Banking

Monthly Report on Banking and the Financial System

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Banking and the Financial System

Slight slowdown in all loan portfolios to the non-financial private sector (NFPS) during January

The nominal balance of the performing loan portfolio granted by commercial banking to the NFPS grew 12.8% annually during January 2023. In real terms (stripping out the inflationary effect), this increase is equivalent to 4.6%, similar to that observed in December. For the second consecutive month, real growth decelerated in all the portfolios that make up this type of financing. The environment of higher interest rates, as well as a slowdown in some components of aggregate demand and formal employment, could explain the lower dynamism registered in outstanding balances.

By aggregates that make up the country's loans to the NFPS, the annual nominal growth rates were: consumption, 17.6% (9.0% real); housing, 11.8% (3.6% real); and companies, 11.4% (3.2% real). In January 2023, the contributions to the 12.8 pp growth in bank loans to the NFPS were (in descending order): companies, 6.3 pp; consumption, 3.8 pp; and housing, 2.7 pp.

During the first month of the year, the appreciation of the peso in year-on-year terms mitigated the increase in the outstanding nominal balances of the corporate portfolio in foreign currency. Expressed in pesos, this portfolio presented a nominal variation of 12.2% (12.6% in the month immediately prior (MIP) and 6.3% in January 2022), which in dollars is equivalent to 23.2% (18.4% in the MIP and 4.2% in January 2022). Nominal outstanding balances in domestic currency increased 11.2% in January (after registering increases of 11.1% in the MIP and 0.7% in January 2022).

Overdue balances in foreign currency showed an annual contraction during January, presenting a nominal annual variation of -0.8% (equivalent to a growth of 8.9% in USD), leaving behind a year with an average increase of 158.7%. In particular, overdue balances of the portfolio to individuals with business activity (PFAE for its acronym in Spanish) represent less than 0.1%, while those of companies account for 99.9% of such balances.

With respect to consumer credit, the greatest dynamism can be found in the credit card segment, whose outstanding balances showed a nominal annual variation of 21.8% (12.9% real), the highest since May 2008. Likewise, outstanding balances for the acquisition of consumer durables grew by 11.8% nominal annualized (3.6% real), with the automotive portfolio contributing 8.9pp to this increase and the acquisition of personal property, 2.9pp. The nominal outstanding balances of personal and payroll loans increased 16.2% and 15.9% (7.7% and 7.4% in real terms), respectively. In the case of payroll loans, this variation represents a slowdown with respect to the MIP, in parallel to a lower dynamism of formal employment during the period.

A mixed dynamic was observed in outstanding corporate credit during the first month of 2023, with sectors such as mining and the generation, transmission, distribution and commercialization of electricity, water and natural gas growing 1.5% and 155.2% in real terms, respectively, which represents a significant improvement with respect to the variations observed in the MIP. In the case of construction, although the magnitude of the real annual contraction is significantly lower than that recorded in December (-0.1% vs. -3.6%), the sector's outstanding balances accumulate 25 months of declines in real terms. For the agricultural sector, manufacturing and tertiary activities, the figures point to a slowdown in the performance of outstanding balances.

In the case of manufacturing, the dynamism of the transportation equipment manufacturing industry and the food industry is particularly noteworthy, whose outstanding portfolios grew 51.9% and 16.2% in real terms, respectively. With respect to services, real outstanding balances in the commerce sector slowed down, growing 3.7% (5.2% in the MIA), while sectors such as hotels and restaurants, transportation and mass media experienced contractions of -1.6%, -2.2% and -11.9%, respectively.

In spite of the dynamism observed in recent months, it should be noted that, as of January 2023, the real balances of the consumer and corporate loan portfolios are still 3.8% and 7.4% lower than those recorded in February 2020, respectively. Although the current dynamism could imply the recovery of pre-pandemic balances in all portfolios in the short term, the NPL trend is beginning to reflect a relative deterioration. In the case of consumer credit, NPLs reached 3.0%, with increases in almost all segments of the portfolio. The exception is automotive financing, whose delinquency rate (IMOR for its acronym in Spanish) decreased from 1.40% to 1.35% from December 2022 to January 2023. In the case of corporates, after a continuous reduction in the IMOR from January to September 2022 (following the abrupt increase when the accounting methodology under IFRS9 was implemented), NPLs have shown an increase in the last 4 months, closing January 2023 at 2.1%.

