Banks

Monthly Report on Banking and the Financial System

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August 30, 2019

1. Banking and the Financial System

In June, growth in the total non-financial private sector credit remained at one-digit levels

At the close of the first half of 2019, the annual nominal growth rate of the outstanding balance of credit granted by commercial banks to the non-financial private sector was 8.4% (4.3% in real terms). This growth rate was lower than in May (9.1%) and in June 2018 (13.4%). It should be noted that the nominal annual growth of non-financial private sector bank credit stopped increasing in June 2018 (when it reached a nominal growth rate of 13.4%), and began to slow down from then on. In June 2019, the contribution to the growth in total non-financial private sector credit per category was as follows: corporate contributed 5 percentage points (pp) to the 8.4 pp growth in total private sector credit; mortgages contributed 2.0 pp, and consumer 1.4 pp.

One of the main reasons for the recent decline in the growth rate of private sector bank credit is the slowdown in corporate lending. This appears to be a reflection of the slowdown in economic activity, while it is also possible that larger companies are beginning to stop replacing their sources of external financing with internal sources. From now on, unless the performance of gross fixed investment improves and the process of economic slowdown is reverted, there will be no driving factor for the growth of corporate demand for financing to support new investment projects. Meanwhile, the slowdown in the growth rate of the number of workers registered with the Mexican Social Security Institute (IMSS) observed in the second half of 2018, which was accentuated in the first six months of the year, has not favored the growth of consumer loans. If the slowdown in economic activity and, consequently, IMSS formal employment, is not reverted, consumer loans may continue to lose momentum. Moreover, if the current macroeconomic environment persists, it could not only continue to impact the growth rate of business and consumer loans, but could also begin to impact the performance of mortgage loans recorded to date.

Growth of demand deposits shows record lows in June 2019

During the month of June, the weakness of the economy negatively affected growth in deposits in the banking system. Similarly to recent months, low growth rates in demand deposits were predominant over the double-digit growth rates of term deposits and placed the growth of traditional deposits in the banking system at levels not seen since 2013. In fact, even though the share of term deposits has increased to 41.1% of traditional banking deposits in the last year, the record low nominal annual growth of demand deposits in June (1.2%) predominated over the high growth of term deposits (16.6%) and caused a further decline in the annual growth of traditional deposits at a nominal rate of 7.0%.

The diverging trends of demand deposits and term deposits can largely be explained by the combination of economic slowdown and high short-term interest rates that has prevailed in recent months. While no major reversal of these trends is expected in the short term, as the expected cycle of interest rate cuts by Banco de México progresses and assuming that the economic weakness does not worsen, we may see that a reduction in the allocation of term deposits has a certain positive effect on the growth of demand deposits.

Personal loans slow down, with lower average origination figures and higher interest rates in 2019

Banco de México (Banxico) has published its updated Report on Basic Personal Loan Indicators with information as of February 2019. The report considers the personal loans granted by the different banking institutions and their regulated SOFOMES [multipurpose financial institutions]. This Report also includes information and an analysis of individual and group microloans.

According to Banxico, in February 2019 (Feb-19) the real annual change in the balance of total personal loan portfolio (current plus past-due) was -0.8%. This was in addition to the fact that this credit category represented 21% of total consumer loans. The adjusted delinquency rate of personal loans was the second highest after that for credit cards (15.1% vs. 16.0%). In Feb-19 there were 14.8 million personal loans, the balance of which amounted to MXN 246.7 billion. Only 56% of these loans met the criteria for comparability between institutions[1], i.e. almost 8.3 million. In addition, the loan portfolio balance associated with this subset represented 59% of the total personal loan portfolio. Banxico has analyzed the 6.4 million loans granted in the last year (from Mar-18 to Feb-19). The balance of these loans was MXN 96.3 billion and their average origination amount was MXN 18,244, lower than the amount recorded one year earlier (MXN 18,589). Regarding the rest of the financing conditions, the average term was 21 months (as in the previous year); the weighted average interest rate was 36.8% (greater than the 35.3% recorded in the previous year) and the expected loss of the loans was 4.6% (less than 5.1% in Feb-18).

Furthermore, the document reports that in Feb-19 the number of comparable group and personal microloans was 2.7 million, with a balance of MXN 23.4 million. For this type of loan, the average origination amount was MXN 14,192 (vs. MXN 13,614 reported for Feb-18). The average term was 5 months (the same as the previous year), the weighted average interest rate per balance was 83% (slightly below the figure of 86.8% reported for Feb-18). Meanwhile, the expected loss was 2.6% (slightly less than the 2.8% loss reported the previous year).

