Banking

Monthly Report on Banking and the Financial System

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1. Banking and the Financial System

Traditional bank deposits are slowing down, mainly due to a lower dynamism of term deposits

In March 2024, the balance of traditional bank deposits (sight + term) registered a real annual growth rate of 4.5% (equivalent to a nominal growth of 9.1%), a slight slowdown after the rebound in February (when it increased 5.8% real annually). Despite this result, the average annual dynamism in the first quarter of 2024 (1Q24) was 4.9% in real terms, above the growth recorded in the previous quarter (4.4% observed in 4Q23). Term deposits registered the largest decrease in their growth rate compared to the immediately previous month (IPM), and in March, they contributed 2.3 percentage points (pp) to its growth, while sight deposits showed a slight slowdown and contributed 2.2 pp to the growth of traditional deposits. Lower interest rates could already be negatively impacting the performance of term deposits.

In March, sight deposits registered a real annual change of 3.3% (a nominal growth of 7.9%), slightly lower than the growth observed the previous month (2.3%). With this result, sight deposits averaged real growth of 7.5% in 1Q24, exceeding the average observed in the previous quarter (6.1% in 4Q23). In March, the holders that contributed most to real annual growth were companies, whose balances showed a real annual change of 5.3%, a smaller increase than that recorded in February (6.4%). Sight deposits of individuals recorded a real annual change of 3.4%, a change in trend with respect to the real annual change of -2.0% of the IPM. Additionally, it highlights that the balances of the non-financial public sector fell at a real rate of -15.1%, first month in negative territory in a year. In contrast, sight deposit balances of other intermediaries recorded the highest dynamism, registering a real increase of 27.7% in March, an acceleration with respect to the 27.4% real annual change in February.

On the other hand, term deposits decreased their dynamism significantly. In March 2024, these savings instruments showed a real annual growth of 6.8% (11.5% nominal), the lowest variation recorded so far this year. On average, in 1Q24 term deposits registered a real growth of 8.8%, below the 9.9% observed in the previous quarter. The balances of most sectors holding this type of savings (companies, individuals, and non-financial public sector, which represent 83.8% of time deposits) registered a slowdown in annual real terms. Only in the case of other financial intermediaries was a greater dynamism observed in these balances (5.1 vs. 4.6% in the preceding month), which could be explained as an attempt to hedge against an expectation of lower rates in the medium term.

The current scenario of falling interest rates would discourage agents from holding balances in term instruments, while the gradual slowdown in employment and real wage (for individuals) and revenues (for companies) could explain the slowdown of traditional deposit gathering as a whole.

The dynamism of bank credit to the private sector remains stable even with the boost of the consumer portfolio

In March 2024, the balance of the current loan portfolio granted by commercial banks to the non-financial private sector (NFPS) registered an annual real growth of 4.9% (9.5% nominal), slightly lower in real terms compared to the previous month (when real growth was 5.0%). Consumer credit contributed 2.6 pp to the annual real growth rate of 4.9% in March, while the business and housing portfolios contributed 1.4 and 0.9 pp, respectively

In the third month of the year, real annual rates show a slowdown in housing and business portfolios, while the consumer credit portfolio has managed to maintain its dynamism. These trends resulted in a lower growth of total credit to the NFPS, which is most evident when considering the performance of the first months of the year. In 1Q24, the average real growth rate of credit to NFPS was 4.9%, below the growth recorded in the previous quarter (5.6% in 4Q23).

In March 2024, outstanding consumer credit achieved an annual real growth of 11.2% (16.1% nominal), a slight increase in its dynamism compared to the previous month (when real growth of 11.1% was observed). The credit card segment (37.9% of the consumer portfolio) continues to be the main driver of growth in this portfolio, contributing 4.7 pp to the real annual change. Financing for the acquisition of consumer durables (ACD, 16.7% of consumer credit) increased by 15.7% in real annual terms, consolidating its position as the most dynamic segment and contributing 2.5 pp to consumer credit growth, while payroll and personal loans recorded real annual changes of 6.0 and 8.9%, respectively, and contributed 1.6 and 1.4 pp. The good performance of employment and real wages (even with slowdowns in both variables in March) have boosted the good performance of the consumer portfolio.

