Banking

Monthly Report on Banking and the Financial System

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1. Banking and the Financial System

Growth in traditional bank deposits stabilized as a greater dynamism in sight deposits was offset by a slowdown in term deposits

In June 2024, the balance of traditional bank deposits (sight + term) registered a real annual growth rate of 5.0% (equivalent to a nominal growth of 10.2%), a dynamism equal to that recorded in May. Sight deposits reported a recovery compared to the previous month, and in June, they contributed 3.5 percentage points (pp) to the total growth of traditional deposits, while term deposits contributed 1.5 pp.

It should be noted that traditional deposits managed to maintain their dynamism in June, partly due to the accounting effect of the depreciation of the exchange rate. In particular, if this valuation effect were discounted, the real growth rate of traditional deposits in June would be 4.1% (lower than the 5.5% recorded in May). Contrary to what was observed between September 2022 and May 2024, when the exchange rate valuation effect tempered growth rates, the depreciation recorded in June contributed close to 1% to the dynamism observed for the month, due to the accounting effect.

In the sixth month of the year, sight deposits showed a real annual change of 5.3% (nominal growth of 10.5%), exceeding the average recorded in the previous five months (2.8% in real terms). With this result, sight deposits continue the recovery trend that has been observed since August 2023. In June, individual holders were the main contributors to growth, with balances showing a real annual change of 4.6%, reaching the highest rate recorded since June 2022. This dynamism seems to be associated with a reallocation of household financial savings toward more liquid resources, in an environment in which lower interest rates are expected and both salaries and employment show more moderate growth. In the case of companies, the balance of their sight deposits grew 4.2%, below the 4.6% reported in May. This lower dynamism could be associated with the more moderate performance of revenues in some sectors of economic activity. For example, the indicator of revenues from the supply of goods and services dropped between April and May (latest available information) for the wholesale, retail and services sectors (from -2.1% to -4.1%, from 3.2% to 0.3% and from 7.5% to 5.4%, respectively). Additionally, the ANTAD sales indicator also registered a slowdown by going (for total stores) from a real growth of 6.1% in May to 1.4% in June.

Meanwhile, term deposits slowed in June 2024, with a real annual growth rate of 4.4% (9.5% nominal), the lowest recorded since December 2022. The holders that most contributed to this dynamism were companies, whose term deposits reached a real annual growth rate of 8.5% in June (higher than the 6.7% recorded the previous month). Companies may be looking for returns in anticipation of an interest rate reduction or awaiting a more favorable environment to carry out other investment plans. In particular, the Gross Fixed Capital Formation indicator registered a slowdown, going from 18.3% in April to 6.0% in May (latest available information). Individuals' term deposits also slowed from a real annual growth rate of 2.3% in May to just 0.7% in June. In this case, the reduction seems to be associated with the restructuring of household savings in the face of the slowdown in employment and wages.

The results as of June 2024 show that this lower economic dynamism is beginning to be reflected in the composition of bank deposits, with greater dynamism in sight deposits and a slowdown in term deposits.

Outstanding credit to the non-financial private sector continues to improve its growth, supported by the performance of business loans

In June 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 7.5% (12.9% nominal), above the change in real terms of 6.4% observed in the previous month. To the annual real growth rate of 7.5%, business loans contributed 3.7 pp, while the consumer and housing portfolios contributed 3.1 and 0.7 pp, respectively.

At the closing of the first half of the year, current consumer loans registered a real annual growth of 13.1% (18.7% nominal), reducing their dynamism with respect to the immediately previous month when such growth was 14.5%. The credit segment for the acquisition of consumer durables (ACD, 19.2% of the consumer portfolio) remained the main source of dynamism, contributing 5.8 pp to the consumer portfolio’s real annual change. The increase in this contribution stemmed from the acquisition of a Sofom ER by a commercial bank, in such a way that the consolidation of this portfolio affected the balance of consumer loans for all commercial banking. In particular, this operation increased the real growth rate of automotive lending from an average of 18.9% in 1Q24 to 43.5% in 2Q24.

