BBVA Research

Banks

Monthly Report on Banking and the Financial System

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1.1. Banking and the Financial System

Business loans underpin the dynamism of financing to the private sector

In June 2018 the annual nominal rate of growth in the outstanding balance of credit granted to the private sector by commercial banks was 12.8% (7.8% in real terms). This growth rate was slightly higher than that of the previous month (12.6%) and lower than the rate recorded in the same month of 2017 (13.7%). Lending to businesses was at its most dynamic in June, when its nominal annual growth rate reached 17.7% (12.5% in real terms), the highest rate seen for 14 months. This brisk growth in lending to businesses was largely due to external financing being replaced by domestic bank borrowing. As for consumer credit, the nominal annual growth rate was 7.1% (2.4% in real terms), which was lower than that of the previous month and lower than that of June 2017 (10.3%). This slowing could be the result of consumers' perception about restrictions on their purchasing power, leading to a precautionary limitation over their demand for credit. Lastly, the annual nominal growth rate in housing loans was 8.7% (3.9% in real terms). This growth was a little more than that of the previous month (8.5%) and less than that of the same month of 2017 (9.8%). The performance of housing loans is probably associated with the trend in real wages, which started to recover from March 2018 at the same time as housing loans started to pick up pace slightly. Thus lending to businesses contributed 9.7 of the 12.8 percentage points (pp) by which the total lending portfolio grew in June. Consumer credit contributed 1.7 pp and housing loans 1.6 pp.

Commercial banks' deposit growth continues to be driven by sight deposits

In June 2018, the nominal annual growth rate in traditional banking deposits (sight + term) was 11.8% (6.9% in real terms), higher than that seen in May (11.3%) and 1.7 pp more than the nominal rate posted in June 2017. The dynamism seen in traditional banking deposits came from both their components: sight deposits, which grew at an annual nominal rate of 11.8%, and term deposits, which grew at an annual nominal rate of 11.9%. During June, sight deposits continued to pick up speed adding 0.5 pp to their nominal growth rate compared to that seen in May. This performance seems to be reflecting both a shift into more liquid instruments and increased household purchasing power. Term deposits also livened up, pushing the nominal rate of growth up by 0.6 pp compared with that recorded in the previous month, largely due to the valuation effect of the exchange rate on companies' deposits. As a result of the dynamic described, sight deposits contributed 7.4 pp to the total rate of growth in traditional banking deposits, while term deposits contributed 4.5 pp. As for debt investment funds (FIDs), shareholdings grew at a nominal annual rate of 9.1%, or 4.2% in real terms, in June 2018 — below the 11.4% posted in the previous month, but well ahead of that seen in June 2017 (1.3%). Although the pace has slackened, the nominal balance of FIDs has remained on the upward trend seen for the past 13 months.

Reduced absorption of financial resources by the public sector has contributed to relieving pressure on markets for funds available for lending in Mexico

In its report on the second quarter of 2018, Banco de México (Banxico) highlights the fact that sources of financing remained somewhat sluggish in 2Q18, although less so than in 2017. In Banxico's opinion, this lacklustre performance partly reflects the various adverse shocks that have affected the Mexican economy since the end of 2014, prominent among which have been: lower oil prices on world markets, uncertainty surrounding the renewal of NAFTA, Mexico's elections and volatility in international markets stemming from the normalisation of US monetary policy. These factors have combined to bring about more restricted levels of financing from external sources, so the slight recovery seen in sources of financing in the first half of 2018 came from an increase in domestic sources. In this regard, the increases in the target monetary policy interest rate since 2015 have led to increased financial savings by the private sector, and this, together with the public sector's reduced requirements for financial resources, has helped to mitigate the effect that more restricted levels of external financing has on financing conditions for the private sector. In particular, domestic sources grew at an annual rate of 4.7% in real terms in 2Q18, a similar rate to the 5.0% seen in 1Q18 and ahead of the 3.6% recorded in 2017. Thus according to the central bank's report, the increased return on financial instruments and the dynamism of formal employment favoured term bank deposits, savings in debt investment funds and resources channelled into savings funds for housing and retirement.

As regards the uses of financial resources in the economy, the most noticeable feature is the slower pace of growth in public sector financing in the first half of 2018 — 1.4% in real annual terms, well below the 5.4% annual average observed between 2013 and 2015. This reduced absorption of resources by the public sector facilitated the channelling of financial resources to the country's private sector. In particular, financing of the non-financial private sector continued to grow, driven mainly by the dynamism of domestic financing to businesses, which grew at 8.9% in real terms in 2Q18, outpacing the 6% average recorded in 2017. For large companies, this dynamism was underpinned both by increased debt issuances in the domestic market and by growth in lending by commercial banks, reflecting the substitution of external debt by domestic borrowings in reaction to tighter financing conditions in the international markets and recent exchange rate volatility. In the case of SMEs, commercial banks' lending continued to grow at rates that, while still moderate, were greater than those seen in 2017. Lending to households for its part saw its growth slow from an annual real rate of 4.3% in 1Q18 to one of 3.6% in 2Q18. In 2Q18, mortgage lending continued to grow, at a rate, which, while still moderate, was more than that of the previous quarter. In contrast, consumer credit granted by the commercial banks posted a low rate of growth, particularly in the cards, personal loans and payroll loans segments.

