Economic Analysis

The financial system has strengths to face the slowdown

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In the current context of a sharp economic slowdown, the country grew in recent years by a rate of 2%, but no longer seems to be growing. Considering the high uncertainty regarding the direction of economic policies and the future of its trade relationship with the US (as well as the rise in global risk aversion resulting in a quarter of the world's fixed-income instruments offering an investment grade with negative returns), it is worth asking how well prepared the Mexican financial system is in view of the challenges that this context represents.

In general, I think that the system is in a good position to withstand the current economic situation, although there are risks that need to be monitored. The financial system now has several strengths, including high solvency levels, which are reflected in the high capitalization indices of the banks: This index, at the system level, is 15.8%, which is comfortably above Basel III requirements. Not only can high levels of capitalization be seen, but the capital itself is of a very high quality, as more than 85% is composed of fundamental capital (paid shares and reinvested earnings) — the capital with the greatest capacity to absorb losses.

Additionally, the levels of provisions to cover losses are adequate. Mexican regulations require that for the majority of portfolios, provisions be calculated based on expected losses rather than on one observed loss. This approach is much more robust in terms of risk management, and results in both improvements in institutions' credit origination techniques, and low levels of non-performing loans (2.6% compared to the portfolio total).

In addition to solvency, the banking system shows high levels of liquidity. Unlike what was observed in various banking systems during the global financial crisis of 2009, where several countries had a high dependence on short-term market funding (funding that is more likely to be interrupted by risk aversion), the Mexican banking system was mostly funded by public deposits, which are much more stable.

This means that not only do people have healthy bank balances but they also have healthy businesses and families. The debt levels of Mexican companies are low compared to those of other emerging countries with similar levels of development. Moreover, there are no significant exchange rate mismatches. After the 2009 crisis, several corporate exchange rates adopted significant exposures against the dollar, some suffered financial problems and some saw instances of non-compliance payments; today, companies have a low exchange rate exposure and regulations impose more clear and transparent disclosure regimes confirming this.

Households also show low levels of leverage, which has also demonstrated stable behavior. Unfortunately, this is largely due to the low levels of banking in the country.

All the above is reflected in the fact that stress tests completed by the regulatory authorities indicate that the Mexican financial system can face severely adverse scenarios, such as a recession, significant depreciation of the exchange rate or significant increases in interest rates, without suffering losses that jeopardize its healthy functioning.

Recognizing these strengths is necessary but it is also important to identify the risks. I think that the biggest risk is Pemex's financial situation. In the event that the company's fundamental problems, high levels of debt and a decline in production are not resolved, Pemex's financial problems will be reflected in their weakening fiscal position. I assume, of course, that federal government support for Pemex will continue and that it must be assumed that the company's credit quality is the same as that of the federal government. Another risk to be mitigated is cyber-attacks. Many countries have seen such attacks and Mexico is no exception. High-level attacks can threaten the stability of the system as a whole.