Banks

Monthly Report on Banking and the Financial System

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1. Banking and the Financial System

Bank credit to the private sector reported single-digit growth for the seventh consecutive month

In October and November 2019, the nominal annual growth rates of the balance of the current credit portfolio granted by commercial banking to the non-financial private sector were 5.7% and 5.8%, respectively (2.6% real in October and 2.8% real in November). These growth rates contrast with the rates registered in the same months of 2018, when nominal rates in October and November were 11.9% and 12.0%, respectively. After November 2018, the pace of credit growth to the non-financial private sector began to slow, and April 2019 was the last month to see double-digit growth (10.3%). Growth in private sector credit continued to slow from May to November 2019, stringing together seven months of single-digit nominal annual growth.

The nominal annual growth rates of the three credit categories that make up the bank credit to the non-financial private sector in October and November were, respectively, as follows: consumption, 5.9% and 5.6% (2.8% real November); housing, 10.7% and 10.8% (7.6% real November); and corporate, 4.0% and 4.3% (1.3% real November). If we look at how much growth in bank credit contributed to the non-financial private sector in November 2019 across its three components, we observe that business loans accounted for 2.4 percentage points (pp) of the 5.8 pp growth in credit to the non-financial private sector that month. The contribution to mortgage and consumer loans were 2.0 pp and 1.3 pp, respectively.

This slowdown in business loans in October and November points to an end of the substitution of external financing by domestic bank credit. Inasmuch as business loans grow further at annual nominal rates of about 4%, this segment's contribution to total credit to the non-financial private sector will remain low, in fact it is likely to be maintained with limited growth and at one-digit levels.

Consumer credit kept pace with growth thanks to credit card performance and payroll loans. The observed figures for economic activity and growth in formal employment explain the limited growth of consumer loans. Lastly, in November, mortgage loans reached nine consecutive months of double-digit nominal growth, driven in part by the improvement in real wages and the dynamic formal employment reported in previous years.

Further slowdown in traditional deposits in the last quarter of 2019

In November 2019, bank deposits maintained their trend of slowdown as seen at the start of the year, although there was a marginal improvement against October, which may be associated with seasonal factors. This is taking place against a background in which economic stagnation prevails over the cycle of easing short-term interest rates.

Thus, the nominal annual growth rate of traditional deposits rose 0.3 percentage points (pp) in November to 4.7% nominal (1.7% real), a rate that is far from the nominal growth of 9.8% that it registered in the same month of 2018. The source of this growth was mainly the monthly increase of 0.6 percentage points (pp) in the nominal annual growth rate of sight deposits, which was 5.5% (2.5% real) in November, a level similar to 5.3% (0.9% real) recorded in early 2019. This increase was sufficient to offset the slight reduction in the nominal growth rate of time deposits, which in November was 3.6% (0.6% real), its lowest level since September 2014.

During the second half of 2019, sight deposits performed more dynamically, underpinned by a slowdown in time deposits due to the start of the monetary easing cycle. However, growth in sight deposits has been further constrained by negligible economic activity and reduced formal job creation. While the monetary policy rate is expected to fall further throughout 2020, the higher rate of replacement between sight deposits and term deposits is fading, so available funds for the banking system will therefore depend on the reactivation of economic activity and formal job creation.

Auto lending loses momentum, reflecting weak sales and increased cost of financing

In December 2019, the Bank of Mexico (Banxico) updated its report on Basic auto lending indicators with information at the close of April 2019. In that month, the balance of the auto loans granted by the banks (13.8% of the total consumer loan portfolio) recorded a real annual growth rate of 10.4%, slightly lower than the real growth of 10.6% recorded the previous year. Despite this lower traction, auto loans remained the most dynamic segment among the different types of consumer loans. The slowdown in auto lending reflects the weak performance in light vehicle sales, which between January and April 2019 were 3.9% lower than sales reported in the same period of 2018. The NPL rate, for its part, reached 2.1% in April 2019 and the adjusted NPL rate was 4.8%, both indicators showing increases against those observed the previous year (1.8% and 3.9%, respectively, in April 2018).

