

Economic Watch

Mexico

November 26, 2012
Economic Analysis

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Penetration of Credit in Mexico: Evolution and Comparison with Some Latin American Countries

Introduction

Bank services coverage ("bancarization") can be defined as the establishment of stable and ample relations among the financial institutions and their users regarding a series of available financial services¹. The measurement of bank services coverage is complex and must be done in a multidimensional way. The three must used dimensions are: i) depth, of which the common way of doing it is to consider the proportion of credit in relation to GDP, which can also be referred to as credit penetration in a country's economy; ii) inclusion, which is considered in terms of the population segments that are served by the banks and their geographic range, which can also be interpreted as coverage of services; and, iii) intensity: of the use of the various bank instruments or products.

In this *Economic Watch* that considers banking topics the measurement of bankarization in Mexico is approached from the perspective of its depth, measured as the ratio of credit to GDP in recent years. It should be mentioned that, since 1995, this ratio was reduced as a result of the economic and banking crisis of that year. Because of this, the importance of certain non-bank credit and financing items is also considered, excluding financing by suppliers. When incorporating certain items of non-bank financing it is intended to have a broader definition of credit penetration in the country, which considers non-bank financing sources that have been institutionalized and which, in an integral manner, represent the existing financing sources. This definition reflects in a better way the credit and financing used in the country, for this reason it is more appropriate to use when comparing credit penetration in Mexico with other economies. This last point is important because some non-bank financing sources in the country besides being relevant, are already fully institutionalized. This is the case of housing credit through public housing institutes, such as Infonavit and Fovissste, of financing to companies from banks abroad and of financing from local financial markets.

¹ Morales, L. and A. Yañez, "La bancarización en Chile: concepto y medición" ("Bank services coverage in Chile, concept and measurement"), Superintendence of Banks and Financial Institutions of Chile, April 2006.

Evolution of credit and financing to the private sector

Banco de Mexico (Banxico, the central bank) quarterly statistics of total credit and financing granted to the private sector has two components: bank and non-bank. These data indicate that after 1994, total credit and financing to the private sector as a proportion of GDP was reduced, and it was until 2006 that this proportion once again increased. Bank credit to the private sector lost the greatest percentage share of GDP in those years, but since 2006, it has shown the greatest recovery (Table 1).

Table 1

Mexico: credit and financing to the private and public sectors as a percentage of GDP (%)

	1994	2000	2005	2007	2009	2011	Increase 2011 - 2005
A: Credit and Financing to the Private Sector *							
I. Total Domestic Banking to the Private Sector	35.2	12.0	9.8	13.3	14.3	15.2	5.4
I.1 Commercial Banks	32.4	11.0	9.3	12.9	13.6	14.3	5.0
I.2 Development Banks	2.8	1.0	0.5	0.4	0.7	1.0	0.4
II. Non-Bank Entities of the Private Sector (NBEPS or ENBSP in Spanish)	2.2	3.5	5.2	5.8	6.6	6.4	1.3
III.1 Infonavit	2.2	3.5	5.2	4.7	5.4	5.4	0.3
III.2 Fovissste	-	-	-	1.1	1.3	1.0	1.0
III. Foreign Banking							
III Bank Loans and Other Direct Credit	4.4	5.1	3.9	4.3	4.7	4.0	0.1
IV. Non-Bank Financial Intermediaries in the Country (NBFI or IFNB in Spanish)							
IV. NBFI (IFNB): Factoring, Leasing Companies, Credit Unions, Sofoles, Other NBFI (Non-Bank Financial Intermediar	4.0	1.5	2.8	2.1	1.4	1.4	-1.3
V. Securitized Loan Portfolio							
V. Securitization of Housing Loans of Infonavit, Fovissste, banks and Sofoles	-	-	0.1	0.6	1.2	1.4	1.3
VI. Debt Issues by Private Companies	5.0	4.4	4.0	3.7	4.4	5.8	1.8
VI.1 Debt Issued Abroad	3.7	3.1	2.2	2.2	2.4	3.7	1.5
VI.2 Debt issued in the domestic market by companies listed on the Mexican Stock Exchange (BMV)	1.3	1.3	1.7	1.6	2.0	2.0	0.3
Total Amount to the Private Sector = I + II + III + IV + V + VI	50.7	26.4	25.8	29.9	32.7	34.3	8.5
B. Credit and Financing to the Public Sector							
VII. Bank Credit to the Public Sector: Commercial Banks & Development Banks	nd	5.0	3.8	2.7	3.2	3.2	-0.5
I.1 Credit of the commercial banks *	nd	3.4	2.3	1.5	2.3	2.4	0.0
I.2 Credit of the development banks or public banks *	nd	1.6	1.4	1.1	1.0	0.9	-0.6
VIII. Debt issue (bonds) by the public sector on the financial market in the country	nd	13.0	23.9	26.3	31.4	34.2	10.3
IX. Debt issue (bonds) by the public sector on the international financial market	nd	4.2	5.2	3.4	3.8	4.0	-1.2
X. Bank credit granted to the public sector by international banks	nd	4.5	2.7	1.3	3.9	4.4	1.8
Total Amount to the Public Sector = VII + VIII + IX + X	37.8	26.7	35.5	33.7	42.4	45.9	10.4
Total Amount to the Private Sector + the Public Sector = A + B	88.5	53.1	61.3	63.6	75.0	80.2	18.9

