Banking

Monthly Report on Banking and the Financial System

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1. Banking and the Financial System

In November, the dynamism of traditional deposits increased, mainly driven by the real acceleration of term deposits

In November 2023, the balance of traditional bank deposits (sight + term) recorded real annual growth of 5.4% (equivalent to nominal growth of 9.9%), improving its performance with respect to the previous month (4.5% in real terms). For the second consecutive month, sight deposits registered a slight slowdown and contributed 1.1 pp to the 5.4% dynamism of traditional deposits, while term deposits continue to be the most relevant source of growth, contributing 4.3 pp.

Once again, 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 12.1% of total traditional deposits). Discounting this effect (and that of inflation), balances in November 2023 registered a real growth of 7.0%.

In November, sight deposits registered real annual growth of 1.7% (6.1% nominal), the fourth month in positive territory after seven consecutive months of real contractions. The greater dynamism is associated with a better performance of sight deposits from other financial intermediaries and sight deposits from individuals, which was sufficient to offset the slowdown in sight deposits from the non-financial public sector and companies. The downward trend in sight deposits for individuals seems to have reversed and the real change in their balances amounted to 1.3%, the first month in positive territory since August 2022. The growth rates of employment and real wages have more than offset the negative effect of higher private consumption on sight deposits, as well as the greater attractiveness of term instruments in an environment where interest rates remain high.

The real y/y growth of term deposits has shown an additional rebound. In November 2023, these savings instruments showed a real growth rate of 13.0% (17.9% nominal), higher than that observed in the previous month (10.2% real) and the real annual growth rate observed in the first ten months of 2023 (7.8%). By holder, term deposits of individuals showed a slight slowdown, although they maintained double-digit real annual growth (12.1% in November vs. 12.3% in October). It is also worth highlighting the slowdown in term balances of other financial intermediaries, which grew at a rate of 8.5% in the eleventh month of the year, following growth of 14.4% and 12.1% in October and September 2023, respectively. In the case of corporate term deposits, these registered a strong dynamism, with a real annual growth of 16.8%, well above the average growth in the first ten months of 2023 (of 4.5% real). The non-financial public sector was the only holder whose term balances contracted in real annual terms, with a fall of 3.9%. On aggregate, the high interest rate environment continues to maintain the attractiveness of term instruments for savers.

In November, credit balances recorded a slowdown in real terms in all NFPS loan portfolios

In November 2023, the outstanding loan portfolio balance granted by commercial banks to the non-financial private sector (NFPS) grew 5.6% annually in real terms (10.1% nominal), a smaller increase than the 5.9% of the previous month (MIA). Nominal rates show a slowdown in both household credit portfolios - consumer and mortgage - as well as in corporate credit, which was observed in real terms during the eleventh month of the year. By portfolio, consumer credit contributed 2.9 pp to the real annual growth of 5.6% reported in November, while the corporate and housing portfolios contributed 1.6 and 1.1 pp, respectively.

Real outstanding consumer credit balances recorded annual growth of 12.8% (17.7% nominal), a slower pace than that observed in October. Balances in the credit card (CC) and payroll loans segments (39.1% and 25.1% of the consumer portfolio, respectively) registered real growth of 15.0% and 9.3%, a slowdown with respect to the preceding month, the same as in the case of personal loans (15.4% of the consumer portfolio), whose balances registered a real annual variation of 8.9%. In contrast, credit for the acquisition of consumer durables (ACD, 15.9% of consumer credit) increased 14.9% in real annual terms, slightly higher than the 14.6% recorded in October. The sustained growth of employment and real wages, together with the good performance of private consumption, explain a large part of the performance of consumer credit balances, which, although it has registered a slowdown, maintains growth well above the average of recent years, as well as the first 10 months of 2023.

