their accounts to be subjected to the highest identification requirements in the context of the prevention of money laundering, and additional validations to be made of transfers of funds to these clients. The rule also reinforces the risk management system in general, requiring institutions to establish policies for tests of trustworthiness for their personnel and significant providers of IT services and to appoint a Data Security Officer, among other things.

#### Amendments to the rules of SPEI

On 27 July Banco de México issued Circular [11/2018](#) amending the Rules of the Interbank Electronic Payments System. The changes seek to strengthen the management of risks starting from the identification of clients other than financial institutions that habitually and professionally offer to exchange, buy or sell virtual assets. Notable measures include the additional validation by participants receiving transfer orders from these clients; the system administrator's power to notify the other participants of the existence of situations in which they must raise the level of their monitoring and alert mechanisms regarding transfers of funds that they process by means of SPEI, as well as the responsibilities incumbent upon SPEI participants' Data Security Officers.

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