Banking

Monthly Report on Banking and the Financial System

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1. Banking and the Financial System

Traditional bank deposits are gaining momentum due to a better performance of sight deposits

In May 2024, the balance of traditional bank deposits (demand + term) registered a real annual growth rate of 5.0% (equivalent to a nominal growth of 9.9%), increasing its dynamism compared to the previous month (when a real annual change of 3.8% was observed). Sight deposits reported a recovery compared to the previous month, and in May they contributed 2.4 percentage points (pp) to the total growth of traditional deposits, while term deposits contributed 2.6 pp.

In May, sight deposits recorded a real annual change of 3.7% (a nominal growth of 8.5%), more than doubling in real terms the growth observed in the previous month (when the observed real rate was 1.8%). With this result, sight deposits achieved the highest annual change in real terms so far this year. In May, the holders that contributed the most to growth were companies and individuals, whose balances showed a real annual variation of 4.9% and 3.2%, respectively, improving their performance compared to that observed in the previous month (when the growth rates were 3.6% and 0.1%, respectively).

In the case of companies, this recovery may be associated with better revenues performance in some sectors of economic activity. For example, the indicator of revenues from the supply of goods and services improved between March and April (latest available information) for the wholesale, retail and services sectors (from -5.1 to -2.1%, from -1.7 to 3.2% and from 3.2% to 7.5%, respectively). Additionally, the ANTAD sales indicator also registered greater dynamism by going (for total stores) from a real contraction of -1.1% in April to a growth of 6.1% in May. The increase in sight balances of individuals, given the slowdown in formal employment and real wages observed in May, seems to be associated with a reallocation of financial savings toward more liquid instruments as an incipient response to the expectation of lower interest rates in the medium and long term.

Term deposits showed moderated growth in May 2024, registering a real annual growth rate of 7.4% (12.4% nominal), slightly below the real rate of 7.5% observed in the previous month. In this case, the holding sectors that contributed the most to growth were companies and other financial intermediaries (OFIs). For companies (35.9% of term deposits), term savings grew from 12.9% to 13.3% in real terms between April and May. The good performance of corporate revenues may have contributed to allocating a part of the resources toward investments in less liquid instruments. However, this growth was not enough to offset the slowdown in individuals' term deposits (46.3% of term deposits), which slowed from a real annual rate of 4.0% in April to 2.0% in May. This lower result could be reflecting both the lower dynamism in household revenues (which would allow less margin to allocate resources to term savings), and a lower relative attractiveness of term savings associated with the incipient reduction in interest rates.

In the future, the performance of household and business revenues will be key to following the performance of traditional deposits. The current environment, in which a gradual interest rate reduction is anticipated, would point to a lower growth in agents' financial savings, which could only be offset by a sustained recovery in revenues.

Outstanding credit to the non-financial private sector becomes more dynamic, driven by consumer and business financing

In May 2024, the balance of the current loan portfolio granted by retail banking to the non-financial private sector (NFPS) registered a real annual growth of 6.4% (11.4% nominal), above the change in real terms of 5.6% observed in the previous month. To the annual real growth rate of 6.4%, consumer credit contributed 3.4 pp, while the business and housing portfolios contributed 2.3 and 0.8 pp, respectively.

In the fifth month of 2024, outstanding consumer credit registered an annual real growth of 14.5% (19.9% nominal), the highest double-digit real rate seen since March 2023. The credit segment for the acquisition of durable consumer goods (ACD, 19.1% of the consumer portfolio) continued to be the main driver of growth in this portfolio, contributing 5.9 pp to its real annual change. Within this segment, automotive credit stands out, accumulating 12 months with double-digit real growth rates driven by the recovery in vehicle sales.

The second segment with the greatest contribution to the growth observed in May was credit cards (36.6% of consumer credit), whose outstanding balance increased 11.5% in real annual terms, exceeding the growth observed in April (10.2% in real terms) and contributing 4.3 pp to the total growth of consumer credit. This result reflects the recovery of private consumption in April (latest available information), which grew at an annual rate of 8.0%, exceeding the average growth observed in 1Q24 of 3.8%.

