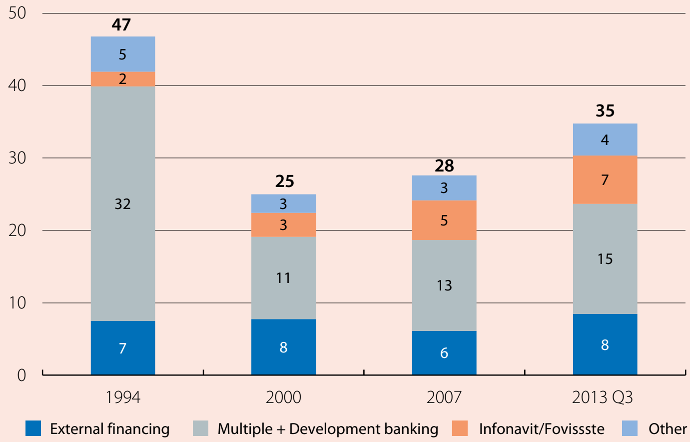
Mexican banks: solvent and with room to grow

In banking terms, the Mexican economy is relatively underdeveloped when compared with other Latin American countries. On average, bank credit in the Latin American region accounts for approximately 40% of GDP while this figure falls to 15% for Mexico. Part of this difference can be explained by the impact of the economic and financial crisis in 1994, which resulted in bank credit plummeting from a level of 32% of GDP. This crisis caused numerous national banks to disappear while encouraging foreign groups to enter the sector, a trend that has continued to consolidate up to the present day. However, the sector is currently in a solid situation with good growth prospects. Before describing the underlying fundamentals of Mexico's banking industry, it is important to present its main components.

Financing for the private, non-banking sector

(% of GDP)



Source: *"la Caixa" Research, based on data from the Bank of Mexico and INEGI.*

The country's banking system, also known as multiple banking, is currently made up of forty-five financial institutions with assets that represent around 39% of GDP. December 2009 saw the incorporation of specialised or niche banks within banking regulation. Such niche banks can only carry out certain limited activities but this change has brought already existing non-bank intermediaries within banking regulations, allowing them to obtain retail banking resources, which are much more stable than wholesale sources of financing, as shown by the recent financial crisis. Among these non-bank intermediaries, of note are credit unions whose aim is to provide their members with access to credit, as well as *sofomes* or multiple purpose financial institutions. *Sofomes* specialise in granting credit to productive sectors and they are financed via other financial institutions and by issuing debt. In spite of the gradual entrance of new participants, seven financial institutions dominate the Mexican banking scene and their assets account for 85% of the whole sector.

Apart from multiple banking, there is also development banking: this is made up of six public entities whose assets total about 7% of GDP, channelling their resources towards specific social goals and sectors. Their main activities focus on financing and advising exporting firms, promoting public infrastructures, providing access to housing and giving financial support to low-income people, microfirms and SMEs. The credit policy of development banks, together with other development institutions, is based on guarantees, financing through private institutions and directly by granting loans to end users.

It is also important to mention two public financial institutions that play a highly significant role in the mortgage market: Infonavit and Fovissste. Infonavit is the major mortgage lender in Mexico with a share of 58% in June 2013.[1] Mortgage repayments are made directly via withholdings from wages and all loans granted since 2007 are covered by an unemployment insurance policy to minimise potential default. One traditional source of resources for Infonavit has been its securitised portfolios. However, the placement rate dropped in 2012 and 2013, causing the securitised portfolio to fall to 10% of the total in September this year. On the other hand, Fovissste grants housing loans to civil servants. Its portfolio is six times smaller than Infonavit and 40% is securitised.

As will be explained in more detail below, the banking system has a favourable evolution and position in terms of credit, solvency and returns although there has been a slight upswing in non-performing loans (NPL). On average, credit increased by 12% annually during the period 2002-2013. Growth was particularly sharp between 2004 and 2008, a trend halted by the global financial crisis. In the last three years, this trend has recovered with growth of around 12%. Breaking down credit by sector, the consumption portfolio has seen its growth slow down in the last few quarters but still enjoys high rates in the order of 15%, while the increase in credit to non-financial firms and housing loans remained at around 10% in 2011-2013.

(1) «Reporte sobre el Sistema Financiero», Banco de México, September 2013.