The share of customers who pay in full each month has grown in both the number of credit cards and the balance of credit granted

According to the updated Basic Credit Card Indicators published by Banco de México, providing information as of December 2018 (Dec-18), the balance of the credit card portfolio saw a real annual growth of 0.6%, which represents less than half of the 1.5% rate observed in December of the previous year. Meanwhile, the adjusted delinquency rate in

1 The following loans are excluded from the creation of the comparable portfolio: a) Those offered by institutions to their employees or employees of companies belonging to the same financial group; b) Those that, at the time of preparation of the report, are overdue, in default, or have been restructured; c) Those that are not in national currency; d) Those that require the customer to supply a physical guarantee and e) Those that have a rate of zero or for which an original amount of credit greater than MXN 1 million was reported.

Dec-18 was 15.7%, similar to that observed in the same month of 2017 (15.8%). It should be noted that, among the various consumer finance products, credit cards continue to have the highest adjusted delinquency rate.

At the close of 2018, a total of 18.6 million credit cards up-to-date with payments, representing an increase of 2.9% compared to the figure in Dec-17. Within these cards, 9.3 million corresponded to customers who pay in full each month (50.1% of the total), exceeding the number of cards corresponding to customers who don't pay in full each month for the first time since the statistics have been published (Jun-09). Meanwhile, the balance associated with cards with all payments are up-to-date was MXN 350.7 billion. MXN 98.9 billion (28.2% of the total) of that balance was the balance associated with customers who pay in full each month, which increased by 12.5% in real terms compared with the previous year, making it the highest growth recorded since the close of 2015.

The reference period also saw an increase in the balance associated with purchases with promotional interest rates. Specifically, in Dec-18, the balance granted through promotions of interest-free months amounted to MXN 77.9 billion, equating to 21% of the total balance, showing a 1.7 pp increase with respect to the percentage observed in Dec-17. Moreover, purchases with a different promotional rate accounted for 21.7% of the total balance, 0.9 pp higher than the figure recorded the previous year.

Banks granted better conditions for auto loans in 2018

Banco de México (Banxico) has published its updated Basic Auto Loan Indicators with data up to October 2018 (Oct-18). Banxico defines an auto loan as an amount of resources provided by a credit institution to a person for the purchase of a car for private use. The customer leaves the certificate of title by way of guarantee. Certain criteria are established to allow the comparison of these loans. Thus, the loans considered are those that are up-to-date (with no overdue payments); for an amount greater than MXN 30,000; and which have been used for the purchase of vehicles not for use as taxis or transport trucks of any kind. The report considers information from banks and regulated SOFOMs.

Banxico reports that, according to data from the Asociación Mexicana de Distribuidores de Automóviles [Mexican Association of Automobile Distributors] (AMDA), 1,145,704 cars were sold in Mexico between January and October 2018, 68.3% of which were on credit. The participation by type of credit provider in this total number of financed units was: banks, 28.6%; car manufacturers finance companies, 68.2%; and self-financing, 3.2%.

In Oct-18, the total number of auto loans granted by all participants in this market was 2.1 million and the balance of the total portfolio amounted to MXN 285.9 billion. During that month, of the 2.1 million loans, only 1.9 million were comparable. These represented a balance of MXN 253.9 billion (88.8% of the total recorded on the reference date). In addition, in the 12 months considered between Nov-17 and Oct-18, the total number of comparable loans granted was 640,500. The balance for this total was MXN 118.1 billion. Of this total number of loans, 333,446 were traditional bank loans (52.1% of the total) and 307,054 were granted by car manufacturers (47.9%).

With regard to bank credit, the average value of loans granted was MXN 213,388 (greater than the average amount granted by car manufacturers: MXN 203,206), with an average term of 53 months (greater than the 51 months recorded for car manufacturers) and with a weighted average interest rate of 13.2% (lower than the 13.5% reported for car manufacturers during the same period). In addition, it was reported that the adjusted delinquency rate of this type of credit was 4.7% in Oct-18, the lowest among the different consumer loan categories. The low delinquency of auto credits is explained by the fact that they have a guarantee, which is not the case for other types of consumer loans.

Construction sees its lowest performance since the 2009 crisis

According to data from the ENEC (National Survey of Construction Companies) by INEGI, housing construction from January to June was 2.8% lower on average than the same period of 2018. The construction of industrial, commercial and service warehouses showed a 9.7% on average drop during the first six months of the year.

The general decline in construction activity is in line with lower demand for new housing, reflecting lower formal employment growth rates. With regard to productivity, the slowdown in manufacturing, which began in the second half of 2018, has sharpened during the first half of 2019. This translates into a reduced need for commercial properties for storage and centers for the sale of final goods.

However, with regard to funding, the stability in mortgage interest rates, which remain at historically low levels, and the apparent beginning of a new downward cycle in short-term interest rates will be key to reviving the industry, provided that the domestic market is reactivated, driving demand once again.

2. Financial Markets

Increased trade tensions trigger strong demand for risk-free assets

Movements in the financial markets over the past few months had been based mainly on the expectation that a more lax monetary stance by the main central banks worldwide could sustain economic growth, even in a context of trade disputes. In August this expectation was put aside as a result of the significant increase in trade tensions between the United States and China that triggered risk aversion and increased demand for risk-free assets.