The dynamism of term deposits was not enough to maintain the growth of traditional bank term deposits

In January 2023, the balance of traditional bank deposits ("sight + term") registered an annual contraction of -0.1% when discounting the effect of inflation (equivalent to a nominal growth of 7.8%), interrupting the brief recovery that had been registered at the end of 2022 (the real annual growth rate was 1% in the previous month). The drop observed in January partly reflects the accounting effect associated with the appreciation of the exchange rate, a factor that has had a downward effect on the performance of bank deposit balances since September 2022 (close to 14% of the total balance is denominated in foreign currency). Term deposits continue to be the most dynamic component of deposits, contributing 1.7 percentage points (pp) to the real annual variation observed, while sight deposits subtracted -1.8 pp from this dynamism.

Sight deposits (65.7% of traditional deposits) recorded an annual decline of 2.8% in real terms (nominal growth of 4.9%), the largest contraction recorded since June 2019. Both corporate and individual deposits contributed to the decline recorded in January. In the case of companies, the real annual change was -3.2%, while the real annual change in sight deposits for individuals declined -5.3%. The adjustment in the costs of various goods and services at the beginning of the year may have increased the need for agents to use their liquid resources to cover their current expenses, contributing to a reduction in the balance of sight deposits.

Meanwhile, term deposits accelerated their dynamism in the first month of the year, reaching a real annual rate of 5.4% (13.7% nominal), more than double the rate recorded in the previous month (2.4% real in December 2022). The recovery of corporate term balances was noteworthy, which registered real growth of 3.0% after two consecutive months of declines. In the case of individuals, it maintained double-digit dynamism for the third consecutive month, registering a real growth rate of 13.5% in January, the highest since December 2018. The greater relative attractiveness of this type of savings instruments in the face of higher interest rates, coupled with a gradual recovery of income, both from companies and households, has favored the recovery of term deposit balances, although these have not yet recovered their pre-pandemic level, as they are (in real terms) 8.8% below the level recorded in December 2019.

An environment in which interest rates remain high will continue to favor the recovery of term deposits, as long as agents' sources of income remain dynamic. In this environment, a lower preference for liquidity is to be expected, which will be reflected in a more moderate performance of sight deposits.

Financial Markets

Financial stability risks increase uncertainty about the monetary cycle and risk asset prices

The bankruptcy of Silicon Valley Bank (SVB) brought the issue of financial stability to the forefront of a discussion that for several months had focused almost exclusively on inflation, employment and economic growth.

In the context of more persistent inflation and better-than-expected employment and economic activity data during the first months of the year, market expectations about the monetary cycle had not only aligned with those of the Fed, but already incorporated a greater tightening than that signaled by the FOMC in December, following the more restrictive tone adopted by the Chair of the Fed just a few days before the bankruptcy of the SVB.

However, the first bank failure since 2008 forced the US financial authorities to take extraordinary measures to provide liquidity to commercial banking and thus eliminate the risk of additional bank runs. This event not only changed participants' expectations about the prices of risk assets in the markets, but also introduced greater uncertainty into the risk-return reference plane on which investment decisions are based.

One sign of this heightened uncertainty is the market's lack of direction in terms of expectations for the federal funds rate. According to the fed funds rate futures market, the market's expectation for the March 22 meeting went from 50 basis points (bps) following the Fed Chair's speech to the Senate on Tuesday, March 8, to only about a 47% probability on March 15 following the volatility caused by the drop in Credit Suisse shares.

Furthermore, the expectation of cuts in the federal funds rate for 2023, which contrasted sharply with the December projections of FOMC members, was taken off the table by March 8. However, it not only returned, but was fueled by March 15, as markets now price in as much as 100 basis points of cuts this year.

A natural consequence of these movements in expectations has been volatility in government curves. On March 13, the yield to maturity of the 2-year Treasury bond fell 61 bp, something not seen since 1982, a day later it rose by around 20 bp, but the uncertainty over Credit Suisse caused it to fall again by 23 bp on March 15 (see graph 1). The long end of the curve recorded, as expected, more moderate movements that have been reflected in a drop of around 47 bp in the yield to maturity during March (see graph 1).

In Mexico, rate cuts have predominated, albeit of a lesser magnitude. The yield to maturity on the 3-year Mbond has fallen 37 bp between March 9 and March 15, to trade at around 9.8%. Meanwhile, at the long end of the curve, the yield on the 10-year node has fallen 8 bp over the same period, to trade at around 9.07%.

