Banking

Monthly Report on Banking and the Financial System

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1. Banking and the Financial System

Sight deposits increase their dynamism, driving growth in traditional bank deposits

In February 2024, the balance of traditional bank deposits (sight + term) recorded a real annual growth rate of 5.8% (10.5% nominal), the highest seen since February 2021. The growth rate of sight deposits accelerated, managing to contribute 2.3 percentage points (pp) to the growth of traditional deposits, the highest contribution recorded in the last 20 months, while term deposits kept up their good performance and contributed 3.5 pp to growth, similar to the contribution observed in the previous month.

Sight deposits (64.2% of traditional bank deposits) improved their performance after exhibiting moderate growth (of around 1.5%) in real terms over the previous six months, and in the second month of 2024, they reached a real annual change of 3.5% (8.1% nominal), the highest growth rate observed since May 2022.

Despite the aggregate growth observed, performance by holder remained differentiated. In February, sight deposits held by individuals again showed a contraction of 1.8% in real terms, after the slight recovery observed in January (when the real annual growth rate was 0.3%). This reduction could be associated with the reallocation of resources to higher-yielding instruments, since, as discussed in more detail below, the term deposits of these holders increased in February. Corporate sight deposits registered a real annual growth rate of 6.3% in February, significantly higher than the 2.0% observed in the previous month as well as in February 2023 (-5.1%). This improvement could reflect higher revenues from companies in certain sectors. For example, total revenue from the supply of goods and services associated with the private non-financial services sector increased 2.3% YoY in January (latest available information), while ANTAD's total store sales indicator reached a real growth of 7.6% in February, in both cases improving its performance with respect to previous months. In the case of the non-financial public sector, sight deposits grew by 3.5% in February, a lower rate than in January (4.8%). Finally, sight deposits from other financial intermediaries grew at an annual rate of 27.4% in real terms, a significant improvement over the 3.6% growth reported in January, but below the average growth rate observed in 4Q23 (37.2%).

The volume of term deposits regained momentum, with a double-digit real annual growth rate of 10.2% (15.0% nominal) in February, higher than in January (9.6% real) and in February of the previous year (5.2%). A high interest rate environment has encouraged savings in term instruments, a trend which can be seen in the majority of holders. Term deposits for individuals grew at a real annual rate of 8.3% in February, while corporations grew at a real rate of 15.0% and the non-financial public sector grew at a real rate of 17.6%. In all three cases, momentum increased compared to the first month of the year. In contrast, term deposits from other financial intermediaries experienced a decrease in momentum, with a real growth rate of 4.6% in February, down from 7.3% in January.

The high interest rate environment has maintained the attractiveness of term savings instruments; therefore, as interest rates begin to decline in the medium and long term, term deposits are expected to grow more moderately and sight deposits are expected to become the main driver of traditional deposits.

Outstanding housing and corporate loans rebound in February 2024, while consumer credit continues to slow

In February 2024, the balance of the outstanding loan portfolio granted by commercial banking to the non-financial private sector (NFPS) registered a 5.1% real annual growth rate (9.7% nominal), slightly higher than the 4.9% recorded in the previous month. Consumer credit was less dynamic than in January, both in nominal and real terms. The housing and corporate portfolio recorded a better performance only in real terms. As a result, consumer credit contributed 2.5 pp to February's 5.1% real annual growth, while the corporate and housing portfolios contributed 1.6 and 0.9 pp, respectively.

Outstanding consumer credit balances grew by 11.1% real annualized in February (15.9% nominal), accumulating a five-month slowdown in real terms. Balances in the credit card (CC) and payroll loans segments (38.0% and 25.2% of the consumer portfolio, respectively) recorded real growth rates of 12.0% and 6.3%, below those observed in January. In contrast, credit for the acquisition of durable consumer goods (ADCGs, 16.6% of consumer credit) increased 16.0% in real annual terms (14.9% in the previous month), while personal loans (15.5% of the consumer portfolio) registered a real annual change of 8.9%, a higher dynamism than that of the previous month (8.4%). The performance of the consumer portfolio can be partially attributed to the growth of formal employment (which has maintained growth rates of around 3.0%, with a slight slowdown in February) and real wages, whose performance is highly correlated with that of private consumption, contributing to a sustained increase in demand for this type of financing.