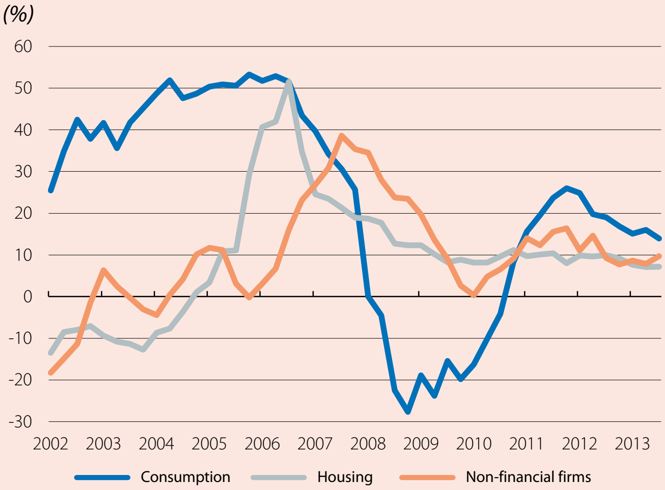
The banking sector's NPL ratio was 3.4% in September 2013 and is continuing the moderately upward trend started at the beginning of 2011. In the last year there has been an upswing in non-performing loans among companies: the rate has gone from 2.1% to 3.5% in one year due largely to the problems faced by the country's large construction firms.

Main indicators of multiple banking

	2007	2013 Q3	Change
Assets/GDP	35%	39%	4 p.p.
Credit/deposits	90%	97%	7 p.p.
Non-performing loans	2.5%	3.4%	1 p.p.
Coverage ratio	169%	153%	–16 p.p.
Solvency	16%	16.1%	0 p.p.
Cost-to-income ratio	50%	52%	1 p.p.
RoA	2.0%	1.6%	–0.4 p.p.
RoE	20.9%	14.7%	–6.2 p.p.
Employees	158,028 (*)	219,651	39%
Branches	10,722 (*)	12,544	17%

Note: *(*) Data from 2008.*
Source: *"la Caixa" Research, based on data from the CNBV.*

Trends in multiple bank lending



Source: *"la Caixa" Research, based on data from the Bank of Mexico.*

With regard to solvency, Mexico is ahead of many developed economies in terms of adopting the new Basel III capital requirements at the beginning of the year. In Q3, multiple banking's solvency ratio (capital divided by risk-weighted assets) stood at 16.1%, far above the 10.5% required. As a result of these new requirements, in June the system started to implement a new methodology for classifying the commercial portfolio according to expected losses, which has increased the need for provisions in some institutions.

The banking system enjoys high returns. The RoA (returns as a percentage of average assets) stood at 1.6% in Q3, slightly lower than the figure recorded in 2007. Thanks to this, the return on equity (RoE) rose to almost 15%, a notably higher return than the one currently provided by the banking systems of more mature economies. The cost-to-income ratio (the percentage of banks' operating expenses to their gross margin) has risen by 1 percentage point compared with 2007 due to costs rising slightly in relation to revenue.

In the last few years, the banking system's capacity has increased, indicating that banks are seizing the opportunities offered by the sector. The model of very large banks but with few branches, one of the features of this system, has continued and has even become stronger over the last few years. On average, a bank branch in Mexico has eighteen employees, almost three times more than in Spain. In 2011, the ratio of branches per inhabitant in Mexico was 1.8 per 10,000 adult inhabitants, far from Brazil's ratio (4.6) and Peru's (5.9), although slightly higher than that of Chile (1.7) and Colombia (1.5). In 2013, it is estimated that 782 towns (32% of the total) did not have access to branches, ATMs or correspondent banks. The Bank of Mexico highlights this fact when it points to one of the challenges currently facing the sector, suggesting that financial inclusion should be improved in the different segments of the population, both in bank terms and also in terms of access points.

The proposed reform of the financial system (for more details see the article «A reformist drive is shaking up Mexico» in the Dossier in this Report) tackles the problem of financial inclusion and other important challenges for the sector. Broadly speaking, this reform aims to encourage competition by giving development banks greater powers and by improving the granting and execution of guarantees. Customers will also be allowed to change bank with lower transaction costs and regulatory powers focusing on consumer protection will be strengthened. These are not large structural changes for a sector that already boasts solid foundations. However, they are measures in the right direction to boost the growth of banking in Mexico. And it still has a lot of room to grow.

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