The second segment with the highest contribution to the growth observed in June was credit cards (36.5% of consumer loans), whose outstanding balance increased by a real annualized 9.2%, reducing dynamism with respect to May (11.5% real) and recording the first real rate below double digits since September 2022. In June, the contribution of this segment to the dynamism of consumer loans was 3.5 pp, down from 4.3 pp in the previous month. This result partly reflects the slowdown in private consumption, which in May (latest available information), grew at an annual rate of 2.6%, below the average growth of 4.8% observed in the first four months of the year.

On the other hand, payroll and personal loans registered a real annual change of 5.3 and 8.9%, respectively, which together contributed 2.8 pp to the total growth of consumer loans. Both segments reduced their dynamism compared to that observed in the previous month, in such a way that their performance has begun to reflect the lower growth of formal employment and wages. In particular, the number of IMSS-insured workers recorded an annual growth rate of 2.0% in June, below the 2.6% average recorded in the first five months of the year, while real wage showed a real growth rate of 4.3% in June, below the 5.1% average observed from January to May 2024.

Outstanding mortgage loans continued to decelerate in June, reaching a real annual growth rate of 2.9% (8.0% nominal), the lowest rate recorded since September 2022. This result reflects the lower dynamism of the middle-income residential housing segment, which grew at a real annual rate of 3.3% in June. In the case of outstanding financing for low-income housing, the annual rate of contraction worsened from -2.2% in real terms in May to -7.2% in June. 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, explaining the lower growth in mortgage loan balances.

Business loans (53.2% of the current portfolio for the NFPS) recorded a growth in real terms of 7.0% (12.3% nominal), exceeding the real growth of 4.2% recorded in the previous month. By sector of activity, the contribution to growth of companies in the service sector stands out, which in June contributed 4.8 pp to the growth of the total current business portfolio, while companies in the electricity, gas, and water sector contributed 1.0 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 June registered a decline of 0.9% real year-on-year, which subtracted 0.2 pp from the dynamism of the total portfolio.

In terms of composition by currency, outstanding business loans in domestic currency (75.9% of the outstanding business loan portfolio) grew at a real annual rate of 3.6%, the same rate observed in May, while outstanding business loans in foreign currency reached a real growth rate of 19.1%, much higher than that observed in the previous month (6.2%). Part of this increase in dynamism is due to the accounting effect of exchange rate valuation. Discounting this effect and the effect associated with inflation, the real growth rate of business loans in foreign currency shows a more moderate dynamic, going from a growth of 10.7% in May to 11.9% in June. Taking into account this same valuation effect on the total outstanding business loan portfolio, the growth rate increased from 5.2% in May to 5.5% in June, a more moderate improvement than that observed if the impact of the exchange rate depreciation is not discounted (from 4.2% to 7.0%).

From now on, the available economic activity indicators point to a possible slowdown in the different credit portfolios of commercial banking, insofar as the accounting effect of the exchange rate depreciation is not enough to offset the negative impact on credit demand that lower investment, weak employment, and stagnant wages could generate.

The emergence of artificial intelligence (AI) has an impact on the financial system and its stability

Due to its cognitively demanding tasks and dependence on data, the financial sector is among those facing the greatest opportunities and risks from the rise of Artificial Intelligence (AI). According to the BIS Annual Economic Report 2024, Artificial Intelligence can increase efficiency and decrease costs significantly in several key areas, such as: payments, loans, insurance, and investments. In these sectors, AI can play a fundamental role, improving efficiency and reducing costs in aspects such as regulation, fraud detection, and customer service.

In the payments industry, the abundance of data allows AI models to analyze each customer's financial and reputational information in detail and detect patterns of anomalies, thus reducing the risk of money laundering. However, this sector faces the risk of cyber-attacks, as AI poses an opportunity for hackers to write emails that are more credible, mimic the writing style or voice of individuals, or even create fake avatars, increasing the likelihood of sophisticated fraud.