The housing portfolio registered a real annual growth rate of 3.8% (8.4% nominal) in March, with a decrease in its dynamism after a slight rebound in the preceding month, and due to a lower dynamism of the medium-residential housing segment, as well as the greater magnitude of the annual contraction of the financing balances for low-income housing. The relatively high long-term interest rates (and the expectation that they will be lower in the medium term) could discourage agents from using of this type of financing and lead to its postponement, provided that the good performance of the labor market continues to contribute (with a lag) to sustaining the growth of this portfolio.

Finally, business loans (53.1% of outstanding balances to the NFPS) registered a growth of 2.6% in real terms (7.2% nominal), a slowdown compared to February (when real growth was 2.9%). March also saw the lowest real annual growth since September 2023. The high cost of financing and weaker business revenue dynamism (e.g. a slowdown in real annual growth in business revenue since the beginning of the year, compared to 2023[1]) could be holding back stronger business portfolio dynamism.

The inflationary and downward interest rate trajectories could generate a prudential effect on credit demanders, who could shift their investment and financing decisions to the near future in the expectation of lower financing costs. Likewise, the resilience of the labor market and the good performance of the components of national output are necessary conditions to sustain the demand for loanable funds of agents and, consequently, the real dynamism of bank credit balances to the NFPS in the medium term.

[1] Wholesale trade revenues recorded an average annual real variation in January and February of -1.7%, while retail trade revenues recorded a growth of 1.1% (vs. 0.9% and 1.9%, respectively in 4Q23).

Vulnerabilities of the private credit market in the face of rapid growth

Private credit is defined as non-bank corporate credit based on bilateral agreements that are outside the scope of public instruments and commercial banks. It is aimed at providing long-term financing to companies that are too large or risky for commercial banks or too small for public markets.

According to the April Global Financial Stability Report, private credit has grown steadily since the 2008 crisis to such an extent that it now accounts for 7.0% of credit to financial institutions in the US. As of June 2023, the private credit market had assets under management of USD 1.6 trillion, which grew at an annual average of 20% over the last five years. In Europe this asset class represents only 1.6% of total corporate credit, although its average annual growth rate was 17% over the last five years, while in Asia the average annual growth was also in the order of 20%, although it only represents 0.2 percent of credit to non-financial corporations.

For the IMF, risks to private credit are contained at the moment. However, given the accelerated growth it has registered in recent years, it could, in the near future, become a critical asset at the macro level and, consequently, amplify the negative effects on the economy.

Based on this, it identifies the following as the main vulnerabilities: (i) fragile creditors; ii) high exposure of pension funds and insurers to the asset class; iii) multiple phases of borrowing; iv) the growth of illiquid investment vehicles; v) valuations that do not reflect the latest information; and vi) unclear linkages between participants.

In order to prevent these vulnerabilities from enhancing the materialization of risks, the IMF recommends greater regulation by the authorities of private credit funds, their institutional investors, and their financing providers. Additionally, it proposes to monitor more closely the liquidity of private credit funds, since they could face greater redemption risks.

2. Financial markets

Caution regarding ambiguity about inflationary trajectory redirects investment flows to less risky assets

During April and the first days of May 2024, new information on the performance of the US economy has led to a change in the expectations of agents facing an environment of high interest rates for a longer period and, consequently, the prices of the various financial assets have registered adjustments that imply a recomposition toward assets with a lower risk component.

A weaker-than-expected US GDP data seems not to have been enough to catalyze a downward start to the interest rate cycle, partly due to still resilient consumer spending, as well as better-than-expected corporate earnings, retail sales and inflation data in March.

Uncertainty about a concrete direction for real variables in the US economy was evident in the Fed's 1 May communication, in which, in line with market expectations, it decided to wait to reduce the monetary policy rate until there is more confidence that inflation is on a path of sustained convergence toward the 2% target. The expectation of rate cuts by the Fed is based, at the beginning of May, on a cut towards the end of 2024, which would help dispel expectations of a stagflation context in the US.

All of the above influenced that between March 27 and May 3, the North American curve registered an increase of 25 bps for the two-year node and 32 bps for the long part of the curve (see graph 1). It should be noted that between March 27 and April 10, the day on which the inflation results for the month of March were announced, the movements had been upwards, of 40 and 35 bps, respectively.

In the case of the main stock indices, the movements between March 27 and May 3 registered a generalized fall, with the exception of the rise in the shares of the *Magnificent 7* and the MSCI of emerging markets, which could be explained by the growth expectations due to the use of artificial intelligence and a future increase in cash flow in the case of the *Magnificent 7*, as well as better economic growth expectations and increased exposure to commodities in emerging markets.