Risk aversion has increased in the rest of the markets, which in turn has led to a tightening of financial conditions in the U.S. After a long period of relative stability, spreads on corporate debt, both investment grade and speculative grade bonds, have increased, whereas stock markets have registered losses, particularly concentrated in the banking sector (see graph 1).

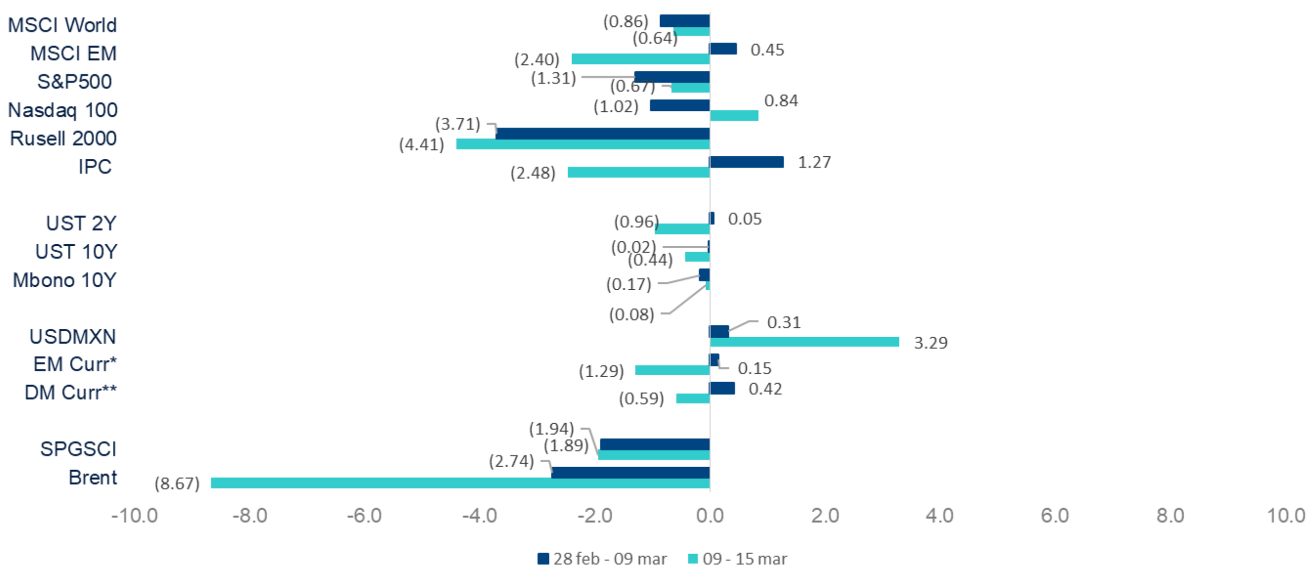
The KBW bank index, which tracks the performance of the 24 US domestic banks, shows a 15.5% reduction between March 9 and March 15, compared to a 17.4% decline in the regional bank index. In Mexico, bank stocks (19.2% of the index) have shown the greatest pressure, with losses of between 6.9% and 15.2% in the same period.

In line with increased risk aversion, the dollar has strengthened across the board. Between March 9 and March 15, the emerging economies currencies weakened 1.3% against the US dollar, whereas the dollar strengthened 0.6% against the currencies of developed countries. During this period, the Mexican peso was the third most depreciated currency (-3.2%), which has resulted in an exchange rate of 18.96 pesos per dollar.

Although it can be stated that the bankruptcy of SVB does not in itself represent a systemic risk, it is undeniable that this event has brought uncertainty back to the financial sector, and this has proven not to be a short-lived phenomenon. Furthermore, this event raises the issue of the weight that monetary authorities should give to financial stability in their decisions, particularly in the current environment of high inflation and after a long period of low rates that have exacerbated risk-taking.

The next few weeks will allow the new context and, above all, the changes to the reference framework for investment decisions to be defined. For the time being, it is to be expected that uncertainty will be high in the coming days, which will bias the prices of risk assets downward.

Figure 1. **PERFORMANCE OF THE PRICES OF THE PRINCIPAL FINANCIAL ASSETS DURING MARCH 2023**
(% CHANGE IN LOCAL CURRENCY)



Source: BBVA Research with data from Bloomberg.

*JP Morgan Emerging Markets Currency Index. For this index a reduction (increase) implies a depreciation (appreciation) of a basket of emerging economy currencies against the USD. **DXY Index, for this index a reduction (increase) implies a depreciation (appreciation) of the USD against a basket of developed countries' currencies.

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