Banking

Monthly Report on Banking and the Financial System

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October 12, 2023

1. Banking and the Financial System

Recovery in sight deposits provides welcome boost to traditional bank deposits

In August 2023, the balance of traditional bank deposits (sight + term) recorded real annual growth of 3.2% (equivalent to nominal growth of 8.0%), marking an improvement on the previous month (1.5% real). For the first time this year, sight deposits made a positive contribution by adding 0.7 pp to the 3.2% growth in traditional deposits, although term deposits remained the main growth driver, contributing 2.5 pp.

Notably, since September 2022 the appreciation of the exchange rate has had a negative effect on growth in traditional bank deposit balances, due to the valuation effect of balances denominated in foreign currency (close to 13% of total traditional deposits). Stripping out this effect (and that of inflation), balances in August were up 5.8% in real terms.

Sight deposits recorded real annual growth of 1.0% (5.7% nominal) in August, their first time in positive territory following seven straight months of declines. This recovery is down to an improved performance from sight deposits among other financial intermediaries, the non-financial public sector and corporates, which was enough to offset the dip in sight deposits among individuals, which have now fallen at an annual rate for 13 months running. This trend has now slowed, and in August, the real annual change in sight deposits among individuals amounted to -5.1%, an improvement on the -7.3% observed in the previous month. This slowdown in sight deposits among individuals can be explained by the growth in private consumption (which in the first seven months of the year recorded an average annual growth rate of 4.2%) and by the fact that term instruments are now more attractive amid an environment of persistently high interest rates.

Meanwhile, the busy growth in term deposits has now stabilized somewhat. In August 2023, these savings instruments showed real growth of 7.5% (12.5% nominal), slightly below the growth observed in the previous month (+7.7% real), though still above the average real annual growth rate observed in the first seven months of 2023 (+7.2%). Broken down by type of holder, term deposits among individuals continued to perform strongly by posting double-digit real annual growth for the tenth straight month (+12.4% in August). Further highlights included the slight recovery in term balances among other financial intermediaries, which in August grew at a rate of 0.4% after having fallen in the previous two months. The non-financial public sector and corporates also remained buoyant in August, albeit growing at a somewhat slower pace: for the non-financial public sector, the real annual growth rate in August was 3.5% (down from 5.2% in the previous month), while for corporates, the real annual growth rate was 9.0% (down from 9.8% in July). Thus, savers are continuing to be lured toward term instruments due to the prevailing environment of high interest rates.

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

In August 2023, the balance of outstanding loans from commercial banks to the non-financial private sector (NFPS) grew by 5.6% annually in real terms (10.5% nominal), clearly outpacing the 5.2% growth reported in the immediately preceding month. Nominal annual rates revealed stronger growth in the consumer and business loan portfolios, which can also be observed in real terms. Meanwhile, the housing loan portfolio slowed during August, in both nominal and real terms. By portfolio, consumer credit contributed 2.9 pp to the real annual growth of 5.6% reported in August, while the business and housing portfolios contributed 1.5 and 1.2 pp, respectively.

Real outstanding consumer credit balances recorded annual growth of 12.9% (18.2% nominal), marking an improvement on July. Balances in the credit card (CC) and payroll loans segments (37.9% and 26.0% of the consumer portfolio, respectively) recorded real growth rates of 17.2% and 10.5%, similar to the level reported in July. Meanwhile, credit for the acquisition of consumer durables (ACD; 15.9% of total consumer credit) was up 12.0% in real annual terms, while personal loans (15.8% of the consumer portfolio) registered a real annual change of 7.9%. Aside from the strong performance of private consumption, which is largely responsible for the growth in the CC segment, the current strength of real wages —and resulting improvement in household purchasing power— has increased demand for payroll and personal loans, as households can now afford more debt for this type of credit.

