Banking

Monthly Report on Banking and the Financial System

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1. Banking and the Financial System

In March, the real annual performance of traditional deposits remained in negative territory, despite the dynamism of term deposits

In March 2023, the balance of traditional bank deposits (demand + term) registered an annual growth rate of -0.3% in real terms (equivalent to a nominal growth of 6.5%), the third month in negative territory if the effect of inflation is discounted. Term deposits mitigated the contraction of traditional deposits and in March contributed 2.7 percentage points (pp) to their growth, which were more than offset by the -3.0 pp drop in demand deposits, which are affected by the recomposition of bank deposits toward longer-term instruments in an environment of high interest rates.

Demand deposits registered a real annual change of -4.3% (nominal growth of 2.2%), a slightly smaller drop than that observed in the previous month (-4.6%). However, in March, the real monthly change in demand deposits showed a growth of 1.8%, returning to positive territory after recording negative changes during the first two months of the year. The holders that most contributed to this contraction were individuals, whose balances showed a real annual change of -5.2% in March, a smaller drop than that recorded in February (-7.2%). Corporate demand deposits, in turn, showed a real annual change of -2.5% (also lower than the contraction of -5.0% in February). It should also be noted that the balances of the non-financial public sector fell at a real rate of -12.6%, the first month in negative territory after a year of real growth. In contrast, demand deposit balances of other financial intermediaries (OFIs) were the only ones to remain in positive territory, recording a real increase of 11.8% in March, the first double-digit increase since July 2020.

Term deposits, meanwhile, continue to show significant dynamism. In March 2023, these savings instruments showed a real growth of 8.5% (15.9% nominal), the strongest change recorded since March 2020, marking four months in positive territory. Most sectors holding this type of savings (companies, individuals, and the non-financial public sector, which represent 83.8% of term deposits) have recorded an increase in their balances with respect to the previous year. Only in the case of OFIs, has there been a reduction in these balances, which would partly explain the increase observed in their holdings of demand deposits (due to a shift toward more liquid savings). It should be noted that this recomposition of balances for OFIs follows a trend opposite to that of the rest of the holders and could be related to the increase in the cost of funding sources for these agents.

Although higher interest rates have encouraged agents to maintain more balances in term instruments, the financing of current spending in the face of the inflation levels recorded since last year could account for the insufficiency of this dynamism to compensate for the contraction in demand deposits. The effects of lower real income on purchasing power to finance spending may have prevented an even transfer of resources between savings instruments in order to take advantage of the positive real return on term deposits. As a result, traditional bank deposits have contracted, the persistence of which will depend on the relative dominance of these effects.

Real balances of bank financing to households increase their dynamism

In March 2023, the balance of the outstanding loan portfolio granted by commercial banks to the non-financial private sector (NFPS) recorded a real annual growth of 5.1% (12.3% nominal), the highest increase in real terms observed since May 2020.

It should be noted that the nominal annual rates show a slowdown in most portfolios as a result of the gradual dissipation of the nominal effect of inflation, and, in real terms, only the business portfolio registered a lower dynamism, while credit to households — consumer credit and mortgage loans — grew in a more dynamic manner, resulting in an increase in total credit to the NFPS. Thus, in terms of the real annual growth of 5.1% in March, consumer credit contributed 2.2 pp, while the business and housing portfolios contributed 1.8 and 1.0 pp, respectively.

Outstanding consumer credit achieved real annual growth of 10.3% (17.8% nominal), increasing its dynamism with respect to the previous month (when a real growth rate of 9.6% was observed). The credit card and payroll loans segments (37.4% and 26.4% of the consumer portfolio, respectively) were the main drivers of this recovery, with real growth rates of 14.6% and 10.1%. Financing for the acquisition of consumer durables ("ABCD" loans, 16.0% of consumer credit) increased by 6.4% in real annual terms, while personal loans (15.9% of the consumer portfolio) registered a real annual change of 6.5%. In general terms, the dynamism of the consumer portfolio has been supported by the dynamism of employment and real wages.

