BBVA Research

Creating Opportunities

Banking

Monthly Report on Banking and the Financial System

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1. Banking and the Financial System

Traditional bank deposits continue to slow down despite the recovery in term deposits

In April 2024, the balance of traditional bank deposits (sight + term) registered a real annual growth rate of 3.8% (equivalent to a nominal growth of 9.1%), reducing its dynamism compared to the previous month (when a real annual change of 4.5% was observed) to stand at more than one percentage point below the average recorded in 1Q24 (4.9%). Sight deposits recorded the sharpest slowdown with respect to the previous month, and in April, they contributed 1.2 percentage points (pp) to the total growth of traditional deposits, while term deposits recovered dynamism and contributed 2.6 pp to dynamism.

In April, sight deposits recorded a real annual change of 1.8% (a nominal growth of 6.6%), lower than the growth observed in the previous month (3.3%). With this result, sight deposits interrupted the recovery observed in February and March of this year, moderating their dynamism to levels similar to those observed in 4Q23 (when real growth averaged 1.6%). In April, the holders that contributed the most to growth were companies, whose balances showed a real annual variation of 3.7%, an increase of a smaller magnitude than that recorded in March (5.3%). This result could be associated with lower dynamism in the revenues of companies in some sectors. INEGI's income indicators for the supply of goods and services recorded in March (last month available) a fall at annual rate in the trade sector (-5.1% in the case of wholesale trade and -1.7% in the case of retail trade) and the ANTAD sales indicator even showed a contraction in real terms in April (of 1.1%). Sight deposits of individuals recorded a minimal growth of 0.1%, significantly below the 3.4% recorded in the previous month. The weak performance of these deposits could be associated with lower dynamism in employment and real wages. In particular, in April, the number of insured persons in the IMSS had an annual growth rate of 2.5% (lower than the 2.7% average of 1Q24) and wages grew at a rate of 4.8% (vs. 5.3% average of 1Q24).

Term deposits recovered dynamism in April 2024, recording a real annual growth rate of 7.5% (12.5% nominal), surpassing the 6.8% rate observed in the previous month, but below the average observed in 1Q24 (8.8% real annual growth rate). The balances of a significant part of the sectors holding this type of savings (companies, non-financial public sector and other financial intermediaries, which represent 53% of term deposits) recorded a recovery in dynamism with respect to March. Only in the case of individuals was there a lower growth in balances in real terms, going from 7.0% in March to 4.1% in April. This reduction could be associated both with the weakening of household income and with lower interest rates than those observed in 1Q24.

The current environment, in which a gradual interest rate reduction and a lower dynamism of corporate and household income sources are anticipated, could be reflected in a further slowdown in the balances of traditional deposits in the short and medium terms.

Outstanding credit to the non-financial private sector increases its dynamism, driven by consumer and corporate portfolios

In April 2024, the balance of the current loan portfolio granted by commercial banking to the non-financial private sector (NFPS) recorded an annual real growth of 5.6% (10.5% nominal), greater dynamism in real terms compared to the previous period (when real growth was 4.9%). At the annual real growth rate of 5.6% in April, consumer credit contributed 3.2 pp, while the business and housing portfolios contributed 1.6 and 0.8 pp, respectively.

In the fourth month of the year, real annual rates accelerated in the consumer and business portfolios, while the mortgage loan portfolio slightly decreased in dynamism. These trends resulted in greater dynamism in total credit to NFPS, which was significantly higher than the average growth of 4.9% recorded in 1Q24 and matching the growth recorded in 4Q23 (5.6% in real terms).

In April 2024, current consumer credit registered a real annual growth of 13.9% (19.2% nominal), a dynamism much higher than that observed in the previous month (when real growth of 11.2% was observed). The credit segment for the acquisition of consumer durables (ACD, 19.1% of the consumer portfolio) consolidated in April as the main driver of growth in this portfolio, contributing 5.8 pp to its real annual change. Credit card financing (36.4% of consumer credit) increased 10.2% in real annual terms, reducing its dynamism with respect to the previous month (12.4% in real terms) and contributing 3.8 pp to the growth of consumer credit, while payroll and personal loans recorded a real annual variation of 5.5% and 9.3%, respectively, and contributed 1.4 and 1.5 pp. Although employment and real wages have shown a slowdown according to the latest available data, which could partially explain the lower real annual change in the credit card, payroll and personal loan segments, the performance of the automotive portfolio was exceptional and generated greater dynamism in total outstanding consumer credit.