However, the rest of the stock indices registered falls in prices, in the face of an expectation of elevated rates for a longer period. Notably, the S&P500 fell 2.3%, while the Euro Stoxx 600 fell 1.22%, the NASDAQ 100 1.48%, and the Russell 2000 3.72%. In general terms, at the beginning of the fifth month of the year, there is a redirection of investment flows towards fixed-income instruments, as is the case with government bonds.

Commodities registered a good performance in April (2.14%), although they exhibited a fall in the first days of May. In the case of industrial metals, their prices rose 12.30% during the month of March 27 to May 3, while precious metals rose 4.63%, and the latter could represent a diversification tool for investors as a hedge against an uncertain inflationary trajectory.

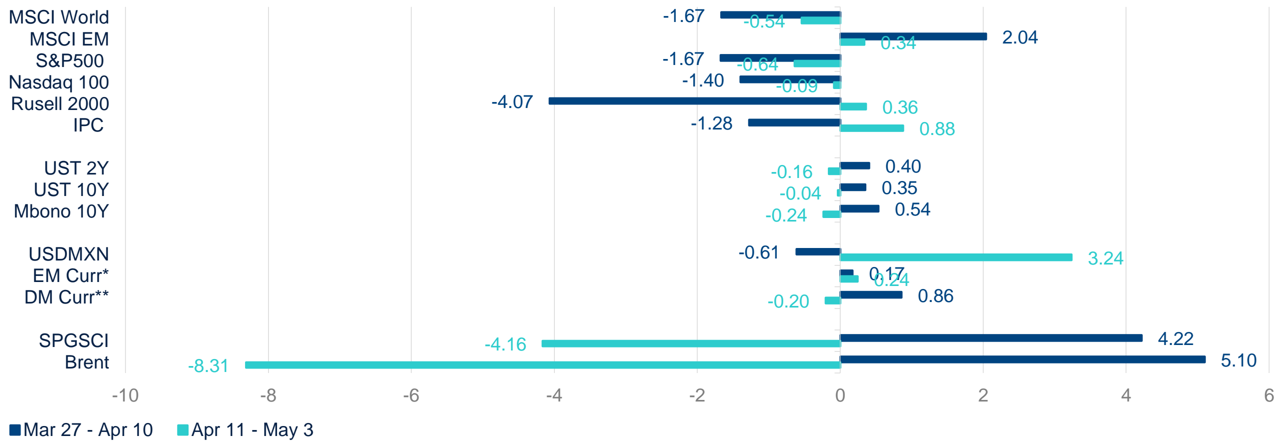
For Mexican assets, it is worth noting that the IPC was the stock index with the smallest contraction in the sample between March 27 and May 3 (-0.41%, see Chart 1), which means that it has already registered losses of 0.43% so far in 2024. This figure, however, implies an underperformance compared to the main indexes in the sample, being the only one in negative territory.

As for government bonds in Mexico, the rise in 10-year Treasury bonds, as well as higher interest rates for a longer period and higher headline inflation in the first half of April (despite lower core inflation) could explain the 30 bps increase in the yield to maturity of the 10-year Mbono between March 27 and May 3 (see Chart 1). With this, this indicator closes the first days of May at 9.6%, 64 bps above the closing of 2023.

It should be noted that, within domestic assets, the most prominent continues to be the Mexican peso. Between March 27 and May 3, it depreciated by just 2.61% (see chart 1). As a result, the exchange rate closed on May 3 at 16.97 pesos per dollar, an increase of just 0.01%, with respect to the close of 2023.

Thus, there seems to be a consistency in general terms between the prices of different assets under a scenario whose main element is the expectation of high interest rates for a longer period of time and a component of uncertainty regarding the performance of real and financial variables in the economy. In short, the dynamics of inflation, economic growth and the labor market continue to be in the sights of actors in the financial markets to consolidate expectations and have a clearer picture regarding the path of inflationary convergence.

