Banking

# Monthly Report on Banking and the Financial System

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## 1. Banking and the Financial System

### Real business financing balances decrease in dynamism

In April 2023, the outstanding loan portfolio balance granted by commercial banking to the non-financial private sector (NFPS) registered real annual growth of 5.1% (11.6% nominal), an increase of equal magnitude to that of the previous month. Although the nominal annual rates show a slowdown in the housing and business portfolios, in real terms, only the business portfolio registered a lower dynamism, while credit to households—consumption and housing—continued to accelerate. As a result, consumer credit contributed 2.4 pp to the real annual growth of 5.1% in April, while the business and housing portfolios contributed 1.1 and 1.5 pp, respectively.

Performing consumer credit recorded a real annual growth of 11.2% (18.2% nominal), once again increasing its dynamism compared to the previous month (when a real growth of 10.3% was observed). The credit card (CC) and payroll loans segments (37.7% and 26.4% of the consumer portfolio, respectively) are the main drivers of this recovery, with real growth of 15.6% and 10.6%. Financing for the acquisition of durable consumer goods (ADCG, 15.9% of consumer credit) increased 7.8% in real annual terms, while personal loans (15.9% of the consumer portfolio) recorded a real annual change of 6.7%. The dynamism of the consumer portfolio was mainly driven by dynamic employment and real wages, as well as by the growth of private consumption through April.

The housing portfolio recorded an annual growth rate in real terms in March of 4.8% (11.4% nominal). The result for the fourth month of the year shows an increase in the dynamism of this portfolio, which has been sustained for the third consecutive month, due to the greater momentum of the medium-residential housing segment, and even with a greater contraction in scale in the financing balances for low-income housing. The end of the cycle of hikes in the reference interest rate could mean an incentive for agents to use this type of financing, especially in view of the good performance of the labor market, which has a lagged impact on the growth of this portfolio.

Business financing (54.4% of the outstanding NFPS portfolio) registered a growth in real terms of 2.7% (9.2% nominal), a decline compared to March's figure. However, in April, this portfolio's momentum increased in monthly terms (1.0% vs. -0.3 average during the first quarter of 2023, 1Q23). The high cost of financing, coupled with a relative stagnation of business revenues (for example, in real terms, ANTAD's total nominal store sales indicator showed no real annual growth during April) could be holding back better performance in this type of financing.

The inflationary and interest rate trends seem to have already passed a peak, and their respective decreases could stimulate demand for loanable funds in the coming months, although maintaining the dynamism of the real sector of the economy is also a necessary condition for growth, in order to generate a greater real dynamism of bank credit balances to the NFPS.

## Term deposits were the main source of momentum for traditional bank deposits in April

In April 2023, the balance of traditional bank deposits (sight + term deposits) experienced a real annual growth rate of 0.2% (6.4% nominal), regaining positive ground after the declines observed in 1Q23, which as a whole averaged -0.6%. Term deposits contributed 2.4 pp to the dynamism reported in April, which was enough to offset the 2.3 pp drop in demand deposits. Over the course of 2023, term deposits have consolidated as the main source of dynamism of traditional deposits.

Sight deposits registered a real annual change of -2.3% (2.7% nominal), accumulating four consecutive months of decreases. Part of this drop is due to the negative impact of the valuation of balances denominated in foreign currency (FC, 13.6% of total sight deposits), which have fallen because of the appreciation of the exchange rate. The reduction in the dynamism of these instruments is also attributable to a substitution effect, as savers have opted to allocate part of their resources to longer-term instruments, due to the higher interest rates offered by these types of deposits.

Among sight deposit holders, the contraction of balances in the hands of the private sector is noteworthy; in April, companies reported a drop in real terms of 4.7%, while for individuals this drop was 6.3%. In both cases, the decrease was greater than that recorded the previous month (3.3% and 5.7%, respectively). The dynamism observed in domestic consumption (which grew at a rate of 3.4% in March), together with the sustained growth of real wages (which increases part of the working capital costs for companies) could explain the observed decumulation of liquid resources so far this year. Despite the decrease observed in demand deposit balances in the first months of 2023, it is noteworthy that, discounting the accounting effects of inflation and the exchange rate, balances are still 17% above the level observed in February 2020.