Meanwhile, mortgage loans registered an annual growth rate of 4.1% in real terms in February (8.7% nominal), the first improvement after seven consecutive months of slowdown with respect to the previous month. By type of housing, financing balances for low-income housing showed a real contraction of 5.1%, a significantly larger drop than in the previous month, while credit for middle-income housing registered a real annual growth of 4.5%, a greater dynamism than in the previous month (4.0% real annual growth). The greater dynamism in mortgage loan balances could be partially due to the expectation of lower long-term interest rates, which would be enough to offset persistent residential real estate inflation.

The business portfolio (53.1% of the outstanding credit to the NFPS) registered annual growth of 2.9% in real terms (7.4% nominal), a lesser dynamism than that observed in the previous month. Looking at the performance of balances according to business activity, real estate services and commerce stand out, both contributing 2.2 pp to growth, followed by the manufacture of transport equipment (1.3 pp) and professional services (0.8 pp), the main drivers of portfolio growth, despite the declines recorded in other activities, such as telecommunications, the agricultural sector, hotels and restaurants and the food, chemical and non-metallic product manufacturing industries.

With respect to trade, February saw a better real performance of total ANTAD store sales (7.6% vs. 1.7% in the previous month), which may have contributed to a higher demand for financing from banks. With respect to real estate services, as mentioned in previous issues of this report, the dynamism seen could be due to companies' readiness to take advantage of nearshoring, although, unlike in previous periods, this was not accompanied by credit to private construction, where balances did not grow in real terms in February.

Investment, while lagging, seems to be consolidating as one of the main variables in the increase of balances, as it expands the demand for business financing. Likewise, the downward trend in interest rates could exacerbate the positive effect that investment has had on the balances of this portfolio. With respect to household credit, formal employment and real wage should sustain the growth of the consumer and housing portfolios, although perhaps at a slower pace than in 2023.

Outstanding loans increased in dynamism in the central region of the country in 4Q23, mainly driven by the services sector

According to Banco de México's October-December 2023 Regional Economies Report[1], based on the Credit Market Conjunctural Evaluation Survey (EECMC) corresponding to the fourth quarter of 2023 (4Q23), the outstanding portfolio of non-financial private companies in commercial banking showed a real annual growth[2] of 3.2% in the last quarter of the year, 0.4 percentage points (pp) higher than that recorded in 3Q23.

Bank credit in the central region, which accounts for 53% of credit, contributed 2.2 of these 3.2 pp, while 1.2 pp are attributable to the north region, 0.1 pp to the north central region, and 0.3 to the south region.

By type of activity during 4T23, the outstanding portfolio of the agricultural sector only grew in the north central region of the country, with a real annual change of 9.1%. In contrast, outstanding loans to the agricultural sector in the north region dipped by 4.3%, while in the north central and south regions, the declines were 1.2% and 12.1%, respectively.

In the case of secondary activities, the most notable increase in 4T23 was seen in the north central region, which reported real annual growth of 5.6%. Financing for industry in the north region was up 0.6%, while in the central and south regions, outstanding loans to the industrial sector were down 2.8% and 2.5%, respectively.

The only contraction in services (of 5.0%) occurred in the south region of the country. Meanwhile, the central, north and north central regions continued to register real annual growth rates. The central region experienced the largest increase (9.1%), followed by the north (6.5%) and north central regions (1.1%).

Credit performance shows greater dynamism in the north, driven by the growth of outstanding balances to non-financial private companies engaged in industry and services. The current trend of relocating production plants to Mexico could partially account for the acceleration in the growth of demand for industrial business credit in the north region. This has not been the case in the north central region, despite the fact that it has manufacturing subsectors integrated into global value chains. This may be due to the lack of conditions necessary to consolidate the flow of investment in the region and translate them into an increase in the demand for credit, promoting the development and financing of complementary sectors, such as services.