Payroll and personal loans registered a real annual change of 5.5 and 9.9%, respectively, contributing 2.4 and 1.5 pp to the total growth of consumer credit. In particular, the growth of personal loans partially managed to compensate for the lower dynamism observed in payroll loans, which has begun to reflect the slowdown observed in formal employment and real wages, which in May registered growth rates of 2.2% and 4.6%, respectively. These rates were even lower than those recorded the previous month (2.5% and 4.8%).

Outstanding housing credit continued to decelerate in May, but at a slower pace, reaching a real annual growth rate of 3.4% (8.2% nominal), below the average real growth observed in the first four months of the year (3.8% in real terms). This result reflects the lower growth of the middle-income residential housing segment, which in May grew at a real annual rate of 3.6%, the lowest observed since November 2021.

In the case of the current balance of financing for low-income public housing, it continues to experience contraction at an annual rate, although to a lesser degree than that recorded in the previous month (-2.2% in May vs. -6.7% in April). The slowdown in the growth of formal employment since June 2023, coupled with a slower recovery in real wages and the expectation of high long-term interest rates for a longer period, could be reflected in a contraction in the demand for loanable housing funds, partially explaining the lower growth in housing finance balances.

Business loans (52.8% of the current portfolio for the NFPS) recorded a growth in real terms of 4.2% (9.1% nominal), exceeding the real growth of 2.9% recorded in the previous month. By sector of activity, the contribution to growth of companies in the service sector stands out, which in May contributed 3.4 pp to the growth of the total current business portfolio, while companies in the electricity, gas and water sector contributed 0.9 pp to this dynamism. This performance was enough to offset the contraction that continues to be recorded in the current balances of companies in the manufacturing sector, which in May registered a 5.0% real annual decline, which subtracted 1.1 pp from the dynamism of the total portfolio.

In composition by currency, it is noteworthy that current business loans in domestic currency (77.6% of the current portfolio of loans to companies) grew at a real rate of 3.3%, the highest growth recorded in this segment since September 2023; while outstanding business loans in foreign currency reached a real growth rate of 6.2%, a rate higher than that observed in the previous month (5.9%). However, part of this increase in momentum is due to the accounting effect of exchange rate valuation. Discounting this effect and that of inflation, the real growth rate of business loans in foreign currency reduced its growth from 11.4% in April to 10.7% in May, accumulating, with this result, six months of slowdown (after reaching a peak of 19.5% in November 2023).

The greater momentum observed in business loans during May could be associated with the delayed effect of the recovery in investment. In particular, in April (latest available Information) the Gross Fixed Capital Formation indicator grew at an annual rate of 18.1%, exceeding the average recorded in 1Q24 (10%). Additionally, there was an improvement in some revenue indicators for companies. For example, the total revenue indicator for the supply of goods and services improved in April with respect to March for wholesale trade (from an annual contraction of -5.1% in March to 2.1% in April), retail trade (with an annual change that went from -1.7% to 3.2% in the same reference period) and services (whose revenue increased at an annual rate of 3.2% to 7.5% between March and April 2024).

Although the cost of financing is expected to fall more gradually, the good performance of revenues in some sectors could continue to underpin the demand for business loans, which would allow a more gradual slowdown in the growth of this portfolio in the short and medium term.

Services and industrial sectors lead credit growth in the northern and central regions of the country during 1Q24

According to the Banco de México March 2024 Regional Economies Report[1], based on the Credit Market Conjunctural Evaluation Survey (EECMC) corresponding to the first quarter of 2024 (1Q24), the current portfolio of non-financial private companies in retail banking showed a real annual growth[2] of 2.5%, a pace 0.6 pp slower than that recorded in 4Q23, when growth of 3.1% was observed. However, in all regions there were levels above those recorded before the pandemic.

Bank credit in the central region, which represents 52% of total credit, contributed to the growth with 1.1 pp of the total of 2.5 pp. Similarly, the north region contributed 1.1 pp, although it only represents 24% of the credit. Only 0.2 pp is attributable to the south region and 0.1 pp to the north central region.

Regarding the current portfolio by type of activity, during 1Q24, the agricultural sector experienced growth only in the central region of the country, with a real annual change of 4.5%. In contrast, the same portfolio in the south region registered the largest drop, with a decrease of 8.1%. In the north and north central regions, the decreases were 4.1 and 0.6%, respectively.

