Banks

Monthly Report on Banking and the Financial System

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1. Banking and the Financial System

A break in the downward trend in non-financial private sector credit

In August 2019, the annual nominal growth rate in the balance of the current credit portfolio granted by commercial banks to the non-financial private sector was 8.9% (5.5% in real terms). This growth was slightly above that of the previous month (8.6%) but less than the growth recorded in August 2018 (11.9%). With this result, steady one-digit growth in bank financing to the private sector continues, marking a break in the downward trend observed during the first half of the year. The three credit categories that make up this aggregate showed relative improvements compared to the annual nominal growth rates observed the previous month: consumer loans grew 6.5% (vs. 6.2% in Jul–19), mortgage loans reached 11.0% (vs. 10.8% in Jul–19), and business loans increased 9.2% (from 8.8% in Jul–19). With these results, the contribution to private sector credit growth in August 2019 was as follows: business loans contributed 5.3 percentage points (pp) of the 8.9 pp growth in this credit; mortgages contributed 2.1 pp, and consumer loans contributed 1.5 pp.

The upturn in non-financial private sector credit growth observed in August compared to recent months is partly a result of short-term factors, one of the most noteworthy factors being the valuation effect that the depreciation of the exchange rate has on the business loan balance. However, when compared with August 2018, the business and consumer loan segments continue to show signs of slowdown that reflect the loss of dynamism in economic activity, private consumption and formal employment. Therefore, until these indicators show signs of recovery, a higher expansion rate can be expected in these credit segments. Finally, it should be mentioned that, in August 2019, bank credit to the non-financial private sector recorded a one-digit growth rate for the fourth consecutive month, which also reflects the slowdown in economic activity.

A change in the dynamics of banking sector deposits was confirmed in August

The sign of change in the dynamics of banking sector deposits was confirmed in August. The start of the central bank's cycle of short-term interest rate cuts saw the growth rate of term deposits reach the lowest level in almost two years. As mentioned above, this rate reduction in the context of the current economic slowdown created a partial substitution effect in favor of demand deposits. The latter showed more dynamic growth compared to the same month last year, after its annual nominal growth rate reached its all-time low (1.2%) two months ago.

Thus, during the eighth month of the year, the annual nominal growth rate of term deposits fell to 10.1% (6.7% in real terms), its lowest level since September 2017. Meanwhile, the annual nominal growth rate of demand deposits increased by almost 2.0 pp to 7.4% (4.1% in real terms). The substitution between these two traditional bank deposit components is far from being one to one, which was reflected in the traditional deposit growth of just 0.1 pp to 8.5% at the annual nominal rate (5.1% in real terms).

The current economic outlook suggests that this trend change among the main bank deposit components can be maintained in the coming months, albeit with less intensity. However, this will depend on both the observed and expected speed of the monetary easing cycle and the time it takes the economy to stabilize on a new path of positive growth.

National Corporate Financing Survey (ENAFIN 2018)

The National Institute of Statistics and Geography (INEGI) and the National Banking and Securities Commission (CNBV) published the results of the National Corporate Financing Survey (ENAFIN 2018). The goal of this survey was to obtain information on the needs, sources, conditions, and use of financing in micro, small, medium and large enterprises in the construction, manufacturing, trading and non-financial private services sectors, located in Mexican towns with 50,000 or more inhabitants. The information was collected between August and October 2018, therefore the main reference period is 2017. ENAFIN 2018 sheds light on the main characteristics of the companies represented, the type of financial products they use, as well as their knowledge and use of financial technologies and different means of payment.

In terms of corporate lending, the results of ENAFIN 2018 show that 46% of the companies have requested or obtained financing at least once since they started operations. In 2017 and 2018, nine out of ten credit applications were approved. In 2018, 21.7% of the companies obtained financing to support their operations, to pay for transactions, or to perform other activities. The sources of financing were: commercial banks (75.4%), suppliers (30.4%), family or friends (11.7%), non-bank financial institutions (7.4%), and other sources (5.4%). Meanwhile, 65% of companies have not requested any financing, indicating that they do not need it, that it does not interest them, or that they have other means.