Term deposit balances in April 2023 registered real annual growth of 7.6% (14.3% real), accumulating five consecutive months of recovery, despite the fact that, like sight deposits, the valuation effect of the exchange rate (12.3% of the balance of these deposits is denominated in FC) has reduced momentum. This positive performance is directly linked to the cycle of rising interest rates, which has increased the relative attractiveness of this type of savings instrument. Among term deposit holders, balances held by individuals were particularly noteworthy, reaching a real growth rate of 14.9% in April, the sixth month with double-digit growth in real terms. Meanwhile, companies recorded a 3.0% growth in the balance of their term deposits. The only agents that continue to reduce their time savings are other financial intermediaries (with a -0.8% drop in April) and the non-financial public sector (whose balances contracted by -4.1% in real terms). Going forward, a high interest rate environment heralds a period in which the balances of this type of savings will continue to consolidate their recovery after the deep plunge experienced during the pandemic. In particular, discounting the effect of inflation and the exchange rate, the balance of term deposits is still 7.7% below the level observed in February 2020.

Lastly, among the financial savings alternatives that banks offer, the favorable performance of debt investment funds (DIFs) is particularly noteworthy, which in April reported a real annual rate change of 10.9%, marking 10 months of growth and achieving double-digit momentum, a level that has not been seen since July 2012. The stability of the exchange rate and a low-volatility environment have contributed to boosting the dynamism of these instruments, even in an environment of higher interest rates.

## Basic credit indicators show increases in real terms for consumer and housing portfolios

According to the series of Basic Indicator Reports (RIB for the acronym in Spanish) published by Bank of Mexico, there was an increase in the balance of consumer credit between August 2021 and August 2022, with the exception of automotive loans. The total mortgage loan portfolio grew 2.5% in real terms between September 2021 and September 2022, and the total balance of the portfolio granted by commercial banks represented 22.6% of the total loan portfolio granted by these institutions to the non-financial private sector (NFPS).

In June 2022, the credit card market, the leading consumer credit product, accounted for 37.0% of the total consumer lending portfolio, and recorded a growth of 3.2% in real terms for that period. The delinquency rate (IMOR for its acronym in Spanish) stood at 2.5%, while the adjusted delinquency rate (IMORA for its acronym in Spanish) amounted to 9.7%. Banking institutions reported a total of 27 million cards for individuals, corresponding to a total credit balance of 386.5 billion pesos. The characteristics of the comparable portfolio show a total portfolio of 364.1 billion pesos, of which non-pay-in-full customers account for 8.2 million cards with a credit balance of 223.3 billion pesos (61.3% of the total comparable portfolio balance).

The share of the balance represented by payroll loans in the period from December 2021 to 2022 increased by 9.3% in real terms, with a total balance of 321.1 billion pesos, maintaining its share of the consumer credit portfolio with respect to the previous year and representing 26.6% of the total portfolio. Of the 5.4 million total payroll loans, the comparable portfolio granted in 2022 consisted of 2.6 million payroll loans and represented a balance of 192.0 billion pesos, where the 62-basis point (bp) increase in the weighted average interest rate with respect to the same period of the previous year is noteworthy, standing at 27.5%.

According to the analysis by subsets of payroll loans, we can observe an inverse relationship between loan amounts and the interest rate; that is, for payroll loans of higher amounts originated during 2022, the average interest rate is lower, and loans of more than 120 thousand pesos represented 80.0% of the total balance. Similarly, the average rate decreases as the term granted increases.

Personal loans increased 6.1% in real terms and represented 16.9% of the consumer credit portfolio in August 2022, recording an increase of 0.3 percentage points (pp) with respect to their share in the previous year. The number of personal loans granted between September 2021 and August 2022 totaled 7.6 million, with a balance of 104.7 billion pesos, whose weighted average interest rate was 2.4 pp higher than the rate for the same period of the previous year, closing at 46.4% in August 2022.