* Includes credit granted to the Federal Government, to States and Municipalities and public sector entities.

Source: Banco de Mexico (Banxico, the central bank) for Items I, II, III, IV + VI; the Federal Mortgage Association, (SHF), Infonavit and Fovissste for Item V; the National Banking and Securities Commission (CNBV) for Items from VII to X from 2000 to 2011. For Items VII to X of 1994, the source is the Finance Ministry (SHCP).

There are several reasons that explain the lower penetration of bank credit to the private sector until 2006. Some of the main causes that explain this evolution are the following:

- Deterioration of the macroeconomic environment in 1995: That year GDP contracted 6.2%, inflation was once again of two digits (from 7.1% in December 1994, it rose to 52% at the end of 1995), and reference interest rates quickly rose (in December 1994 the 28-day Cetes rate was 18.5%, whereas in April of 1995, it was 74.8%). Moreover, from December 1994 to December 1995 the real average wage of workers affiliated to the Mexican Social Security Institute (IMSS, by its Spanish acronym), was reduced 22% and the total number of workers affiliated to the IMSS fell 6.5%.
- Long run effect of the 1995 crisis and its effects on payment capacity: The 1995 crisis affected banking and credit activity for several years, with the inflation rate returning to one digit until April 2000, and until June 2001 the 28-day Cetes interest rate was again one digit. This adverse long-lasting effect on inflation and on interest rates was not favorable for credit activity since it affected the payment capacity of families and companies, and also inhibited the granting of new credit.
- Lack of a strong regulatory framework for banking activity up to 1995: The 1995 bank crisis quickly increased delinquent payments, undercapitalizing various banking institutions, reflecting a deficient regulatory framework for banking and credit activity (in the following paragraphs reference is made to the manner in which banking and its regulatory framework was strengthened).

- iv. Emergence and expansion of non-bank financing: To a certain extent, the 1995 banking crisis gave rise to some non-bank financial intermediaries, which gained importance (mortgage and automobile credit Sofoles), at the same time that government housing institutes (Infonavit and Foivissste) increased their credit activity and new financing instruments that compete with bank credit appeared, such as private debt (stock certificates are one of the new financing instruments). Transforming the debt balance into another more liquid instrument (securitization of bank housing loans) also had an effect on the penetration of bank credit.

So as to bolster, on one hand, the capitalization of the banking institutions and, on the other, to boost the reactivation and expansion of credit in general and of the banking sector in particular, various aspects of the banking legal and regulatory framework were modified and improved. Among the initially undertaken measures, the following are of note: improvement of the accounting framework for banking activity so as to bring it more in line with international standards; the establishment of stricter capitalization and evaluation of bank loan portfolio rules; the creation of credit information associations (credit bureaus). In a later stage, the total opening to foreign investment was allowed in the banking sector; deposit insurance was delimited; early warning mechanisms on the banking capitalization index were established; use of tools to measure client credit risk was introduced and protection of creditor rights was improved (Guarantees Miscellaneous Law and Bankruptcy Law).