As for secondary activities, the south region showed the highest growth, with a real annual variation of 4.0%. Meanwhile, financing for industry increased 2.7% in the north region and 0.7% in the north central region, while in the central region there was a 6.4% contraction in the outstanding portfolio for industry.

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.

With regard to the services sector, all regions recorded real annual growth in their outstanding portfolio. The north and central regions experienced the largest increases, with increases of 8.3 and 8.2%, respectively. These were followed by the south region, with a growth of 2.8% (greater growth compared to the contraction of 4.7 pp in 4Q23), and the north central region, with an increase of 1.2%.

Credit dynamics in the north region show a significant increase, attributable to the growth of the outstanding balances of private non-financial companies in the industrial and service sectors. Based on this evidence, it can be stated that this dynamic could be partially influenced by the phenomenon of nearshoring, which has fostered an acceleration in the demand for business loans in the aforementioned region.

It is relevant that this trend is not observed in the central and north central regions. Despite their geographic proximity and potential to integrate into the value chains of companies seeking to relocate to Mexico, factors such as insufficient infrastructure or the lack of specific incentives to attract investment could be limiting participation in the nearshoring economic phenomenon.

According to Banxico, although a forward expansion of regional economies is expected, the challenges they face must be taken into account. The report highlights the possible decrease in external demand (especially from the United States), which could affect the northern and central regions of the country. In addition, insecurity problems continue to affect the operation of domestic companies. Similarly, executives interviewed for the EECMC underscore the growing challenges posed by natural disasters over the past five years.

Although business financing has exceeded pre-pandemic levels, the report highlights that it is imperative to continue strengthening domestic sources of growth, create favorable conditions for investment and capitalize on the opportunities offered by the nearshoring process. From the retail banking sector, it is necessary to address the concerns of business executives regarding high interest rates, the amounts of financing offered, collateral requirements, loan approval times, fees and other costs associated with business loans.

2. Financial markets

Reduction of volatility in Mexican assets in the face of the soft-landing scenario that the markets discount for the summer

The United States inflation data in line with expectations, together with economic activity data that indicate a gradual slowdown in the U.S. economy, maintain the predominant narrative of the soft landing in the financial markets. This can be seen despite the lapses of volatility that recent political events have caused in various regions.

Between June 18 and July 9, the yield curve of Treasury bonds reduced its slope by 16 basis points (bp), while the main stock indexes recorded new gains. In the face of weaker activity data and an unsurprising inflation performance, the yield to maturity of the two-year bond fell 9 bp in the period in question to settle at 4.62% on July 9. The yield on the 10-year Treasury bond increased 7 bp. However, much of this increase could be associated with the higher expectations of a victory for the Republican candidate in the U.S. presidential elections following the first debate on June 27.

In Mexico, despite the fact that uncertainty remains regarding the institutional changes announced for September, the volatility of domestic assets after the presidential election has stabilized. This allowed the returns of the Mexican curve between the 3-year and 10-year nodes to fall 9 bp on average between June 18 and July 9 (see chart 1). Despite the lower volatility, the yield to maturity of the Mexico 10-year bond remains 21 bp higher (10.0%) than the day before the June 2 election.