The 13.7% of the total consumer lending portfolio corresponding to automotive credit contracted at a real annual rate of 6.9%, being the only type of consumer credit that showed a decrease for the period between April 2021 and April 2022. The total portfolio was comprised of 1.5 million loans corresponding to a total balance of 220.2 billion pesos, where the comparable portfolio for April 2022 had a balance of 187.8 billion pesos and a balance-weighted average interest rate of 13.1%. When segmenting the comparable portfolio by institution, the balance-weighted average interest rates of brand lenders – financial arms of international vehicle manufacturers – have been higher than those of traditional banks in all the months observed.

The commercial banking mortgage loan market experienced positive growth between September 2021 and September 2022, rising by 2.5% in real terms and, in September 2022, consisted of a balance of 1.0787 trillion pesos granted in 1.4 million loans. Home purchase loans represented 82.6% of the total balance of the comparable portfolio, whose balance granted by commercial banks amounted to 210.9 billion pesos during the October 2021-September 2022 period, with a weighted average interest rate of 9.2%. These home purchase loans were made up of 43.5% of loans granted for the purchase of residential real estate, 40.9% for middle-income housing and 15.6% for low-income housing.

As for interest rates, all three housing finance segments experienced increases during the third quarter of 2022, where the weighted average interest rate for low-income housing was higher than the rest, followed by middle-income housing and residential housing, with rates of 9.5%, 9.3% and 9.0%, respectively.

## In Mexico, total financial savings fell 4.1%, and total financing fell 2.7% in real annual terms in 3Q22

On May 17, 2023, the National Banking and Securities Commission (CNBV) published the Report on Financial Savings and Financing in Mexico, with data as of September 2022. The report highlights that, in 3Q22, total financial savings presented a real annual contraction of 4.1% and reached 95.0% of GDP. Likewise, total financing recorded a real annual decrease of 2.7%, reaching 97.5% of GDP.

Foreign savings showed a real annual contraction of 12.7%, reaching 23.3% of GDP in September 2022. By destination, foreign resources received by the public sector amounted to 14.8% of GDP, while those captured by the private sector represented 8.5% of GDP. In terms of their composition as a percentage of GDP, securities issued abroad accounted for 11.7%, loans obtained abroad 6.0%, securities issued in Mexico by non-residents 5.5%, lower proportions than those recorded in previous quarters.

Domestic financial savings fell 0.9% in real annual terms at the end of 3Q22, and its share of GDP grew to 71.7% (from 69.2% at the end of 2Q22). Holdings of fixed-income securities and trust stock certificates ("CBFs" for the acronym in Spanish, 35.9% of GDP) showed a real annual drop of 3.1%, while deposits acquired by financial intermediaries (35.8% of GDP) grew 1.5%. Commercial banks accounted for most of the funds acquired, with balances representing 22.9% of GDP, while Infonavit and development banking represented 5.5% and 3.5% of GDP, respectively.

Foreign financing (17.7% of GDP) recorded a real annual contraction of 9.2%, foreign funding to the private sector (8.1% of GDP) decreased 9.7% in real terms, and foreign funding to the public sector (9.6% of GDP) recorded a real annual change of -8.7%.

By type of foreign financing, fixed-income securities issued abroad were equivalent to 11.7% of GDP, while foreign loans represented 6.0% of GDP, lower than the proportions recorded at the end of 2Q22. Domestic financing showed a real annual contraction of 1.1%, reaching 79.8% of GDP. In September, by type of financing, domestic debt issuance and trust certificates (45.5% of GDP) fell 2.2% in real annual terms, while the total loan portfolio (34.3% of GDP) grew 0.5%.

Total private sector financing (44.5% of GDP) was mainly composed of credit from commercial banks (18.4% of GDP), followed by credit from other financial intermediaries (10.8% of GDP), foreign debt issuance (5.8% of GDP), domestic debt issuance and CBFs (5.5% of GDP), foreign loans (2.3% of GDP) and development banking (1.1.7% of GDP). Meanwhile, public sector financing (52.9% of GDP) was made up of domestic debt issuance and CBFs (40.0% of GDP), followed by foreign debt issuance (5.9% of GDP), foreign loans (3.7% of GDP), commercial bank loans (2.3% of GDP) and development banking (1.2% of GDP).

