Banks

Monthly Report on Banking and the Financial System

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Banking and the Financial System

Lending to the private sector starts the year with growth of 11.7%, driven by consumer credit

In January 2018 the outstanding balance of credit granted to the private sector by commercial banks grew at a nominal annual rate of 11.7% (5.8% in real terms), 0.3% below the rate seen in the previous month (12.0%) and 0.9% below the reading in January 2017 (12.6%). This was due to the reduced dynamism of housing and business loans, which grew by 8.1% and 14.6% respectively, both rates being about half a percentage point less than in the last month of 2017. Consumer credit for its part saw a slight uptick in its nominal annual growth rate, from 8.2% in December 2017 to 8.4% in January 2018. The increased growth in consumer credit could be associated with the relative improvement in households' purchasing power, given the reduction observed in the contraction of real wages, which in turn is linked to lower inflation at the beginning of the year. However, this improvement does not yet seem to be enough to stimulate all segments of consumer credit or the housing loan sector. Lending to businesses was influenced by a short-term economic factor associated to the exchange rate valuation, more specifically the significant appreciation of the peso as at the end of January 2018 relative to the same date one year earlier. Going forward, we expect this category of lending to be associated rather with variables such as interest rates and investment.

Commercial banks' new deposit gathering loses steam at the beginning of 2018

In January 2018, the nominal annual growth rate in traditional banking deposits (sight + term) was 9% (3.2% in real terms), 1.5% less than that seen in December 2017 and 4.7% less than the nominal rate posted in January 2017. The increased growth in term deposits in January was not enough to offset the slowdown in growth of sight deposits. Growth in sight deposits slowed considerably to a nominal annual rate of 5.8% (0.3% in real terms), less than that seen in December 2017 (10.1%). On the other hand, the annual nominal growth rate in term deposits recovered to 14.3% (8.3% in real terms) from the 11.2% observed in December 2017. The reduced dynamism in sight deposits was due to a slowdown in deposits from businesses, private individuals and other financial intermediaries. There were the same segments that in turn showed greater dynamism in term savings. So the major part of the dynamic observed during the month seems to be explained by a shift in private sector savings away from liquid instruments and into longer term savings.

Annual report of the Financial System Stability Council (CESF)

In March the CESF presented its eighth annual report on activities and its assessment of the stability of the Mexican financial system. The report highlights the fact that from April 2017 to March 2018, world economic indicators reflected sustained and generalised growth, in both developed and emerging economies. However, there are still risks of a world economic slowdown, risks associated with geopolitical factors and the resurgence of protectionist policies in various regions. According to the CESF, the external environment is the main source of risks faced by the Mexican economy and its financial system.

Prominent among the various potential risks to Mexico's financial system are: 1) An adverse outcome of the renegotiation of the North American Free Trade Agreement (NAFTA) which could translate into lower potential growth for the Mexican economy, due to a reduction in capital expenditure and reduced access by Mexico to external resources. 2) The recent US tax reform could be a source of uncertainty as regards incentives for investment in Mexico in the medium-term. 3) This reform has also intensified the risk of rising inflation in the US and consequently of the Federal Reserve's being forced to accelerate the pace of normalisation of its monetary policy. If this normalisation were to take place in a disorderly manner, it could affect capital flows into Mexico and the functioning of its national financial markets. 4) On the domestic front, the upcoming elections in July could also give rise to bouts of volatility in the Mexican financial markets.

For these reasons, the CESF expects capital flows in 2018 and 2019 to be particularly sensitive to international financial conditions, so further bouts of volatility cannot be ruled out. In this situation, it will be particularly important to keep the public finances healthy and inflation low and stable, since these are fundamental factors for achieving efficient and orderly functioning of the country's financial system.

As regards Mexico's banking system, the report highlights its appropriate capitalisation and its reasonable levels of liquidity, achieved largely by implementing the international (Basel III) standards. Thanks to these standards, together with the prudential measures to which the banks are subject in their currency positions, episodes of exchange rate volatility do not represent a direct risk to Mexican banks' solvency or liquidity.