The report highlights the fact that Mexico's banks remain well capitalised (CAR of 15.9% in June 2018), and with sufficient buffers to face portfolio losses (reserves represent 152.6% of NPLs), so the system is in a solid position to face any averse scenarios. The banking system also shows a comfortable liquidity situation, with all banks close to or in excess of the 100% limit for the liquidity coverage ratio (LCR) and, the net stable funding ratio (NSFR), although not mandatory until 2019, is also above 100%, indicating that bank lending is mainly funded by stable resources.

The mortgage lending market in the next few years

On 6 September 2018 the Mexican Banking Association (ABM by its Spanish acronym) held the Annual Symposium on Housing Finance. Much of the content centred on the guidelines needed to shape the mortgage financing model for the coming years. While the main objective is to attend segments of the population with still no access to mortgage loans due to insufficient income, it also seeks to help those who do not form part of the formal market and therefore do not contribute to any housing savings system.

With a view to affording access by people earning less than five times the legal minimum wage per month, the need to stimulate demand for housing through savings was discussed. To do this, there would need to be a shift in policy such that subsidies for house buying would be redirected to low-income households. Federal government assistance has until now been aimed at stimulating supply. This has pushed prices up and benefited construction companies. A savings subsidy for low-income households would be more efficient, since it would encourage saving and allow households to buy a better quality house with better characteristics in a region that suits them as opposed to only where subsidised supply is available.

Mention was also made of the need to establish a Housing Fund for workers who do not contribute to any social security system. It is estimated that there are nearly 23 million workers with incomes of between one and five times the legal minimum wage. For this segment of the population the costs of obtaining loans could be reduced, and collaboration agreements could be made between the banks and associations of notaries to reduce the fees for formalising deeds.

With these measures, mortgage lending as a proportion of GDP could rise from the current 10% to 21% by 2025.

1.2. Financial Markets

Limited contagion from the Turkish crisis

The depreciation of the Turkish lira and the announcement of a preliminary trade agreement between Mexico and the US were the events with the biggest influence on movements in domestic financial markets. The depreciation of the lira unleashed a sell-off of emerging market assets across the board, although subsequently we saw differentiation among countries. The announcement of a preliminary trade agreement between Mexico and the US had only an ephemeral effect in view of Canada's absence from the negotiations and given that the actual reaching of an agreement had been largely factored in.

Thus the peso depreciated by 2.5%, less than the 6.8% average depreciation of emerging market currencies. In the fixed income market, consistent with this bout of risk aversion, yield to maturity on the ten-year M-bond (peso-denominated government bond) increased by 16 bps to 7.92%, while on the ten-year Treasury bond it fell by 10 bps to end the month at 2.86%.

As regards stock market indices, Mexico's IPyC ended the month practically unchanged from July, which represented a positive differentiation relative to the emerging market benchmark, which fell by 2.7%, although a negative one compared with the 3.0% increase in the US equity market (S&P500) and the 1.3% rise in equity markets worldwide.

Mexico still offers attractive risk-adjusted returns compared with its peers, and this has led to holdings of M-bonds by non-residents reaching nearly US$4 billion during the first half of the year.

1.3. Regulation

CNBV publishes secondary regulations for the FinTech Law

On September 10th, secondary regulation associated with the FinTech Law was published:

The CNBV (National Banking and Securities Commission) issued the general provisions applying to Financial Technology Institutions (FinTech Circular) establishing, among others, the prudential regulations, accounting principles and rules for financial reporting and disclosure. The prudential rules contain important requirements such as the ones relating to minimum capital for Financial Technology Institutions, limits to the cash deposits an on international transfers by Electronic Payment Funds Institutions, as well as limits applying to projects that can be published on Collective Finance Institutions´ platforms and diversification requirements for their investors. The circular also establishes requirements for the methodologies to be used in the evaluation, selection and classification of crowdfunding applicants and projects.

Banco de México published its Circular 12/2018 "General provisions applying to transactions of Electronic Payment Funds", which includes limits for transactions in foreign currencies by said institutions, establishes a regime for prompt refund of client's unrecognised charges and requires Electronic Payment Funds Institutions to participate in a payment system when warranted by the scale of their operations.

Lastly, with the issue of the General Provisions referred to by Article 58 of the Law to Regulate Financial Technology Institutions, the Secretariat of Finance (SHCP) extends to the FinTech system the regime for the prevention of money laundering and the financing of terrorism that already applied to the rest of the financial system. Notable in this regard is the definition of three levels of account for FinTech customers, each with identification requirements and corresponding transaction limits.

On 26 June the CNBV amended the "Single Banking Circular", making the procedure for submitting information and results of stress tests under supervisors' and own scenarios more flexible. Previously it had been established that the CNBV would send institutions the calendar for submitting this information and results in June of each year; now the Commission will publish the calendar on its website in January, also establishing the date from which projections must be made. For 2018 it establishes that institutions will use the supervisor scenarios officially sent to them by the CNBV in September of the same year and submit the results within the deadlines established in that communication.