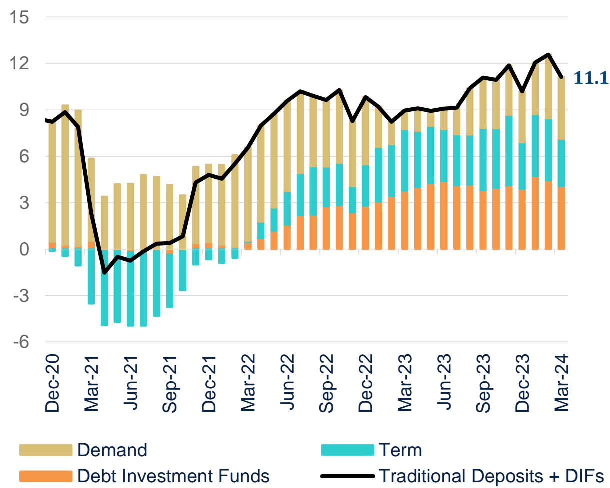
Figure 1. **PERFORMANCE OF THE PRICES OF THE MAIN FINANCIAL ASSETS DURING APRIL AND MAY 2024** (% CHANGE IN LOCAL CURRENCY)



*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.

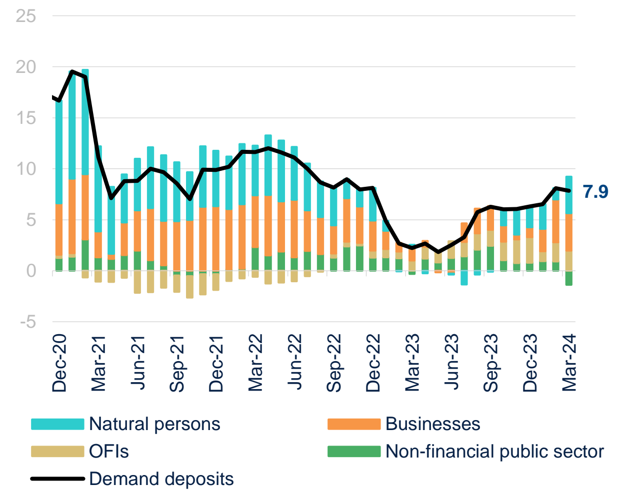
Deposits: figures

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



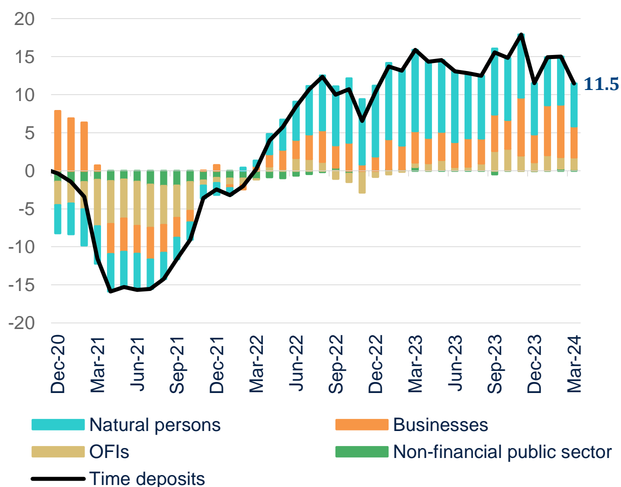
Source: BBVA Research based on Banxico data.

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



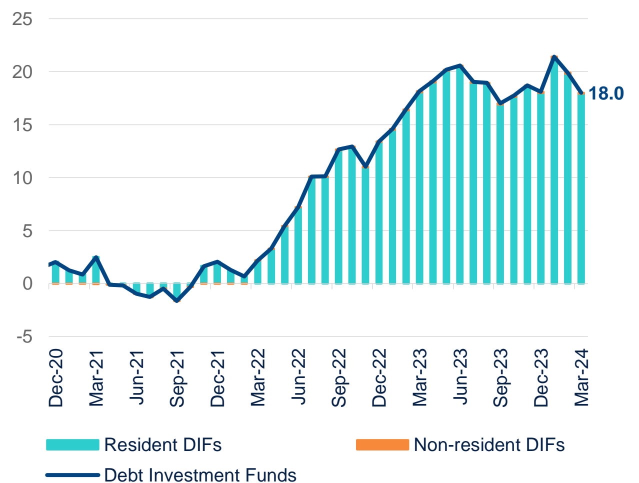
Source: BBVA Research based on Banxico data.

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



Source: BBVA Research based on Banxico data.

