Banking

Monthly Report on Banking and the Financial System

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1. Banking and the Financial System

Further mild growth in traditional deposits among commercial banks, driven by term deposits

In July 2023, traditional bank deposits (sight + term) reported a real annual growth rate of 1.5% (equivalent to nominal growth of 6.4%), making it the fourth straight month in positive territory following the annual real rate declines recorded in the first quarter of 2023 (1Q23, when the rate averaged -0.6%). Term deposits continue to be the main driver of traditional deposits, contributing 2.5 percentage points (pp) to their growth in July, which was more than enough to offset the -1.0 pp slump in sight deposits.

Sight deposits experienced a real annual change of -1.4% in July (nominal growth of 3.3%), the smallest decline so far this year (on average, in the first half of 2023 (1H23), the real annual rate was down 3.5%). The deposit holders largely responsible for this decline were individuals (43.6% of the total), whose balances showed a real annual change of -7.4% in July —the largest drop recorded since August 2022. This reduction in sight deposits in the hands of individuals was likely down to private consumption now moving at a stable pace, amid an inflationary environment that is gradually easing, coupled with the reallocation of money toward instruments offering higher returns. Sight deposits in the hands of businesses (38.7% of the total) stopped falling in July to record a zero change in the annual real rate (0.0%), while the other financial intermediaries and non-financial public sector segments showed positive real growth rates (of 24.6% and 7.8%, respectively), albeit not enough to offset the decline in sight deposits held by individuals.

The growth figures were more eye-catching in the case of term deposits. In July 2023, these savings instruments reported real growth of 7.7% (nominal rate of 12.8%), higher than the average real annual growth rate observed in 1H23 (7.1%). Term deposits in the hands of individuals fared particularly well (12.9% in July), having now made it nine straight months of double-digit real annual growth (excluding the exchange rate effect). Most segments holding this type of savings (businesses, individuals and the non-financial public sector, which account for 84.3% of term deposits) continued to report an increase in their balances with respect to the previous year. Only in the case of other financial intermediaries was there a reduction in these balances (-2.3% real annual rate in July), which goes some way to explaining the increase in their holdings of sight deposits. Notably, this reshuffling of balances in the other financial intermediaries segment has been following a different trend to that of the other term deposit holders, a circumstance that could be down to the increase in the cost of their funding sources.

Although the current environment of higher interest rates has prompted many economic agents to hold more of their money in term instruments, the buoyant pace of private consumption could explain why this increase has failed to offset the decline in sight deposits. In all likelihood, we will continue to observe this gradual restructuring of bank deposits for as long as the high interest rates persist and economic activity and employment continue to grow.

Household credit continues to grow, while the corporate portfolio picks up the pace in real terms

In July 2023, the balance of the current loan portfolio granted by commercial banks to the non-financial private sector (NFPS) recorded real annual growth of 5.1% (nominal rate of 10.2%), showing an increase on the 4.6% reported the previous month. Although the nominal annual rates revealed a gentle slowdown in loans to households (consumer and mortgages) in real terms, the performance was substantially similar to the previous month, with only the corporate portfolio picking up the pace. However, loans to households continued to grow at double-digit real rates, meaning that consumer credit contributed 2.8 pp to the real annual growth of 5.1% in July, while the mortgage loan and business loan portfolios contributed 1.3 and 1.1 pp, respectively.

Outstanding consumer credit recorded real annual growth of 12.6% in July (18.0% in nominal terms), on a par with the level reported in June. The credit card and payroll loan segments (37.9% and 26.1% of the consumer portfolio, respectively) were the main drivers of this recovery, with real growth rates of 17.2% and 10.5%, respectively. Financing for the acquisition of consumer durables (ACD, 15.9% of consumer credit) reported real annual growth of 11.5%, while personal loans (15.8% of the consumer portfolio) recorded a real annual change of 7.7%. The strong performance of the consumer portfolio has come largely on the back of private consumption, further supported by a buoyant environment in terms of employment and real wages.

