Banks

Monthly Report on Banking and the Financial System

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1. Banking and the Financial System

For the third consecutive month, total non-financial private sector credit growth remained at one-digit levels

In July 2019, the annual nominal growth rate in the outstanding balance of credit granted by commercial banks to the non-financial private sector was 8.6% (4.6% in real terms). This growth was slightly above that of the previous month (8.4%) and, in turn, less than the growth of the same month of 2018 (12.1%). The contribution of credit growth to the non-financial private sector in July 2019 by its three components was as follows: business loans contributed 5.1 percentage points (pp) of the 8.6 pp by which this credit grew; home loans contributed 2.0 pp; and consumer credit contributed 1.5 pp. It should be noted that July is the third consecutive month in which the annual nominal growth rate of credit to the non-financial private sector was one digit. This credits' average annual nominal growth rate from May to July 2019 was 8.7%, while in the same months of 2018 this average annual growth rate was higher, at 12.3%. This data indicates that a gradual slowdown has been recorded in the growth of bank credit to the private sector.

The slowdown in economic activity and the slower growth rate in the number of workers registered at the Mexican Social Security Institute (IMSS) observed throughout 2019 are important reasons that largely explain the behavior of the dynamism of each of the three categories of bank credit to the private sector. In addition to these general factors, particular aspects of the demand for each of these three credit categories have also affected their behavior. With regard to business loans, a factor which contributed to lower dynamism was the lower substitution of foreign financing with domestic bank credit; and for consumer loans, the relevant factor was the lower number of new formal IMSS workers who registered between July 2018 and July 2019, in comparison with data for the same period the previous year. Lastly, with regard to mortgage loans, according to a quarterly survey released by Banco de México, larger banking institutions do not expect demand for this type of loan to increase in the short term. Together, these factors would have to change significantly to expect a more dynamic growth in private sector credit in the near future.

Signs of change in the recent dynamics of demand and term deposits

The month of July saw the stagnation of economic activity confirmed which, coupled with external risks, could influence a change in the dynamics recently observed in bank deposits. In an international environment with risks of a slowdown exacerbated by trade tensions, preliminary data on GDP growth during the second quarter confirmed the lack of dynamism in economic activity in Mexico. In face of this scenario, expectations for the start of the next cycle of domestic interest rate cuts increased, influenced in turn by cuts in the US federal funds rate. The expectation of lower interest rates in the short term, together with the absence of economic growth, not only reduces incentives for higher dynamism of term deposits in the future; but also it could begin to generate substitutions among term and demand deposits as has been observed in other episodes of marked economic slowdown.

In this regard, during the seventh month of the year, the annual nominal growth rate of term deposits fell by 3.7 percentage points to 12.9% (8.7% in real terms), its largest monthly fall since June 2017. For its part, the annual nominal growth rate of demand deposits increased by 5.4 pp to 5.7% (1.8% in real terms), a significant increase not seen since June 2015.

The dynamics of macroeconomic variables in the coming months could particularly affect the behavior of bank deposits. The degree to which they will be affected and their persistence will depend, above all, on the speed of the monetary easing cycle and the time it takes for the economy to return to its growth path.

Mexico's Banking and Securities Commission (CNBV), publishes its financial access report

The CNBV has published its Annual Financial Inclusion Overview 2019, a report that gathers information on financial infrastructure, accounts, credits, retirement savings accounts, insurance, transactions, consumer protection and financial inclusion in Mexico with data as of December 2018. Because of its content, this document would be the continuation to the National Financial Inclusion Report, the last edition of which was published in September 2018. The results in the document include:

With regard to service infrastructure, at the close of 2018, the number of branches increased by 1%. This translates into 51% of the municipalities in the country—where 92% of the population lives—with at least one branch. 76% of the population lives less than four kilometers from a branch and almost three out of four branches belong to a commercial bank. In turn, the number of ATMs grew by 7.5% between 2017 and 2018, reaching 58% municipal coverage and 95% demographic coverage. 79% of the population lives less than four kilometers from an ATM. Lastly, point of sale terminals increased by 17% in the reference period, reaching 69% municipal coverage and 97% demographic coverage.

