BBVA Research

Banks

Monthly Report on Banking and the Financial System

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1.1. Banking and the Financial System

The replacement of foreign credit with domestic bank lending to businesses was the main source of credit growth in 2018

In December 2018, the annual nominal growth rate in the balance of the current portfolio of loans granted by commercial banks to the private sector was 10.0% (4.9% in real terms). Furthermore, the average nominal annual growth rate in 2018 for the current portfolio of loans granted by commercial banks to the non-financial private sector was 12.0% (6.7% in real terms). This was below the nominal growth rate of 12.8% recorded in 2017. The 12.0% contribution to real annual growth of loans granted to the private sector in 2018, broken down into its three components, was: 8.5 percentage points (pp) from business loans; 1.7 pp from mortgages; and 1.8 pp from consumer loans.

The dynamism observed in 2018 was in line with the moderate growth in economic activity, as GDP grew by 2.1% in 2017 and preliminary data indicates that this same figure was slightly lower in 2018 (2.0%). A second factor that could have limited an improved credit performance in 2018 (compared to the dynamism observed in 2017) was the increase in benchmark interest rates. For example, the TIIE 28 (Tasa de Interés Interbancaria de Equilibrio — Mexican 28-day Equilibrium Interbank Interest Rate) increased from 6.15% in January 2017 to 7.62% in December of that year, and had risen up to 8.59% by December 2018. A third factor that may have limited credit growth is the lower annual increase in the number of workers registered by the IMSS (Instituto Mexicano del Seguro Social — Mexican Social Security Institute).

Examples of specific factors that had a positive influence on credit performance in 2018, particularly on business and mortagages, include: i) the replacement of foreign corporate financing with domestic bank loans, which boosted the growth of business loans, in particular those of larger companies; and ii) the expectation that mortgage interest rates could increase at a higher rate than over the course of 2018, which also raised the demand for this type of credit because, for a certain type of customer, postponing taking out a loan could involve increased cost in the future if the interest rate on these loans were also to increase by a higher percentage. Finally, there were no factors beneficial to the growth rate of consumer loans, which, to a large extent, explains its modest average growth in 2018.

Traditional deposits reverse the downward trend, albeit at a moderate pace

In December 2018, the nominal annual growth rate of traditional deposits in commercial banks (sight deposits + term deposits) was 7.9% (2.9% in real terms). This meant that, in 2018, the average nominal annual growth rate of traditional deposits was 10.0%, 1.5 pp lower than the 2017 average. The first eight months of 2018 saw a reversal of the downward trend in nominal growth rates for traditional deposits that was observed in the second half of 2017. Nevertheless, a slowdown was once again observed from the start of September 2018, reflected in the slow recovery of real wages, a pace of economic activity that has remained relatively stable, and the draw of higher interest rates on term deposits.

By deposit type, sight and term deposits showed a differentiated performance. In particular, over the course of 2018, an accelerated growth rate of term deposits was observed, favored by an environment of higher interest rates that made savings in this kind of instrument more attractive. In fact, for the first time in the last five years, the dynamism of term deposits has driven growth in traditional deposits, unlike in previous years, during which the momentum came mainly from sight deposits. Thus, the contribution of term deposits (39.3% of traditional deposits) to the nominal growth rate of traditional deposits increased in 2018; making up 5.6 pp of the 10% total deposit growth in 2018, higher than the 4.0 pp contribution to nominal growth in 2017. Sight deposits (60.7% of the total) showed reduced dynamism, with their average contribution to the growth of traditional deposits falling from 7.5 pp in 2017 to 4.4 pp in 2018. The lower demand for this type of instrument would be linked to two effects: first, the moderate recovery of household purchasing power, which limited stronger consumer growth and reduced the use of sight deposits for transactional purposes, and, second, the agents' greater preference for longer-term deposits incentivized by higher interest rates.

Financing provided to the non-financial private sector slowed in the second half of 2018

In its report corresponding to 4Q18, the Bank of Mexico highlighted the fact that there was a marked slowdown in the economy's sources of financing during that quarter, meaning that in terms of the year as a whole, the annual flow of these resources was equivalent to 4.9% of GDP, lower than the figure of 7.9% observed in 2017. The annual flow of foreign financing in 2018 amounted to 0.8%, the lowest percentage observed since the international financial crisis. The Bank of Mexico underlined the fact that this reflects the restriction—which could have become tougher—on foreign financing faced by Mexico. Growth in terms of domestic sources of financing continued to slow, averaging 4.1% in 2018, which was below the 6.5% observed the previous year. The slower growth with regard to sources of financing is a reflection of the reduced availability of foreign financing since 2014 in the wake of various adverse shocks that have affected the country, which include: the fall in international oil prices; the reduction of the oil production capacity; the uncertainty around the renegotiation of trade agreements with the US and Canada; the impact of the normalization of US monetary policy; and, domestically, the 2018 electoral process and the uncertainty surrounding the public policy agenda of the incoming government.