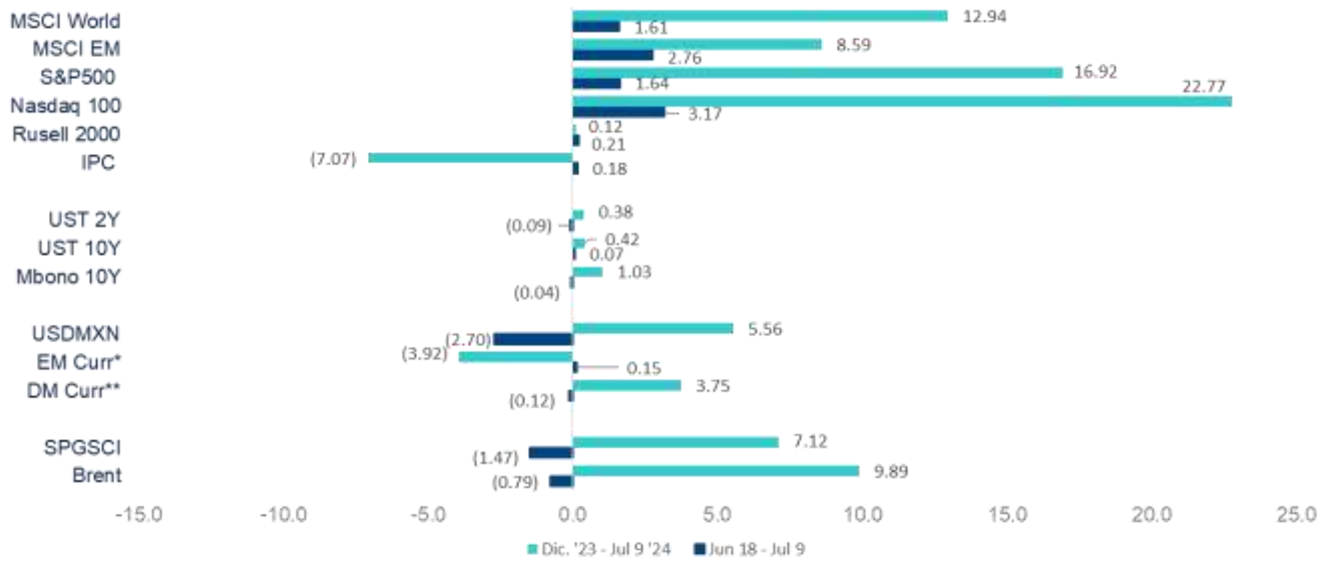
For the main stock indices, the last third of June and the beginning of July meant a new period of gains, given the satisfactory corporate reports and the expectation in the markets that the Fed will begin its cycle of cuts this year. As has been the case over the last few months, shares of tech companies account for most of the gains, which explains why the growth of the Nasdaq index (3.2%), between June 18 and July 9, has been above both the benchmark of this class of assets on a global level as in the case of the U.S. (see chart 1).

In the case of the performance of the BMV's CPI, it was again below the benchmark for emerging country shares (MSCI EM) with a barely positive performance (0.2%) in the aforementioned period. It is relevant to mention that, so far this year, the CPI has accumulated a 7.0% drop, which ranks it as the index with the worst performance when compared to the main benchmarks of the United States, Europe and emerging markets.

In the foreign exchange market, the fall in the implied volatility of the peso-dollar exchange rate and the expectation that the monetary cycle in Mexico could be delayed in the face of higher-than-expected inflation data contributed to appreciation of the Mexican currency of 2.7% between June 18 and July 9. With this, the Mexican peso clearly stood out positively with respect to the behavior of the benchmark currencies of emerging and developed countries against the dollar (see chart 1).

Over the next few weeks, the financial markets will enter a period of lower liquidity anticipating a soft-landing scenario that anticipates, with high likelihood, up to two Fed rate cuts in the remainder of 2024. Once the summer ends, the conjunction of the U.S. presidential election, the possible start of the cycle of cuts and legislative changes in Mexico will bring with them a period of high volatility that will probably set the tone for the movements of financial assets for the remainder of this year.

Figure 1. **PRICE PERFORMANCE OF THE MAIN FINANCIAL ASSETS DURING JUNE AND JULY 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.

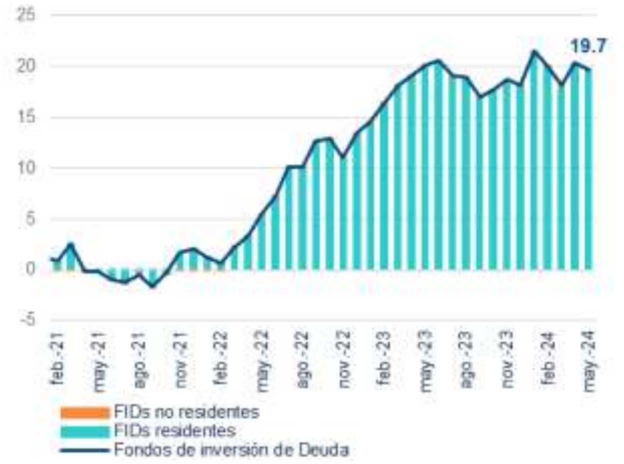
Figure 3. **SIGHT DEPOSITS (NOMINAL ANNUAL CHANGE, %)**

Source: BBVA Research based on Banxico data.

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

Source: BBVA Research based on Banxico data.