The housing portfolio recorded real annual growth rate of 4.7% in November (nominal growth of 9.2%), down on the preceding month but once again showing opposing dynamics between its two components. First, credit balances for the acquisition of middle-income residential housing experienced a slight slowdown in real terms (5.0% vs. 5.5% in the preceding month), while low-income housing financing balances registered a real contraction of 2.0%, a smaller drop than that recorded during October (-6.0%). As in the case of the consumer portfolio, demand for mortgage loans would be driven by expectations of higher real wages, contributing to sustained growth in housing credit, even in the current environment of high long-term rates.

Corporate financing (53.2% of outstanding loans to the NFPS) was up 2.9% in real terms (7.3% nominal), a less dynamic performance than that observed in October. The sector with the greatest contribution to growth is commerce, followed by real estate services. Commercial revenues (reflected in the real growth of ANTAD[1]'s total store sales) have shown real growth (2.1% and 3.9% real growth in October and November), which would contribute to a higher demand for business financing in the sector.

The real balances of the construction sector grew 2.8%, while those of manufacturing fell 6.7%. Within the manufacturing industry, real balances in the transportation equipment manufacturing industry showed a strong slowdown and grew at an annual rate of 19.4%, well below the 32.3% recorded in October and only 5.4% above their February 2020 levels. Meanwhile, credit to the agricultural and mass media sectors contracted 0.6% and 26.1% in real y/y terms, respectively, accumulating 9 and 11 consecutive months of contractions in real balances.

1: National Association of Supermarkets and Department Stores.

Outstanding corporate credit balances increase in both the North and North Central regions in 3T23

According to Banco de México's July - September 2023 Regional Economies Report[2], based on the 3Q23 Credit Market Conjunctural Evaluation Survey (EECMC), the outstanding portfolio of non-financial private companies in commercial banking presented a real annual growth[3] of 2.8% in the third quarter of the year, an acceleration with respect to the 2Q23 figure, when it registered a growth of 0.6%.

Bank credit in the Northern region, which represents 23% of credit, contributed with 1.7 of these 2.8 pp, while 0.5 is attributable to the North Central region, 1.2 to the Central region, and -0.6 to the Southern region, highlighting that the Northern and North Central regions increased their dynamism with respect to the previous quarter, with real annual changes of 7.6 and 2.2%, respectively (vs. 5.6 and -1.6% in 2Q23).

In 3Q23, the outstanding portfolio within the agricultural sector grew only in the North Central region of the country, with a real annual change of 2.6%. In contrast, outstanding loans to the agricultural sector in the North region fell by 9.2%, while in the Central and Southern regions the declines were 8.6%.

In the case of secondary activities, the greatest dynamism in 3Q23 was recorded in the Northern region, with a real annual change of 4.0%, followed by financing to industry in the North Central region, which increased 1.8%, whereas in the Central and Southern regions, outstanding balances to industry contracted by 3.7% and 5.0%, respectively. Regarding services, the South registered a 9.3% real decline in the outstanding corporate portfolio. In contrast, the portfolio to tertiary activities registered real annual growth in the North (14.1%), the Center (7.0%) and the North Center (4.1%).

Total outstanding corporate loans showed a real annual growth rate well above that recorded in the previous quarter, and was heterogeneous among regions. This was explained by the growth of outstanding balances in the North, North Central and Central regions (due to the performance of the services sector) and the real contractions in the outstanding portfolio of all activities in the South region.

Manufacturing activity has shown a slowdown in annual terms during each quarter in 2023, which, according to our analysis, is consistent with the drop in balances observed in the manufacturing sector. Investment opportunities in light of the current expectation of industrial growth due to nearshoring do not yet seem to have implied a change in the trend of demand for financing in the sector if we compare real growth in each region with that recorded in 3Q22, except in the Northern region.

The current downward inflationary trajectory, as well as the opportunities that nearshoring could generate, would imply an expansion of credit demand, particularly by local companies that act as suppliers or service providers to large transnational companies involved in the relocation of productive activities. However, at the end of 3Q23, growth is mainly explained by the tertiary sector and nearshoring does not yet seem to have materialized in terms of boosting bank financing to companies across the board.

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.