Thanks to the referred improvements to the regulatory framework for banking and credit activity, and also to the recovery of economic activity and price stability, bank credit once again grew and increased its relative importance within the economy. Another important aspect that has accompanied the reactivation of bank credit is the financial strength of the institutions and the important capitalization process that the banks have undertaken. This can be observed both in the increase of its net worth or by the increase of its capitalization index (CAPI) (or by the capital that complies with certain rules and is used in the computing of the bank capitalization index). For example, in December 2000 the capitalization index of the banking system was 13.8% and in June 2012 it rose to 15.95%. This index is greater than the 10% minimum required and will allow the country to be among the first to adopt the Basel III guidelines and regulations.

Moreover, the current dynamic of the financial market makes the main sources of credit and financing of families and companies to now be: i) bank credit; ii) credit granted by public housing institutes; iii) credit to companies from foreign banks residing abroad; iv) credit granted by local non-bank financial intermediaries (regulated and unregulated Sofoles and Sofomes); v) securitization of mortgage loans; and, vi) debt issued by private companies in local and international financial markets. Thus, for example, in 2011, the percentage of bank credit in relation to GDP was 15.2%, while financing by the non-bank components rose to 19.1%. The sum of its two components makes the ratio of total credit and financing to the private sector in 2011 to be at 34.3% of GDP.

Importance and implications of credit and financing to the public sector

Another important credit and financing item that banking institutions and local and international financial markets grant is that destined to the public sector (Federal Government, States and Municipalities and public sector agencies). The greater the percentage of resources that are destined for the public sector in relation to GDP, that financing acquires greater importance in itself (Table 1). This is because public sector liabilities have implications in terms of public spending and of the debt service that it implies. Also, under certain circumstances, it can inhibit the expansion of credit and financing to the private sector to the extent that both sectors compete for the same savings pool.

In the case of Mexico, the inclusion of public sector debt indicates that the country's total indebtedness ratio (debt of the public and private sectors) is high, and in 2011 it was 80.2%. That is, to the ratio of 34.3% of credit and financing to the private sector of that year the 45.9% that corresponds to that of the public sector must be added. In addition to the fact that the greater part of the debt has been placed on the local financial market.

Comparison of the penetration of credit and financing with other Latin American countries

To illustrate the importance of the inclusion of credit and financing that is granted to the public sector, an exercise of comparison was carried out on credit and financing in Mexico with other Latin American countries for 2011 (Table 2). This exercise considered the credit and financing that both the private and public sectors received in Argentina, Brazil, Chile, Colombia, Mexico, Peru and Venezuela.²

If only the penetration of credit and financing that has been granted to the private sector is considered, it turns out that the credit penetration of Mexico is much lower than that of Chile and, to a lesser degree, than that of Brazil, Colombia and Peru. That is, Mexico, given this indicator, has, in principle, an important distance to advance in the coming years in terms of the rise in its penetration of credit and financing to the private sector. The above will be possible provided that an environment of sustained GDP growth and price stability exists. To this, it is necessary to add that the expansion of credit must be carried out prudently, maintaining risk delimited so that it will be lasting.

Table 2

Credit and financing to the private and public sectors in Mexico and in some Latin American countries as a percentage of GDP in 2011 (%)

	Argentina	Perú	Venezuela	México	Colombia	Chile	Brasil
A. Credit and Financing to the Private Sector *							
I. Total domestic Banki credit to the Private Sector	14.0	27.0	20.3	15.2	32.0	73.1	52.3
I.1 Commercial Banks	14.0	26.4	20.2	14.3	30.9	73.1	25.3
I.2 Development Banks	0.0	0.6	0.1	3.6	1.0	-	27.0
II. Non-Bank Entities of the Public Sector NBEPS)	0.0	-	0.2	6.4	0.8	-	-
III. Foreign Bank credit	3.5	-	-	4.0	-	-	8.0
IV. Non-Bank Financial Intermediaries in the Country (NBFI)	0.5	4.8	0.1	1.4	4.6	5.7	1.3
V. Securitized Loan Portfolio	0.0	-	-	1.4	1.0	-	-
VI. Debt Issues by Private Companies	3.3	9.3	0.1	5.8	10.7	14.5	1.6
VI.1 Debt Issued Abroad	1.4	6.4	-	3.7	7.3	-	1.1
VI.2 Debt Issued by Companies on the Domestic Market	1.9	2.9	0.1	2.0	3.4	14.5	0.5
Total Amount to the Private Sector = I + II + III + IV + V + VI	21.3	41.2	20.7	34.3	49.1	93.3	63.2
B. Credit and Financing to the Public Sector							
VII. Bank Credit to the Public Sector: Commercial Banks and Development Banks	1.4	2.0		3.2	7.8	0.3	2.0
I.1 Credit of the commercial banks *				2.4	5.8		0.1
I.2 Credit of the development banks or public banks *				0.9	2.0		1.9
VIII. Debt issues (bonds) of the public sector on the financial market in the country.	27.1	8.1		34.2	25.6	27.2	60.6
IX. Debt issues (bonds) of the public sector on the international financial market	0	5.2		4.0	5.8	1.8	1.5
X. Bank credit granted to the public sector by the international banks.	4.1	6.0		4.4	6.4		1.0
Total Amount to the Public Sector = VII + VIII + IX + X	32.5	21.2	45.5	45.9	45.6	29.3	65.0
Total Amount to the Private Sector + Public Sector = A + B	53.8	62.4	66.2	80.2	94.7	122.6	128.3