With regard to the use of banking and financial services, ENAFIN 2018 reveals that 87% of the companies use at least one bank product or service. Checks and Internet banking are the most widely used means of payment among the companies, but most companies (78% of the total) continue to use traditional channels (branches) for financial operations. Furthermore, 35.2% of companies receive card payments, although acceptance of this payment method varies according to their particular economic activity: 56.8% of trade sector companies receive card payments, 32.9% of firms in the services sector accept this type of payment, 14.6% of manufacturing firms, and only 4.7% of construction firms. During 2017, one in ten companies acquired some fixed assets through financial leasing; out of these companies, 60.8% acquired transport units. In 2017, 70.8% of the total number of companies took out an insurance policy. Within this percentage, construction companies stand out in particular, with 86.5% holding an insurance policy.

Regarding awareness within the sectors of the financial system other than commercial banks, the survey shows that 20% of companies know about financing through the Mexican securities sector. For large companies, this percentage reaches 37%. More than half of the companies know about development banking programs and one in five companies knows about financial technologies, a percentage that increases as the size of the company increases.

The International Monetary Fund (IMF) updates its Global Financial Stability Report

The IMF has published its 2019 Global Financial Stability Report (GFSR). The document highlights the synchronized slowdown of the global economy as a result of major trade barriers, prevailing uncertainty regarding international trade, and idiosyncratic factors that are causing macroeconomic tensions in several emerging economies. In this context, central banks have relaxed their monetary policy in both advanced and emerging economies. The IMF estimates that, without such monetary stimulus, global growth would be 0.5 percentage points lower in both 2019 and 2020 (estimates are 3.0% and 3.4% respectively). Although monetary easing has helped sustain growth in the short term, the IMF emphasizes that it is important to avoid the accumulation of financial risks. In particular, given the expectation that interest rates will remain at low levels for a long period of time, there is a risk that financial vulnerabilities will worsen, therefore countries will need to strengthen their macroprudential policies and to conduct more proactive monitoring to ensure the soundness of the balance sheets of financial institutions and limit systemic risks.

In particular, the report points out that the main vulnerabilities for the global financial system are: a) increased debt burden on companies, accompanied by a weakening of its debt service capacity; b) increased possession of riskier assets and assets with lower liquidity by institutional investors, which can lead to exposures that amplify stress shocks and, c) increased reliance of emerging economies on external financing, which could mean refinancing and sustainability risk. In response to these challenges, the report recommends: a) addressing vulnerabilities in the business sector with stricter supervision of corporate risk assessments and financing practices, with an emphasis on making non-bank financing markets transparent; b) addressing risk among institutional investors through increased monitoring and disclosure of information, in addition to strengthening surveillance of non-bank entities, and c) implementing prudent sovereign debt management practices.

Real estate services grow 1.3% in the first half of 2019

The GDP of real estate services represents 11.4% of total economic activity in Mexico. This share is even greater than that of the Construction GDP in the economy, which is 6.8%. Real estate services are closely linked to productive construction (shopping centers, industrial parks, and offices) and the performance of wholesale trade.

In the first half of 2019, the real estate services GDP increased 1.3%, compared to the same period during the previous year. This moderate growth reflects the slowdown in trade and the decline in construction industry activity, which began in the first quarter of 2018 and has held steady during 2019.

According to data from INEGI's Survey of Construction Companies (ENEC), the company production value allocated for productive construction fell by an average of 2.6% in 2018; while in 2019, the drop has been more than 6%. Meanwhile, the wholesale trade GDP, which had managed to maintain growth of 2.4% in cumulative figures during 2018, already recorded a decline of 1.8% at the close of the first half of this year.

It is important to note that the slowdown in real estate services reflects the reduction in demand with a delay of between ten and 12 months. For this reason, it does not yet record negative growth rates as its main economic determining factors. Based on this, the real estate services GDP could reflect zero growth in the second half of the year and even a decline at the close of 2019.