The housing portfolio recorded real annual growth of 5.5% in March (nominal growth of 10.3%), down on the preceding month but showing opposing dynamics between its two components. First, credit balances for the acquisition of middle-income residential housing experienced a gentle slowdown in real terms (5.9% vs. 6.0% in the preceding month), while balances used to finance low-income housing were down 4.5% in real terms, outpacing the decline reported in July. As in the case of the consumer portfolio, an expectation of higher real wages would boost demand for mortgage loans and contribute to sustained portfolio growth even amid the current environment of high long-term interest rates.

Business financing (53.6% of outstanding loans to the NFPS) was up 2.7% in real terms (7.5% nominal), showing an improvement on the figure reported in July. The sector making the largest contribution to this growth is trade, followed by other tertiary activities and, to a lesser extent, mining. Commercial revenue growth (reflected in the real growth of ANTAD total store sales[1]) was up in real terms (2.3% real growth in July and August), while real balances in the construction and manufacturing sectors fell 0.2 and 3.0%, respectively. Within manufacturing, while the real balances of the transport equipment manufacturing industry showed an annual change of 42.3%, they are still 3.1% below their level in February 2020, showing that balances have yet to recover to pre-pandemic levels.

Outstanding balances of business credit to small and medium-sized enterprises (SMEs) registered real annual growth of 0.8% in August, making it the first month in positive territory since July 2022, according to data from the National Banking and Securities Commission (CNBV). In this segment, several sectors posted double-digit real annual growth rates, including professional services (28.5%), transport (27.5%), telecommunications (22.5%), mining/energy (18.6%), hotels and restaurants (15.8%) and trade (15.2%). In contrast, balances to SMEs in the agricultural and construction sectors were down 10.6 and 3.7%, respectively.

1: National Association of Supermarkets and Department Stores.

In the case of manufacturing SMEs, the real outstanding balance was unchanged in annual terms, although there was notable growth in credit to the construction materials industry, which offset the declines recorded in the food, automotive, chemical and pharmaceutical, textile and footwear industries.

Outstanding business credit balances increase in both the North and North Central regions in 2Q23

According to Banco de México's April–June 2023 Regional Economies Report[2], based on the Credit Market Conjunctural Evaluation Survey (EECMC) for 2Q23, the outstanding portfolio of credit granted by commercial banks to non-financial private companies presented real annual growth of 0.5% in the second quarter of the year, its lowest level in the last five quarters and well below the figure for 1Q23, when it registered growth of 3.1%.[3]

Bank credit in the Northern region, which accounts for 24% of credit, contributed 1.3 pp of these 3.2 pp, while 0.8 pp is attributable to the North Central region, -1.1 pp to the Central region, and -0.6 pp to the Southern region. Notably, none of the regions managed to report any growth increase in quarterly terms and only the Central region managed to do so in annual terms, with a real annual change of 4.8% (vs. 6.8% in 1Q23 and 2.8% in 2Q22).

In 2Q23, the outstanding portfolio within the agricultural sector grew only in the North Central region of the country, with a real annual change of 3.1%. In contrast, outstanding loans to the agricultural sector in the North region dipped by 10.1%, while in the Central and Southern regions, the declines were 6.2% and 2.7%, respectively.

In the case of secondary activities, the most notable increase in 2Q23 was seen in the North Central region, which reported real annual growth of 2.1%. Financing for industry in the Northern region was up 1.9%, while in the Central and Southern regions, outstanding loans to the industrial sector were down 4.3% and 11.9%, respectively. On the services side, the Southern and Central regions recorded real declines in outstanding business loans of 6.3% and 0.1%, respectively. Loans financing tertiary activities were more buoyant in the North (13.5% real annual growth) and the North Central region (6.9% real annual growth).

Total outstanding business credit showed a real annual growth rate well below the previous quarter, and with a very mixed bag between regions: growth in outstanding loans in the North, North Central and Central regions (due to the performance of the services sector), but real declines in the outstanding portfolio across all activities in the Central and Southern regions.