In April, the housing portfolio recorded an annual growth rate in real terms of 3.5% (8.3% nominal), a slowdown that brings it to the lowest real annual growth rate since October 2022. This is the result of slower growth in the medium-residential housing segment, as well as a larger annual contraction in low-income housing financing balances. The expectation of higher long-term interest rates could be generating a contraction in the demand for loanable funds for housing, partially explaining the lower growth in the balances of this type of financing. Likewise, the slowdown in IMSS employment and real wage during the fourth month of the year could influence more moderate growth in the medium term.

Corporate credit (52.8% of the outstanding portfolio to the NFPS) recorded a growth in real terms of 2.9% (7.7% nominal), a greater dynamism than in March (when real growth was 2.6%). The cost of financing and the slowdown in activity seem to have been more than offset by the lower magnitude of the exchange rate appreciation with respect to previous months (in April, the year-on-year appreciation was 5.0%, significantly lower than the average of 10.9% and 8.0% in 4Q23 and 1Q24, respectively), which could be indicating a greater dynamism in the corporate portfolio due to the accounting effect of the exchange rate valuation.

In fact, real corporate balances in domestic currency slowed down in March from 2.6% to 2.1%, while balances in foreign currency expressed in pesos increased in dynamism from 2.7% to 5.9%. If the dynamism of the portfolio is analyzed filtering also the exchange rate effect, the foreign-currency-denominated credit would present a real valuation of 16.6% (a slowdown compared to 17.0% in March) and the total corporate credit would present a real change (in this case, filtering both the inflationary and exchange rate effects) of 8.9% (lower than 9.2% in March). This would be consistent with the scenario of lower economic activity observed.

Inflationary trajectories and high interest rates for a longer period could generate a certain prudential effect on credit demanders, postponing their investment decisions in the expectation of reducing their financing costs. The labor market and the components of national output are already showing a slowdown, which would make it more difficult to sustain credit demand and the real dynamism of bank credit balances to the NFPS in the medium term.

The Mexican financial system maintains a solid and resilient position, considering possible adverse scenarios

In an environment where the main developed economies continue to record inflation above their targets and the financial markets have shown periods of volatility due to the intensification of geopolitical tensions (mainly in the Middle East), the Financial Stability Report - First Half 2024 (REF), published by Banxico, concludes that commercial banks and the financial system as a whole maintain a solid and resilient position.

Regarding commercial banks, the REF points out that, between September 2023 and March 2024, commercial banks assets continued to rise at a similar pace to that recorded in the first half of 2023. This expansion was mainly due to the increase in positions in securities and in the consumer lending portfolio.

Regarding liabilities, there was an increase in the participation of deposits, mainly in its term component, probably due to the influence of the slowdown in the position in derivative instruments. Similarly, it is important to note that the net interest income of banking institutions showed higher levels during the period from September 2023 to March 2024 compared to what was observed in the first half of 2023.

In relation to solvency, the commercial banks showed an increase in its capitalization levels, since the Capitalization Index (ICAP) recorded a value of 19.49% in March 2024 (above the 19.30% recorded in September 2023), which translates into a greater capacity to face risks. This increase is due to an expansion of regulatory capital, which has more than offset the increase in assets subject to risk.

Regarding commercial banks' profitability, Return on Equity (ROE) decreased slightly compared to the level recorded in the second half of 2023, standing at a value of 18.1%. This decrease is partially explained by the increase in expenditure for the constitution of credit reserves and administrative expenditure. In particular, expenditure on the creation of credit reserves increased in both the consumer and corporate portfolios, which negatively impacted returns, despite a slight increase in net interest income.