Tight monetary policy and a slowdown in economic activity are among the main risks to financial stability

The Financial System Stability Board (FSSB) recently updated its Risk Balance Sheet. In its December communiqué, it noted that global risks to financial stability include the possibility that monetary policy and financial conditions will remain tight for an extended period of time. In addition, global economic activity could experience a more pronounced or prolonged slowdown than anticipated. In addition to these two factors, the worsening of geopolitical tensions could generate abrupt adjustments in the prices of some financial assets, thereby increasing market volatility. The FSSB still 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, the risk of a weakening of economic activity persists, although to a lesser extent than anticipated a few months ago, with the expectation that domestic demand will continue to drive national economic activity. The sovereign credit rating remains investment grade with a stable outlook, and the outlook for Pemex was upgraded to stable, although the company continues to face significant challenges in the short term. This quarter's release also highlights the renewal of the Flexible Credit Line with the International Monetary Fund, for an amount of approximately USD 35 billion.

Overall, the Mexican financial system maintains a solid and resilient position, largely due to the support of a banking sector that comfortably exceeds capital and liquidity requirements. Some non-bank financial intermediaries continue to face challenges related to tighter financial conditions. Given that these intermediaries represent a small share of the system and have limited interconnection with commercial banks and other institutional investors, their problems do not represent a potentially systemic risk.

In Mexico, total financial savings fell by 2.3% and total financing dipped 1.0% year-on-year in real terms in 1T23

The National Banking and Securities Commission (CNBV) released its Report on Financial Savings and Financing in Mexico, with figures through to March 2023. For 1Q23, total financial savings shrank by 2.3% year-on-year in real terms, reaching 91.7% of GDP. Meanwhile, total financing showed a real annual change of -1.0%, equivalent to 93.9% of GDP.

Domestic financial savings were equivalent to 71.5% of GDP, higher than the percentage recorded at the end of 4Q22 (69.3% of GDP), as a result of a 2.5% real annual increase at the end of 1Q23. Holdings of fixed-income securities and trust stock certificates (certificados bursátiles fiduciarios, or CBFs for short; 36.5% of GDP) recorded a real annual increase of 3.9%, while deposits acquired by financial intermediaries showed real annual growth of 1.1% to reach 35.0% of GDP. In this segment, deposits acquired by commercial banks (equivalent to 22.6% of GDP) continued to be the main component of total funds raised, while deposits captured by Infonavit and development banks represented 5.6% and 3.7% of GDP, respectively.

Meanwhile, external savings recorded a real annual decline of 16.3%, equivalent to 20.2% of GDP in December 2022. By sector, inflows of foreign funds into the public sector were equivalent to 13.7% of GDP, while funds raised by the private sector accounted for 6.5% of GDP. As for the channel through which funds are obtained, securities issued abroad represented 9.6% of GDP, securities issued in Mexico in the hands of non-residents 5.8%, and loans and other forms of credit obtained abroad 4.8%.

On the financing side, the external component recorded a real annual decline of 20.3%, to reach 14.4% of GDP. Within this component, external financing granted to the private sector (6.1% of GDP) was down 25.7% in real terms and external funding to the public sector (8.3% of GDP) posted a real annual decline of 15.8%.

By type of financing from abroad, fixed income instruments issued abroad accounted for the largest share of private sector funding with 9.6% of GDP, while foreign loans to the private sector reached 4.8%, with a real annual decrease of 20.9% and 19.0%, respectively. Domestic financing achieved real annual growth rate of 3.5%, and was equivalent to 79.5% of GDP. At the end of 1Q23, by destination of domestic financing, financing to the public sector accounted for 43.5% of GDP, while financing to the private sector represented 36% of GDP.

Total financing to the private sector (42.1% of GDP) was mainly composed of commercial bank credit (18.1% of GDP), which was up 4.1% in real annual terms, followed by credit granted by other financial intermediaries (10.8% of GDP), issuances of domestic debt securities and trust certificates (known as CBFs; 5.7% of GDP), debt issuances abroad (4.3% of GDP), foreign credit (1.7% of GDP), and development bank loans (1.5% of GDP). Meanwhile, public sector financing (51.8% of GDP) comprised issuances of domestic debt instruments and CBFs (40.2% of GDP), followed by foreign debt issuances (5.2% of GDP), foreign loans (3.1% of GDP), commercial bank loans (2.1% of GDP), and development bank loans (1.2% of GDP).