Manufacturing activity has slowed in annual terms since 4Q22, which is consistent with the slowdown in balances observed in the manufacturing sector. The investment opportunities that might arise from current expectations of industrial growth due to nearshoring activities have not yet led to any meaningful change in the demand for financing in the sector, if we compare real growth in each region with the levels recorded in 2Q22.

If investment picks up due to this phenomenon and inflation continues to head downward, demand for loanable funds could increase in the medium term, especially due to the spillover effect that foreign investment among large transnational supply or service companies tends to generate on industrial activity, albeit with a lagged effect. At the

2: Regionalization in the report: the North includes Baja California, Chihuahua, Coahuila, Nuevo León, Sonora and Tamaulipas; the North Center includes Aguascalientes, Baja California Sur, Colima, Durango, Jalisco, Michoacán, Nayarit, San Luis Potosí, Sinaloa and Zacatecas; the Center is made up of Mexico City, State of Mexico, Guanajuato, Hidalgo, Morelos, Puebla, Querétaro and Tlaxcala; and the South, Campeche, Chiapas, Guerrero, Oaxaca, Quintana Roo, Tabasco, Veracruz and Yucatán.

3: It should be noted that the real change does not take into account exchange rate effects.

end of 1H23, growth was still largely driven by the tertiary sector and the effects of nearshoring on the business credit portfolios of commercial banks were not yet tangible.

Commercial banking shores up the Mexican financial system

The Financial System Stability Board (FSSB) recently updated its Risk Balance Sheet. In its September release, it noted that global risks to financial stability include the threat of inflationary pressures spreading or become more severe. Given the strength of economic activity and employment in key economies, this could lead to additional monetary policy tightening on a global scale. A further risk factor is the threat of a delayed economic recovery due to a heavier than anticipated slowdown (in 2024) among the large economies of the world, which could increase the likelihood of significant adjustments being made to the prices of certain financial assets, in turn leading to increased market volatility and tighter financial conditions. Moreover, the FSSB does not rule out the risk of systemic events that might affect the global financial system, with implications for national markets.

In its release, the FSSB remarks that domestic financial markets have performed soundly and that the volatility observed in certain periods has been limited in scope and is down to external events. Locally, there is the lingering risk of a downturn in economic activity given the complex external environment, although the consensus view is that domestic demand will continue to drive domestic economic activity. Mexico's sovereign credit rating remains in investment grade territory with a stable outlook, although the outlook for Pemex has been downgraded in recent months.

Overall, the Mexican financial system remains sound, largely because of the comfortable capital and liquidity position of commercial banks. Although certain non-bank financial intermediaries have encountered difficulties in refinancing their debt, as a whole they represent a small share of the system and have limited interconnectedness with commercial banks and other institutional investors, so their problems do not pose a potentially systemic risk.

In Mexico, total financial savings fell by 5.3% and total financing dipped 3.1% year-on-year in real terms in 4Q22

The National Banking and Securities Commission (CNBV) released its Report on Financial Savings and Financing in Mexico, with figures through to December 2022. For 4Q22, total financial savings shrank by 5.3% year-on-year in real terms, reaching 90.8% of GDP. Meanwhile, total financing showed a real annual change of -3.1%, equivalent to 94.1% of GDP.

Domestic financial savings accounted for 69.3% of GDP, down on the figure reported at the end of 3Q22 (71.7% of GDP) and showing a 1.2% real annual decline at the end of 4Q22. Holdings of fixed-income securities and senior trust bonds (*certificados bursátiles fiduciarios*, or CBFs for short; 34.7% of GDP) recorded a real annual decline of 3.1%, while deposits acquired by financial intermediaries showed real annual growth of 0.8% to reach 34.5% of GDP. In this segment, deposits acquired by commercial banks —equivalent to 23.0% of GDP— continued to be the main component of total funds raised, while deposits captured by Infonavit and development banks represented 5.4% and 3.7% of GDP, respectively.