In the area of credit and loan evaluation, AI can refine credit scores by assessing the behaviors and credibility of each user, analyzing alternative data such as bank transfers, information about their rent payments, educational history, and even their online shopping habits. This way, AI can analyze a greater number of potential users, more accurately predict the probability of default, and ultimately enhance financial inclusion. However, this sector is vulnerable to certain risks. Given the inaccuracies and biases of the data with which the AI algorithms have been trained on, AI models pose risks of unjust decisions, perpetuating disparities in access to credit through algorithmic discrimination.

In insurance, AI has multiple uses, particularly in risk analysis and pricing. Companies can now analyze the credibility of images and videos to assess property damage. However, AI gives hackers the ability to access sensitive customer data and leak it on the web.

In terms of investment and asset management, AI models can predict returns, assess risks, and optimize portfolio allocation, improving access to information and reducing management fees. However, the phenomenon of financial institutions relying on the same algorithms could amplify procyclicality and market volatility, by exacerbating herding, liquidity hoarding, runs and fire sales.

In addition to the cyber and fraud challenges that put financial stability at risk, another operational difficulty arises from relying on just a few providers of AI models. Heavy up-front investment is required to build the required infrastructure, so only a few companies provide cutting-edge LLMs. Any failure among or cyber-attack on these providers, or their models, poses risks to financial institutions relying on them.

2. Financial markets

Increased idiosyncratic risk and global factors lead the peso to be the most depreciated currency since the end of May

After being the third best performing currency until May 31, the Mexican peso fell 12.5%, making it the most depreciated currency since then.

Two main factors can be identified that could explain this sudden change in the behavior of the Mexican peso. The first, the increase in idiosyncratic risk. The unexpected achievement of a qualified majority in Congress by the governing party in the June election increased the likelihood that the series of reforms proposed by the Executive Government in February (e.g., judicial, electoral) will be approved as early as September, the last month that the current administration will be in power.

The second factor is the reversal of flows to the Mexican currency because of the lower returns of *the carry trade* strategy. The appreciation of the yen following the unexpectedly restrictive tone of the Bank of Japan's (BoJ) interest rate hike, the first above zero in the last 17 years, generated an increase in the cost of funding for those investors who used the yen to invest in high-yield currencies such as the Mexican peso. Given this unexpected shift, speculative positions in favor of the Mexican peso fell by around 19,000 contracts between July 23 and August 13.

Although it is difficult to quantify the contribution of every factor in the recent depreciation of the Mexican peso, it is possible to try to quantify the differentiation with respect to the emerging market currency benchmark and thus gain an idea of the weight of each factor.

In the period leading up to the elections, between January 1 and May 31, 2024, the Mexican peso appreciated marginally (0.1%), while the emerging market currency benchmark depreciated by 3.1%. That is, until before the election, the Mexican peso's performance was just over 3.0% above the emerging currency benchmark. Starting from the median of the annualized daily returns in the aforementioned period, the result goes in the same direction.

In contrast, between June 2 and July 30, one day before the BoJ's monetary policy announcement, the Mexican peso depreciated 6.1%, while the emerging market currency benchmark appreciated 2.1%. That is, during this period, the performance of the Mexican peso was about 8.0% below that of the emerging currency benchmark. The median of annualized daily returns confirms the direction of the result.

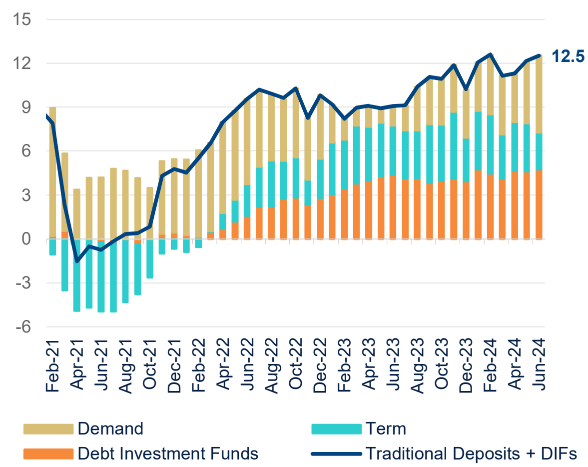
Finally, between August 1 and 6, one day before the BoJ promised not to raise the interest rate in an environment of unstable financial markets, the Mexican peso performed around 3.8% below the emerging currency benchmark. This period also saw volatility, however, due to a lower-than-expected U.S. employment report that sparked fears of recession.