With respect to the adjusted NPL indicator (IMORA), the REF highlights its high degree of uncertainty and the acceleration in its growth. In addition, the REF points out that, although household leverage

has remained at the same levels over the last two quarters, the financial burden of commercial bank credit card borrowers as a percentage of their income remained at similar levels in the period from February 2023 to February 2024, in parallel with a shift toward lower levels in all segments of the non-revolving portfolio.

For the other institutions in the system, the distinct behavior of fixed-income and variable-income investment funds against the backdrop of higher interest rates is of note. According to REF data, fixed-income funds (FRFs) increased their total assets by 12.5% during the first half of 2024, due to both inflows and positive returns observed in the period.

In the area of other non-banking financial intermediaries (OIFNB), the REF indicates that these entities continue to face significant challenges due to restrictive financial conditions, especially in the non-regulated segment. In particular, the biggest challenge continues to be obtaining financing, which has been reflected in a decrease in its loan origination.

In this same context, the REF considers four **macrofinancial risks for Mexican financial stability**: First, more restrictive financial conditions for a longer period than previously anticipated. The materialization of this risk could translate into the aggravation of public and private debts, as well as an increase in credit risk for financial institutions, including those operating in Mexico. Secondly, downward pressures on economic activity and an environment of greater volatility in the markets. Geopolitical tensions and the upcoming elections in some jurisdictions (mainly in the United States) could reflect downward pressures for economic activity, rising inflation and risk aversion in international financial markets, translating into higher risk premiums and increases in the cost of financing.

Third, the occurrence of a systemic event affecting the global financial system. Coupled with increased volatility and risk aversion, this could worsen high levels of indebtedness and the exposure of some institutions or financial sectors to riskier economic sectors. And, finally, unexpected changes in credit ratings for the sovereign or Pemex credit ratings. Under this scenario, risk premiums associated with Mexico could be expected to increase, which would drive capital outflows from the country.

This is evaluated in the impact of macroeconomic scenarios, where the conclusion is that, at the aggregate level, the financial system is resilient based on the results of the solvency and liquidity stress tests.

2. Financial markets

Negative performance of domestic assets as idiosyncratic risk spikes

Over the past few weeks, there has been a particular focus on the exchange rate following the June 2 elections. The cumulative depreciation of the peso, which reached 10.1% on June 12, has attracted attention as an indicator of the degree of uncertainty expected from the current and incoming government's plans.

However, the exchange rate is only one example, as a large part of domestic assets show persistent losses and greater than their counterparts in recent weeks, which suggests the presence of an increase in the idiosyncratic risk of the Mexican economy.

Interest rates on government debt have also increased significantly. As a sample, the yield to maturity of the 10-year Mbond rose 25 basis points (bp) between May 31 and June 18, a behavior contrary to the 28 bp drop in the yield of the 10-year Treasury bond. It should be noted that the yield reached 10.34% on June 12, which represents a peak in at least the last 10 years.

However, the higher returns were not limited to the long part of the curve. In the five-year node, there was the steepest increase in the aforementioned period (+38 bp), and even in the real curve there was an average increase of around 31 bp in the same period. It is relevant to note that all these increases have direct implications for the cost of financing government debt.

Part of this increase in interest rates can be attributed to the increase in sovereign risk, as measured by the five-year CDs spread. Between May 31 and June 18, this indicator widened by 13.2 bp, the largest increase among emerging market (EM) countries in the period, to trade at 107 bp, already below the 115 basis points reached on June 12.

It should be noted that, although these levels are low compared to episodes such as the pandemic or the 2008 crisis, it is the first time in several years that the increase has been primarily driven by a domestic issue.