The opportunities that nearshoring and local investment imply for manufacturing and regions specialized in export manufacturing could generate economic spillovers to other sectors and regions of the country, either through integration into transnational production chains or through local supply networks. In addition, the current downward inflationary path could imply a greater demand by companies for credit in the medium term, which could contribute to boosting business credit balances in all regions of the country.

1: Regionalization in the report: the north includes Baja California, Chihuahua, Coahuila, Nuevo León, Sonora and Tamaulipas; the north central 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.
2: It should be noted that the real change does not take into account exchange rate effects.

The Mexican financial system maintains a solid and solvent position

The Financial System Stability Board (FSSB) recently updated its Risk Balance Sheet. In its March statement, it highlighted that global risks to financial stability include the possibility of prolonged inflationary pressures, of financial conditions remaining restrictive for longer and of geopolitical tensions worsening. It is also likely that there may be periods of high volatility and uncertainty in connection with political and electoral events in some jurisdictions. Also, the FSSB still does not rule out the risk of systemic events that might affect the global financial system, with implications for national markets.

The statement points out that domestic financial markets in Mexico have shown stable behavior and operating conditions, with a strong local currency. However, there are still expectations of a weakening of economic activity with respect to the performance observed in the previous year. Although the sovereign credit rating remains investment grade with a stable outlook, Pemex's credit situation continues to face significant challenges and one of the main agencies lowered its rating in February, maintaining its negative outlook.

As for the Mexican financial system, stress tests show that, as a whole, the system continues to show a capacity to absorb shocks, maintaining its solvency and profitability, which contributes to mitigating volatility and limits systemic risks. In commercial banking, capital and liquidity levels continue to significantly outperform regulatory minimums. Some non-bank financial intermediaries continue to face challenges associated with more restrictive financial conditions and investors' relative aversion to this sector. However, this situation does not represent a systemic risk, since these intermediaries represent a small share of the system and have limited interconnection with commercial banks and other institutional investors.

2. Financial markets

High rates for longer in a no-landing context?

At the beginning of the year, financial market participants were discounting as many as six 25-bp cuts in the federal funds rate over the course of 2024. As of the close of the first week of April, they are discounting less than 75 bp of cuts.

It is clear that the idea of prolonged high rates has permeated market expectations; however, the underlying narrative in terms of economic activity seems to have shifted from a soft landing to a no-landing, judging by the recent behavior of financial asset prices.

Given the strength of labor market data and the persistence of inflation in the U.S., the yield curve has been moving upward. However, there has been no significant adverse effect on stock market prices. Most indices have registered significant gains so far this year, supported by a possible increase in productivity derived from the advent of artificial intelligence.

Indeed, even though there have been increases of 19 and 15 bp in the two- and ten-year treasury bond curve following the most recent Fed meeting (see figure 1), the main U.S. stock indices maintained gains of between 0.78 and 2.10% (see figure 1) between March 14 and April 8, above the gain for the benchmark of this asset class (0.78%).

It is worth noting that equity indices in Europe, emerging markets and Mexico diverged from U.S. indices after the Fed's latest monetary policy announcement, with rises between 0.75% and 2.42% (see figure 1), which could be indicative of a diversification movement following the high levels of valuation in the U.S.