The housing portfolio registered an annual growth rate in real terms of 4.5% (11.7% nominal) in March. The result for the third month of the year shows an increase in the dynamism of this portfolio for the second consecutive month, due to the greater dynamism of the medium-residential housing segment, as well as to the lower scale of the annual fall in financing balances for low-income housing. Although higher long-term interest rates could explain a lower incentive for agents to use this type of financing, the good performance of the labor market has contributed (with a lag) to sustaining the growth of this portfolio.

Finally, business loans (54.4% of the outstanding portfolio to the NFPS) registered a growth in real terms of 3.3% (10.3% nominal), a slight slowdown with respect to the previous month. However, March saw the first real monthly growth of the year (0.9% vs. -0.8 average Jan.-Feb.). The higher cost of financing, together with the slowdown in private investment and a relative stagnation of business revenues (for example, in real terms, ANTAD's nominal sales indicator showed no real annual growth during March) could be limiting a greater dynamism of the business portfolio.

Inflationary and interest rate trajectories will continue to be in focus as determinants of loan dynamics, although the resilience of the real sector of the economy will also be imperative in order to sustainably expand agents' income and their demand for loanable funds, which would promote a greater real dynamism in bank credit balances to the NFPS in the medium term.

The Mexican financial system shows a solid and resilient position in the face of increased risks in the current environment

The Financial System Stability Council (Consejo de Estabilidad del Sistema Financiero — CESF) presented the thirteenth Annual Report on the Stability of the Financial System in Mexico for the period from April 1, 2022 to

March 31, 2023. The report highlights increased risks from the aftermath of the COVID-19 pandemic, the economic consequences of the war in Ukraine, and the tightening of monetary policy to contain inflationary pressures.

The analysis of credit, market and liquidity risks for the Mexican financial system as a whole indicates a stable position. During 2022, commercial banks maintained capitalization and liquidity levels that comfortably exceed regulatory minimums, all in the face of a scenario of high inflation, risks to financial stability and complex global financial conditions.

Regarding the solvency of commercial banks, the report notes that all institutions maintained the minimum capitalization index (ICAP) required throughout 2022, showing a level of 19.0% at year-end, lower than the 19.5% observed in December 2021, but consistent with the increase in provisions in view of the greater granting of loans to companies and families, whose balances already show a growing trend following the stagnation caused by the pandemic. Nominal growth rates, at the close of 2022, stood at 5.7% in the government portfolio, 11.3% in housing loans, 12.5% in business financing, as well as 16.1% and 20.4% in the non-revolving and revolving consumer portfolios, respectively.

Delinquencies in the total loan portfolio, as well as the percentage of non-performing loans that would have increased due to the effects of the pandemic, show a downward trend. The delinquency rate (IMOR) corresponding to the business portfolio closed the year with a level of 2.0%, while the housing portfolio registered 2.6%, while the adjusted delinquency rate (IMORA) levels of the loan portfolio were 2.5% and 3.5% for the business and housing portfolios, respectively.

Regarding the indicators related to the liquidity risk of commercial banks, the Liquidity Coverage Ratio (LCR) recorded shows a median of 231% and a minimum of 100%, evidencing the liquidity sufficiency of commercial banks, with a median for local systemically important banks (LSIB) of 182% as of December 2022. The Net Stable Funding Ratio (NFFR) of commercial banks closed the year with a median of 140.6%, with each institution complying with the minimum established by regulation (100%). The main source of funding for commercial banks is over-the-counter deposits, which account for 70.0% of total deposits. It is worth noting that this funding increased its balance with respect to December 2021, going from 6.0 to 6.6 trillion pesos in December 2022.

Regarding the market risk faced by commercial banking institutions, the report analyzes the composition of portfolios at the end of 2022. Although the distribution is similar to that of the end of 2021, there has been an increase in the share of debt securities with maturities of 0 to 1 year and 1 to 3 years, a decrease in the average duration of the portfolios from 2.4 to 1.3 years and an increase in the percentage of positions in variable rate instruments between December 2021 and December 2022. In the multiple banking portfolios, the main market risk factors are domestic interest rates—due to debt securities and interest rate swaps—and the peso/dollar exchange rate.

