Banking

Monthly Report on Banking and the Financial System

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November 15, 2023

1. Banking and the Financial System

The private sector drives term deposits, while the non-financial public sector has been the main contributor to the increase in demand deposits

In September 2023, the balance of traditional bank deposits (sight + term) recorded a real annual growth rate of 4.7% (9.4% nominal growth rate), a more dynamic growth with respect to the previous month (3.2% real). For the second consecutive month, sight deposits had a positive impact on this dynamism, contributing 1.2 pp to the 4.7% growth of traditional deposits, while term deposits remained its main source, contributing 3.5 pp.

The appreciation of the Mexican Peso, as has been the case over the last year, had a downward effect on the dynamism of traditional deposit balances of commercial banks, as a result of the valuation effect of balances denominated in foreign currency (12.5% of total traditional deposits). Discounting both the inflationary and exchange rate effects, balances in September recorded a real growth of 6.8%.

Demand deposits recorded real annual growth of 1.7% (6.3% nominal) in September. The recovery is associated with an improved performance of demand deposits in the non-financial public sector (with a real growth of 19.3%), as well as the growth of balances in this type of instruments of other financial intermediaries, which, despite having slowed, recorded a real annual change of 24.3%. This slowdown was also seen in corporate balances, which experienced a real annual growth of 1.5% (1.6% in the previous month). Real demand deposits of individuals continued to decrease in annual terms, with a drop of 4.5% in September, reducing the magnitude of the real decrease in these instruments for the second consecutive month. The drop in demand deposits of individuals is consistent with higher private consumption (which in the period January-August 2023 averaged an annual growth rate of 4.2%), as well as with the current expectation of high interest rates for a longer period, which promotes a shift of balances toward term instruments.

Term deposits showed a rebound in dynamism. In September 2023, these savings instruments showed real growth of 10.6% (15.6% nominal), well above the growth observed in the previous month (7.5% real) and the average real annual growth rate observed in the first eight months of 2023 (7.2%). By holder, term deposits of individuals showed improved performance, again recording a real annual growth of 13.1% (18.1% nominal). It is worth highlighting the great dynamism of term balances of other financial intermediaries, which in September grew at a rate of 12.0% after having hit 0.4% in August and an average real change in January-August of -3.1%. Companies also showed greater dynamism in September, with an increase in real balances of 8.8% (4.5% in the previous month). Term balances in the non-financial public sector recorded a real annual contraction of 33.4%, the largest drop in 15 months, after an average January-August growth of 7.7%.

Household credit growth slows down, while the business portfolio increased its dynamism in real terms

In September 2023, the balance of the outstanding credit portfolio granted by commercial banks to the non-financial private sector (NFPS) recorded a 5.4% real annual growth rate (10.1% nominal), an increase of greater magnitude with respect to the 5.1% of the immediately preceding month (IPM). Consumer and business credit showed improved performance with respect to August, both in nominal and real terms. The housing loan portfolio recorded a slowdown—nominal and real—for the third consecutive month. For September, consumer credit contributed 3.0 pp to the month's 5.4% real annual growth, while the corporate and housing portfolios contributed 1.2 pp each.

In September, outstanding consumer credit recorded a real annual growth of 13.5% (18.5% nominal), maintaining the upward trend that began in January 2023. The credit card (CC) and payroll loans segments (37.9% and 26.0% of the consumer portfolio, respectively) registered real growth of 17.3% and 10.6%, similar to August levels. Credit for the acquisition of consumer durables (ACDs, 15.9% of consumer credit) increased 13.4% in real annual terms, while personal loans (15.8% of the consumer portfolio) recorded a real annual change of 8.4%, surpassing the annual growth of the previous month. Consumer portfolio dynamism has been driven mainly by the good performance of formal employment and real wages, factors that have driven higher private consumption.