In sum, the overall calculations around each of this year's relevant events suggest that both the electoral outcome and the BoJ-derived movements have produced a negative differentiation for the Mexican peso, and the weight of the idiosyncratic matter is of great magnitude and persistence for financial markets.

Going forward, it cannot be ruled out that the cost of the idiosyncratic factor will increase as the judicial reform package moves forward in Congress and as the U.S. presidential election approaches. On the magnitude of this cost, it will be necessary to clearly differentiate to what extent these risks affect the long-term estimate of the exchange rate level.

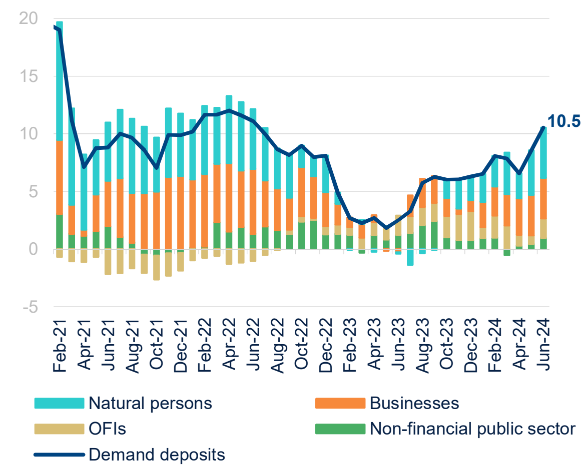
Deposits: figures

Figure 1. **COMMERCIAL BANKING DEPOSITS**
(NOMINAL ANNUAL CHANGE, %)



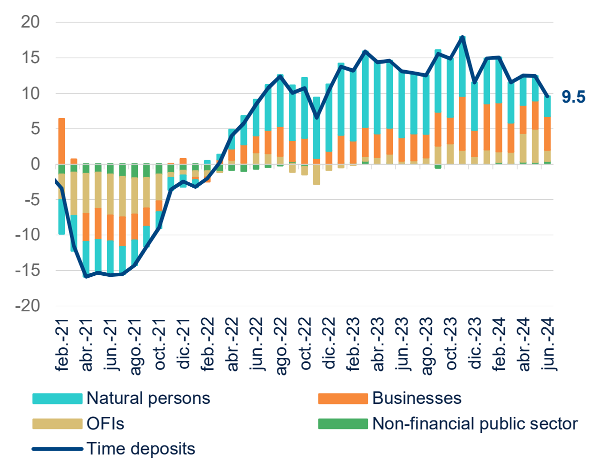
Source: BBVA Research based on Banxico data.

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



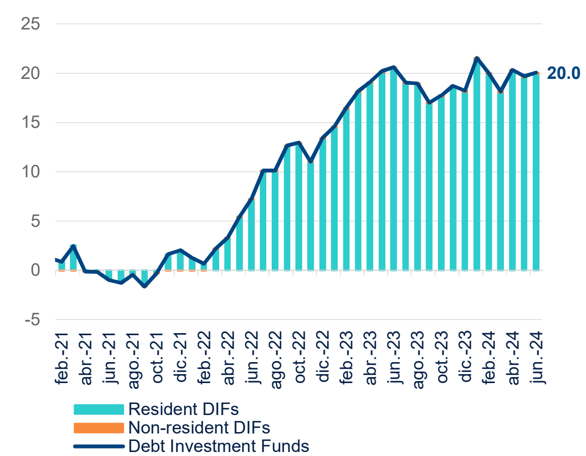
Source: BBVA Research based on Banxico data.

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



Source: BBVA Research based on Banxico data.