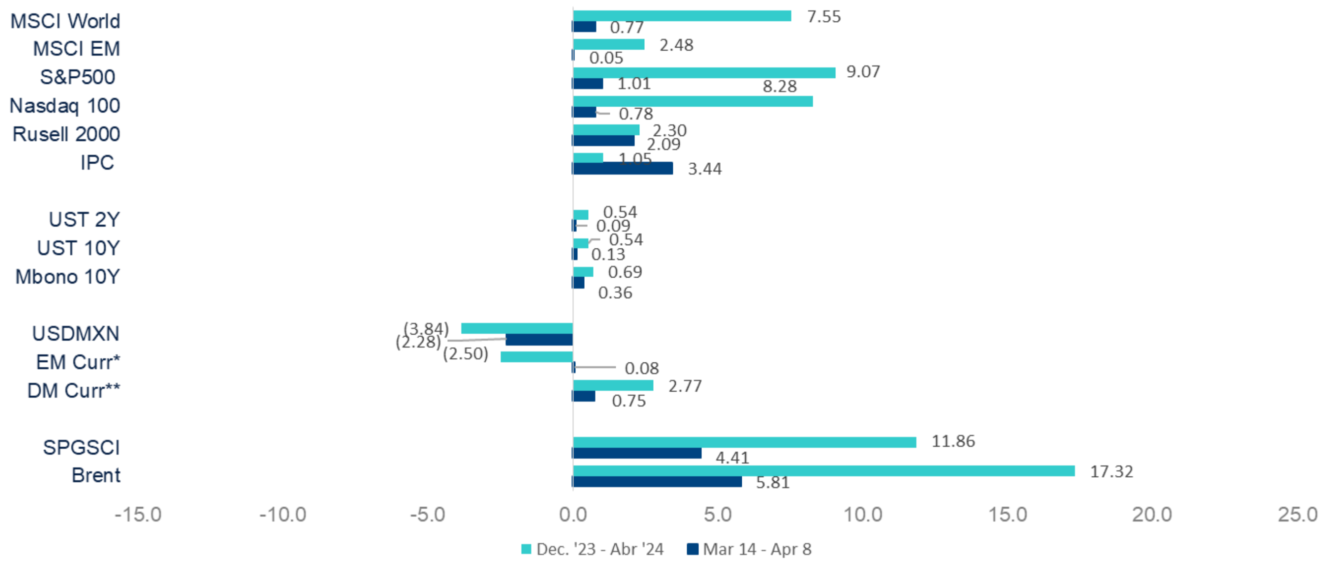
The yield to maturity of Mexico's 10-year bond increased 36 bp between March 14 and April 8 (see figure 1), almost three times the change in the treasury bond at the same maturity, even in the context of the first monetary policy rate cut. One possible explanation for this behavior may be Banxico's cautious tone after the cut, which has translated into expectations of a more moderate monetary easing cycle on the part of the market given the persistence of services inflation. The Mexico 10-year bond is thus trading at 9.65%, 70 bp above its 2023 close.

In the foreign exchange market, the dollar strengthened against the currencies of emerging markets and developed countries as a whole between March 14 and April 8, while the Mexican peso stood out in this period as the second most appreciated currency with a gain of 2.30%, keeping it as the most appreciated currency so far this year with a yield of 3.95%. The exchange rate is thus trading at 16.32 pesos per dollar, its most appreciated level since mid-2015.

One additional contextual element that points more in the direction of a possible no-landing is the recovery of commodity prices. The benchmark of this asset class increased by 4.41% between March 14 and April 8, as a result of a generalized rise (see figure 1). Energy prices rose by 15.90% so far this year, and the price of gold rose by 12.54% on expectations of monetary rate cuts.

Thus, the narrative that has shaped market expectations has been modified in favor of risk appetite because, despite the effects that a prolonged high interest rate environment could have, these have been more than offset by the disappearance of recession expectations and there is even a possibility that the U.S. economy could maintain its recent growth path. This context is unexpected, and the risks ahead could come from an adjustment to credit markets, which are unusually calm.

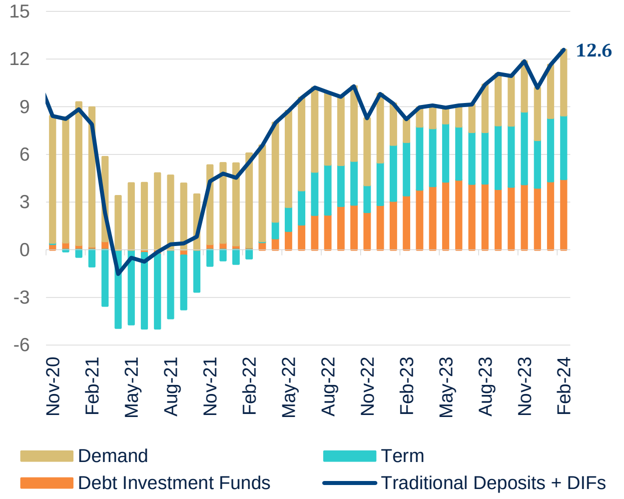
Figure 1. **PERFORMANCE OF THE PRICES OF THE MAIN FINANCIAL ASSETS DURING MARCH AND APRIL 2024** (% CHANGE IN LOCAL CURRENCY)



*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.

