Banks

Monthly Report on Banking and the Financial System

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1. Banking and the Financial System

Bank credit for the private sector stabilizes at a single-digit growth rate

In September 2019, the annual nominal growth rate in the outstanding balance of credit granted by commercial banks to the non-financial private sector was 7.7% (4.5% in real terms). This growth rate was lower than in the previous month (8.9%) and also, lower than the rate recorded in September 2018 (11.8%). Since May 2019, the growth of bank credit to the non-financial private sector has been single-digit.

The lower dynamism of credit to the non-financial private sector observed during 2019 is explained by the stagnation of economic activity. According to INEGI, the economy showed no growth from January to September this year compared to the same months of 2018. The zero GDP growth reflects lower dynamism in all types of economic activity, including banking. This zero GDP growth also increases uncertainty about the immediate future of the economy. This uncertainty is another factor that could dampen the demand for credit from private sector agents. In this context, companies may not apply for credit because there are no viable investment projects arising from a stagnant economy; and families may not increase their demand for consumer and housing loans because of the possibility that the source of their income will deteriorate and they will not be able to meet their future financial commitments.

Economic weakness affects the performance of bank deposits

During September 2019, bank deposits appear to have been more influenced by the prolonged weakness of economic activity in Mexico than by the environment of lower interest rates. This was reflected in a lower combined growth rate for sight and term deposits, something that has not been seen since December 2018. As discussed previously, an expected consequence of Banxico's monetary easing cycle is a certain reallocation between sight and term bank deposits. However, the September figures suggest that both the observed and expected duration of the economic slowdown may have had more of an influence than this rebalancing, leading to a slower rate of growth in banking savings in general.

The effects of the prolonged economic weakness experienced by the country during 2019 have fed through to bank deposits more intensively and earlier than expected, even with an environment where the short-term interest rate remains restrictive and a recovery in real wages has been observed. Movements in September seem to suggest that if economic stagnation continues, traditional banking deposits could continue with this trend of deceleration, albeit at a slower pace, resulting in even lower growth rates

The International Monetary Fund (IMF) has reported on the results of the annual assessment of the Mexican economy for 2019

The IMF assesses the economic figures and outlook for each member country through the Article IV Consultation process. On November 4, it released the results of that exercise for Mexico in 2019. The report notes that the Mexican economy has continued to exhibit resilience in a complex environment, but growth has come to a standstill amid elevated policy uncertainty, tight monetary conditions, and budget under-execution.

The report recognizes that the authorities' commitment to fiscal prudence is strong, although it notes that in the absence of additional measures to increase public revenue or reduce spending there may be a fiscal gap. The Executive Board (EB) also stresses that more ambitious targets are needed to put the public debt to GDP ratio on a downward path and considers it desirable to create a fiscal council to support the government's commitment to fiscal responsibility.

Regarding Pemex's situation, the EB suggests revising Pemex's business plan to strengthen its financial position and reduce risks to the budget. In addition, it underscored the need for Pemex to make progress in selling non-core assets and provide credible plans to reduce operating costs. The report suggests that increased cooperation with private firms could also bolster production and diversify risks.

Regarding monetary policy, the report mentions the effectiveness of monetary policy in bringing inflation to target, stressing the importance of the flexible exchange rate in helping the economy adjust to shocks. Finally, with regard to the financial sector, the report emphasizes that the financial sector remains sound and that this resilience could be further enhanced by closing gaps in the regulatory and supervisory framework.

The International Monetary Fund (IMF) approves a new flexible credit line for Mexico

The IMF announced the approval of a new two-year arrangement with the Mexican government for access to a flexible credit line (FCL) for an amount of US$61 billion. This instrument is precautionary and has never been used, despite being available since 2009. At the request of the Mexican authorities, the amount of the new line is US$13 billion lower than the line in place since 2018. This decrease is consistent with the strategy of phasing out this instrument. It should be noted that a previous reduction in the amount of the line had already taken place in 2018 when the Mexican government requested that the line originally approved in November 2017 for US$86 billion be cut to US$74 billion.

Commercial banking contributed to growth in 1H19

According to an article in the Mexico Regional Sectoral Outlook report for the second half of 2019, the financial services and insurance sector accounts for almost 5% of GDP and, in 2018, explained 14.5% of national economic activity. In accordance with the Mexican System of National Accounts (known as SCNM), the sector is composed of five sub-sectors: central banking; non-market credit and financial intermediation; securities, foreign exchange and financial investment activities; retirement fund management, insurance companies and commodity contracts institutions; and investment companies specializing in retirement funds and investment funds.

The commercial banks sub-sector accounts for 57.6% of the overall sector and therefore determines much of its dynamics. According to the SCNM, the financial margin is the main indicator used for the calculation of GDP in the sector, in addition to other indicators specific to each sub-sector. Banking activity as a whole is also closely linked to the other production sectors.

During the first half of 2019, financial services and insurance GDP grew by 3.9%, reflecting greater dynamism than in the first half of 2018, with a 2.7% growth rate. However, in the third quarter of 2019, the sector experienced a 3.6% contraction in its activity year-on-year, reducing cumulative growth for the year to 1.4%. The slowdown in banking activity, as well as the decrease in net interest income, are two of the factors that could explain this phenomenon.