The housing portfolio recorded an annual growth rate of 5.2% in real terms in September (9.9% nominal). With this result, this portfolio experienced a slowdown with respect to the IPM, accounted for by the middle-income residential housing segment, whose balances showed lower growth compared to the IPM in real terms (5.6% vs. 5.9% in the IPM). Financing balances for low-income housing contracted by 2.7% in real annual terms, a smaller drop than that recorded the previous month (4.5% in real annual terms). This slowdown could be attributed to lower demand in an environment where long-term interest rates remain high and a significant increase in the housing price index has been observed.

Business credit (53.6% of the outstanding portfolio of the NFPS) registered an annual growth of 3.0% in real terms (7.6% nominal), higher dynamism than that observed in the IPM. With respect to the sectors that make up this portfolio, the real estate services and trade sectors stand out with a contribution to growth of 2.4 and 2.3 pp, respectively, which managed to offset the declines still observed in other sectors. The positive income performance of some sectors could be reactivating the demand for financing. In particular, income from the supply of goods and services from wholesale trade grew at a real annual rate of 2.8% in August (latest available information) after five months of decline. Higher real sales growth was also recorded for ANTAD's total stores (3.2% in September vs. 1.3% the previous month). The growth of the real estate services sector, however, partly reflects the emergence of nearshoring; this relocation of companies, together with the growth of corporate credit, would reflect the destination of the investments needed to finance industrial buildings and the rental of personal property. The manufacturing sector, agriculture and livestock sector and the electricity, water and gas sector contracted by 4.6%, 5.0% and 6.4%, respectively.

Employment dynamism and real wage growth act as drivers of credit for homes, boosting demand for financing. The improved performance of investment, with a certain lag, has a positive impact on the performance of corporate credit, driving demand for this type of financing. These factors have contributed to cushioning the negative effect of higher interest rates on the demand for loanable funds in all portfolios that make up NFPS credit.

Banking sector vulnerabilities at a global level: IMF

The latest edition of the IMF's Global Financial Stability Report analyzes global banking vulnerabilities through the use of stress tests based on two macroeconomic scenarios (i.e. baseline and adverse) and through a map of risk indicators that incorporates analysts' expectations.

The stress tests were conducted for a sample of 900 banks in 29 countries with public data observed through the second quarter of 2023. The baseline scenario, based on the World Economic Outlook for October, assumes an anchoring of long-term inflation expectations, that interest rates peak after slight additional tightening, and that term premiums fall in all regions.

The adverse scenario, however, proposes stagflation with a global contraction of 2.0% in 2023, persistent inflation due to supply shocks and an additional monetary tightening of 160 basis points compared to the baseline scenario.

The main contribution of this financial year compared to previous editions, in addition to modifying the methodology for projecting the main components of net income, is the inclusion of a new channel for the transmission of lower liquidity to solvency for the adverse scenario based on the assumption of a bank run of 25% of deposits at the end of 2023.

Results show that, under both macroeconomic scenarios, the banking system as a whole is resilient. In the baseline scenario, the level of global bank capitalization remains at 12.7% of risk-weighted assets in 2023, the period when the interest rate reaches its highest level, and then increases toward 2025. In the adverse scenario, capitalization falls to a minimum level of 10.0% in 2025, closing 2025 at a level of 10.8%.

However, the baseline scenario identifies 55 banks with more than USD 5.5 trillion in assets, whose capitalization level is below the regulatory minimum of 7.0% or that experience a drop in this metric by more than 5.0% in 2023. In the adverse scenario, this figure rises to 215 institutions, which would represent 42% of global banking assets.

As a second element for the analysis of bank vulnerabilities, the IMF uses key risk indicators in five dimensions (solvency, asset quality, profitability, liquidity and market metrics), measured through twelve indicators such as ROE, capitalization level, dividend growth forecast and price-to-book value ratio.

This analysis was conducted for a set of 375 banks from 43 different jurisdictions and includes 28 of the 30 banks considered to be systemically important at a global level according to the Financial Stability Board. It should be noted that this analysis includes forecasts of risk indicators for the last two quarters of 2023, which allows for a prospective analysis.