The report also presents information for non-financial institutions. Supplier credit to issuers on the BMV (Mexico Stock Exchange) was down 9.5% in real annual terms, while non-bank credit card balances were up 7.0% in real annual terms in the quarter.

2. Financial markets

High returns for risky assets in 2023 as soft landing expectations became widespread. But, isn't this scenario a fragile one?

The movements of the financial markets during 2023 were mainly influenced by the unusual strength of the U.S. labor market in the face of high interest rates; the reduction in global inflation and a change in the tone of the Fed's communication starting in November, which led the market to expect interest rate cuts as early as next March.

Despite a short-term interest rate environment not seen in the last twenty years, this combination of trends was favorable for risk asset prices, particularly towards the end of the year, driving the VIX index to levels not seen since 2019. These trends more than offset adverse events such as the failure of SVB Bank and Signature during March, the slowdown in the Chinese economy, and multiple geopolitical risks.

A key part of these favorable trends for risk assets has been the reduction in inflation. The main component of this reduction has been goods, an element associated with the almost generalized fall in commodity prices. During 2023, the benchmark for this asset class (S&PGSCI) fell 12.2 percent (see figure 1), after rising 37 percent in 2021 and 8.7 percent in 2022.

For the global equity market benchmark (MSCI World) these 2023 trends were reflected in a growth of 21.7 percent, following a 19.5 percent decline in 2022, which represented its second best annual performance since 2013. Most of the U.S. equity indices outperformed the benchmark, while their counterparts for Europe and Emerging Markets (EM) were clearly lagging (see figure 1). The BMV's IPyC posted gains of 18.4 percent in 2023, its second best annual performance since 2010.

Within the stock indexes, technology companies stood out, which was reflected in a gain of 43.2 percent for the Nasdaq index (see figure 1), although this gain did not allow it to reach the level of the end of 2021. Such was the performance of technology stocks in 2023 that the group known as the magnificent 7 (Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia, and Tesla) had a return of 106.6 percent. This set of stocks accounted for about 30 percent of the total capitalization of the S&P500 index at the end of 2023.

These gains in equity indices were concentrated to some extent in the last two months of the year and were associated with significant interest rate cuts, following a change in tone in the Fed's communication at the November 1 meeting. The yield to maturity on the 2-year Treasury bond, one of the most sensitive to the federal funds rate, fell 75 basis points (bps) between the end of October and December, after having risen 57 bps over the previous months (see figure 1).

For the long end of the curve, after the yield to maturity of the 10-year Treasury bond reached a level of 5.0% at the end of October, influenced by the pressure on the Term Premium from the higher bond issuance in the face of the rise in U.S. public debt, it recorded a fall of 96 bps during the last two months of the year and closed 2023 at 3.8 percent, practically the same level with which it started the year.

In the case of the M10, the behavior was similar. Influenced by U.S. treasury bonds, persistent core inflation, Banxico's tightening tone and higher budgeted borrowing for 2024, yield to maturity peaked at 10.25 percent in October. However, for the last two months of the year, a 118 bp drop was recorded, which led this indicator to close 2023 at 8.95 percent, 9 bp below its level at the beginning of the year (see figure 1).

