Banks

Monthly Report on Banking and the Financial System

Alfonso Gurza / Iván Martínez / F. Javier Morales / Carlos Serrano / Mariana A. Torán

1.1. Banking and the Financial System

Corporate financing remains the main source of momentum for bank credit

In March 2019, the annual nominal growth rate in the balance of the current credit portfolio granted by commercial banks to the private sector was 10.8% (6.2% in real terms). This rate was higher than in the previous month (10.0%) and lower than in the same month in 2018 (11.7%). The annual nominal growth rate in March 2019 for the three performing loans components granted by commercial banks to the private sector was as follows: 6.1% for consumer loans; 10.4% for mortgage loans; and 13.0% for corporate loans. The percentage structure of the balance of bank credit to the non-financial private sector was as follows: 58.2% for corporate loans; 22.9% for consumer loans; and 18.9% for mortgage loans. The relative importance of each component of bank credit to the private sector weighted by its annual growth rate provides the contribution of each of these components to the growth of total credit to the non-financial private sector. Each component's contribution to growth in March 2019 were as follows: of the 10.8 percentage point (pp) increase of bank credit to the private sector, corporate loans contributed 7.4 pp, mortgage loans contributed 2.0 pp, and consumer loans contributed 1.5 pp. The high level of dynamism and high relative importance of corporate loans make this the credit category that contributed the most to the growth of total credit to the non-financial private sector in March 2019. It should be noted that since July 2013, corporate loans has been the component that has contributed the most to the growth of bank credit to the non-financial private sector. The importance of corporate loans as a credit category of total bank credit to the non-financial private sector is particularly noticeable in the last 12 months, when taking into consideration the average nominal annual growth rates of those three categories of bank credit. These average growth rates were as follows: corporate loans, 14.5% (9.4% in real terms); mortgage loans, 9.3% (4.5% in real terms); and consumer loans, 6.6% (1.9% in real terms).

Traditional deposits slow down reflecting the moderate dynamism of demand deposits

In the first quarter of 2019 (1Q19) the decline in economic activity had a significant impact on traditional bank deposits, whose nominal annual growth of 7.8% (3.5% in real terms) was the lowest since the end of 2013. This behavior is primarily sustained by the stagnation of demand deposits, which predominated over the dynamism of term deposits. In fact, demand deposits grew for the second consecutive quarter to its lowest nominal annual growth rate in historical terms (4.3%), which represented reduced real growth (0.1%). These figures exceeded the good rhythm of term deposits, which, despite having slowed slightly during the first three months of the year, maintain an annual growth above 13.0% (8.7% in real terms). Furthermore, the high levels of interest rates also contributed to a lower rate of saving through debt investment funds, to such an extent that the average nominal annual growth of these in 1Q19 was the lowest since mid-2017 (3.0%).

In this regard, the annual growth of foreign-currency traditional bank deposits experienced a slight recovery in March, possibly linked to higher exchange rates in comparison to those at the start of 2018. However, this slight recovery was not enough to prevent this segment from experiencing a historic low in its average nominal annual growth rate (1.2%) during 1Q19.

In the context of a global trading uncertainty that translates into a slowdown in the external sector, together with signs of lower dynamism in domestic demand and expectations of historically high interest rates, there is limited space for greater dynamism of bank deposits in the coming months.

The CNBV publishes a new financial education indicator

In April 2019 the Comisión Nacional Bancaria y de Valores (Mexican National Banking and Securities Commission — CNBV) published the Índice de Alfabetización Financiera (Financial Literacy Index — IAF). The IAF is structured around the answers to three categories of questions that were included in the Mexican National Financial Inclusion Survey, which was conducted in 2018. According to the CNBV, financial education is a process that leads to financial literacy, which the CNBV defines as the combination of the awareness, knowledge, skills and behavior needed to make sound financial decisions that eventually lead to individual financial well-being.