As in previous periods, the lower scale of contraction in domestic financing has implied a restructuring, to the detriment of foreign sources. As for savings, the foreign component presented the greatest contraction, implying a similar restructuring to that of financing. It is noteworthy that deposits from commercial banks mitigated the growth of domestic savings in Mexico, showing a real annual drop of 0.4%.

The report also shows informative data on non-financial entities. Non-bank credit cards reduced their balances by 0.5% in real annual terms in 3Q22, while supplier credit to BMV (Mexican stock exchange) issuers fell by 4.9%, perhaps reflecting a certain degree of substituting these sources for bank credit.

### Interest rate increase in an environment of economic growth accounts for the recent change in the composition of financial savings in Mexico

Banxico's most recent Quarterly Inflation Report dedicated a section to analyzing the change in the composition of household financial savings in Mexico. In particular, the section focuses on quantifying the effect of an increase in the interest rate on the composition between sight deposits, or highly liquid deposits, and term deposits in the period from 2006 to 2022.

It estimates a broad money demand model, which essentially includes GDP in order to capture the transactional motive of money demand, as well as the effective interest rate on term deposits in order to capture the speculative motive of money demand.

It finds a negative and significant relationship between the interest rate on term deposits and the balance of deposits in real terms, and a positive relationship with the balance of term deposits. From this relationship, it is possible to account for the increase in term deposits at the expense of sight deposits, given the recent monetary tightening cycle. Additionally, it finds a positive and significant relationship between the balance in real terms of both sight deposits and term deposits with GDP, which validates the hypothesis of the transactional motive of money demand.

Finally, it performs a backtesting exercise to quantify what the behavior of term and sight deposits would have been if the monetary tightening cycle had not taken place. The conclusion is that, had interest rates remained unchanged, the balance of sight deposits would have registered an annual real growth of 8.4 percentage points higher than observed, while term deposits would have registered 7.0% lower annual real growth.

## 2. Financial Markets

### Gradual alignment of market expectations with the Fed's more restrictive forecasts. Peso at its strongest level since 2015

The forecasts of additional interest rate hikes by FOMC members mark the culmination of a process, unfolding between mid-May and June, in which financial market participants aligned their federal funds rate expectations with the US central bank's forecasts.

After several months, and once the issue of the US debt ceiling renegotiation was out of the way, the above-expected employment data and a greater persistence of core inflation gave strength to the FOMC members' emphatic communication, and gradually led the market to incorporate new hikes for the coming months and to practically eliminate interest rate cuts from the most-likely scenario for 2023.

This process of alignment of expectations was reflected in a further increase in interest rates in the US fixed income market. Between May 15 and June 13, the yield to maturity on the 2-year Treasury bond increased 66 basis points (bps), bringing it back above 4.65%, its highest level since early March.

In the same period, the yield to maturity of the 10-year Treasury bond increased 31 bps, bringing the slope (2y-10y) to its lowest level (-0.85%) since early March, just before the collapse of Silicon Valley Bank.

In Mexico, the increases were much more moderate, given the monetary pause already confirmed by Banxico and in view of headline inflation that shows a clear downward trend, although the core component has been highly persistent. In fact, between mid-May and June 13, the yield to maturity of Mexico's 10-year bond increased by 11 basis points to close the period at 8.9%, considerably below the 9.4% reached at the end of February.

In contrast to the fixed income market, the North American equity market saw significant advances for the main indexes due to the rebound in technology companies. The catalyst on this occasion was Nvidia's increase in revenue expectations for the second half of the year, due to the higher demand expected for AI-related components and services.

Thus, between May 15 and June 13, increases of 9.8% and 5.6% were recorded for the Nasdaq and S&P500, respectively. These gains were well above the performance of the benchmark for this asset class globally and in other regions (see Figure 1), given the concentration of technology companies in the North American market. The CPI of the Mexican Stock Exchange recorded a 1.2% drop in the aforementioned period, below the benchmark for emerging markets (see Figure 1).