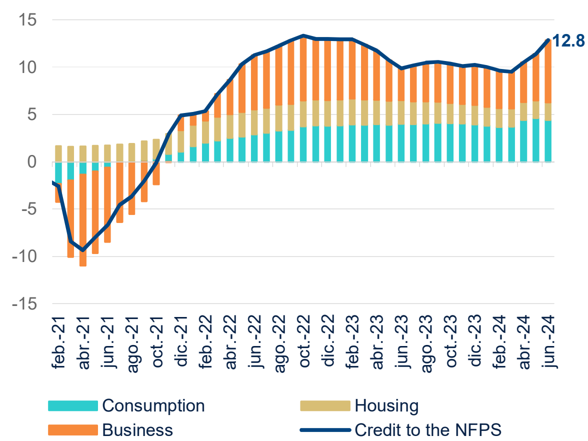
Figure 4. **DEBT INVESTMENT FUND SHARES**
(NOMINAL ANNUAL CHANGE, %)



Source: BBVA Research based on Banxico data.

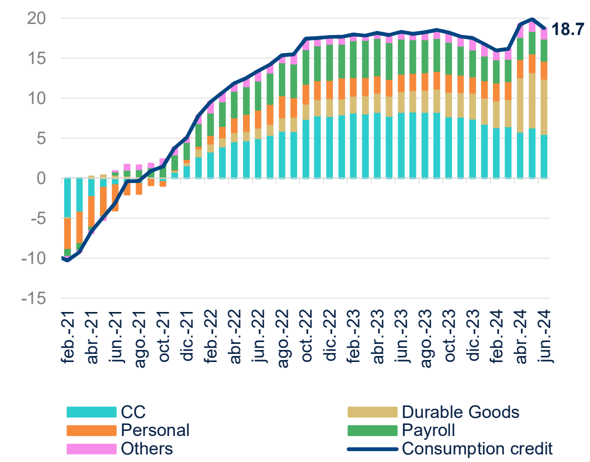
Credit: figures

Figure 5. **OUTSTANDING BANK CREDIT TO THE NON-FINANCIAL PRIVATE SECTOR**
(NOMINAL ANNUAL CHANGE, %)



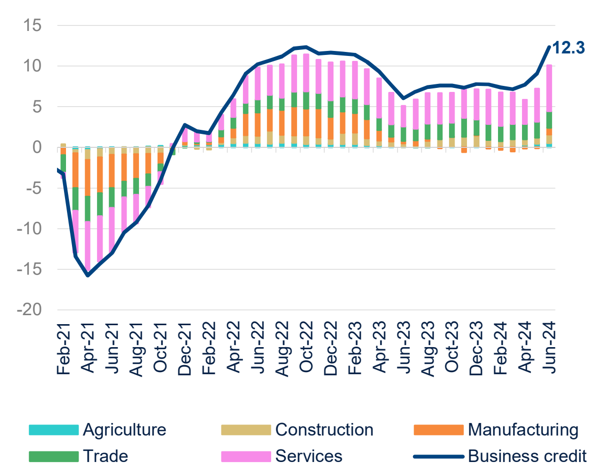
Source: BBVA Research based on Banxico data.

Figure 6. **OUTSTANDING CONSUMER LOANS**
(NOMINAL ANNUAL CHANGE, %)



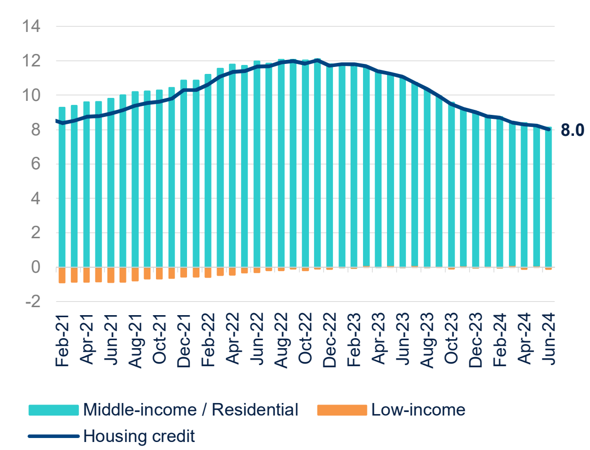
Source: BBVA Research based on Banxico data.

Figure 7. **OUTSTANDING BUSINESS LOANS**
(NOMINAL ANNUAL CHANGE, %)



Source: BBVA Research based on Banxico data.

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



Source: BBVA Research based on Banxico data.

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