Mexico’s economic recovery and the contribution of the banking system

Tuesday, April 5, 2011
Agenda

1. Mexican recovery

2. Banking System: performance and contribution

3. Conclusions
Two years after the Great Recession, Mexico has shown its resilience.

Mexican economy has a recovery path in activity, low and stable inflation and it is isolated from recent global financial uncertainties.

**Mexico, GDP**
1Q08=100
Source: Inegi

**Mexico, inflation**
y/y and contribution
Source: BBVA Research

**Mexico, EMBI spread**
pp
Source: Bloomberg
• Performance of the Mexican manufacturing exports in USA has been impressive in 2009-10. Exchange rate-price competitiveness is not the unique cause behind competitiveness fostering.

• The cost of Banking credit is low and stable, it is supportive for economic growth and employment.

**Mexico, quota on US imports and Exchange Rate**

Source: BBVA Research

**Mexico, Interbank rate**

(Percentage, monthly average)

Source: BBVA Research and Banxico
Improved foreign demand and better funding conditions diffuses by higher employment to foster domestic demand and economic growth.
Expectations agree that during 2011 inflation will be considerably lower than 2010.

Medium and long term inflation expectations remain anchored.
Monetary policy: probably hike, in 4Q11

Banxico could hike rates in a preventive manner in the last quarter of 2011 to avoid the contamination of inflation expectations from current oil and commodities shocks.

Fondeo Rate (%)  
Source: BBVA Research
• Peso appreciation is coherent with a more favorable scenario for the US economy, abundant liquidity and heightened risk appetite among investors.
• We expect the currency to outperform its peers, it is still undervalued with respect to 2008 levels.
Higher potential GDP growth with reforms

The second generation of pending reforms will trigger potential growth by improving economic efficiency.

Mexico: potential GDP
(y/y % change)

Source: BBVA Research

Major reforms that:

- Enforce the rule of law.
- Increase competition and market scrutiny.
- Reduce the fiscal vulnerability of the public sector.
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The Mexican Banks have remained robust and have not required any public stimulus

The Mexican Banking Sector remains highly capitalized and its limited credit risk is well covered.

Why?

- Adequate regulation
- Banking Supervision
- Legal Framework Improvement (Guarantees)
- Solid Risk Management
- In addition, 99.8% of the Collection Accounts are guaranteed (IPAB)
The Mexican Banks have remained robust and have not required any public stimulus

The NPL has declined to pre-crisis levels, while coverage remains high

Source: ABM with information from BANXICO

Source: CNBV
The economic slowdown is the main reason for the Commercial Bank’s Lending growth decrease to the private sector.

Despite the GDP’s decrease because of the recession, the Commercial Bank’s Lending has just simply stopped its growth trend.

Lending to the private sector, GDP by Sectors
Annual Real Growth, %

- Construction GDP (Axis left)
- Factory GDP (Axis left)
- Services GDP (Axis right)
- Credit Banks (Axis right)
During 2003 and 2009, the expansion of credit from the banks to the private sector has been outstanding.

Between 2003-2009, Commercial Bank’s Lending to the private sector grew dynamically based on an adequate regulatory framework as well as a capitalized banking system. Between 1990-1994, the growth was bigger but these elements were absent.

Source: World Bank and AMB.
In comparison to other economic crisis, the Credit Bank’s Lending, as percentage of GDP, did not decreased.
In comparison with other countries, Mexico did not experience a credit contraction during the crisis.

In contrast with other economies, credit in Mexico has shown a more dynamic behavior.

**Banks Credit**
Annual growth rate, %

**Gross Domestic Product (GDP)**
Annual real growth rate, %

Source: SEE BBVA based on central banks and economic authorities
Source: SEE BBVA y FMI.
Since November, the annual growth in loan portfolio reached 10%.

**Total loan portfolio**
Balance (‘000 mdp)

- **2003-2007**
  - Average Growth
  - +18%

- **2008-2009**
  - Growth
  - +4.8%

- **Growth**
  - +10%

Source: BANXICO.
The commercial portfolio has set the momentum with a growth of 10.3%
Commercial Portfolio during 2010
Thousands of Millions Pesos

Total Financing:
$152 mil mdp

Source: ABM and BBVA Bancomer.
Question: «¿Are cost and access to credit a constraint for the firm?»

Almost 80% of the firms’ confirmed that cost and access to credit represent a minor or non constraint: The best figures in last 2 years.

Source: ABM with BANXICO figures
Credit to SMEs has grown strongly: +19%

SMEs loans
Growth %

- 2008: +17%
- 2009: -1%
- 2010: +19%

Source: ABM
The annual growth in mortgage portfolio reached 10%
Also, the Consumption portfolio had a quick recovery

The consumer portfolio has grown since September 2010

Consumer Lending Portfolio
Balance (‘000 mdp)

Source: BANXICO.
In fact, the Consumption Portfolio growth has come from a -15% (jan. 2010) to +9% (jan. 2011), meaning an increase of +2,400 basis points.

