

Banks

Monthly Report on Banking and the Financial System

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Banking and the Financial System

The pace of advance in lending to the private sector eased, with less growth in business and housing loans

In March 2016 total credit loans granted by [commercial banks to the private sector](#) grew at a nominal annual rate of 14.0% (11.1% real), representing a decrease of 2.2 percentage points (pp) relative to the rate seen in February 2016, although still more than that seen in March 2015 (10.1%). This result was due to a slower rate of growth in business and housing loans, linked to the lesser advances in investment and employment.

Banking deposits performed better, thanks to growth in both components

In March 2016 the nominal annual rate of growth in [traditional commercial bank deposits](#) (demand and term) was 11.8%, representing an increase of 1.8 percentage points (pp) relative to February. This dynamism was the result of increased growth in both components: sight balances posted a nominal annual growth rate of 13.6% (10.7% in real terms), 1.2 pp more than the 12.4% reported for the previous month, while term deposits grew by 9.0% (6.2% in real terms), 2.7 pp more than the 6.3% recorded for the previous month. In both cases the improved growth was led by the non-banking financial intermediaries segment, probably as a result of less intermediation and increased preference for liquidity on the part of these economic agents. This in turn would be the result of the volatile environment and moderation in economic activity observed in the period.

Signs of a revival in foreign currency borrowing by Mexican companies

In January 2016 in [Mexico Banking Outlook](#) we presented a study on Mexican corporate borrowing in foreign currency, in which among other results we pointed out that following a period of significant expansion, from the second half of 2014 this kind of borrowing started to slow in dollar terms as the depreciation of the peso led some companies to replace their foreign currency borrowings with financing in pesos. More recent figures indicate that so far in 2016 this type of financing seems to be reviving, mainly in the form of foreign debt issues and loans granted by financial institutions based abroad. According to information from Banco de México, in Q1 2016 these sources of financing showed YoY growth of 6.7% and 11.1% in dollar and nominal terms respectively, more than the average YoY growth seen in the whole of 2015 (-0.1% and 6.1%, respectively). Among the companies issuing debt abroad in Q1 2016 were some of Mexico's biggest, which have often turned to the external debt markets, but there were also some first-time entrants to this market. We should also point out that since the end of 2015, most of the listed issuers identified in the Mexico Banking Outlook study as most vulnerable have managed to refinance part of their dollar-denominated either by financing in pesos or by new issuances abroad at longer terms, and in some cases by repaying it from their own resources or by selling assets. Even so, it will be important to continue monitoring the performance of companies that are still exposed to the risk of further currency depreciation.

According to Banco de México, private sector financing conditions remained favourable in the first quarter of 2016

The most recent [Quarterly Report](#) of Banco de México indicates that in March 2016 there was an upturn in companies' placements of debt in international markets. The resources obtained were used to repay domestic liabilities, which is why there was a slowdown in the growth of domestic financing of businesses in Q1 2016, both on the debt market and in bank lending. Lending to households continues to show dynamism, with slower growth in housing loans than in the previous quarter but faster growth in consumer credit. The central bank points out that NPL rates for all three segments (businesses, housing and consumer) remain low.

Non-residents' financial savings fell for the second quarter in a row, mainly due to the decline in short-term public sector securities held by foreigners, while foreign holdings of medium and long-term securities continued to increase, albeit less strongly than towards the end of 2015. As for domestic financial savings, the pace of expansion seen in the previous quarter was maintained, in both voluntary and mandatory components.

The increase in the reference rate does not appear to have dampened the dynamism of lending to the private sector, since despite the increased cost of short-term financing, it is still close to its all-time low, while the cost of medium- and long-term borrowing was not significantly affected. Additionally, the public sector's reduced use of resources made it easier for lending to the private sector to keep growing at a crisp pace, despite the environment of volatility and austerity in the international financial markets. The central bank points out that looking ahead it expects lacklustre global growth and uncertainty in financial markets, so that there is a considerable risk that sources of financial resources will be relatively limited.

Recent studies

New book on banking competition and efficiency in Mexico

A recently published book by Castellanos, Del Ángel and Garza-García entitled "Competition and Efficiency in the Mexican Banking Industry" analyses the factors influencing the structure of the banking industry and its levels of competition, applied to the Mexican banking system. The work contains an extensive review of the literature on market power, efficiency and competition in banking, including references to the relationship between competition and stability of the financial system. In order to put the analysis into context, the authors review the history of the formation of the Mexican banking industry, highlighting its various consolidation phases.

With a global approach, they assess the efficiency of the banking industry as a whole. Using data envelopment analysis (DEA), the authors find evidence that the level of competition of Mexican banks increased between 2002 and 2005 and reached its highest point in 2008. After that, probably as a result of the financial crisis, there was a decline in this level followed by a slow recovery. As well as competition, other variables that improve the efficiency of the Mexican banking system are the level of capitalisation and loan intensity, while variables such as NPLs, non-interest expenses and inflation have negative effects.