In the analysis of the risks faced by the institutions of the stock market sector, it is worth noting that the net assets managed by the investment funds sector correspond to 10.05% of the GDP. Of these, 41.4% are managed by the two largest operators and 66.25% by the five largest, with a significant concentration in government securities. It should be noted that, given the increase in the reference rate during the first half of 2022 to address the high levels of inflation observed, the market risk in mutual funds in the second quarter increased with respect to the first quarter and was moderately reduced during the third and fourth quarters due to positive trends in private consumption and the rebound in the US economy.

2. Financial Markets

Lack of direction for risky asset prices as banking turmoil persists and debt ceiling lurks

Between the close of March and the first eleven days of May, additional information entering the financial markets did not significantly help major asset prices to find a clear direction.

US macroeconomic data for April (e.g., employment and inflation), in general, continue to show a context of persistent price growth and a labor market resilient to the increase in interest rates, although there are already signs of slowdown.

On the banking front, it is clear that there is no crisis scenario like that of 2008. However, the sale of First Republic, arranged by the FDIC at the end of April, has raised doubts about some parts of the sector, especially in view of the scenario of high interest rates over an extended period of time.

Regarding credit conditions in the US, the most recent survey of credit market practices carried out by the Fed (Senior Loan Officer Opinion Survey — SLOOS) shows that, as of April, the tightening continued, although at a somewhat slower pace than that observed until last December and still far from what was observed in 2007-2008. In other words, the turbulence of March does not seem to have had a significant adverse effect on credit conditions for the time being.

Thus, during April and the first week of May, the prices of the main financial assets found no catalyst to set a concrete direction. At the moment, the leitmotif seems to be the expectation that the Fed will cut interest rates by up to 75 basis points (bps) by January 2024 in light of a shallow recession. It should be noted that this market expectation remains in clear opposition to the US central bank's projections.

In fact, the Fed's May communication, April's inflation and employment data, as well as the volatility caused by the sale of First Republic, played a role in a reduction of the US Treasury curve by 13 bps for the two-year tenor and 8 bps for the long part of the curve (see Chart 1). It should be noted that between March 31 and April 24, when First Republic's quarterly results were released, the shifts had been opposite, with increases of 6.0 and 2.0 bps, respectively.

In the case of the main stock indexes, the trends were opposite. Between April 25 and May 11, following First Republic's quarterly earnings report, the main North American indexes recorded declines, with the exception of the Nasdaq 100 (see graph 1). The upward movement of technology stocks could be explained by the dominance of expectations of interest rate cuts, since in terms of valuation the cash flow of this type of stock lies at a distant point in the future.

As expected, the sale of First Republic led to a further fall in US bank stock prices. Between March 31 and May 11, the KBW index, which groups national banks, fell 8.8%, while the regional bank index fell 17.0% in the same period. As a consequence, the declines so far in 2023 amounted to 27.6% and 50.0%, respectively.

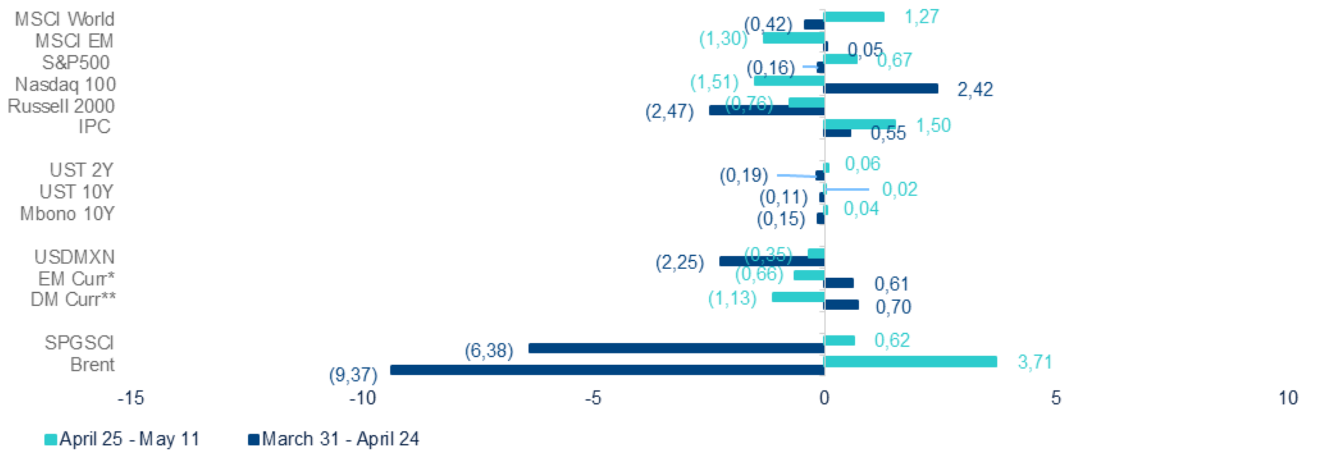
In the case of Mexican assets, it is worth noting that the IPC was the stock index with the highest growth in the sample between March 31 and May 11 (2.1%), and it has already registered gains of 13.5% so far in 2023. This figure is higher than that of the main North American indices with the exception of the Nasdaq 100.