Source: ABM with BANXICO figures
The Mexican Banks have remained robust and have not required any public stimulus.

The level of investment in banking infrastructure is high: 10% of the profits.

<table>
<thead>
<tr>
<th>Year</th>
<th>Capital ('000 Millions Ps)</th>
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<tbody>
<tr>
<td>2001</td>
<td>149</td>
</tr>
<tr>
<td>2010</td>
<td>557</td>
</tr>
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</table>

Source: CNBV
In the past 5 years, Commercial portfolio nearly doubled in proportion to GDP.

Source: BANXICO and INEGI.

Source: CNBV.
In recent years, the credit to the housing sector has grown dynamically

**Housing Portfolio**
Total, banks, and other*
Balance (millions of pesos), December 2010

**Housing Sales**
Thousands, units

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* Other: Includes Infonavit and mortgage non-bank banks

Source: BANXICO

Source: BBVA Bancomer
Banks increased by 44% the number of branches in the last 5 years:

There are almost 165 million employees, 30% more than 2005:
In the period 2005-2010, the growth of ATMs was 57% and POS 139%.
The banking industry has increased almost by 2 credit cards and debit cards times over the past 5 years, improving payment methods.
Remarkable outcomes

In the past years the Banking sector has attained the following achievements:

Increased its customers base in more than 18 million from 2003 to date, reaching an increase of 54% in the last 5 years.

<table>
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<tr>
<th>Year</th>
<th>Customers Millions</th>
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<tbody>
<tr>
<td>2003</td>
<td>25</td>
</tr>
<tr>
<td>2005</td>
<td>28</td>
</tr>
<tr>
<td>2010</td>
<td>43</td>
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There has been a significant expansion in the coverage of banking services in the larger towns:

Municipal level coverage of banks in Mexico*

*% presence in municipalities with more than 35,000 inhabitants
There is still great potential for increasing coverage...

Through **Correspondent Banking**, the gap in coverage of financial services can be narrowed:

![Prospect of Banking Correspondents](image)

**Notes:**
Commercial Banking: includes *Compartamos* service offices
EACP: includes cooperatives, solidarity funds, credit unions and SOFIPOS
Retail Superstores: Walmart, Soriana, Chedraui, Comercial Mexicana, Sears, Sanborns, Coppel
Convenience Stores: Oxxo, 7 Eleven, Farmacias Benavides, Farmacias del ahorro, Farmacias Guadalajara, Waldos, Office Max, Mix Up, Muebles América, Pitico, Promujer
Diconsa: considered only 25% of stores (5.801 out of 23.500) by the technological capability. Considering the 100% Diconsa is present in 90% of municipalities (2.199 out of 2.456)
Support national infrastructure and economic growth

The banks provide most of the resources for infrastructure.

Total investment:
$297,117 millions of pesos

Amount of funding provided by banks:
$218,317 millions of pesos

73% of financing comes from Banks.
Increasing banking licenses has been important and the figure of "niche banks" has been established.

Banking Competition is growing

Number of Banks
(Commercial Banks)

<table>
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<tr>
<th>Year</th>
<th>Number</th>
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<tbody>
<tr>
<td>1996</td>
<td>23</td>
</tr>
<tr>
<td>2006</td>
<td>30</td>
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<tr>
<td>2007</td>
<td>39</td>
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<tr>
<td>2008</td>
<td>42</td>
</tr>
<tr>
<td>2009</td>
<td>41</td>
</tr>
<tr>
<td>2010</td>
<td>41</td>
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Source: ABM with information from the Mexican Financial System Catalogue published by the Mexican Ministry of Finance.
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Conclusions: better forecasts for the Mexican Economy and huge banking potential

- Mexico GDP growth will be in the 4.5 - 5% range in 2011. It is on track to a more mature cyclical stage with a growing contribution of domestic demand.
- A factor supporting the Mexican economy is its isolation from global financial tensions throughout 2010 & 2011 as a result of the commitment to fiscal consolidation.
- The fall in inflation in 2010 will continue in 2011.
- Increasing the growth capacity of the Mexican economy requires a steady and firm process of wide-ranging reforms affecting the rule of law, competition and an enhanced efficiency of the public sector.
- The banking sector was a strength for the economy in this recession: high level of solvency, liquidity and credit supply. Banks do not need public support.
- The performance of bank credit has been very positive compared with other similar episodes and economies. Despite the deep recession, credit penetration has been maintained. The lower rate of credit growth was mainly due to demand factors.
- Mexico offers a huge potential for financial services. Drivers: demographics and under banks clients. There is room for an additional increase in bancarization if measures to foster economic formality are taken.
Asociación de Bancos de México

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