In terms of the utilization of the economy's financial resources in 4Q18, public sector financing accounted for 2.3% of GDP—above the 1.1% reported for 2017, but below the 4.0% average observed from 2013–2016. The decreased dynamism of economic activity was reflected by a slowdown in financing provided to the non-financial private sector in the second half of 2018, with the growth rate in this regard falling from 7.1% in 1H18 to 6.4% in 2H18. In particular, there is a continuing downward trend in terms of gross fixed investment, which would explain the reduced demand from companies for credit for investment projects. There was also a slowdown with regard to consumer loans, consistent with the slower growth observed in terms of private consumption. Moreover, the performance of corporate and consumer financing was also adversely affected by the increase in financing costs. There was a recovery with regard to housing loans, which can be attributed to the stable interest rates for this type of financing.

The report highlights the fact that the credit risk for Mexican banks fell slightly, and that its capitalization index is stable at a level that reflects the fact that it has sufficient capacity to absorb potential losses arising from borrower defaults. Furthermore, the report underlines the fact that there was an overall fall in terms of non-performing loans (NPLs) in 4Q18. On the other hand, there were significant falls in equity markets and depreciations of the peso, creating high levels of volatility that had a moderate impact on the market risk for banks. The existing regulations concerning the coverage of assets and liabilities in foreign currency meant that this impact mitigated the adverse effect of the depreciation of the peso. Finally, commercial banks had sufficient levels of liquidity, although some institutions deviated slightly from the required ratios and must improve their controls. The Bank of Mexico signaled that these deviations are not an indication that the situation for the system is worsening as they were small, isolated and temporary.

Housing prices rose by 7.9% in the first quarter of 2018

At the close of 4Q18, the SHF's (Sociedad Hipotecaria Federal — Federal Mortgage Company) housing price index had increased by 7.9% compared to the same period in 2017. Our report from last January stated that housing prices may have experienced their highest rates of appreciation in 2018 and that, in the future, growth in terms of housing prices may be more moderate. Whilst at the close of 2018 both affordable social housing and middle-income residential housing prices rose at a similar rate of 8.1% in annual terms, a comparison between previously owned and new housing demonstrates that the former generated greater capital gain during 2018 than the latter, which was less dynamic in the market compared to 2017. According to this indicator, the value of existing housing increased by 8.3% in annual terms while the value of new units rose by 7.6%.

The reduced demand for housing during 2H18 was also reflected by stable construction rates and lower demand for construction materials. 1H18 saw the general producer price index for the construction sector increase by 7.3% on average, driven mainly by the 7.9% increase of the materials sub-index over the same period, whilst the machinery- and equipment-rental component showed moderate growth of 2.3%. This moderation of construction costs would also be reflected by a stabilization of final housing prices.

At regional level, the metropolitan areas with the highest appreciation rates at the close of 2018 were: Guadalajara and Monterrey, with increases of 10.7% and 8.8%, respectively, and Puebla-Tlaxcala, where a capital gain of 8.4% was registered. On the other hand, the Valle de México metropolitan area experienced a slowdown, with appreciation of 5.8% compared to the close of 2017.

1.2. Financial Markets

Market players focus on concerns around the financial situation of Pemex and the "patient" stance of the FED

The increased concern regarding Pemex's financial situation and the fluctuations of emerging assets given the FED's anticipated cycle of monetary normalization were the main factors behind movements in financial markets. The first few weeks of the year saw growing concern regarding the financial situation of Pemex, given the risks associated with the change to its business model against a backdrop of reduced output and debt exceeding USD 100 billion. The aforementioned difficult environment, the little confidence that Pemex's directors were able to generate amongst investors and the company's difficulty obtaining significant support from the federal government resulted in Fitch Ratings downgrading its Pemex rating from BBB+ to BBB-. At global level, market players have reacted promptly to economic data suggesting a slowdown of the US economy given the close relationship between such data and the stance of the FED.

At the same time, there was a 0.92% depreciation in the exchange rate, in line with the depreciation of emerging market (EM) currencies (1.07%), with some figures being higher than expected for the US economy. It is worth noting that, in terms of the exchange rate, the positive effect of the FED's stance with regard to EM assets has been more impactful than the concerns surrounding Pemex.

A fall of 24 basis points in the yield to maturity (YtM) on 10-year bonds was recorded in fixed income markets in February, taking it down to below 8.2%. This significant fall was influenced by the positive surprises in terms of inflation that led to the Bank of Mexico considering initiating a cycle of reductions while long-term rates were stable in the US, given the anticipated slowdown.

With respect to sovereign risk, concerns around Pemex's finances and its ties to public finances have resulted in Mexico being listed in financial markets at levels consistent with a BBB- rating rather than the BBB+ rating that it actually holds. This is reflected not only by the country risk, but also in the dollar debt market. The Mexican curve is at levels similarly high to those of countries such as Russia and Colombia (BBB-), and far from the levels of countries such as the Philippines (BBB).

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