With respect to financial products, the number of collection accounts registered a growth of 7.7% compared to 2017. Approximately eight out of ten accounts were provided by a commercial banking institution. In 2018, the number of loans to individuals increased by 3.5% compared to 2017. Over 90% of these loans were granted by commercial banks.

New Digital Collection Scheme (CoDi) comes into operation

On September 30, Banco de México (Banxico) reported the start of the obligation for banks participating in the Interbank Electronic Payment System (Sistema de Pagos Electrónicos Interbancarios — SPEI®), with more than 3,000 customer accounts, to offer the receipt and processing of payments through a digital collection platform (CoDi).

CoDi is a request to pay (RTP) scheme that allows to carry out purchase and sale operations of goods and services. The seller sends a billing message to the buyer, who receives and accepts it. When the message is accepted, a transfer of funds is made, which is processed by the SPEI® or the bank itself. The CoDi is a commission-free scheme, which operates 24/7 and operates amounts up to eight thousand pesos (or larger amounts if the participant decides). The scheme uses mobile devices to send and accept billing messages, as well as to make associated electronic transfers. In order to use this functionality, both the buyer and the seller must link an account they have in an institution participating in the SPEI®.

The benefits of this scheme include: that operations are processed securely and at no cost; sellers have the resources available immediately; it is low-risk, as operations must be explicitly accepted by the buyer; it favors financial inclusion by allowing businesses to accept electronic payments at no cost and encourages competition by allowing service providers to offer different means of payments to their customers. In order to raise awareness and promote this new platform, Banxico made the website www.codi.org.mx publicly available.

1H19 saw the national producer price index in the construction sector grow by 3.1%

As we anticipated in our November 2018 report, construction input prices experienced a marked slowdown in response to lower activity in the sector. However, our forecast rates of appreciation would be below 5% per year during 2019; the data observed at the close of the first half of the year already place it below consumer price inflation, which stood at 3.94% in the same period. The sharp slowdown in the producer price index in the construction sector increased almost since March, in line with lower demand for inputs. This is reflected by an average contraction of 3.8% in the industrial productivity index for construction in cumulative figures between January and June.

The building materials component, which represents more than 80% of the overall index, increased by 2.7%. This includes materials such as cement, concrete and rods. Moreover, the sub-index for the rental of machinery and equipment recorded a 3% appreciation, which, although it is linked to the behavior of the exchange rate, also reflected lower demand in the market. Finally, it should be noted that the remuneration component grew at a rate of 5.4%, although this was the result of the regulatory increase in minimum wage and not due to productivity. In the long-term, these rates of appreciation have not been observed since mid-2014. We can therefore say that the producer price index in the construction sector, similarly to other indicators in the real estate sector, is experiencing its lower part of the cycle during 2019.

2. Financial Markets

Expectations of lower commercial tensions support risk assets

September was characterized by a recovery in the prices of risk assets triggered by higher expectations at commercial level, following the upcoming resumption of talks between the US and China in October. While these talks are far from representing an agreement and do not guarantee that tariffs imposed until now will be reversed, they do represent a short-term truce that is fueling expectations by financial markets that trade-related effects on global growth could be contained. Although the prevailing trend during the month was a higher demand for risk assets, it was not exempt from periods of volatility, such as those resulting from the announcement that an impeachment process could be held against the US president and the unusual episode of lower liquidity in North American short-term markets. In Mexico, the highlight was PEMEX's recent liability management operation was that it will allow the oil company to improve its maturity profile in the short term.