Banxico's report includes information on loans granted by commercial banks and institutions associated with carmakers. Considering both sources of financing, total automotive loans in force at the end of April 2019 amounted to 1.9 million, equivalent to 258.3 billion pesos. In the last year (between May 2018 and April 2019), 620,000 loans were granted, with a balance of 115.1 billion pesos. In that twelve-month period, commercial banking granted 55.6% of the total number of loans (58.5% of the balance). The average amount of automotive loan origination granted in the last year by the banks was $214,273. This figure was higher than the average amount by carmakers' associated financial institutions ($204,412) and that granted by the same commercial banks the previous year ($210,487). Regarding the interest rate, it is reported that the weighted average rate of loans granted by commercial banks in the last year was 13.3% (vs. 14.0% granted by the carmakers' associated financial institutions in the same period and 13.1% granted by commercial banks the previous year).

New financial inclusion study with geographical focus

The National Banking and Securities Commission (CNBV) released a new study on financial inclusion from a spatial perspective, entitled "Geography of Financial Inclusion." The document provides information on the population and locations according to the availability of financial infrastructure to which they have access (branch, ATM, correspondent or point-of-sale terminal) within certain distance ranges (2, 4 and 7 kilometers).

One of the main findings of the study is that 80% of the Mexican population lives in localities that have at least one financial infrastructure point (branch, correspondent or ATM) in a radius of 2km. 70% of the population lives in locations with at least one branch within a 2km radius. If ATMs are taken into account this percentage rises to 73% in the same distance range. The highest percentage is for correspondents: 79% of the population live in localities with at least one correspondent within a radius of 2km. Despite having found percentages between 80% and 90% of the population covered depending on the radios analyzed (up to 7km), the study documents that about 21 million people (19% of the population) in 68,000 towns and cities in Mexico do not have any financial infrastructure within a radius of 2km, so there are still areas of opportunity to reduce these gaps in access. Most of the towns and cities lacking financial infrastructure are in Chiapas, Veracruz, Oaxaca and Guerrero.

Housing prices rose by 8.4% in the third quarter of 2019

According to the Federal Mortgage Society's housing price index, the value of housing increased 8.4% at an annual rate in the third quarter of 2019 (3Q19). After having reached its highest appreciation rate at the close of 4Q18, as we mentioned in our March 2019 report, there has been further appreciation, but at lower rates.

At the segment level, in 3Q19 the price of social housing increased by 7.8%, while the middle-residential segments increased by 8.8%. This pattern reflects lower demand in the market and less activity by the housing institutes during the last year—as this administration will be more focused on adjusting housing institute portfolios than mortgage origination per se.

The highest rate of appreciation in high-value segments is due to a slight recovery in the market covered by banks. While this dynamic tone will lead to growth of between 4% and 5% in private sector mortgages created at the end of 2019, the less dynamic tone in the mortgage market—due to lower job creation rates—will remain apparent with appreciation rates closer to 8% per year in 2020.

At the regional level, the highest rates of appreciation are once again found in metropolitan areas. At the end of the third quarter of 2019, the Guadalajara and Monterrey areas posted increases of 11.1% and 8.6%, respectively. At the same time, the Puebla-Tlaxcala region had an appreciation of 8.4%, while the Valle de México appreciated by 8.8%.

Credit slowdown and divergence among regions

According to the Report on The Regional Economies of the Bank of Mexico[1], the current portfolio of non-financial private companies in commercial banking registered a real annual increase of 5.3% in 3Q19, despite the less buoyant tone, largely due to bank financing in the central region of the country, which accounts for 57% of total credit.

Lower credit activity in turn affects the net interest income of commercial banks, contributing to a lower expectation of annual GDP growth in financial and insurance services during 2019.

In fact, the percentage of companies reporting the use of bank credit to finance their activities fell in most of the country, except for Southern Mexico. At the same time, financing with own funds contracted only in the North Center region, while it expanded in the rest of the country.

In the North and Central regions of the country, the agricultural sector increased the most, by 14.5% and 13.9%, respectively; the industrial sector did so in the Central North and South regions, with growths of 16.0% and 14.2% respectively.