Meanwhile, external savings recorded a real annual decline of 16.4%, equivalent to 21.5% of GDP in December 2022. By sector, inflows of foreign funds into the public sector were equivalent to 14.3% of GDP, while funds raised by the private sector accounted for 7.2% of GDP. As for the channel through which funds are obtained, securities issued abroad represented 10.2% of GDP, securities issued in Mexico in the hands of non-residents 5.9%, and loans and other forms of credit obtained abroad 5.4%.

On the financing side, the external component recorded a real annual decline of 18.7%, to reach 15.7% of GDP. Within this component, external financing granted to the private sector (6.8% of GDP) was down 25.3% in real terms and external funding to the public sector (8.9% of GDP) posted a real annual decline of 12.8%.

If we break down foreign financing by component, fixed income instruments issued abroad accounted for the largest share of private sector funding at 4.8% of GDP, while foreign loans to the private sector amounted to 2.0%, down 29.0% and 14.8% year-on-year in real terms, respectively. Domestic financing achieved real annual growth of 0.8%, equivalent to 78.5% of GDP. At the end of 4Q22, by destination of domestic financing, financing to the public sector accounted for 42.4% of GDP, while financing to the private sector represented 36.1% of GDP.

Total financing to the private sector (42.8% of GDP) was mainly composed of commercial bank credit (18.2% of GDP), which was up 5.2% in real annual terms, followed by credit granted by other financial intermediaries (10.6% of GDP), issuances of domestic debt securities and trust certificates (known as CBFs; 5.7% of GDP), debt issuances abroad (4.8% of GDP), foreign credit (2.0% of GDP), and development bank loans (1.6% of GDP). Meanwhile, public sector financing (51.3% of GDP) comprised issuances of domestic debt instruments and CBFs (39.0% of GDP), followed by foreign debt issuances (5.5% of GDP), foreign loans (3.4% of GDP), commercial bank loans (2.1% of GDP), and development bank loans (1.3% of GDP).

The report also presents information for non-financial institutions. Supplier credit to issuers on the BMV (Mexico Stock Exchange) was down 0.4% in real annual terms, while non-bank credit card balances were up 3.1% in real annual terms in the quarter.

2. Financial markets

Regime shift in long-term rates?

Throughout the second half of September and the first half of October, US long-term interest rates continued to rise to levels not seen since 2007, and in the process caused an increase in the long end of the Mexican curve. The steepening of the US curve was influenced by the two main components of long-term yields.

The term premium incorporates a certain degree of upside given the higher fiscal risks present in the US as its fiscal deficit continues to climb, coupled with lower demand for government bonds by the Fed. Moreover, with growth expectations for the US economy rising, the expectation of a higher neutral rate of interest has begun to take hold, especially following the economic outlook of the members of the Federal Open Market Committee (FOMC) and the most recent address delivered by its Chair.

In addition, expectations regarding long-term interest rates in the US market were also steered by the latest forecasts made by FOMC members, clearly indicating that the federal funds rate will remain higher for longer.

In this context, the yield to maturity on the 10-year Treasury bond hit 4.8% on October 6, its highest level since 2007, before retreating to 4.6% due to the safe-haven effect triggered by the recent conflict in the Middle East. Notably, we have seen more of a change at the long end of the curve than at the short end, resulting in a steepening of the US curve. In fact, between September 12 and October 11, the slope went from -74 bp to -42 bp, its steepest level since May.