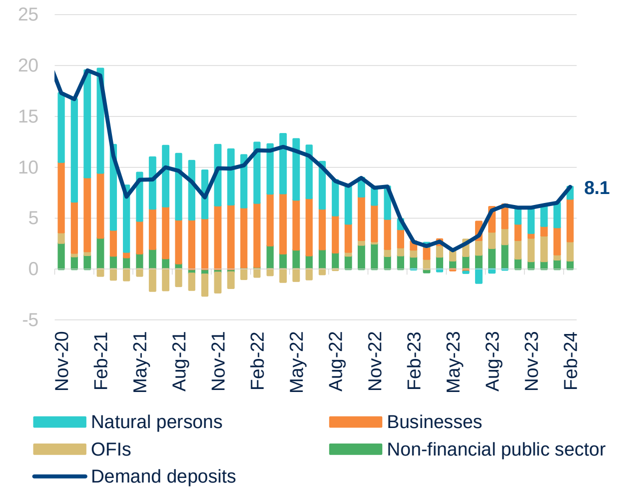
Deposits: figures

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



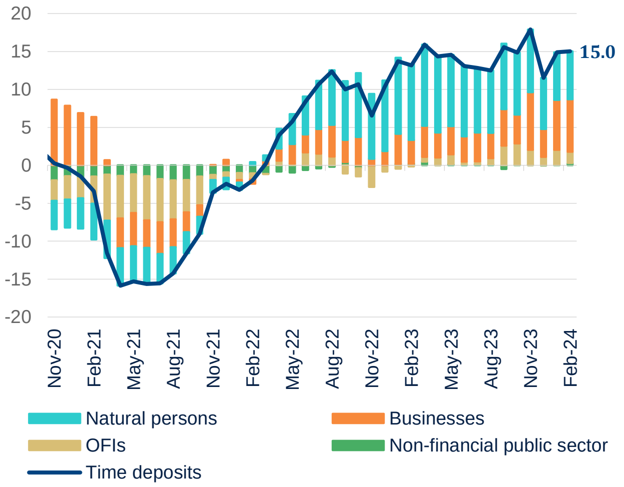
Source: BBVA Research based on Banxico data.

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



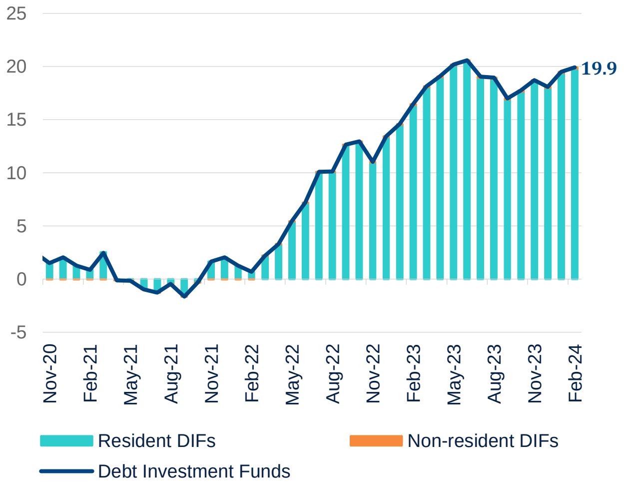
Source: BBVA Research based on Banxico data.

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



Source: BBVA Research based on Banxico data.