A threshold is calculated for each of the 12 risk indicators, taking into account structural differences in terms of region and business model, which is used to identify outliers. In the event that any institution's data qualifies as an outlier for one or more indicators of any risk dimension, that institution is considered potentially vulnerable. If an institution is considered vulnerable in three or more of the five risk categories, it is included in a monitoring list.

The results indicate that, by the end of the second quarter of 2023, a total of 85 banks with assets of USD 26 trillion would be on the monitoring list. This number would be reduced to 80 banks with USD 21 trillion in assets by the third quarter and would close at 82 institutions with USD 25 trillion in assets by the end of the current year. It is worth noting that, for the last quarter, a total of 25 institutions with assets of USD 9 trillion qualify as vulnerable in four out of five of the risk categories analyzed.

According to the analysis, the dynamics of vulnerabilities are a function of the pressures on profitability and liquidity expected for the remainder of 2023, as a result of the high uncertainty in the economic environment and the high probability that interest rates will remain at elevated levels for an extended period of time.

Based on these results, the IMF makes some recommendations: 1) Implement more comprehensive supervisory practices and implement corrective actions earlier and more effectively; 2) Tighten regulation in terms of prudential measures of capital requirements in the face of increased market risk; 3) Prepare banking institutions to access resources provided by central banks to mitigate potential capital losses from the sale of held-to-maturity instruments.

2. Financial Markets

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Higher volatility as markets reluctantly incorporate a context of higher rates for longer time

In a context of considerable changes in the demand and supply of loanable funds at a global level, the degree of convergence between the Fed's interest rate expectations and those of market participants sparked heightened volatility in the prices of financial assets between the second half of October and the first ten days of November.

This degree of convergence of expectations has been mainly influenced by inflation and U.S. labor market data, as well as by the Fed's own communication from the members of the Federal Open Market Committee (FOMC). Thus, in general, when the actions of market participants decrease degree of convergence of expectations, communication from FOMC members tends to be more restrictive in an attempt to bring them back into alignment, and vice versa.

This process has generated an increase in volatility, particularly with respect to long-term rates. As shown in Figure 1, between October 13 and 31, the period prior to the most recent Fed meeting and the below-expected October employment data, the yield to maturity on the 10-year Treasury bond rose 32 basis points (bp), while in the first 10 days of November it fell 28 bp. It should be noted that toward the end of October this instrument traded above 5.0%.

The yield to maturity of the two-year Treasury bond, on the short end of the curve, traded as high as 5.22%, but closed practically unchanged in the abovementioned period. As a consequence of these movements, the slope of the curve remained in negative territory around 40 bp, although it hit its minimum of the year (16 bp) on October 20.

The Mexico 10-year bond rose by 42 bp between October 13 and 31, while in the first 10 days of November it fell by 54 bp (see Figure 1). The yield on this instrument reached 10.26% at the end of October.