The increase in demand for risk assets was clearly reflected in stock markets with earnings across the board during the ninth month of the year. Europe led the good results with a monthly increase of 3.6% (Euro Stoxx 600), above the global benchmark for this asset class (MSCI World), which grew by 1.9%. The S&P 500 increased by 1.7% monthly, however, it reached 2.7% in gains mid-month, before the possible impeachment process against President Trump was announced. In emerging markets (MSCI EM), the increase was of 1.7%, representing the index's first increase in the last three months — a significantly higher figure than the 0.91% increase registered by the Mexican IPC Index.

Increased demand for risk assets was also reflected in an increase in interest rates on government debt in developed countries, particularly during the first half of September. The US 10-year treasury bond yield stood at approximately 1.9% on September 13, representing an increase of 40 bp since the close of August. During the second part of the month, a new fall was recorded that led to a 1.66% yield at the end of the month, bringing the increase during the month of September to around 17 bp. This increase, coupled with the approximately 12 bp increase at the short end of the curve, resulted in a slight rebound of the slope of the North American curve. Similar behavior was observed in Mexico, however, long-term rates ended the month with a reduction as they were influenced by expectations of a more lax monetary policy in the future, in the light of lower-than-expected inflation data. Similarly, the 10-year M bond yield closed September at approximately 6.89%, ten basis points lower than the end of August.

On the foreign exchange market, the dollar showed some signs of weakening that favored emerging currencies. However, this weakening started to fade at the end of the month, influenced by improved relative performance in economic terms in the US in comparison to the rest of the world. Thus, the Mexican peso appreciated by 1.6% during the ninth month of the year, which led the exchange rate to stand at 19.73 pesos per dollar, after reaching 19.36 pesos per dollar in the middle of the month. The appreciation of the Mexican peso against the dollar stood above emerging and developed countries, which recorded appreciations of 0.62% and 0.47%, respectively. However, this appreciation led it to rank only fourth in emerging currencies in terms of appreciation, following the Argentine peso, the Turkish lira and the Russian ruble.

In the context of lower interest rates that characterized the first half of September, PEMEX announced a series of measures to improve its maturity profile in the short term. These measures included: (i) a capital contribution of approximately five billion dollars by the federal government; (ii) the issuance of dollar bonds with maturities of seven, ten and thirty years with placement levels of 6.5, 6.85 and 7.7%, respectively; and iii) an offer to exchange bonds to reduce maturities in the short term. According to the oil company, all these measures are aimed at reducing its debt. The main rating agencies agreed that the measures will have a favorable effect on the company's liquidity, however they maintained a negative outlook. In particular, Fitch Ratings said it maintains its negative outlook since the support by the federal government remains moderate in comparison with the taxes charged to the company. This is generating under-investment in oil production, which, in turn, could lead to additional falls in the current level of production and reserves.

Despite the lower volatility experienced in September, the following months aim to remain cautious. The trade issue will remain as the main determining factor for financial markets in a context of clear slowdown in the manufacturing sector at the global level, which, for the time being, has not been passed on to services sector. This slowdown makes market participants counter the main central banks' more relaxed monetary policy. However, it is increasingly clear that these relaxation measures have very limited capacity to sustain economic growth by themselves. In addition to this challenging context, we must not forget the political uproar in the face of the US presidential election, hints of which have already come to light with the impeachment process of President Trump. This outlook suggests a last quarter of the year in which the probability of various risks materializing could become higher.

3. Regulation

CNBV: proposed adjustments to make mobile payments more flexible

On September 19, the CNBV submitted to the regulatory improvement and public consultation process, a series of adjustments to the Circular Única de Bancos (Single Bank Circular), with a view to facilitate the provision of mobile banking and mobile payment services by banking institutions. In this regard, engaging mobile payment services will be encouraged by removing existing restrictions, but retaining banks' obligation to verify that clients are, in fact, the ones actually requesting it. In addition, the definition of authentication factors is broadened and an exception has been included for the pre-registration of account addressees and the minimum period for their activation; all of which applicable under schemes such as the new CoDi Digital Payment system.