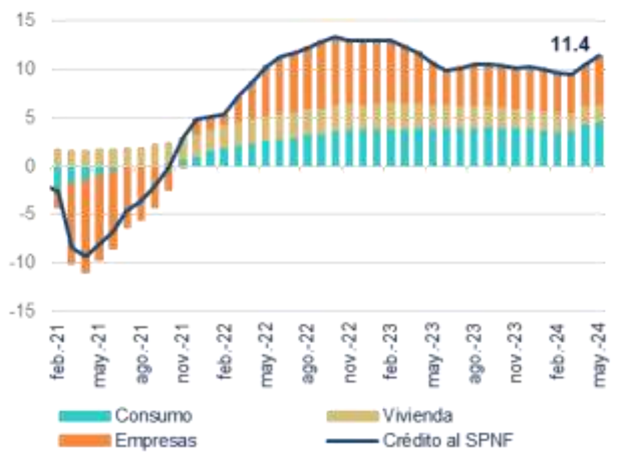
Figure 5. **DEBT INVESTMENT FUND SHARES (NOMINAL ANNUAL CHANGE, %)**



Source: BBVA Research based on Banxico data.

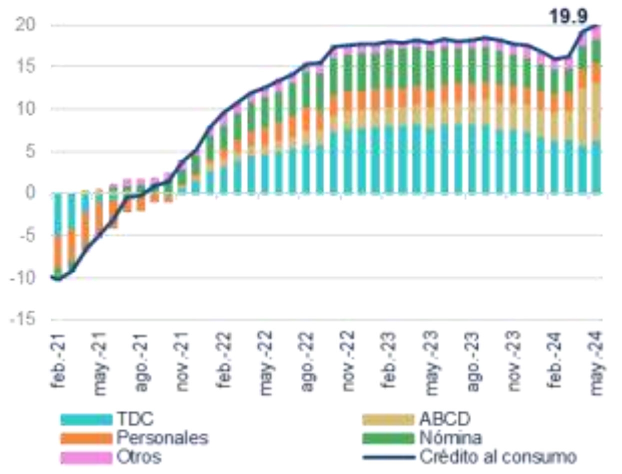
Credit: figures

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



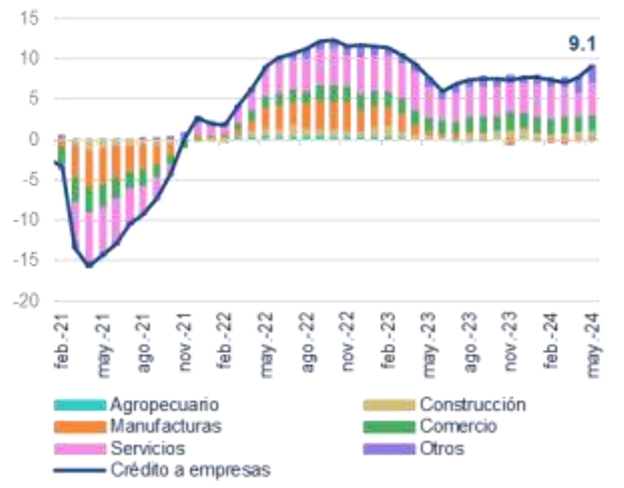
Source: BBVA Research based on Banxico data.

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



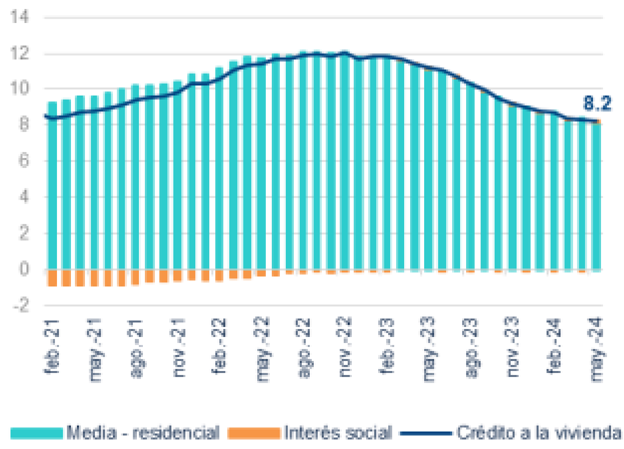
Source: BBVA Research based on Banxico data.

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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