2. Financial Markets

Signs of recovery in the global manufacturing sector drive demand for risky assets

Signs of a rebound in manufacturing activity and the attendant outlook for global economic recovery dominated the financial markets' narrative throughout most of January, even though uncertainty about the coronavirus caught investors' attention during the last third of the month. Manufacturing production surveys for the first month of the year show that the recession in this sector may have come to an end. This would have been influenced by the trade truce between the US and China and the easing of financial conditions following the shift in stance by major central banks globally. With the increased optimism of market participants, there was a higher demand for risky assets that was tempered by concerns about the coronavirus outbreak in China.

It was in the stock markets that this pattern was clearest. The benchmark for this asset class (MSCI World) had earnings of around 2.4% between December 31, 2019 and January 17, 2020, while for the second part of the month there was a fall of 1.7%, putting the net advance at about 0.6% during the first month of the year. The S&P500 had monthly earnings of around 1.3%, after a first half of the year with gains of 3.0%, that led to a new all-time high; while in the second half the losses were around 1.7%. As expected, in emerging markets losses were more common than gains. For the benchmark of this asset class (MSCI EM), the 4.3% decline since January 17 offset the earnings of 2.9%

1: Regional classification in the report: The North includes Baja California, Chihuahua, Coahuila, Nuevo León, Sonora and Tamaulipas; the North Center considers Aguascalientes, Baja California Sur, Colima, Durango, Jalisco, Michoacán, Nayarit, San Luis Potosí, Sinaloa and Zacatecas; The Center is made up of Mexico City, Mexico State, Guanajuato, Hidalgo, Morelos, Puebla, Queretaro and Tlaxcala; and the South, Campeche, Chiapas, Guerrero, Oaxaca, Quintana Roo, Tabasco, Veracruz and Yucatan.

for the first weeks, making a 1.5% fall for January as a whole. The Mexican IPC index maintained earnings during the month (3.7%), perhaps shaped by the - USMCA ratification in the US Congress.

As observed in 2019, interest rates for US Treasury bonds showed a more cautious pattern, suggesting greater concerns about economic growth in this market. At the beginning of January optimism about growth prospects led the 10-year Treasury bond yield to increase and reach 1.9% during the first half of January. Since then, however, there has been a significant reduction in line with the increased demand for safe assets, which led to a yield of about 1.5% at the end of January. This level is the lowest since last October. It is worth noting that this fall was influenced by a more dovish than expected communication from the Federal Reserve at its first meeting of the year. In the short part of the curve, a pattern in the same direction appeared. The two-year Treasury bond YTM fell 20bp from its peak so far this year. Thus, the slope between the 10 and 2-year rates fell from 35 to 17 basis points, reflecting certain concerns about economic performance, although a long way from what was observed last August when this indicator turned negative.

In Mexico, the Mbond's 10-year YTM slipped 26bp in January to around 6.6%, its lowest level since November 2016. This fall was influenced by (i) the reduced yield on Treasury bonds, (ii) expectations that the monetary easing cycle will remain in Mexico; and iii) the low country risk levels. With regard to the latter point, it should be noted that this indicator, measured by the sovereign CDS spread, stands at around 81bp, a level not seen since 2014 and just over 40bp lower than a year ago. This pattern has been widespread throughout the geographies given the more relaxed financial conditions, but this has not changed the fact that Mexico's sovereign risk is more equivalent to that of BBB-rated countries than with that of BBB+ countries.

In January, the Mexican peso maintained the positive differentiation from emerging-market currencies that was observed at the end of 2019. Attractive interest rate levels, in addition to lower tail risks arising from the ratification of the USMCA, made the Mexican peso the second most appreciated currency among the major currencies globally during the first month of the year (0.7%). This brought the exchange rate at the end of January to around 18.8 pesos per dollar, putting the whole month below 19.0 pesos per dollar, something not seen since May 2018.

In short, the data point to a global recovery in manufacturing production that supports, to some extent, the increased demand for risky assets. However, the rich valuations of risky assets remain unrelated to fundamentals. In the coming months, we will have to be vigilant that these incipient signs of recovery on the manufacturing front do not mask complacency about the medium-term risks that are still part of the backdrop.