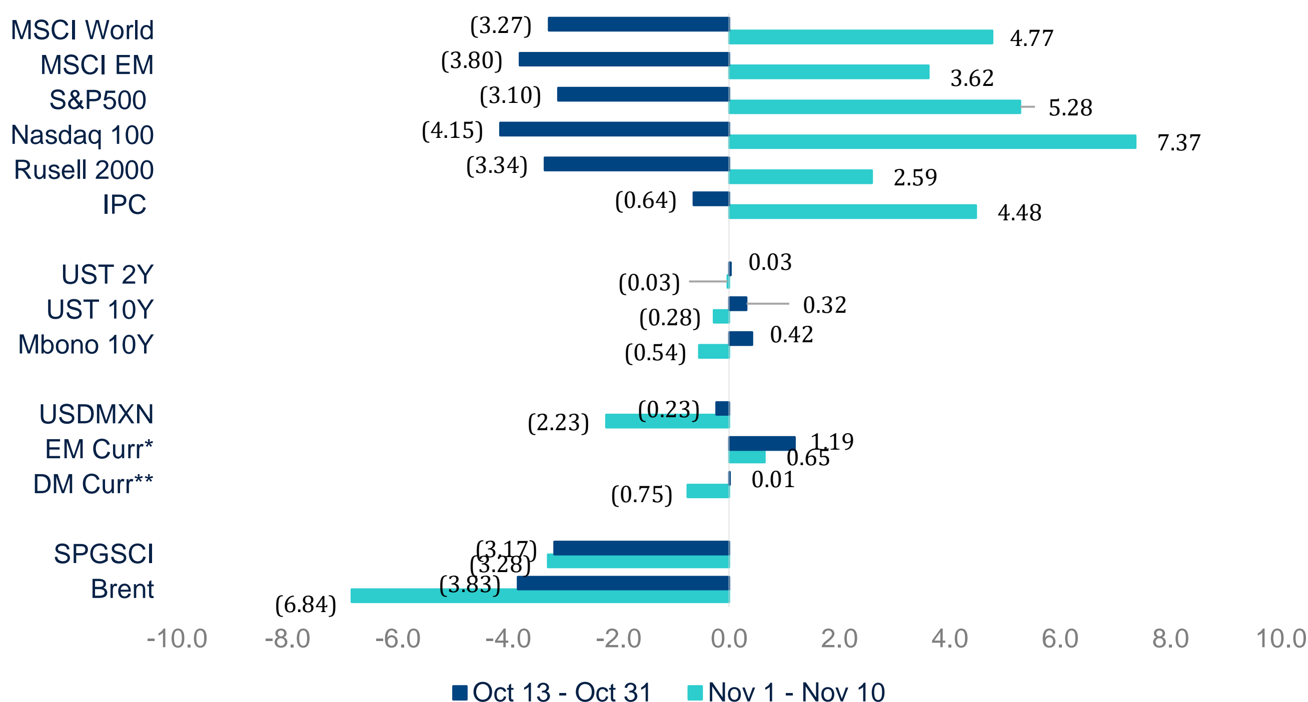
Stock markets performed similarly (see Figure 1). Losses were recorded between October 13 and October 31 as a result of the tightening of financial conditions, while after this date, gains returned, influenced by lower interest rates. However, as can be seen in Figure 1, the benchmarks of this asset class in Europe and emerging markets ended the period between October 13 and November 10 with losses.

The largest movements in terms of gains and losses in the periods mentioned were recorded in the Nasdaq index, which is consistent with the greater sensitivity of technology stocks to changes in long-term rates. It should be noted that, so far in 2023, this index has accumulated gains of 31.8%.

In the foreign exchange market, the Mexican peso gained 2.45% between October 13 and November 10, impacted by a significant appreciation of 2.23% during the first 10 days of November, as financial conditions eased and the dollar weakened across the board. Thus, the exchange rate returned to levels around 17.60 pesos per dollar, after having traded as high as 18.30 pesos per dollar at the end of October.

Financial market participants maintain soft landing as the most likely scenario, especially in view of the first signs of a weakening of the U.S. labor market in a context of falling prices, albeit at a slower pace than expected. However, the fact that interest rates will remain high for a prolonged period of time, given the changes in the global loanable funds market, raises the question of whether the conditions exist for this time to be different from what has been observed in historical terms and for economic activity to avoid a recession.

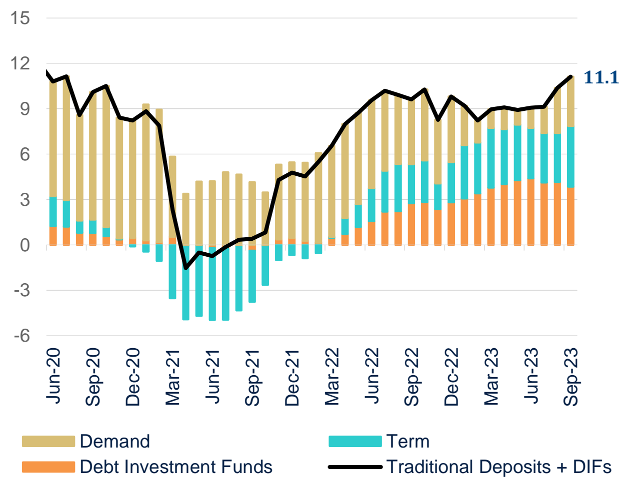
Figure 1. **PERFORMANCE OF MAIN FINANCIAL ASSET PRICES DURING OCTOBER AND NOVEMBER 2023** (% CHANGE IN LOCAL CURRENCY)