Regarding the results of the stress tests presented in the report, they indicate that the Mexican financial system has sufficient capital to confront adverse shocks and could continue to provide its intermediation services even in extreme circumstances. However, the CESF recommends that certain institutions, particularly the smaller ones, keep a close eye on the increase in NPLs in their consumer credit portfolios and diversify their sources of funding in order to reduce their vulnerabilities.

The value of construction company activity fell by 3.5% in 2017

In December 2017, the annualised turnover of construction companies dropped 3.5% in real terms. Buildings, which represented 47.2% of the total, shrank 1.1% over the same period.

Within the building sub-sector, housing construction barely grew at all in 2017. However, in January 2018 it increased by 1% in real terms on an annualised basis. This might be a reflection of the recovery in investor expectations, and of the improvement in consumers' expectations, as it has been confirmed that mortgage rates will be held at historically low rates.

In contrast, the construction of industrial facilities and shopping centres has felt the increase of short-term interest rates more keenly, since lending for these types of constructions, which are mainly based on the TIIE (interbank interest rate), react directly to changes in the Banco de México base rate. Up to December 2007, the value of production of this heading was down by 2.3% in real terms.

As for transport and urban development construction, which represents just over a quarter of the overall output of construction companies, as we anticipated in our October 2017 report, it seems to have returned to growth in the second half of last year. By the end of 2017, such work had grown annually by 3%, so private sector investment in these projects could sustain demand for credit during 2018 in this sub-sector.

Financial Markets

The markets steadied after the temporary upturn in volatility

March was characterised by reduced risk appetite in the markets in view of the escalation of trade tensions. The US announcement of import tariffs on steel and aluminium and the exchange of possible tariff measures on various products between China and the US gave rise to various questions about their possible effect on global economic activity. Nonetheless, in Mexico, the prospect of a more flexible approach by the US to some of its demands in the NAFTA renegotiation gave a positive spin to several domestic markets.

In this environment, during March the global equities benchmark posted a fall of 3.75%, less than that of the S&P500, which was 4.86% down under the additional influence of various events leading to a significant fall in technology stocks. In the case of the emerging markets equities benchmark, the fall was 2.16%, while Mexico's IPC equity index underperformed its peers, falling 3.4%. In the nominal fixed income market, during the third month of the year the yield curve for Treasuries flattened in response to the fall in long-term rates, which went from around 2.86% to 2.73% at the ten-year tenor due to increased demand for safe-haven assets. In Mexico, the fall in these long-term rates was clearly greater given the expectations of progress in the NAFTA renegotiation. Yield to maturity on the ten-year M bond fell by 25 bps to around 7.39% at the end of March. This favourable NAFTA effect was seen clearly in the exchange rate. Whereas during March the emerging currencies as a whole depreciated by 0.3% against the dollar, the Mexican peso appreciated by 3.14%, to 18.25 pesos to the dollar at the end of the first quarter. Mexico's country risk, measured by the spread on the five-year CDS, also reflected these improved expectations. Towards mid-March this indicator reached 117 bps, its highest level since June 2017, but it fell to 109 bps when the US' more flexible stance in the NAFTA negotiations became known.

Regulation

Adjustments to the methodology for determining the degree of systemic importance of multiple purpose banking institutions

The CNBV (Mexico's National Banking and Securities Commission) has adjusted its methodology for determining the systemic importance of commercial banks, by including off-balance sheet items in the total assets taken into account for its calculations; likewise, it will now also use the total value of derivative positions, adding liability sidepositions (instruments held for trading and hedging purposes), which were previously deducted from the asset side items . These changes aimto provide a more comprehensive view of an institution's size and complexity.

Law to regulate Financial Technology Institutions

March 9th saw the publication of the Financial Technology Institutions Act (the "Fintech Law") which regulates the financial services provided by Fintech Institutions as well as their organisation, operation and functioning, along with the financial services offered or provided through innovative means.

The Law sets up new types of financial institutions dedicated to crowdfunding and to the issuance of e-money. It gives powers to Banco de México to issue rules for the recognition and use of virtual assets. Lastly, it introduces a regime for the innovative the provision of financial services ("innovative models") that will allow financial institutions (including Fintechs), as well as other legal persons (start-ups), to offer financial services for the benefit of users in a regulatory environment that, without ceasing to be prudent, will favour innovation (regulatory sandbox).

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