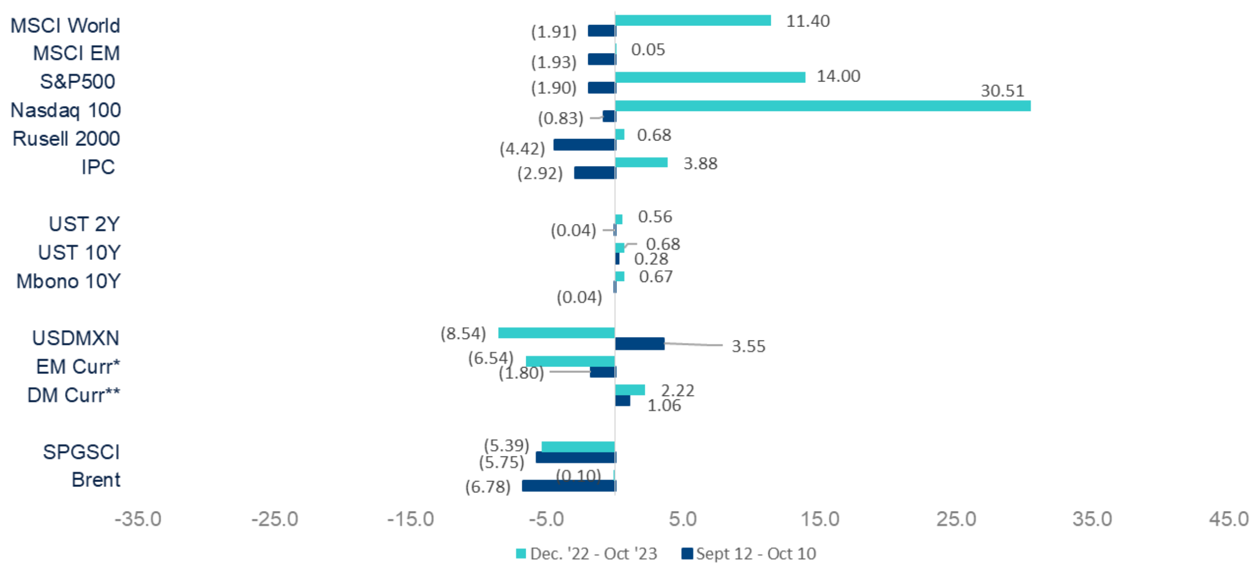
The rising US yields exerted upward pressure on the long end of the Mexican curve. The M10 yield to maturity peaked at 10.1% on September 27, its highest level since 2008.

On expectations of higher US interest rates for longer, the dollar strengthened across the board, pushing the exchange rate to as high as 18.3 pesos per dollar (ppd) at the beginning of October. Subsequently, the peso managed to regain lost ground in response to the somewhat more dovish addresses by Fed members, causing the exchange rate to close at below 18 ppd.

This context of higher interest rates has led to a reduction in risk appetite, a phenomenon that became more pronounced following the recent onset of the armed conflict in the Middle East. Between September 12 and October 11, the global equity benchmark recorded a loss of 1.9%, the same decline as the emerging markets benchmark. For the North American indices, the declines ranged from 0.8 to 4.4% (see Figure 1), while the CPI of the Mexican Stock Exchange (BMV) retreated by 2.9% during the period.

The consensus view among financial market participants is a soft landing, although they are also expecting higher rates for longer. Although the macroeconomic landscape is now more uncertain than ever —especially now that an additional element of geopolitical risk has been added— there is growing evidence of a regime shift in the fixed income markets.

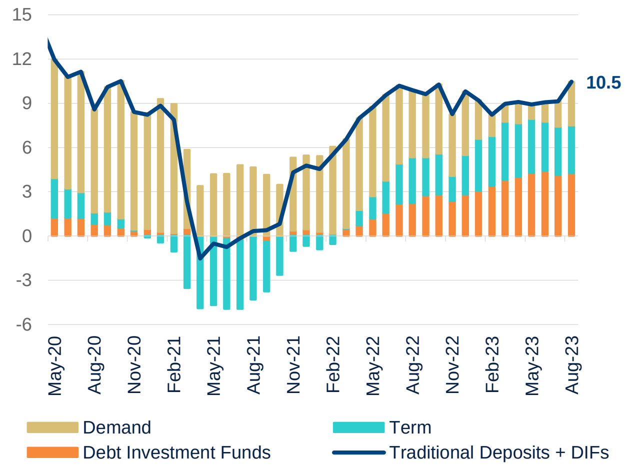
Figure 1. **PRICE PERFORMANCE OF THE MAIN FINANCIAL ASSETS IN SEPTEMBER AND OCTOBER 2023** (% CHANGE IN LOCAL CURRENCY)



*JP Morgan Emerging Markets Currency Index. For this index a reduction (increase) implies a depreciation (appreciation) of a basket of emerging market 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.