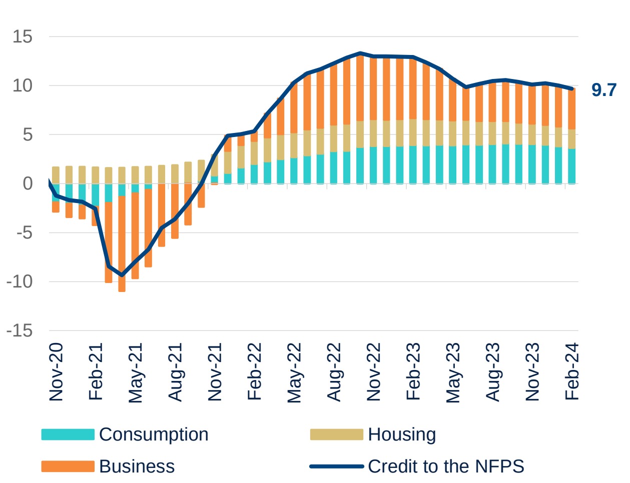
Figure 5. **DEBT INVESTMENT FUND SHARES (NOMINAL ANNUAL CHANGE, %)**



Source: BBVA Research based on Banxico data.

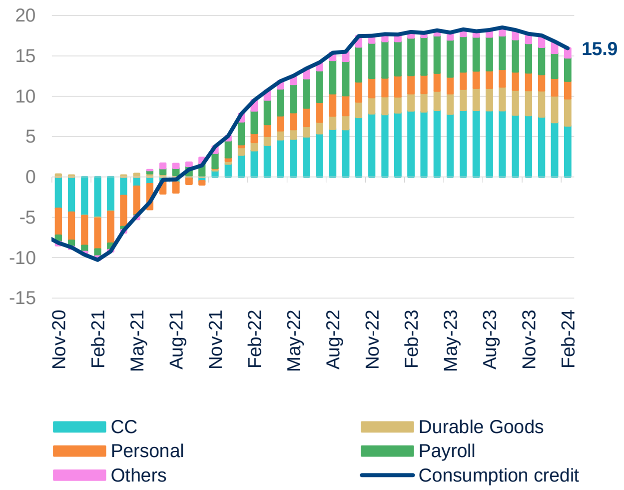
Credit: figures

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



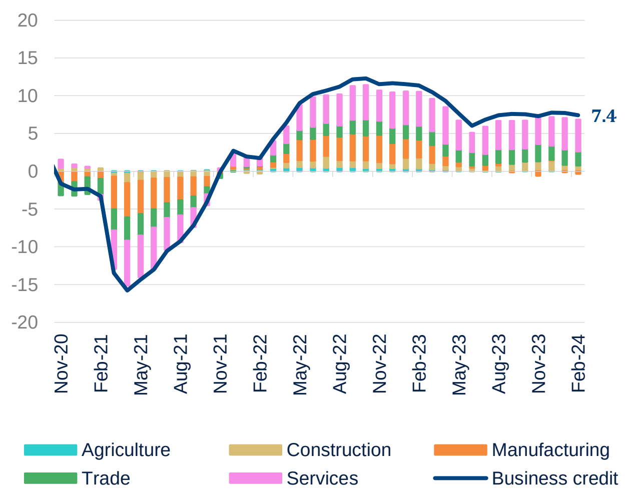
Source: BBVA Research based on Banxico data.

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



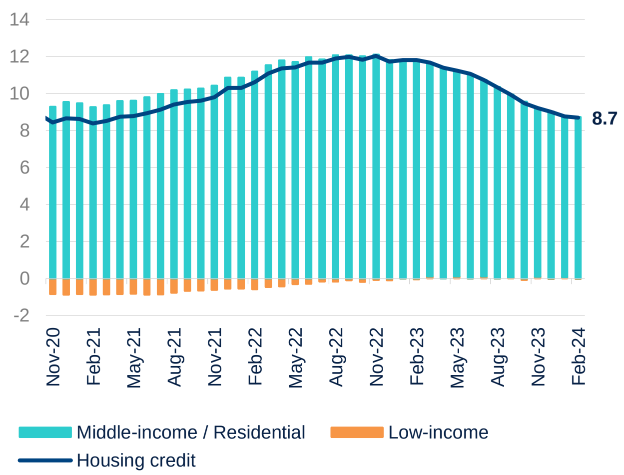
Source: BBVA Research based on Banxico data.

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



Source: BBVA Research based on Banxico data.

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



Source: BBVA Research based on Banxico data.

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