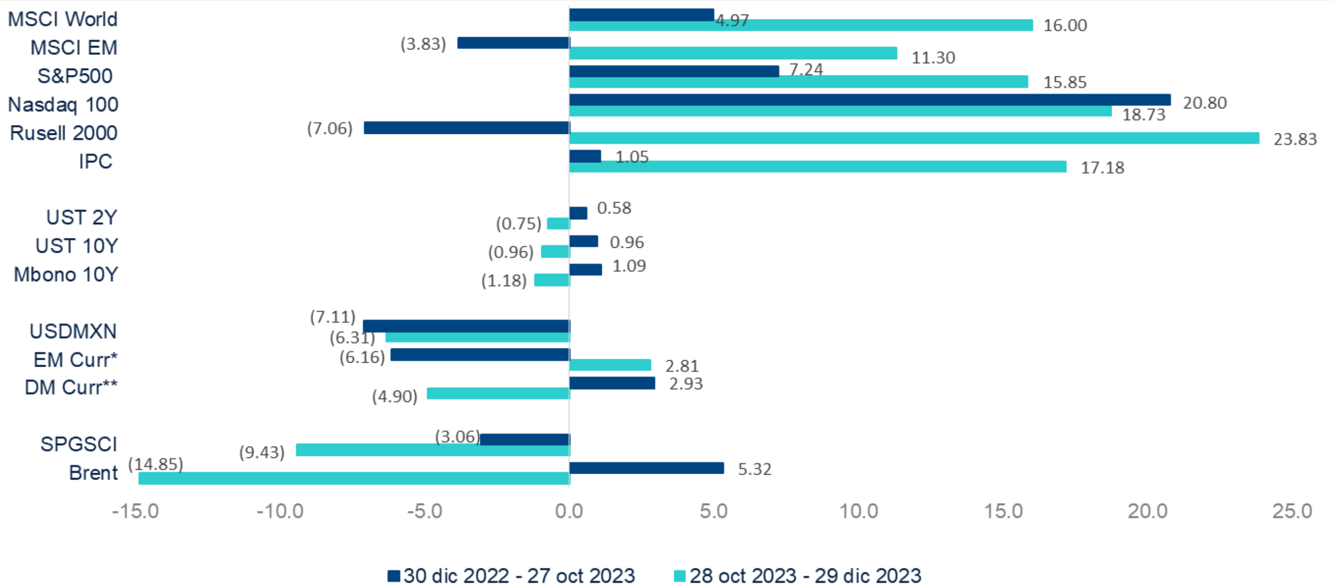
The performance of the foreign exchange market largely reflected changes in short-term interest rate expectations. During the first nine months of the year, the Fed's restrictive tone not only tempered expectations of rate cuts, but also led market participants to incorporate additional rate hikes. In this environment, the dollar recorded greater strength against both EM and developed country currencies.

Conversely, once the change of tone in the Fed's communication at the beginning of November was presented and expectations of rate cuts for 2024 were reinforced, the dollar registered a generalized weakness (see figure 1).

In this environment, the Mexican peso stood out as the second most appreciated emerging economy currency during 2023. Favorable growth expectations for nearshoring, a favorable debt-to-GDP comparison with the rest of EM countries and political instability in the region supported the Mexican peso and led it to close 2023 at 16.97 pesos per dollar (ppd), an appreciation of 13.0 percent.

Throughout 2023, economic data and the Fed's communication fueled the soft landing scenario that currently remains the market consensus. However, market participants' expectations are not only contrary to historical behavior, but they discount such magnitudes and give rise to so little uncertainty that they are not entirely consistent with the soft landing scenario itself, and appear to form a fragile equilibrium that could be corrected, with consequent losses for risk assets.

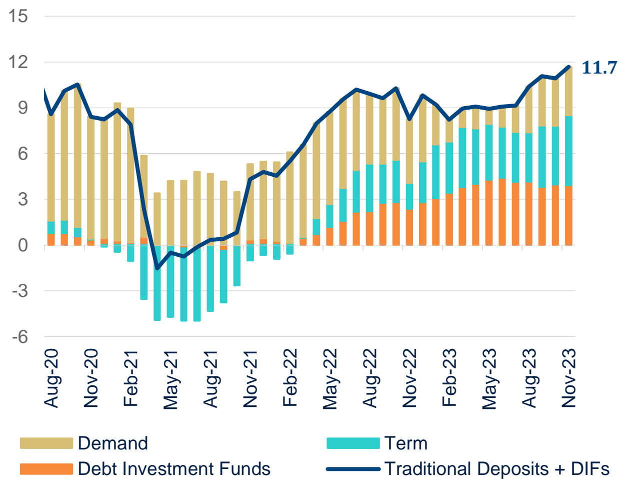
Figure 1. **TREND IN THE PRICES OF THE MAIN FINANCIAL ASSETS IN DECEMBER 2022 AND DECEMBER 2023** (% CHANGE IN LOCAL CURRENCY EXCEPT RATES)



*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.