Source: Table 1 in the case of Mexico. For the other countries it is BBVA Research of the countries indicated except for the case of the external debt of Venezuela, since that datum comes from the IMF.

² Table 2 was structured thanks to the collaboration in contributing information by the following units of BBVA Research: Maria Gonzalez and Gloria Sorensen, BBVA Research Argentina; Enestor Dos Santos, BBVA Research Emerging Markets; Alejandro Puente and Karla Flores, BBVA Research Chile; Juana Téllez and Julio Suarez, BBVA Research Colombia; Stephen Schwartz, BBVA Research Hong Kong; Isaac Foinquinos and Hugo Perea, BBVA Research Peru; Canan Pelin Durtas, BBVA Research Turkey; Hakan Denis and Nathaniel Karp, BBVA Research United States; Frank Gomez and Oswaldo Lopez, BBVA Research Venezuela.

On the other hand, if reference is made to the penetration of total credit (public sector plus private sector), then there is a change in the situation in Mexico. Now, that ratio is more than doubled, because that percentage increased substantially, from 34.3% in the case of considering only credit and financing to the private sector to 80.2% now that reference is made to the penetration of total credit and financing. It should be mentioned that in this last case the gap that Mexico presents in this indicator with other countries is closed significantly, as is the case with Chile, and surpasses Argentina, Peru and Venezuela in penetration. Given the stable amount of savings, there is the possibility that the financing requirements of the public sector limit growth of financing to the private sector.

Evaluation

The current penetration of bank credit to the private sector is due to the macroeconomic and institutional factors that prevailed after the 1995 banking crisis. To the extent that the macroeconomic environment of the country improved and a better legal framework was implemented for credit activity, it responded positively and its proportion in relation to GDP has increased. Also, the penetration of bank credit in the country will continue to increase because its pillars are solid; that is, the financial situation of the banks is solid and its capitalization index is high; there is efficient supervision and an adequate regulatory framework. These factors are supported by a favorable economic environment and of price stability, which allows bank credit to flow with delimited risks.

On the other hand, the analysis of the subject of banking penetration must take into consideration that in Mexico, as in other Latin American countries, there are important non-bank financing sources that have been institutionalized, and also that they eventually compete with or complement bank credit. Based on this consideration, the penetration of credit and financing in the country is substantially greater if we consider credit from non-bank sources that the private sector has received from the public housing institutes and from debt issues of companies, excluding financing by suppliers. Similarly, the penetration of credit in the economy increases its absolute and relative importance if in addition to the credit and financing that is granted to the private sector, that channeled to the public sector is also included. In this case, credit penetration is much greater.

To the points in the previous paragraph it must be added that in Mexico there are numerous non-bank financial intermediaries that are not regulated and that are not obliged to provide information on the amount of credit that they have granted, such as the case of the non-regulated Sofomes.³ To the extent in which this situation is corrected in the future, there will be more elements for determining with greater accuracy the penetration of credit and financing in the country.

To the extent in which the total penetration of credit and financing in Mexico is considered and it is compared with the same indicators of other Latin American countries, then the gap of Mexico with those economies is reduced. In this sense, as long as an environment of economic growth and of price stability prevails, and these factors are supported by the prudent expansion of credit to the private sector based on the correct measurement of its risk, there will be assurance that the relative and absolute importance of credit in the economic activity of the country will continue to grow.

³ According to the Banco de Mexico Report on the Financial System of September 2012, in Mexico, there are 3,763 multiple purpose financial institutions (Sofomes) that are not regulated.

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