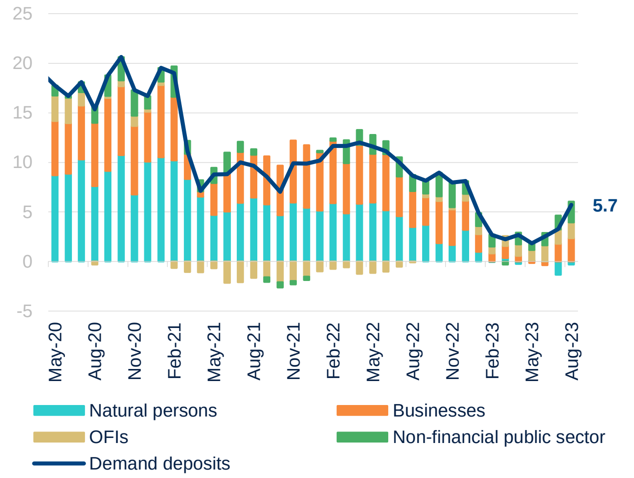
Deposits: figures

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



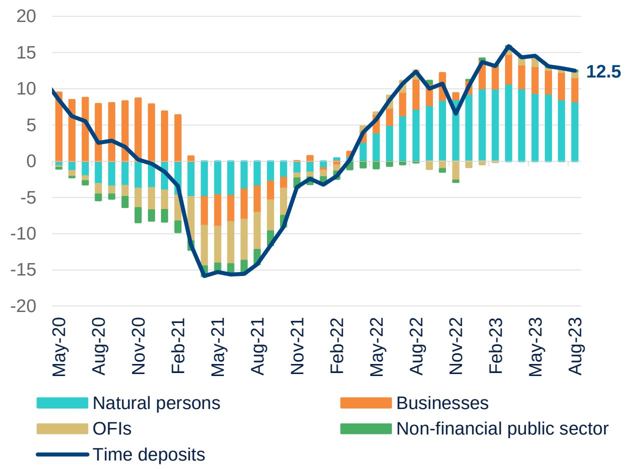
Source: BBVA Research based on Banxico data.

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



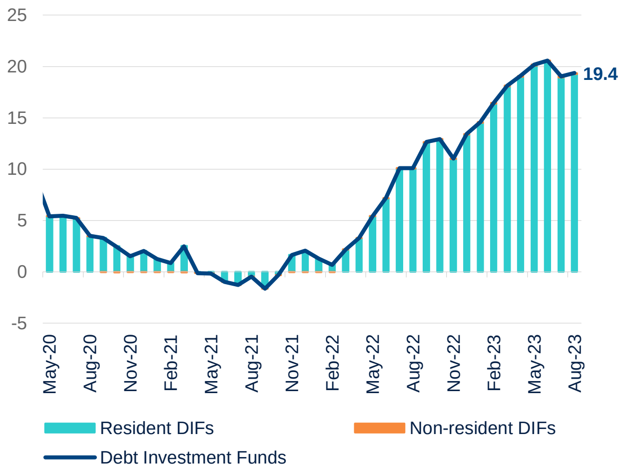
Source: BBVA Research based on Banxico data.

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



Source: BBVA Research based on Banxico data.