As for domestic rates, the influence of the US curve, the reduction in inflation and the expectation that the monetary tightening cycle has come to an end, could account for the 10 bps drop in the yield to maturity of the 10-year Mexican bond between March 31 and May 11 (see graph 1). Thus, this indicator closed the first third of May at 8.8%, 30 bps below the 2022 close.

Undoubtedly, among domestic assets, the Mexican peso continues to be the most prominent. Between March 31 and May 11, it appreciated 2.6% (see graph 1). With this, the exchange rate closed the first third of May at 17.6 pesos per dollar, a reduction of 1.9 pesos per dollar with respect to the close of 2022.

Thus, there does not seem to be complete consistency between the prices of different assets in a scenario where the key element is a series of interest rate cuts in the span of a few months. This behavior is likely to continue in the coming months until there is evidence to define the dynamics of inflation and the labor market. For the time being, the market context will be dominated in the coming weeks by the volatility resulting from the US debt ceiling.

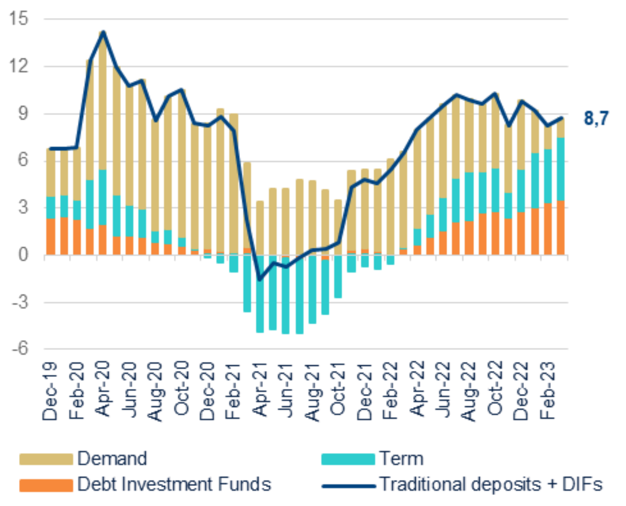
Graph 1. **PERFORMANCE OF MAJOR FINANCIAL ASSET PRICES, DURING APRIL AND MAY 2023** (% CHANGE IN LOCAL CURRENCY)



*JP Morgan Emerging Markets Currency Index. For this index, a decrease (increase) implies a depreciation (appreciation) of a basket of emerging economies currencies against the USD. **DXY Index, for this index a decrease (increase) implies a depreciation (appreciation) of the USD against a basket of developed country currencies.
Source: BBVA Research, with data from Bloomberg.