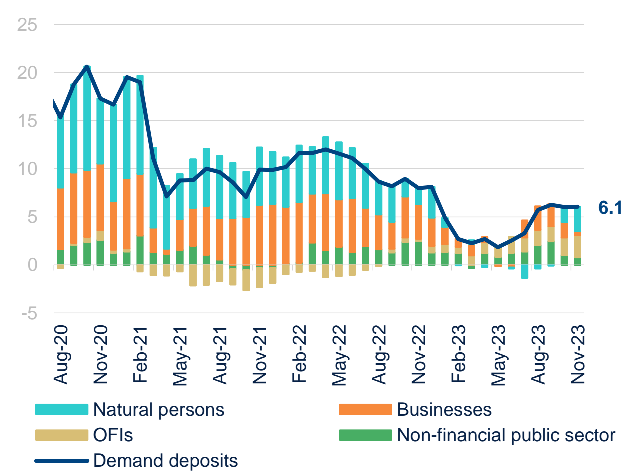
Deposits: figures

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



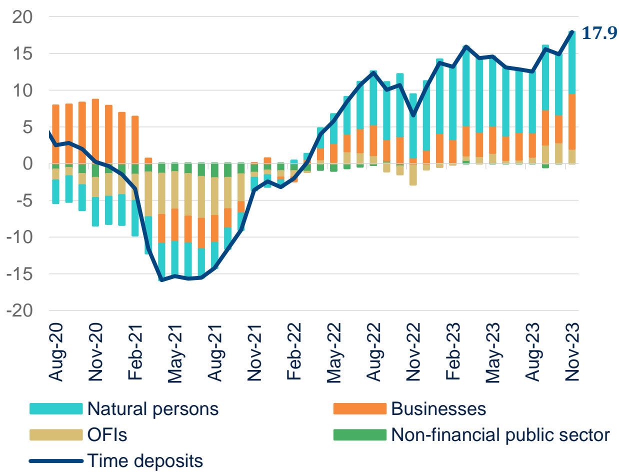
Source: BBVA Research based on Banxico data.

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



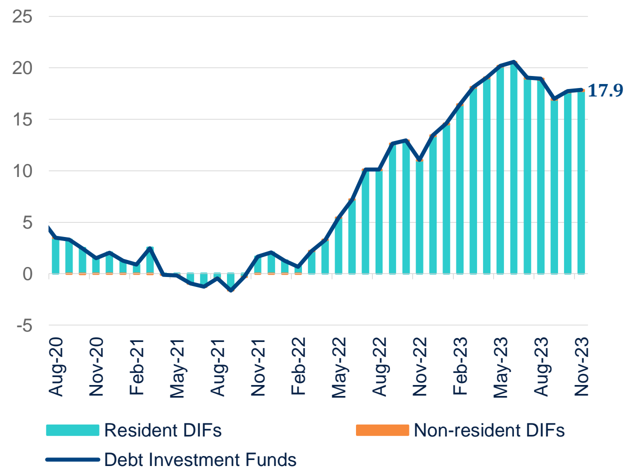
Source: BBVA Research based on Banxico data.

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



Source: BBVA Research based on Banxico data.