The mortgage portfolio recorded an annual growth rate in real terms of 5.7% in March (10.7% in nominal terms), which was also on a par with the previous month and was down to the strength of the middle-income residential housing financing segment, which presented real annual growth of 6.0%, while social housing financing balances continued to report negative growth (-2.1%). This type of financing stands to benefit if the expectation of lower interest rates comes to pass in the medium term and this is passed on to mortgage rates. Further support factors for this segment would include the growth in real wages we are currently seeing, as well as employment data, which lags to feed through to the housing portfolio and affect its performance.

Corporate financing (53.7% of the outstanding portfolio to the NFPS) was up 2.0% in real terms (6.8% in nominal terms), thus picking up the pace compared to June. This portfolio delivered a stronger monthly performance in July (1.7% vs. an average of 0.2% throughout 1H23). A high cost of financing could be holding it back to some degree, although this factor is likely to dissipate in the medium term, given the expectation of lower interest rates. The growth of business revenues (as shown by the real growth in ANTAD[1] total store sales) would also help to drive the performance of this portfolio, provided that it continues to grow as it has done in recent months (4.2% real in July and 2.5% real average in 1H23).

Inflation has been following a downward trend, accompanied by expectations of lower interest rates in the medium term, which may increase the demand for credit. However, this support factor must also be accompanied by a strong performance from the real sector of the economy so that the financial variables effectively lead to sustained growth in credit to the NFPS.

1: National Association of Supermarkets and Department Stores.

Rising demand in the business portfolio and in the credit card and automotive segments of the commercial banking sector in 2Q23

The results of the Survey on General Conditions and/or Standards in the Bank Credit Market for the period April–June 2023 revealed an increase in demand for credit in the second quarter of the year. Banks with the largest market share reported an increase among the large non-financial corporate, SME, credit card and automotive credit sectors, while those with the smallest share of the market also reported an increase in the same segments, though also in the payroll loan and personal loan sectors.

Commercial banking as a whole reported growing demand for credit to large non-financial corporations in 2Q23, of 0.25 and 0.08 according to the diffusion index[2] for banks with higher and lower market shares, respectively. Following the positive trend in the results for the second quarter, commercial banking expects to see a further increase in demand for credit to this segment over the next three months.

The demand for credit to non-financial SMEs among commercial banks was also up in the second quarter, with overall indices of 0.08 (0.12) for banks with higher (lower) market shares, while the overall index for the coming three months is expected to increase for banks with lower shares to reach 0.19 in demand for this type of credit.

The credit to non-bank financial intermediaries segment saw an increase in demand among banks with lower market shares, with 0.25 in the overall index and with a further increase in demand expected for the next quarter. Meanwhile, banks with higher market shares do not expect to see any significant changes. The results for this segment point to a tightening in general conditions and loan approval standards, of up to -0.33 for the higher market share banks and -0.19 for those with a smaller share of the market. Notably, this tightening is expected to continue over the coming three months.

Demand was also up for consumer credit in the form of credit cards, with a diffusion index of 0.40 for banks with larger market shares. Moreover, large and small banks alike expect this trend to continue during the next quarter. Meanwhile, the general conditions and standards of credit approval in this segment reported an index of -0.10 for banks with the largest market share, thus bringing both segments closer together as there was no change in the index among banks with smaller shares of the market.

The other consumer credit segments reported an increase, mainly among banks with smaller shares, where the diffusion rates for payroll and personal loans were 0.22 and 0.11, respectively. Meanwhile, larger banks segment recorded an increase in demand for automotive loans, while there were no significant changes in the payroll and personal loan segments. The general conditions and approval standards for this subset of consumer loans were largely the same as in the previous quarter, easing only for the personal loans segment among both bank segments.