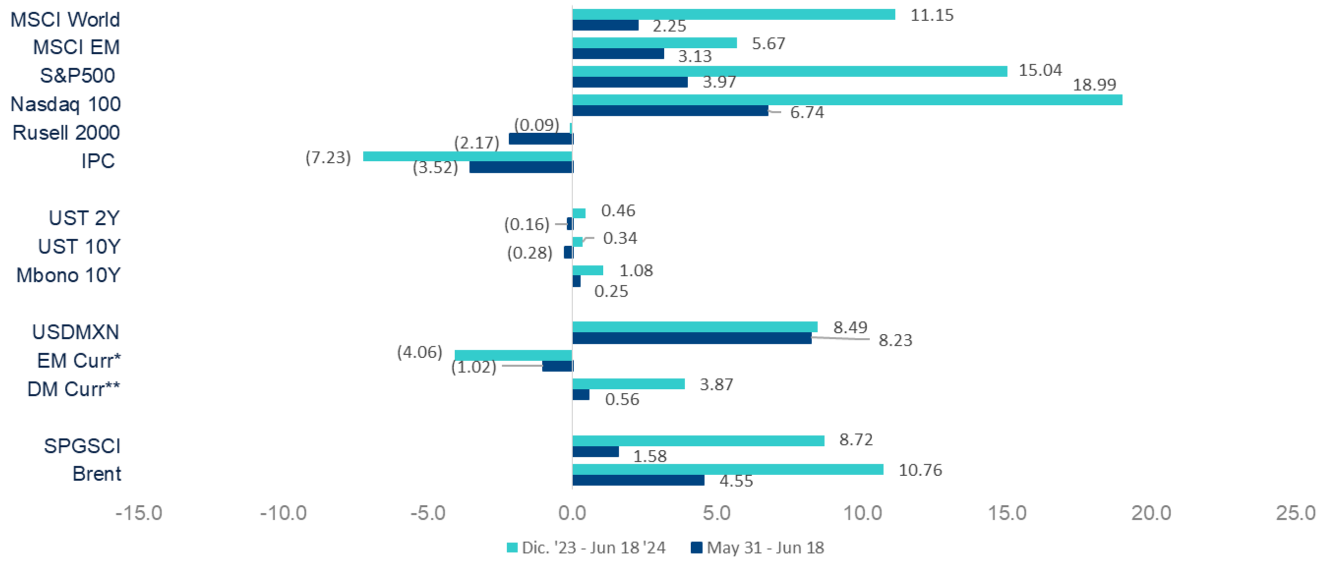
In the stock market, the IPyC of the Mexican Stock Exchange fell 3.5% between May 31 and June 18, a notable difference from the benchmark of this class of assets for EM, which increased 3.1% in the same period. Globally, the stock market benchmark advanced 2.2% because of expectations of a rate cut in the U.S. in the face of lower-than-expected inflation data. Even European indices, which were also impacted by electoral issues, performed better during the period (-0.6%).

In the foreign exchange market, the depreciation of 8.2% between May 31 and June 18 for the Mexican peso was the largest among EM currencies, while the benchmark of EM currencies appreciated 1.0% and that of developed currencies lost only 0.6% against the dollar.

The peso's depreciation was influenced by a rise in implied volatility to 19.4%, in addition to signs in the derivatives market that there is a greater appetite for hedging against currency depreciations. Although these Indicators have recently eased and the exchange rate has stabilized around 18.5 pesos per dollar, high volatility reduces the attractiveness of carry trade strategies, a favorable element for the peso recently, given the high interest rates.

In sum, given the increase in uncertainty due to the election results of June 2, market participants seem to have increased the risk premium they demand from domestic assets. The magnitude of this premium will vary depending on the market's perception of the likelihood of the materialization of risks to investment and public finances, mainly arising from the decisions of the outgoing and incoming governments. However, given the coincidence of the next legislative period in Mexico and the presidential campaign in the US, it is foreseeable that volatility will maintain an upward trend in the coming months.

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

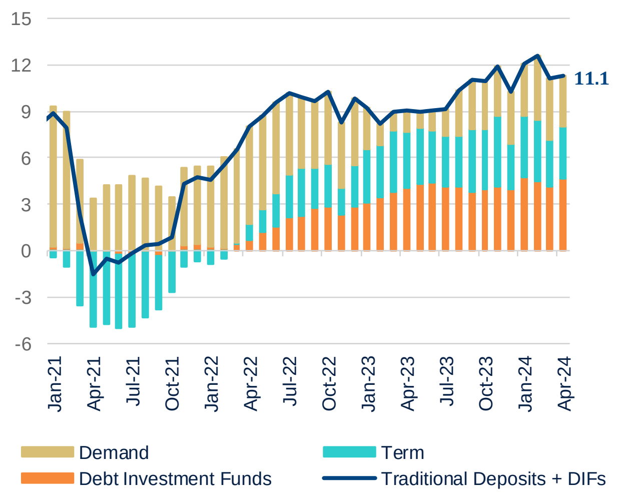


*JP Morgan Emerging Markets Currency Index. For this index, a reduction (increase) implies a depreciation (appreciation) of a basket of emerging economy currencies against the USD. **DXY Index, for this index a reduction (increase) implies a depreciation (appreciation) of the USD against a basket of developed countries currencies.