The IAF has a scale of 21 maximum points, which come from the following three types of question: behavior (9 points); knowledge (7 points); and attitudes (5 points). The score is standardized to transform it to a scale of 0 minimum to 100 maximum points for the index as a whole and for its three components.

According to the information published by the CNBV on the IAF, Mexico's total score was 58.2 points, which was lower than the average score of G20 countries (60.5 points). The score for the three categories was: i) behavior, 48.2%; ii) financial knowledge, 65.8%; and iii) attitude, 65.0%. These results reflect the low performance of the country's financial behavior index. The first section includes, among others, questions that refer to informed decision-making and the financial control that people have, such as, for example, if the person pays their bills on time, if they have savings goals, if they follow a budget, or if they consider whether they can afford something before buying it. Mexico's score of 48.2 points in this indicator is lower than the average for G20 countries (60.0 points). On the other hand, concerning financial knowledge, Mexico scores 4.4 points above the average for G20 countries (61.4 points). Finally, regarding attitudes, which measures the tendency to act in the present or whether greater importance is given to the future, Mexico scored 5 points higher than the average among G20 countries (60.0 points). We should bear in mind that factors such as education, income and size of the locality favorably influence the IAF. Conversely, low education, reduced income and small locality size are factors that are not conducive to a high IAF score.

The dynamism in private sector credit in 1Q19 reflects moderation in economic activity

In its report on the first quarter of 2019, the Bank of Mexico (Banxico), highlights that in this period, there was a slight recovery in the flow of the economy's financial resources, which increased from 5.1% of GDP in 4Q18 to 5.3% in 1Q19. This improvement was driven by both external sources of financing (which increased from 0.9% in the previous quarter to 1.1% of GDP) as well as internal non-monetary sources (1.4% of GDP in 4Q18 to 1.9% in 1Q19). With regard to the former, the increase was brought on by greater investment in government securities (mainly medium- and long-term fixed-income instruments). With regard to internal non-monetary sources (savings funds for housing and retirement, and private securities, among others), this upturn is linked to a valuation effect. Banxico stresses that, despite the recovery recorded, the risk persists that the flow of financial resources remains limited in the future.

With regard to the uses of the economy's financial resources, in 1Q19, public sector financing accounted for 2.1% of GDP, slightly lower than the 2.3% recorded in the previous quarter. In this regard, international reserves maintained low dynamism (0.2% of GDP in 1Q19 compared to 0.1% of GDP in 4Q18). With regard to financing in the non-financial private sector, the annual flow of resources was equal to that observed in 4Q18 (2.2% of GDP). This low dynamism occurred at the same level as the economic activity performance seen over the past two quarters.

In particular, corporate financing saw real annual growth of 6.3%, slightly above the 6.0% recorded for 4Q18. This upturn is attributable to lower internal market debt issuances, i.e. it is associated with a substitution of internal financing sources. The report states that the corporate credit performance seen is a result of larger corporations having a greater need for resources to refinance liabilities, while small and medium-sized enterprises have registered a lower demand for resources.

In terms of loans to households (consumption and mortgages), 1Q19 saw continued moderate growth (3.1% real growth vs 2.5% in the previous quarter). This results from the increased growth of mortgage loans (4.1% real growth in 1Q19 vs 3.0% in 4Q18), which, according to Banxico, was driven by a greater demand for mortgage loans in an environment where interest rates for this type of financing have remained stable. Despite this, the expansion of consumer credit slowed (from 1.6% in real terms in 4Q18 to 1.4% in 1Q19), across two quarters which were characterized by a slowdown in private consumption. The report highlights that the decrease registered in defaults on non-financial private sector loans in 4Q18 was maintained in 1Q19.