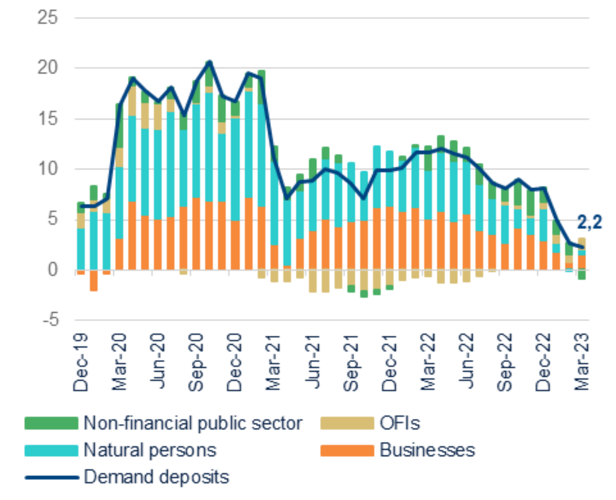
Funding: charts

Graph 2. **COMMERCIAL BANK FUNDING**
(ANNUAL NOMINAL CHANGE, %)



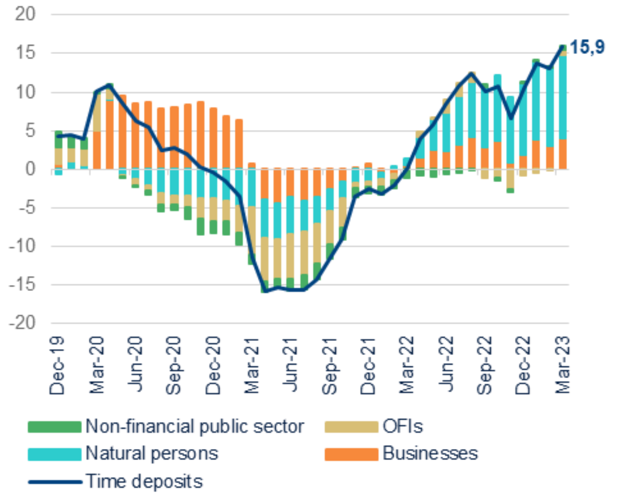
Source: BBVA Research. with data from Banxico.

Graph 3. **DEMAND DEPOSITS**
(ANNUAL NOMINAL CHANGE, %)



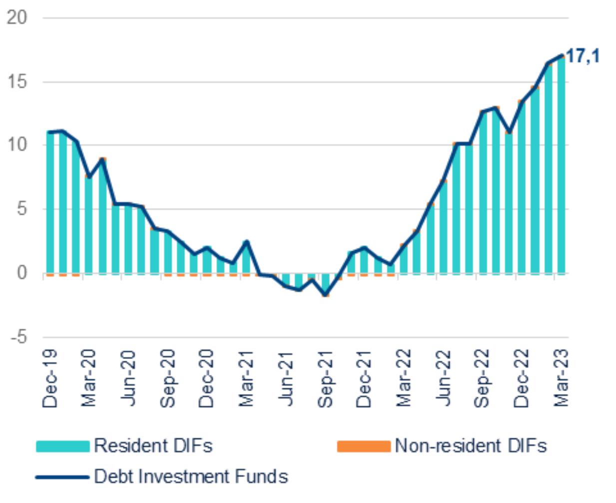
Source: BBVA Research. with data from Banxico.

Graph 4. **TIME DEPOSITS**
(ANNUAL NOMINAL CHANGE, %)



Source: BBVA Research. with data from Banxico.

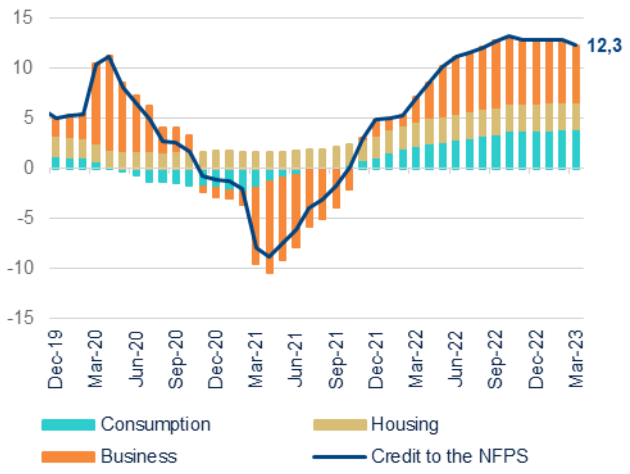
Graph 5. **DEBT INVESTMENT FUND SHARES**
(ANNUAL NOMINAL CHANGE, %)



Source: BBVA Research. with data from Banxico.