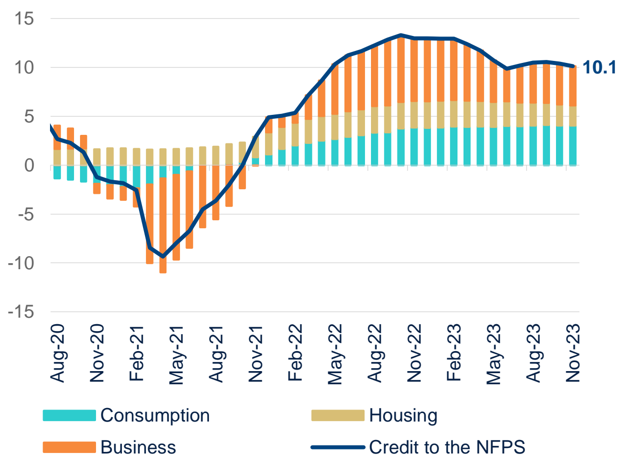
Figure 5. **DEBT INVESTMENT FUND SHARES (NOMINAL ANNUAL CHANGE, %)**



Source: BBVA Research based on Banxico data.

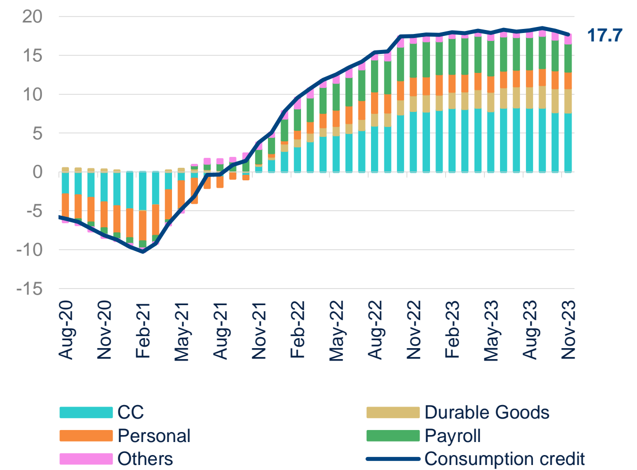
Credit: figures

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



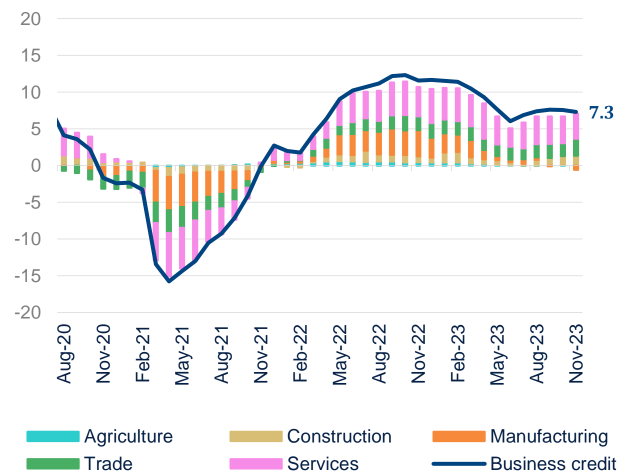
Source: BBVA Research based on Banxico data.

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



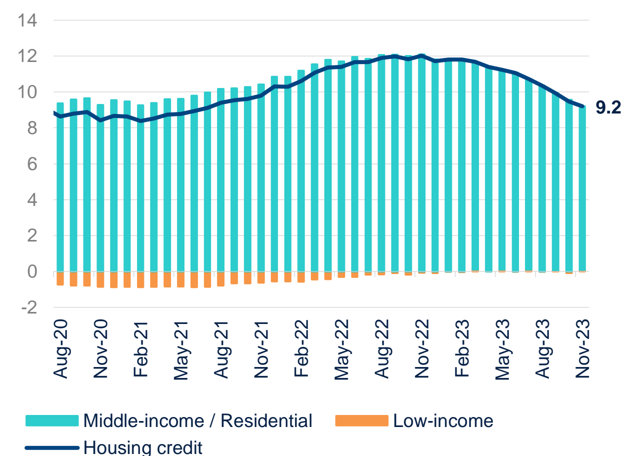
Source: BBVA Research based on Banxico data.

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



Source: BBVA Research based on Banxico data.

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



Source: BBVA Research based on Banxico data.

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