Demand for mortgage loans was unchanged compared to the previous quarter, although both bank segments expect this situation to change over the coming three months. Banks with the largest share of the market anticipate an increase in demand equivalent to 0.17 in the diffusion index, while banks with the smallest share expect to see a decrease in this segment of -0.07.

2: The corresponding diffusion index is a value between -1 and 1, which is calculated as the average of the responses given by institutions belonging to the segment in question. For each question included in the survey, five response options are presented with the following assigned values: -1 (1) for a significant decrease (increase); -0.5 (0.5) for a moderate decrease (increase); and 0 if there has been no change. For the questions regarding general conditions and/or loan approval standards, five response options are given with the following assigned values: -1 (1) for a significant tightening (relaxation); -0.5 (0.5) for a moderate tightening (relaxation); and 0 if there has been no change.

The performance of the commercial banking segment has been driven by an improvement in the domestic and international economic environment. The diffusion index for the national economic environment stood at 0.42 in the second quarter, 0.17 points above the level reported in the previous quarter and mirroring the upturn in the international economic environment, which, with an index of 0.33, is 0.58 points above the level reported in January–March 2023. There was also an improvement during the period in the economic situation of businesses and in confidence in economic activity among businesses and households.

2. Financial markets

Higher rates at the end of the summer as US economic data and oil prices remain above expectations

The main change in the financial markets during the summer and in early September has been the significant increase in interest rates. Better-than-expected figures on economic activity in the United States and rising oil prices were the main factors steering monetary policy expectations toward a scenario of higher rates for a longer period of time.

However, the main component of the increase in interest rates was not the short rate, nor the inflationary component, but the real component. Between August 1 and September 12, the real 10-year interest rate in the United States gained around 27 basis points (bp) to reach 1.94%. This increase, on top of the factors already mentioned, was also influenced by the expected growth in the US fiscal deficit.

As a result, the nominal US Treasury bond curve became steeper at the long end following an increase of 26 bp in the 10-year tenor that brought its yield to maturity to 4.33%, but reported a more modest increase of 11 bp in the short end of the curve.

In Mexico, the federal government's budget proposal for 2024 —characterized by a higher deficit (4.9% of GDP) and a deficit primary balance (-1.2% of GDP)— exerted additional pressure on interest rates during the second week of September. Notably, on September 11 —the first day after the budget was released— the government yield curve rose by an average of 15 bp, with increases of 22 and 18 bp in the 10 and 20-year tenors, respectively. At close of trading on September 12, the yield to maturity of the M10 stood at 9.75%.

In this context of a North American economy growing at a faster pace than expected, in stark contrast with the other main regions of the world (e.g. China and the European Union), the dollar recorded widespread gains. Between August 1 and September 12, the greenback was up 2.35% against a basket of currencies of developed countries, while this appreciation stood at 2.22% against a basket of major emerging market (EM) currencies.

During the same period, the Mexican peso depreciated 1.9%, making it the fourth biggest faller among Latin American currencies. Notably, this depreciation in the Mexican currency was also influenced by the announcement made by the Foreign Exchange Commission on August 31 that it would be winding down the foreign exchange hedging program.