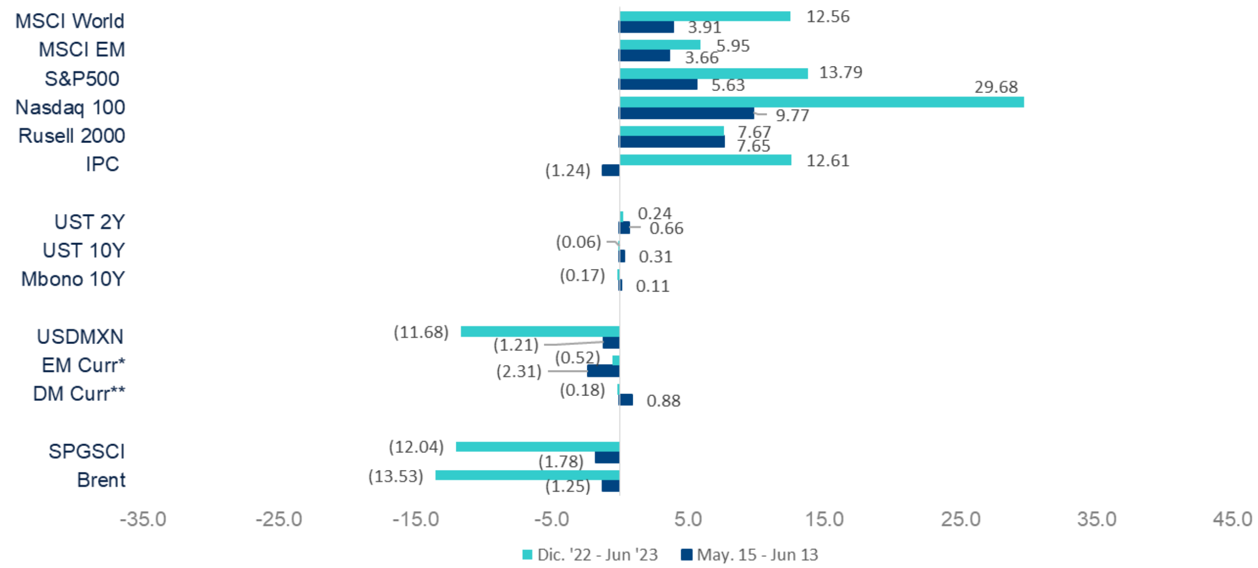
This different behavior of the main North American indexes with respect to the performance of the fixed income market is striking in an environment with expectations of recession. However, it is relevant to consider that most of the aforementioned gains are concentrated in a reduced group of stocks and cannot be said to represent the performance of the US corporate market.

Regarding the foreign exchange market, the performance of the peso is once again worth noting. The Mexican currency appreciated 1.2% between May 15 and June 13, which led the exchange rate to trade at 17.2 pesos per dollar, its lowest level since 2016. With this, the peso has accumulated an appreciation of 11.7% so far in 2023 and ranks as the most appreciated currency in the group of emerging market currencies (Figure 1).

Finally, expectations of a recession this year, as well as a lower-than-expected recovery after the reopening of the Chinese economy, influenced the 1.8% drop in the commodity benchmark between May 15 and June 13. It should be noted that, despite the drop in the energy subindex and the Brent price in the aforementioned period, the price of the Mexican crude oil mixture experienced a 1.0% increase (Figure 1).

The alignment of market expectations with the Fed's projections seems to leave behind the scenario of an elevated tightening of credit conditions after the banking turbulence of a few months ago. Attention could now shift toward the extent to which the US economy will maintain its momentum despite the significant monetary tightening cycle, at a time when several market participants are beginning to downplay the likelihood of a recession this year. Obviously, the Fed's reaction will be equally important if this scenario does play out, particularly if the persistence that core inflation has displayed up to this point continues.

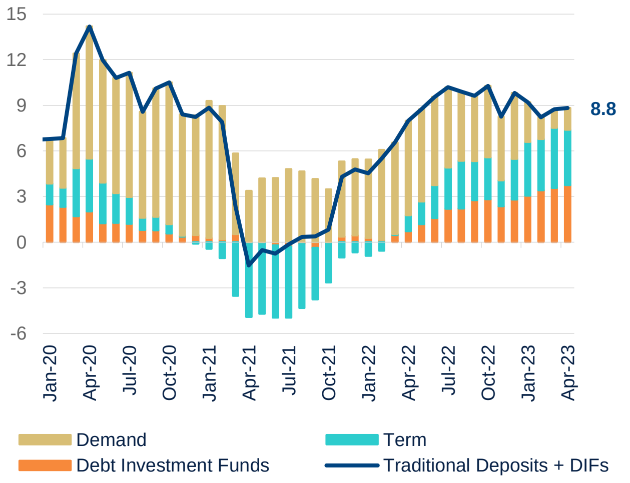
Figure 1. **PERFORMANCE OF MAJOR FINANCIAL ASSET PRICES BETWEEN MAY 15 AND JUNE 13, 2023 (CHANGE IN LOCAL CURRENCY, %)**




*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.
Source: BBVA Research based on Bloomberg data.