In terms of the stability of the financial system, banking credit risk decreased marginally compared to 4Q18 and declines were also recorded in the levels of market risk in bank portfolios. There was also an improvement compared to the previous quarter in the Mexican banking Capitalization Index, which rose from 15.90% in 4Q18 to 16.03% in 1Q19. This reflects the ability of the banking system to withstand current risks. Finally, the Liquidity Coverage Ratios and Net Stable Funding Ratios for banking institutions were satisfactory.

1.2. Financial Markets

Trade Tensions between the USA and China Increase Risks for Global Growth

The significant trade tensions between the USA and China generated increased risk aversion that has greatly influenced financial markets during May so far. The US government's decision to impose 25% tariffs on USD 200 billion of Chinese imports changed the perspectives of market participants, who mostly discounted a trade agreement in an environment of low interest rates connected to the global slowdown. In this regard, there has been a marked fly to quality, to the detriment of the prices of riskier assets.

Without a doubt, stock market prices have been the most affected insofar as prices have changed to incorporate the possibility of a large-scale trade war. Thus, as of May 28, the global benchmark stock index has fallen 4.3%, whereas the S&P 500 has recorded a decline of 4.9%. As is often the case in this context of risk aversion, emerging markets have seen negative differentiation. The benchmark index for emerging markets has fallen 8.4%, meaning that it is now at its lowest level since January, while the IPC has fallen 5.4%.

Despite this, the additional effects of the trade restrictions on global growth seem to be incorporated into the US Treasuries market, causing the 10-year rate to fall to 2.27%, its lowest level in the past 19 months. In the short section of the curve, the yield to maturity of the two-year node is already close to 2.1%, its lowest level since September 2018, faced with the market expectation that the FED will cut the federal funds rate for the rest of the year (82% probability), in accordance with the futures market. In Mexico, the yield to maturity of the 10-year M bond has fallen around 15 basis points (bp) so far this month, placing it slightly below 8.0%. This has been influenced by its high correlation with US Treasury yields, as well as the relative stability of country risk and expectations of a potential cut in the monetary policy rate toward the second half of the year.

In the foreign exchange market, the Mexican peso depreciated by 1.3% between April 30 and May 28, the eighth largest depreciation of all major global currencies. However, this year to date, the Mexican peso ranks second in emerging currencies in terms of appreciation. Better still, the Mexican peso sits alongside the Canadian dollar as the most appreciated of the major global currencies. This behavior has been influenced not only by the change in the FED positioning but, above all, by the USA recently lifting tariffs on steel and aluminum, which was perceived in market terms as increasing the probability of USMCA (United States-Mexico-Canada Agreement) ratification.

If the absence of trade agreements between the USA and China persists, market participants are expected to incorporate greater adverse effects into the already weak economic landscape, with a consequent negative effect on risk assets.

1.3. Regulation

Bank of Mexico: Adjustments in the use of employment benefits to endorse financial services contracted by workers and guidelines for the provision of payroll services

On April 30, Banxico published amendments to Circular 15/2018: postponing deadlines, extending the regime to Sofoms (*non-bank banks*) linked to credit institutions, and establishing requirements for offering payroll services on matters like transparency and standards of conduct for their provision, contracting, and annual internal audit procedures.

The adjustments require payroll direct debit application forms to highlight the periodic immobilization—by the payroll bank—of labor resources up to the amount of the corresponding payment, meaning that it will not be available to the worker. In addition, the corresponding form must show that credit information companies will be informed if a direct debit for a current loan is canceled and that this will result in a nine-month ban on payroll loans.

Banxico: Digital Collection and adjustments to the Interbank Electronic Payments System

On May 20, Circular 8/2019 was issued, focusing on adapting the rules of the SPEI (Sistema de Pagos Electrónicos Interbancarios — Interbank Electronic Payments System) to the CoDi (Cobro Digital — digital charge) system. Among other items, the circular establishes an additional operating procedure and specific obligations for CoDi transfers, requires round-the-clock processing by instructions, and prohibits any charge for CoDi transfers, as well as establishing CoDi service standards.