2. Financial Markets

Optimism about the Phase 1 trade agreement between the US and China dominates stock markets. Prices in other markets suggest the need for some caution

Optimism due to the partial trade agreement between the US and China (phase 1) and the better-than-expected performance of the US economy were the most significant factors behind financial market movements during the month of November. Most participants continue to expect that, as part of the partial trade agreement, the recently imposed tariffs will be eliminated and those scheduled for the end of the year by the US will not be introduced. In an environment of low rates, in general terms this fed the appetite for risky assets during the eleventh month of the year. However, given the lack of certainty about the details of the agreement and the absence of a date for its signing, the declarations between the US and Chinese authorities began to be treated with some caution in some markets. This was reflected in a reduction in the prices of emerging market risk assets and a further fall in risk-free asset rates toward the second half of November.

Similar to the reactions observed in recent months, there have been different responses from the equity and fixed income markets to the changes in the economic environment. This is in terms of the scale of response but not in the direction of response. In the case of the former, there has been a lack of caution, as high expectations about the scope of phase 1 of the trade agreement between China and the US were reflected in widespread gains that resulted in new record highs in several equity markets in developed countries. This is the case of the S&P500, the Dow Jones Industrial Average and the Nasdaq, which registered rises of 3.8%, 5.29% and 6.46% during November, respectively. It should be noted that the upward revision of US GDP in Q3 fueled the gains in the US stock markets during the last week of the month, leaving aside the disagreements with China on the issue of the political situation in Hong Kong. These yields were higher than those observed for the global benchmark stock index (MSCI World) which grew by 3.1%. However, this limited growth was enough for it also to reach a new record high during the month. For emerging markets there were also gains in November, but of a smaller magnitude and with different behavior. In the first week of the month, the benchmark for this group of countries gained more than 3.0%. However, influenced, among other factors, by doubts about the scope of the trade agreement, it fell by over 2.0% during the following weeks. This led it to close the month with gains of 1.0%. The IPC in Mexico fell again, with a reduction of 1.0% in response to more significant losses during the last third of November.

In the fixed-income market there was more caution given the doubts about phase 1 of the trade agreement. In the long part of the Treasury yield curve, the 10-year YTM increased 25bp by November 8 and then fell 20bp during the final third of the month to close November with an increase of only 10bp, which gives a yield of 1.79%. Similar to the development of events in the stock market indices, the better GDP data in the third quarter allowed for a rise toward the end of the month, even after the Hong Kong issue raised new concerns about the US-China trade relationship. In the short part of the curve there was an increase of 10bp in response to the market adjustment at the end of the FED's mid-cycle cut. As a result the slope between the 2 and 10 year nodes closed November at about 16bp. In Mexico, the long part of the curve saw a significant increase during the eleventh month of the year. The 10-year Mbono YTM is again around 7.1% after starting the month below 6.8%. To the emergence of short periods of risk aversion we can also add the fact that the cautious tone of Banxico's latest statement and the exchange rate depreciation may have reduced expectations of additional tax cuts in the coming months, which might have supported a steady rise in the 10-year rate during the second half of the month.

Better-than-expected data from the US economy and fewer concerns about the trade issue, in an environment of low interest rates, have reduced the likelihood of adverse scenarios for the US economy and positioned it favorably against the rest of the geographic areas. These events were reflected in a widespread strengthening of the dollar. Against developed countries, the US dollar gained around 0.97%, while it gained almost 2.0% against emerging market currencies. Within the emerging currencies it is worth noting the depreciations during the month for Colombia (3.9%) and Chile (8.6%) due to concerns about internal political unrest. The Mexican peso ended November as the ninth most depreciated currency, with a monthly fall of 1.5%, which puts the dollar price at 19.53 pesos, its highest level since the beginning of October. Even with this depreciation, the peso has retained marginal gains (0.5%) against the dollar so far this year, making it one of the seven emerging currencies that has not fallen against the dollar in 2019. At the global level, it should be noted that the implicit volatility of the main currencies has fallen again, providing an additional signal that the perception of risk has diminished.

In short, expectations about the economic environment improved somewhat in November, which has been reflected in a favorable performance for various asset classes. However, it can be argued that risk assets valuations are largely based on a possibly overstated optimism about the trade issue and remain unrelated to the fundamentals. In the coming months we will have to be vigilant to ensure that this optimism does not turn into complacency about the risks that still exist in the environment, particularly given the geopolitical risks (e.g. political situation in Hong Kong) and the next presidential election in the US.

3. Regulation

Adjustments for securities operations

On November 3, the CNBV's single banking rulebook was amended to establish the period within which banks must communicate the execution of operations to the corresponding Securities Depository Institutions. In the case of sales operations with debt instruments, it must not exceed thirty minutes and the time at which the operation was closed must be indicated.

Amendments for bank correspondents

On November 25, the regime applicable to bank correspondents was revised, allowing the signing of contracts regarding the acceptance of deposits from the public and other banking operations outside bank offices, with private assistance institutions and pawnbrokers, provided they belong to the same consortium or business group.

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