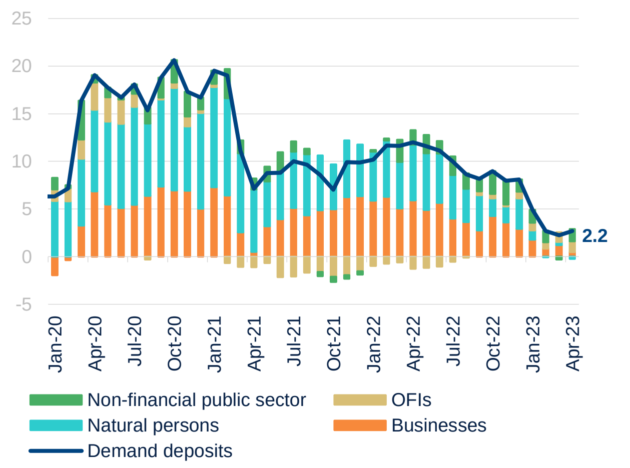
# Deposits: figures

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



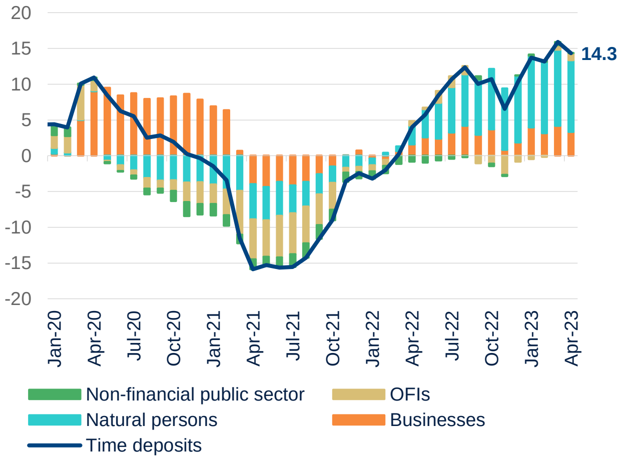

Source: BBVA Research with data from Banxico.

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



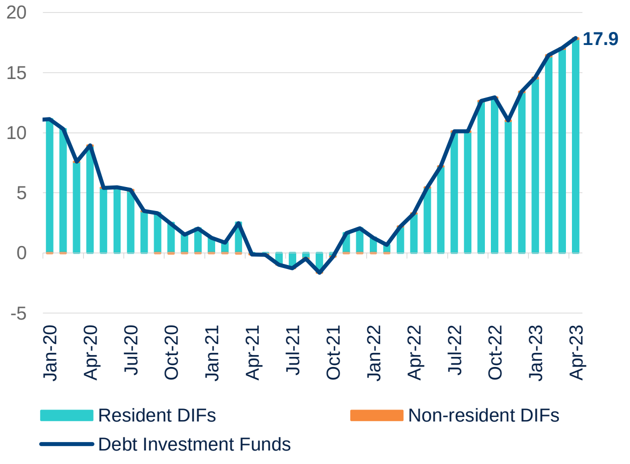

Source: BBVA Research with data from Banxico.

Figure 4. **TERM DEPOSITS (NOMINAL ANNUAL CHANGE, %)**




Source: BBVA Research with data from Banxico.