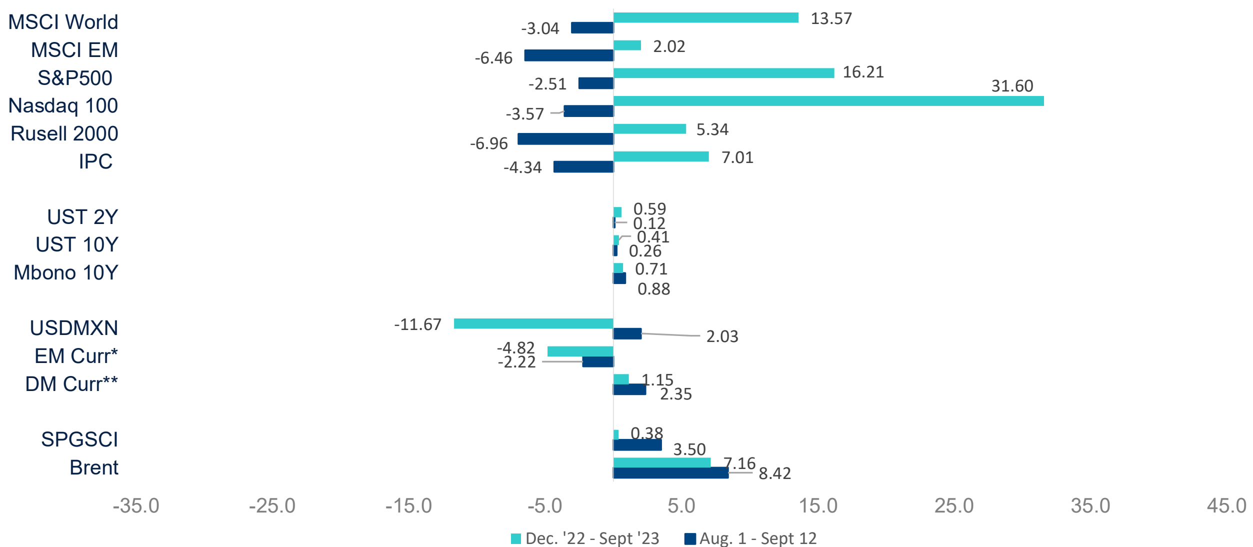
This context of higher interest rates led to a reduction in risk appetite, which in turn triggered a decline in the main stock indexes. Between August 1 and September 12, the global benchmark for this asset class reported losses of 3.0%, while for the emerging economies benchmark the decline was 6.5%. For North American indices, the

reduction ranged from 2.5% to 6.9% (see Figure 1), while the CPI of the Mexican Stock Exchange was down 4.3% in the same period.

In the commodities market, the most noteworthy change was the increase in oil prices in response to lower supply within the market, especially following the announcement made by Russia and Saudi Arabia that they would be maintaining their oil production cuts. Thus, between August 1 and September 12, the price of a barrel of Brent oil was up 8.4% to USD 92 per barrel —an increase well above the 3.5% of the benchmark for this asset class. Meanwhile, Mexican mixed crude oil was up 9.6% to reach a price of USD 85 per barrel at the close of trading on September 12.

In view of the latest economic data, the general consensus among financial market participants is that of a soft landing. The market has been becoming increasingly confident that the Fed will be able to get inflation on a path consistent with its 2.0% target, without generating any significant increase in unemployment in the process. However, the recent rise in oil prices, the unusual strength of the US labor market amid high interest rates and the fiscal position of the US economy are all factors that could end up derailing what seems to be the most likely scenario for the financial markets.

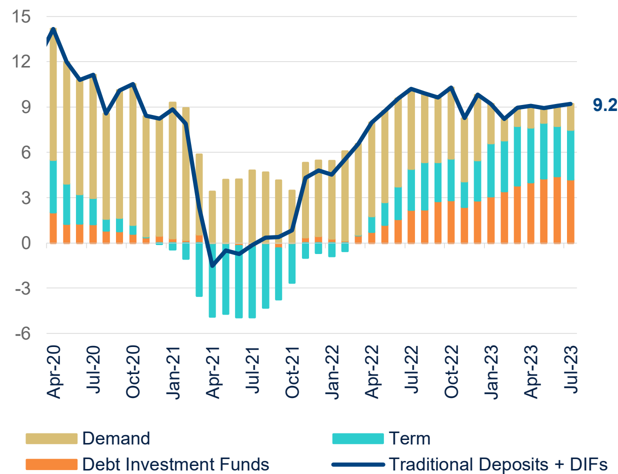
Figure 1. **PRICE PERFORMANCE OF THE MAIN FINANCIAL ASSETS IN AUGUST AND SEPTEMBER 2023 (% CHANGE IN LOCAL CURRENCY)**



*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.