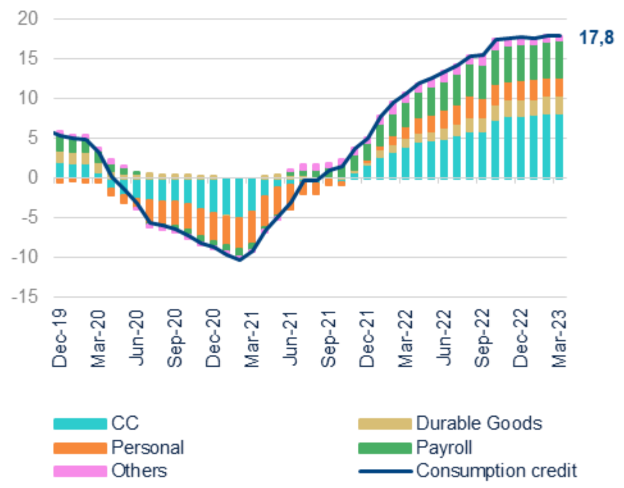
Loans: charts

Graph 6. **PERFORMING BANK CREDIT TO THE NON-FINANCIAL PRIVATE SECTOR** (ANNUAL NOMINAL CHANGE, %)



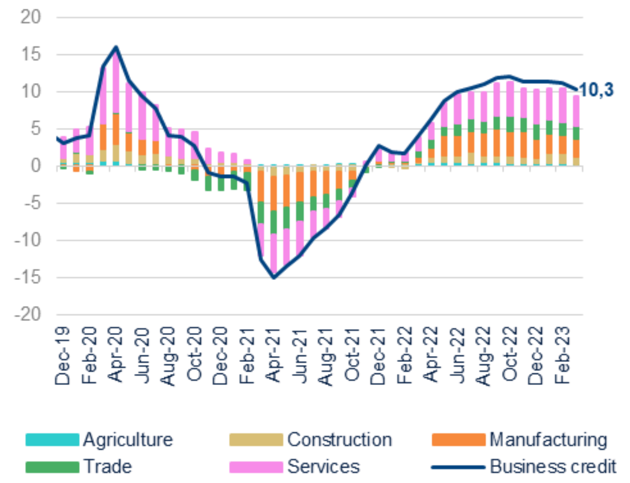
Source: BBVA Research. with data from Banxico.

Graph 7. **PERFORMING CONSUMER CREDIT** (ANNUAL NOMINAL CHANGE, %)



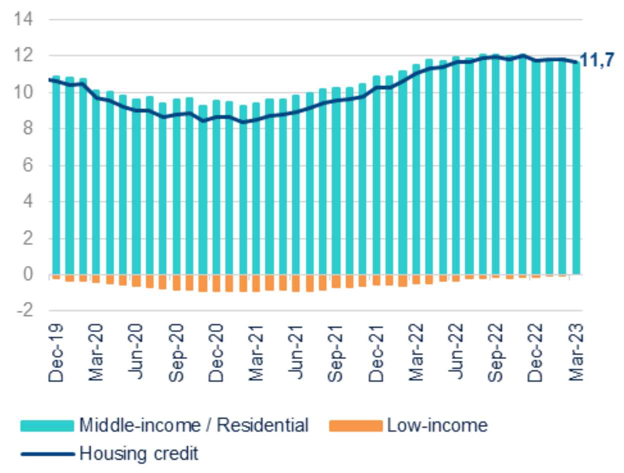
Source: BBVA Research. with data from Banxico.

Graph 8. **PERFORMING BUSINESS CREDIT** (ANNUAL NOMINAL CHANGE, %)



Source: BBVA Research. with data from Banxico.

Graph 9. **PERFORMING HOUSING CREDIT** (ANNUAL NOMINAL CHANGE, %)



Source: BBVA Research. with data from Banxico.

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