On studying the relative efficiency of different participants in the industry, they find evidence that local banks are slightly more efficient than foreign banks, foreign banks entering the Mexican industry through merger or acquisition are more efficient than *de novo* foreign banks, and that Spanish banks show higher efficiency indices than those of other nationalities.

Lastly, the book covers the main changes in the regulatory context since the period for which the exercise is carried out (2002-2012), including the main measures approved under the financial reform of 2014, and a brief review of the recommendations made by the Federal Commission for Economic Competition (COFECE in the Spanish acronym) to improve competitive conditions in the financial system and its markets.

Means of Payment

The Foundation for Financial Studies (FUNDEF, for its Spanish acronym) publishes a study on the rise and development of credit cards in Mexico and Spain

In this [study](#) the authors explain the drivers behind the adoption of bank credit cards in Mexico and Spain and how this instrument was transformed from a closed-system technology into a global network. They find that the success of credit cards in both countries is explained firstly by the fact that the banks adopting them were major players in the market, so that their extensive branch networks and credit relationships facilitated their acceptance by merchants and their use by customers. Secondly, investment in technology made it possible to massify transactions and create economies of scale. Thirdly, international cooperation among banks from different countries and the coordination of an international card provider was an essential factor for the standardisation and rapid acceptance of credit cards. This study provides an insight into the development of an instrument which currently constitutes one of the main means of payment and consumer financing in Mexico and sets out some of the challenges that may be faced by innovations aiming to become disruptive technologies.

Capital Markets

Peso under pressure from renewed concerns about the global cycle and increased probability of a rate hike

During May movements in the financial markets were influenced by two main factors: renewed concerns about the global cycle and the increased probability of a rate hike in the June meeting of the US Federal Reserve. In a movement similar to that seen at the beginning of the year, albeit of lesser magnitude, worse-than-expected data on both the Chinese and US economies led to increased concerns about the global cycle and gave rise to a brief bout of risk aversion and flight to quality. Subsequently, towards the middle of the month, the minutes of the latest meeting of the US Federal Reserve were interpreted by the markets as more restrictive, which was reflected on the futures market in an increase in the implied probability of a rate hike at the next meeting in June. In fact this probability went from 4.0% to 33.0% after the minutes were published, although by month end it had fallen back to 24.0%. In this environment, movements were different from one asset class to another.

The equity markets ended with gains, mostly offsetting the losses posted in the first half of the month, underpinned by the perception that a rate hike signals that the US economy is continuing to recover. Thus the global equities benchmark MSCI World gained 0.36% and the S&P500 advanced by 1.50%, while the Mexico's IPC ended practically unchanged relative to the end of April. On the other hand the increased probability of a rate hike in the US caused the dollar to appreciate against most other world currencies. In particular the peso depreciated by 6.76% against the dollar in May, the third biggest depreciation among emerging market currencies, ending the month at around 18.40 pesos to the dollar. We should point out that the correlation between the peso and the price of oil weakened and indeed in the first ten days of the month the peso' depreciation was more intense than that of the average of all emerging markets. In these conditions of depreciation the market started to factor in a further rise in the reference rate, anticipating that of the US Federal Reserve, as was seen in February. However, in its recent communiqué the central bank significantly reduced this possibility, pointing out that movements in the forex market had been orderly and saying that it expected the movements of the reference rate to proceed in accordance with the pre-established calendar of meetings ([See Flash Banxico](#)).

Despite the return of risk aversion in May, long-term interest rates held relatively steady, fluctuating within a narrow range. Notwithstanding the peso's sharp depreciation in May, the interest rate on ten-year M-bonds increased by only 27 bps to stand at 6.14% at month end, a similar level to the average for this year to date (6.05%). This relative stability is consistent with the low rate of inflation and the anchoring of long-term

inflationary expectations. Looking ahead we still think the most likely scenario is one of gradual increases in step with those of the US, which in turn will respond mainly to movements in short-term interest rates. Thus for the ten-year M-bond we are maintaining our forecast of 6.3% for the end of this year, although the risks would tilt slightly upwards if the Federal Reserve were to increase its key rate twice in the remainder of the year and if as we anticipate Mexico's monetary policy keeps step with that of the US.

Regulatory

CNBV prepares regulations on leverage ratios

In line with international standards, the National Banking and Securities Commission (CNBV for its Spanish acronym) has prepared a draft rule for the [leverage ratio](#) for credit institutions. For its part, the Federal Commission on Regulatory Improvement, after conducting the applicable public consultation process, issued its [Final Ruling](#) on the draft on March 30th; however the rules have not yet been published in the official gazette and could still be amended.

The regulations establish the methodology for calculation and the obligation to periodically disclose the leverage ratio and its components both online and in the notes to banks' quarterly financial statements. The CNBV has required that institutions identified as of local systemic importance must begin this calculation and disclosure from June 2016, while the remaining institutions must do so from December of this year.

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