Source: BBVA Research based on Bloomberg data.

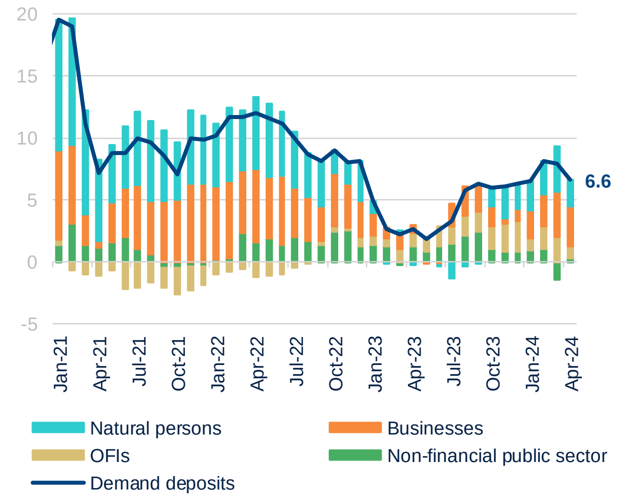
Deposits: figures

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



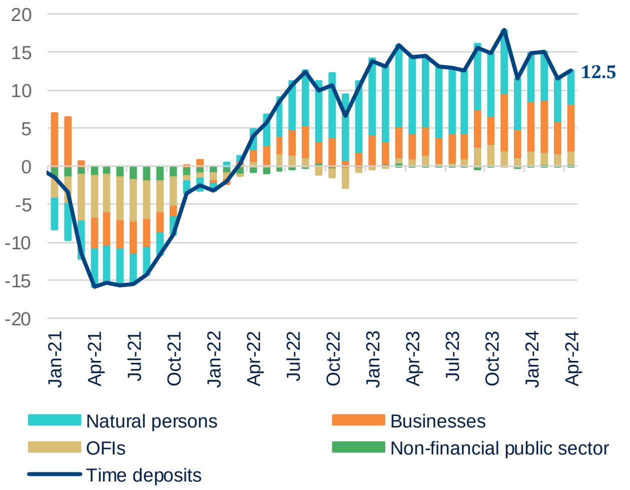
Source: BBVA Research based on Banxico data.

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



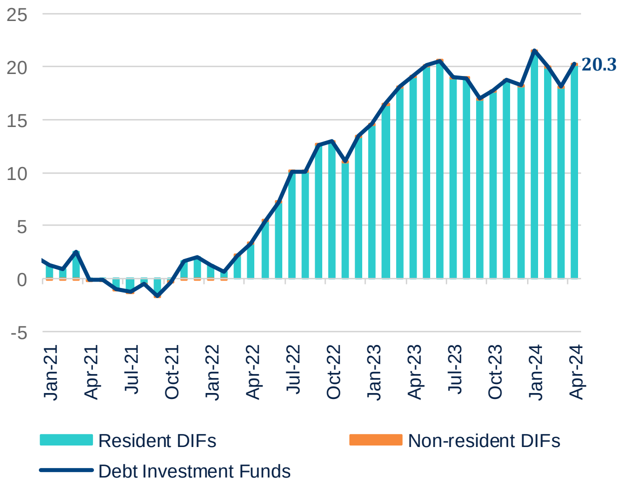
Source: BBVA Research based on Banxico data.

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



Source: BBVA Research based on Banxico data.