As a response to fears of a sharp economic slowdown, there was a significant increase in investor demand for government bonds issued by developed countries. This demand was so significant that the entire yield curve of countries such as Germany, Switzerland and Denmark is below zero percent. In the United States, expectations of further cuts of between 50 and 75 basis points (bp) to the federal funds rate and the compression of the term premium led to a considerable fall in the yield curve. In fact, the yield to maturity of the 10-year node reached 1.44% on the August 26 intraday trading and closed the month at approximately 1.49%, its lowest level since mid-2016, after a drop of 52 bp throughout the month. Meanwhile, the 30-year Treasury bond yield reached a new historic low on August 27, when it dropped to 1.95%. It should be noted that the first half of the month saw the inversion of the curves for the 2-year and 10-year node maturities, exacerbating fears of a possible recession and feeding back into demand for US treasury bonds.

In Mexico, the 25 bp cut in the monetary policy rate, not fully incorporated in prices, in addition to expectations of higher future cuts and lower yields of the US curve, influenced a decline in rates in longer-term nodes. In fact, the 10-year bond yield fell by 50 bp, standing slightly above 7.0% at month-end. It is worth mentioning that data available for the first half of August shows that foreign appetite for CETES (Mexican Federal Treasury Certificates) and Bonos M continues to decline. The proportion of foreign holdings of total CETES in circulation is below 20%, the lowest level since 2011. For Bonos M, this figure is 57%, the lowest since the end of 2014. Notably, holdings of CETES by foreigners have fallen during seven of the eight months of the year so far, placing the total balance accumulated in January-August 2019 below USD -4 billion, representing its worst performance for that period since 2016. In the case of Bonos M, the total balance for 2019 remains positive, standing at approximately USD 3.6 billion, a similar performance to that of 2017.

In contrast to the increased demand for government fixed-income instruments, significant sales of risk assets were observed. In stock markets, the S&P500 recorded a decline of about 1.9% throughout the month, its second monthly fall in 2019. During the month of August, these losses were lower than those observed for the global benchmark of this asset class (MSCI World Index), which experienced a monthly decline of about 2.5%. In the case of emerging markets, the decline was more significant, reflecting a 6.45% drop in the MSCI Emerging Markets index. Mexico´s stock exchange index (IPC) performed well with yields of 2.37% during the month. However, this does not remove the fact that the Mexican stock market returns year-to-date are barely positive after having quoted below 39,000 points in August, a level not observed since 2014.

In the foreign exchange market, the dollar continued to gain strength and stood at its highest against emerging currencies in at least the last ten years. The Mexican peso was no exception and fell by 5.0% against the dollar in August; the fourth largest depreciation among all emerging currencies, led by the almost 25% fall of the Argentine peso. With this depreciation, the exchange rate exceeded MXN 20 per dollar again, impacted by a fall in speculative positions in favor of the Mexican peso during the last three weeks. One point to take into account is the increase in implicit exchange rate volatility, as increases of 2.0% as those seen in August are detrimental to its risk-adjusted yield, a relevant indicator in the exchange market. It should be noted that, even with this increased volatility, the risk-adjusted yield of the national currency remains favorable in comparison with other emerging currencies.

The international trade issue will continue to be the focus of investors and at least one truce between the US and China will be needed to ensure a lasting reduction in market volatility. At the domestic level, the presentation of the federal government's budget for next year will also be relevant, especially in the face of the upcoming maturities of PEMEX's debt and a clear economic slowdown.

3. Regulation

CONDUSEF: Transparency and sound practices of FinTech institutions

On July 9, CONDUSEF (the National Commission for the Protection and Defense of Financial Users) published rules on transparency and sound practices for Financial Technology Institutions. The rules replicate the regulatory framework applicable to the rest of the financial institutions in the areas of: standard contracts (format, minimum content, disclosure); advertising; disclosure and characteristics of Costs and Commissions; characteristics of account statements and proof of operations; the definition of activities that deviate from good practices (misleading information, unclear offer conditions, conditions other than those offered, etc.), as well as clarifications for standard contracts for collective financing operations and electronic payment fund contracts.

National Banking and Securities Commission (CNBV): Adjustments to the Circular Única de Bancos [Single Bank Circular] (CUB) for internal control and securities operations

Amendments to the CUB published on July 5 include adjustments to recognize the existence of more than one stock exchange, as well as an alignment of automated system for the reception of instructions, registration and allocation of operations of credit institutions with the provisions established for brokerage houses. Furthermore, a person responsible for compliance with the provisions regarding investment services (sales practices) is incorporated into the Internal Control System. Lastly, it regulates the sending of information regarding securities operations to the Instituto para el Deposito de Valores [Securities Depository Institute] (INDEVAL), establishing the obligation to report the time when each operation is closed, and a 30-minute period to report operations with debt instruments.