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

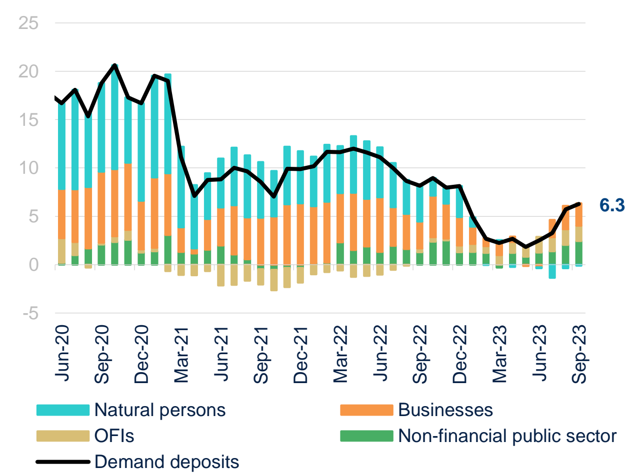
Funding: charts

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



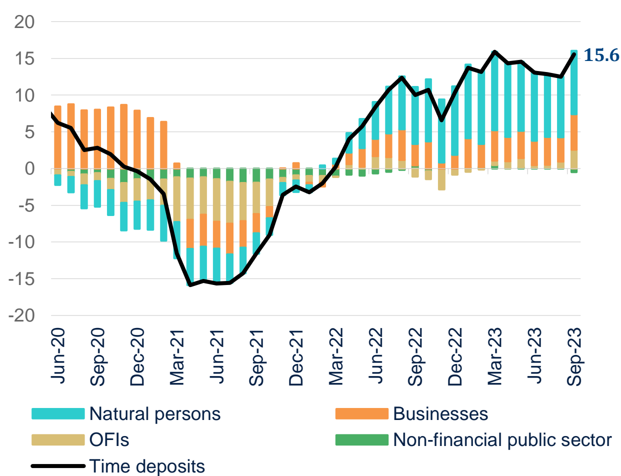
Source: BBVA Research, with data from Banxico.

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



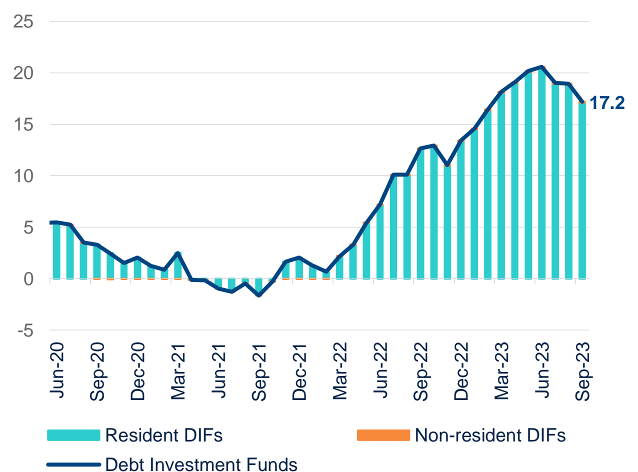
Source: BBVA Research, with data from Banxico.

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



Source: BBVA Research, with data from Banxico.