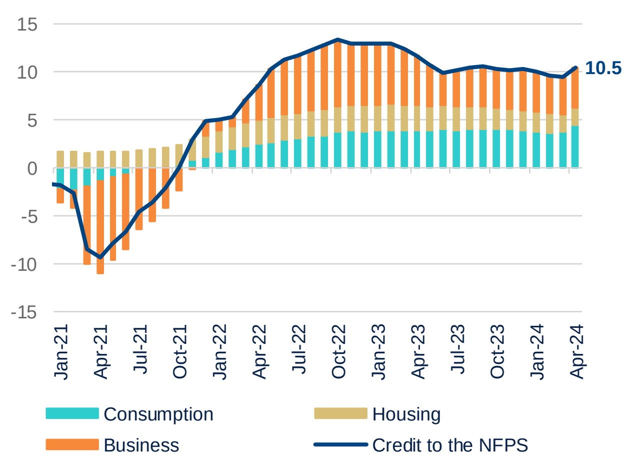
Figure 5. **DEBT INVESTMENT FUND SHARES (NOMINAL ANNUAL CHANGE, %)**



Source: BBVA Research based on Banxico data.

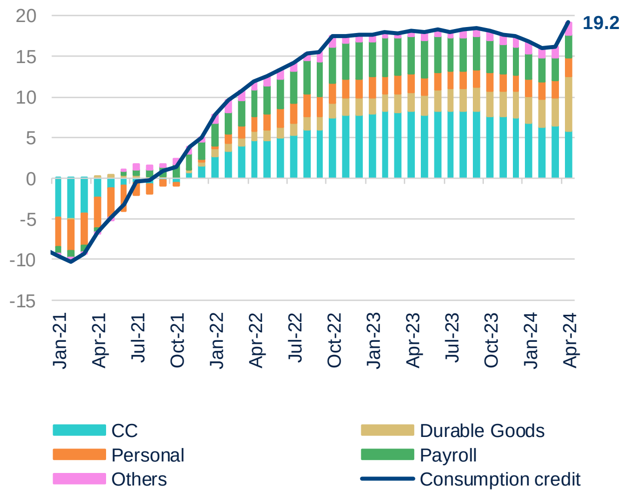
Credit: figures

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



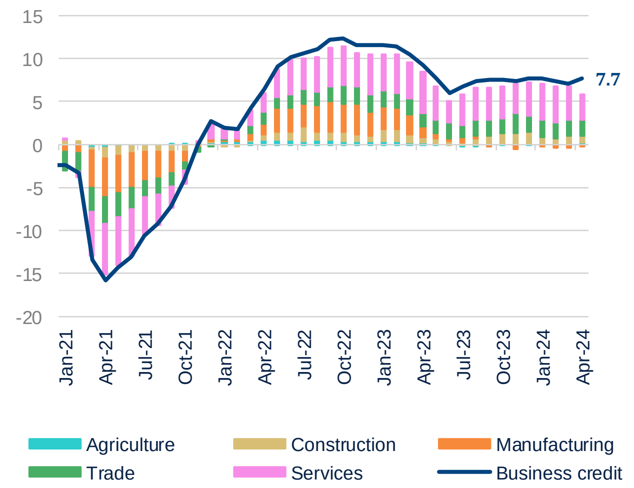
Source: BBVA Research based on Banxico data.

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



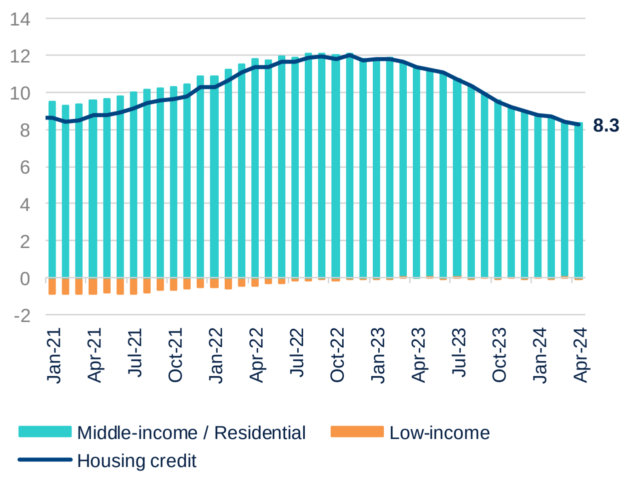
Source: BBVA Research based on Banxico data.

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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