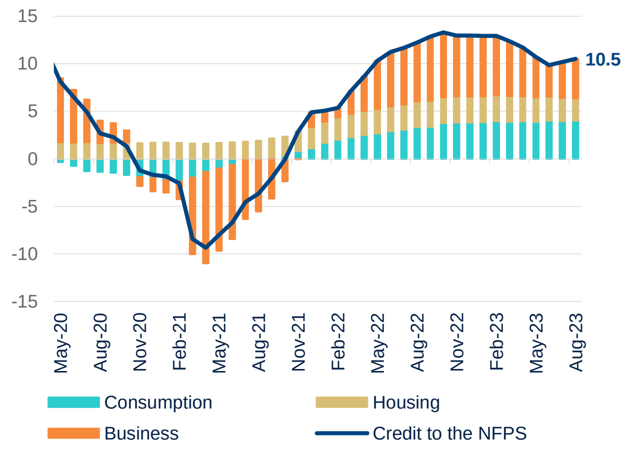
Figure 5. **DEBT INVESTMENT FUND SHARES**
(NOMINAL ANNUAL CHANGE, %)



Source: BBVA Research based on Banxico data.

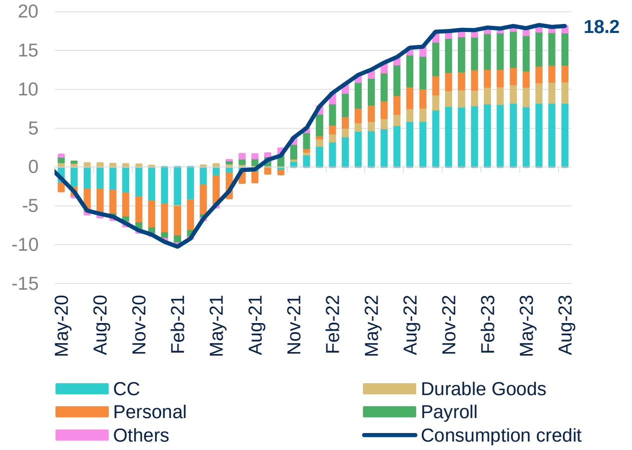
Credit: figures

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



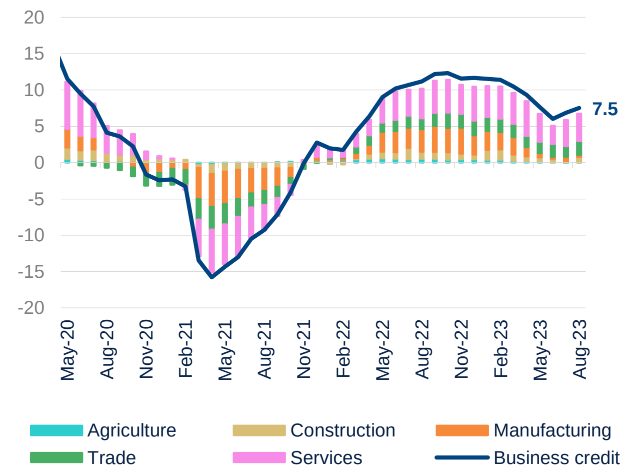
Source: BBVA Research based on Banxico data.

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



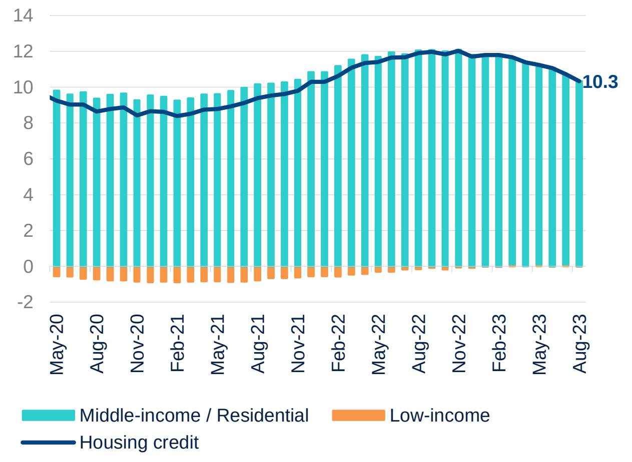
Source: BBVA Research based on Banxico data.

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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