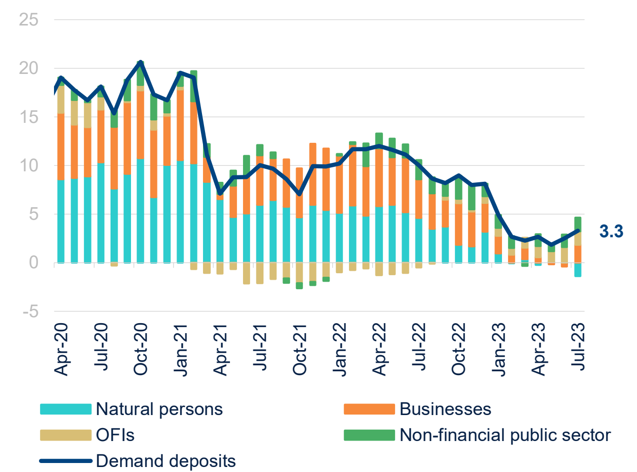
Deposits: figures

Figure 2. **COMMERCIAL BANKING DEPOSITS (NOMINAL ANNUAL CHANGE, %)**



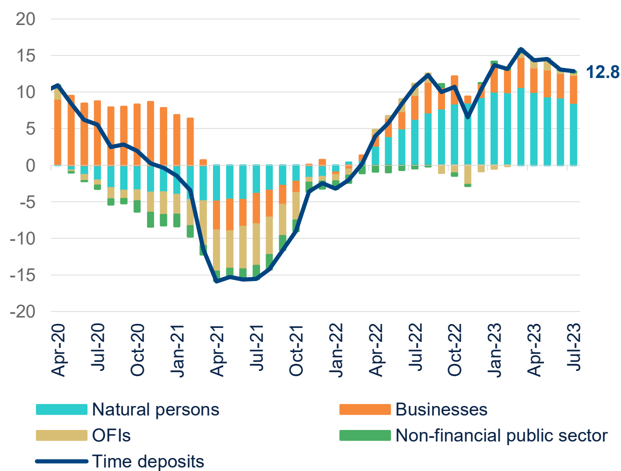
Source: BBVA Research based on Banxico data.

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



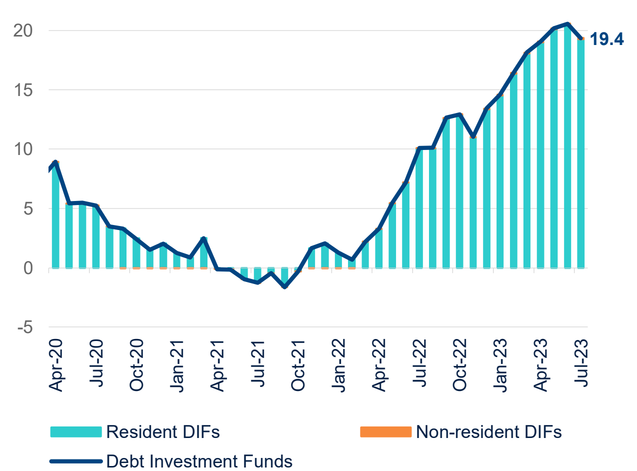
Source: BBVA Research based on Banxico data.

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



Source: BBVA Research based on Banxico data.

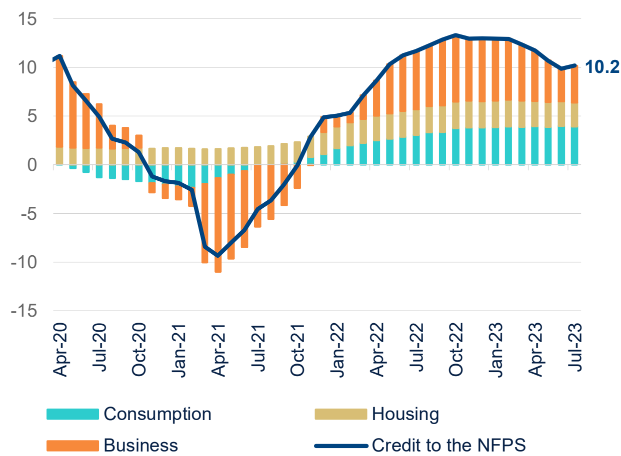
Figure 5. **DEBT INVESTMENT FUND SHARES (NOMINAL ANNUAL CHANGE, %)**



Source: BBVA Research based on Banxico data.