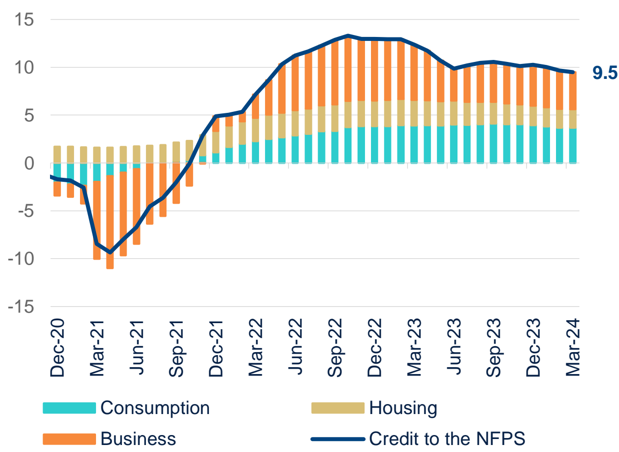
Figure 5. **DEBT INVESTMENT FUND SHARES (NOMINAL ANNUAL CHANGE, %)**



Source: BBVA Research based on Banxico data.

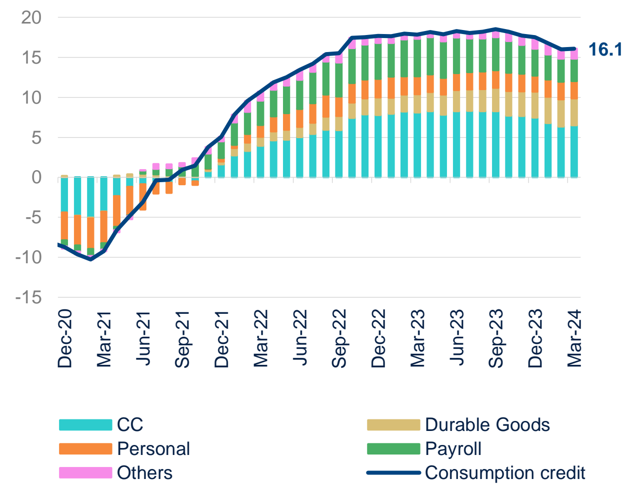
Credit: figures

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



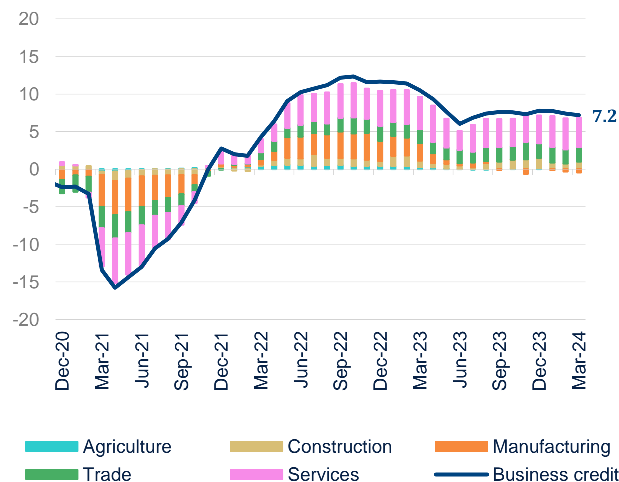
Source: BBVA Research based on Banxico data.

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



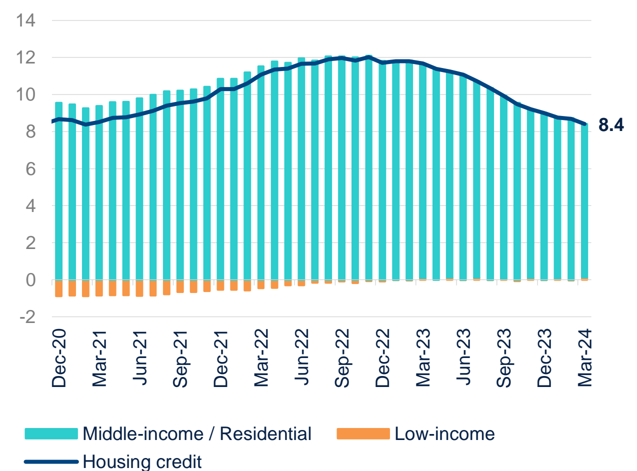
Source: BBVA Research based on Banxico data.

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



Source: BBVA Research based on Banxico data.

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



Source: BBVA Research based on Banxico data.

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