2. Financial Markets

Trade truce between the US and China reawakens risk appetite

The driving force behind financial market movements during October was the partial trade agreement between the US and China. Although the agreement is yet to be officially signed and there is no certainty about its details, the markets have interpreted the fact that a tariff deal has been reached as a decrease in the likelihood of the riskiest scenarios for global economic growth. This has resulted in a greater risk appetite and the pursuit of returns in financial markets, which in recent months have considered the trade issue as the main risk factor for growth, particularly in the current context of the global economic slowdown.

Given the reduction in trade tensions and the expectation that interest rates will remain at low levels in the coming months, stock market indexes gave a clear indication of a greater risk appetite. The largest gains were reported in emerging markets, where its benchmark (MSCI Emerging Markets) recorded a 4.0% increase during the month of October, its highest monthly growth since June. Overall, this asset class had monthly yields of 2.6% (MSCI World), a figure that exceeded the 2.3% increase of the S&P500, which nevertheless recorded a new all-time high at the end of October when it was quoted above 3000 points. In the case of the IPC, gains were also recorded during the tenth month of the year, although only at 1.7%. Even with this lower growth in relative terms, Mexico's main stock market indicator has seen three consecutive months of growth for the very first time this year.

Increased demand for risk assets was once again reflected in an increase in interest rates on government debt in developed countries. The ten-year Treasury bond yield increased by about 11 bp in October, closing the month at around 1.8%. It is important to note that most of this increase occurred during the second week of the month when the trade meeting between the US and China took place. This rise places the slope between the two and ten year nodes above 15 bp, relatively far from the negative territory that drew so much attention to the markets. The month closes with the signal from the Fed that the current level of the federal funds rate (1.5–1.75%) is appropriate for reaching its objectives, which reduces one of the factors that have influenced the decline in rates. Meanwhile, in Mexico, the long end of the curve recorded a reduction in line with the search for market yields and expectations of a cut in the funding rate. The ten-year-old node fell 8 bp in October to about 6.9%. Thus the reduction in 2019 amounts to around 170 bp.

In October, the foreign exchange market was characterized by a generalized weakness of the dollar after the US currency reached peak levels for the year against developed and emerging currencies in September. Against the latter group of currencies, the dollar lost 1.4%, while it lost 1.7% against the first group. The Mexican peso was the fifth-highest appreciating currency against the dollar in October with an appreciation of 3.4%, which allowed it to once again reach close to 19 pesos per dollar. This significant appreciation could also be influenced by expectations that in the coming weeks there may be approval of the Free Trade Agreement between the US, Mexico, and Canada. Similar to the recent strengthening of the national currency, the domestic credit risk measured by the five-year CSD spread has recorded a significant recovery. During the tenth month of the year, this indicator fell by 26 bp, its biggest drop in 2019. With this, the five-year CSD spread dropped below 90 bp, its lowest level since December 2014. Despite this significant reduction, Mexico's credit risk remains slightly above that of countries such as Colombia and Russia, which have a BBB− rating, up to two levels below that of Mexico.

The trade truce between the US and China gave a respite to financial markets. Even so, there has been no significant change to the challenging conditions of the economic scenario. On the one hand, the partial trade agreement reached in October is far from a definitive solution, so it cannot be ruled out that commercial risks will resurface going forward and generate new episodes of volatility. On the other hand, latest economic figures in Europe and China exacerbate concerns about a slowdown scenario, which will hardly be reversed by monetary easing measures and the strength of the American consumer alone. In sum, economic fundamentals do not provide, at present, the foundation for a scenario of sustained gains in risk assets.

3. Regulation

CNBV: Adjustments to mobile operations regulation

On October 1, 2019, CNBV published adjustments to the Circular Única de Bancos (Single Bank Circular) in order for banks to be able to provide the transfer service by loosening definitions that restricted Mobile Banking and Mobile Payment operations to the use of a mobile phone (and no other device), among others. It also facilitates contracting the Mobile Payment service by removing existing restrictions regarding the linking of telephone numbers and accounts, establishing in its place the obligation to verify that it is indeed the client requesting the service. Finally, the definition of authentication factors is extended to include information generated by the institutions themselves.