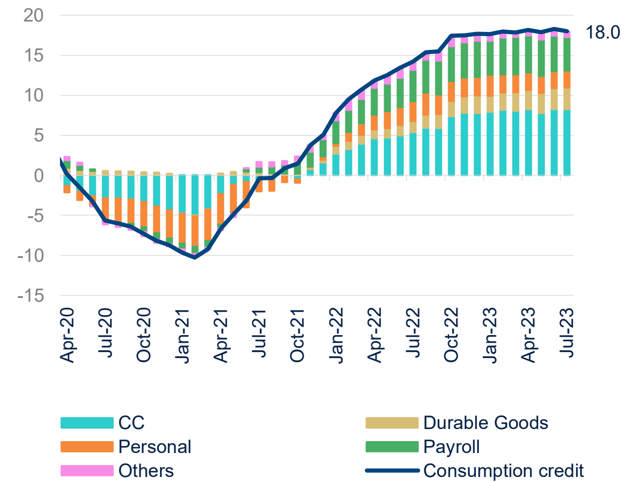
Credit: figures

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



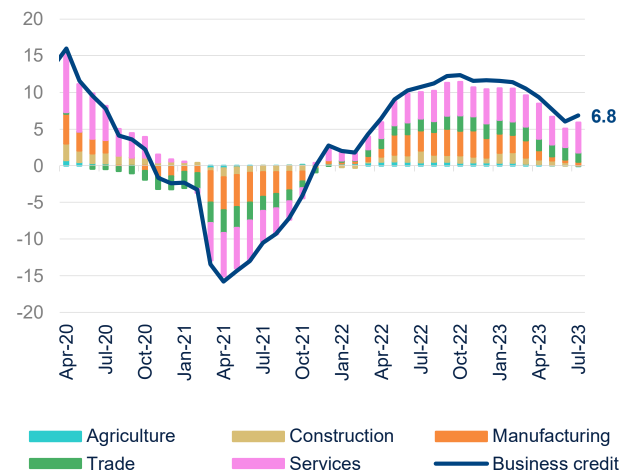
Source: BBVA Research based on Banxico data.

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



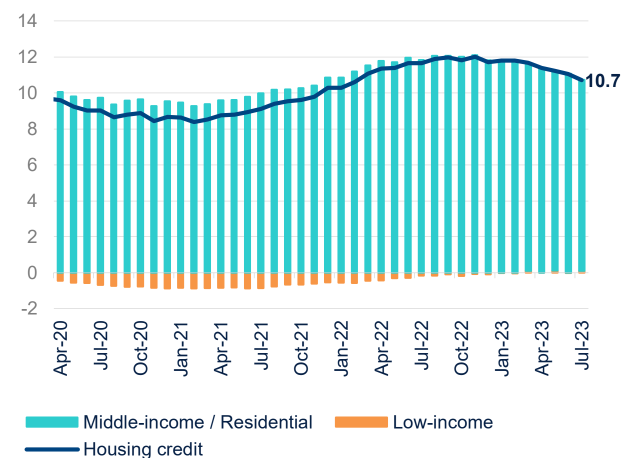
Source: BBVA Research based on Banxico data.

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



Source: BBVA Research based on Banxico data.

Figure 9. **OUTSTANDING HOUSING LOANS** (NOMINAL ANNUAL CHANGE, %)



Source: BBVA Research based on Banxico data.

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