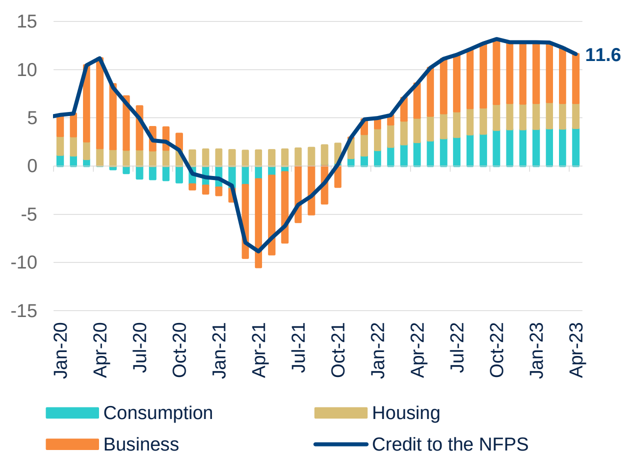
Figure 5. **DEBT INVESTMENT FUND SHARES (NOMINAL ANNUAL CHANGE, %)**




Source: BBVA Research with data from Banxico.

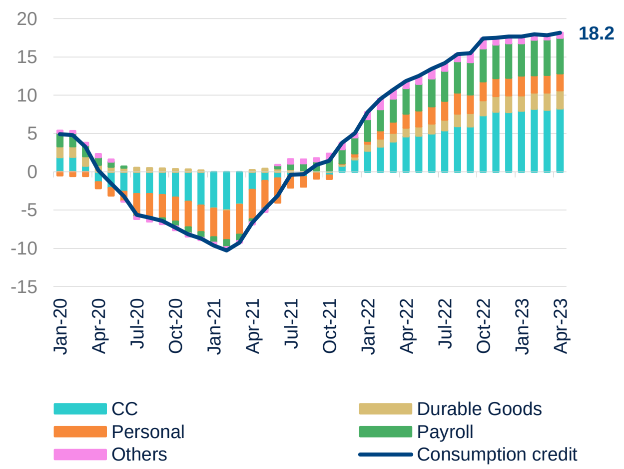
# Credit: figures

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



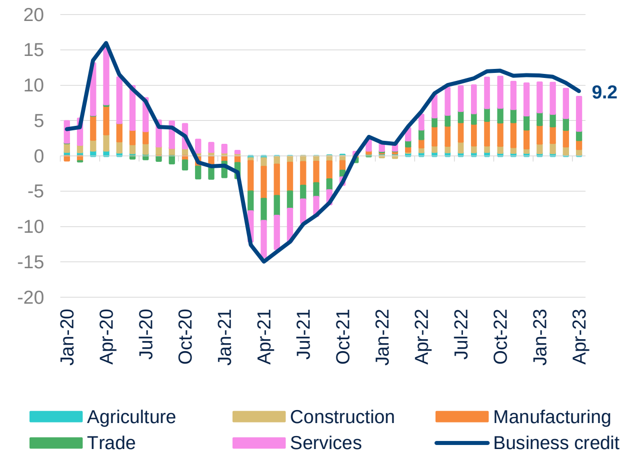

Source: BBVA Research with data from Banxico.

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



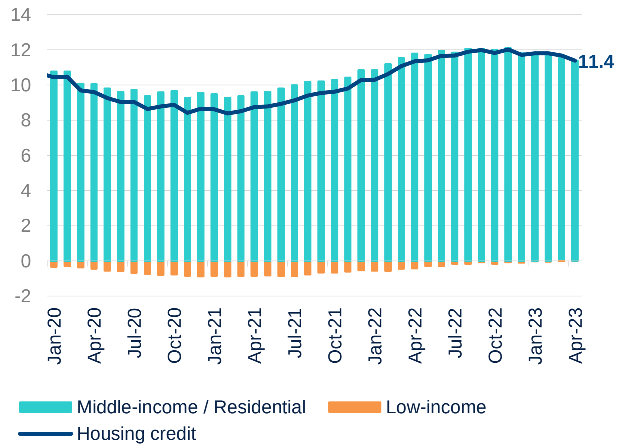

Source: BBVA Research with data from Banxico.

Figure 8. **PERFORMING BUSINESS LOANS** (NOMINAL ANNUAL CHANGE, %)




Source: BBVA Research with data from Banxico.

Figure 9. **PERFORMING MORTGAGE LOANS** (NOMINAL ANNUAL CHANGE, %)




Source: BBVA Research with data from Banxico.

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