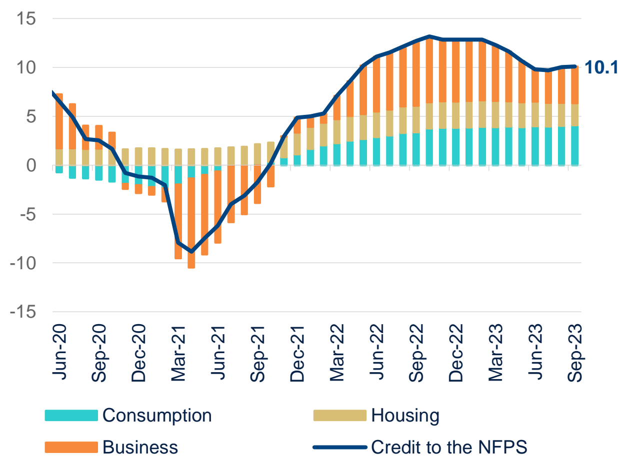
Figure 5. **DEBT INVESTMENT FUND SHARES (NOMINAL ANNUAL CHANGE, %)**



Source: BBVA Research, with data from Banxico.

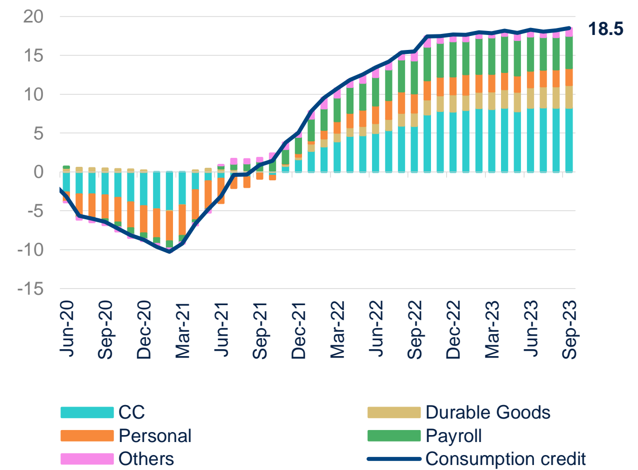
Loans: charts

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



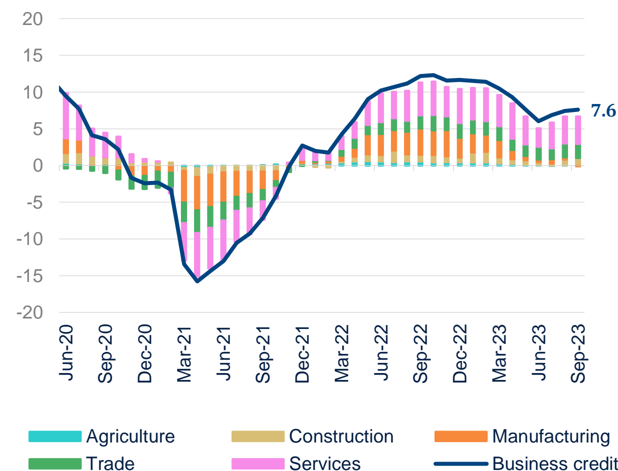
Source: BBVA Research, with data from Banxico.

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



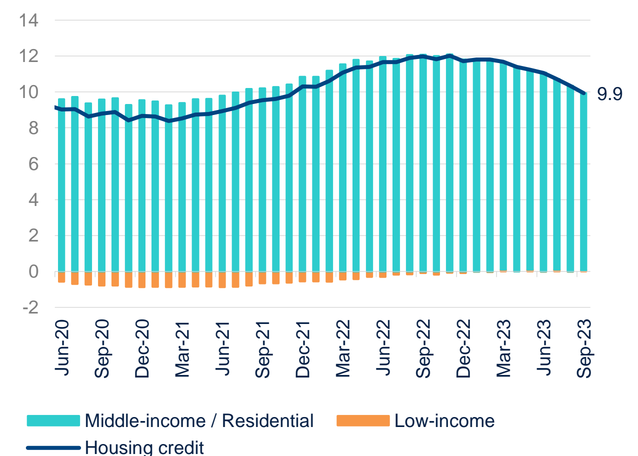
Source: BBVA Research, with data from Banxico.

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



Source: BBVA Research, with data from Banxico.

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



Source: BBVA Research, with data from Banxico.

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