



BANCO DE MÉXICO®

Executive Summary of the Financial Stability Report

December 2023

Executive summary

The Mexican financial system maintains a solid and resilient position despite the complex and uncertain global macrofinancial environment that prevailed during the second half of 2023. This environment was characterized by the risk of prolonged inflationary pressures, which could lead to a further tightening of global financial conditions. Additionally, risk aversion has increased due to the intensification of geopolitical tensions, specifically those associated with the war between Russia and Ukraine and the escalation of the military conflict in the Middle East. Global financial conditions have thus been affected by an environment of high volatility in financial markets, and by increases in long-term interest rates. These increases are mainly explained by the expectation that reference rates will be maintained at a high level for a longer period than previously anticipated. Also, term premiums have risen in response to the increase in uncertainty. Finally, it should be noted that said tightening of financial conditions and the increase in long-term interest rates were marginally reversed in November.

In October, the International Monetary Fund (IMF) maintained its global growth forecasts for 2023 and slightly decreased its estimates for 2024 as compared to those published in July. During the third quarter of 2023, GDP growth for Mexico was 1.1 %. This was due to the favorable evolution of both primary sector activities and industrial production, the latter associated with higher activity in non-residential construction.

This *Report* presents the monitoring and the analysis of potential challenges posed to financial stability by the evolution of key risks. The analyzed risks are divided into two main categories. The first category comprises possible macrofinancial risks, which consist of risks that may arise from the deterioration of financial and macroeconomic variables at both the domestic and international levels. The second category addresses the risks that affect each of the main segments participating in the financial system: households, firms, the public sector, the banking sector, and the non-bank financial sector. The analysis also includes discussion of disruptions and risks that may arise in financial markets and payment systems.

Regarding the first category, four important potential macrofinancial risks are identified as relevant to the stability of the financial system. These are the following: i) a more intense or prolonged tightening of financial conditions than anticipated, ii) a more pronounced or extended slowdown of the world economy than anticipated, iii) a systemic event that affects the global financial system, and iv) unexpected adjustments of credit ratings for either the Mexican government or Pemex.

The analysis of risks corresponding to the second category is based on a series of quantitative and qualitative indicators. The analysis of aggregate risk indicators shows that financial conditions in Mexico, as measured by the Financial Conditions Index (ICF, for its acronym in Spanish), have tightened slightly since the last *Report*. Also, the Mexican Financial Markets Stress Index (IEMF, for its acronym in Spanish) increased slightly since the previous *Report*. Similarly, overall risks in the banking system, as illustrated by the heat map, decreased slightly. The above indicators suggest that the aggregate risk of the Mexican financial system remains contained, having increased marginally with respect to the previous six months.

During the third quarter of 2023, total financing to the Mexican economy increased moderately compared to the previous year and is around a level similar to that observed in 2015. However, the financing gap accumulates ten consecutive quarters with negative values.

The analysis of the financial position of households shows that, as of the end of September 2023, it was slightly reduced in comparison with the previous *Report*. Thus, leverage, measured as the ratio of monthly income available to pay down debt, remained at levels similar to those of last year, while higher leverage is observed for lower-income borrowers than other groups. Consumer credit granted by commercial banks and their related sofomes, as well as by other non-bank financial intermediaries and department stores, exhibited notable dynamism, particularly increases in the credit card, payroll, and, to a lesser extent, automotive segments. Non-performing rates of consumer loans granted by bank and non-bank financial intermediaries increased at the margin. However,

associated risks remain limited because the newly granted credits have a low probability of default. Mortgage loans grew moderately in real annual terms with respect to the previous *Report*, and non-performing loan rates for this portfolio are at historic lows.

With respect to the financial position of non-financial private firms, credit granted by commercial banks to this sector remains the most relevant, although it grew at a slower rate than in the previous three quarters. This is attributed to a moderation of credit granted to large companies. However, credit to smaller companies continued to grow rapidly. The non-performing loan rates of credit granted by commercial banks remained at levels similar to those at the beginning of 2023, while that of credit granted by non-bank financial intermediaries increased slightly with respect to the last *Report*. The Listed Companies Vulnerability Index (IVEL, for its acronym in Spanish) increased due to a deterioration in indicators associated with debt service capacity. However, its level remains below its historical average and exposure of Mexican banks to private non-financial listed companies with some vulnerability remains low when compared to banks' net capital levels.

With respect to the public sector's financial position, from January to September 2023, the budget deficit registered a lower deficit than estimated in the government's 2023 Economic Package. In addition, according to the Ministry of Finance's (SHCP, for its acronym in Spanish) warning system indicators, the debt levels of state and municipal governments remain at sustainable levels. Based on data as of the end of September 2023, state-owned enterprises Pemex and the Federal Electricity Commission (CFE, for its acronym in Spanish) registered quarterly net losses. In the case of Pemex, looking at a twelve-month cumulative period, the loss was higher than that reported in our previous *Report*. In the case of CFE, the quarterly net loss was lower than that observed in the same quarter of the previous year.

Regarding the external sector, based on data from the balance of payments, net cumulative capital inflows were registered for the first three quarters of 2023. Also, during July to September 2023, net portfolio flows from non-residents continued

consolidating the recovery exhibited since October 2022 and were within the range of their natural value in the short and medium term. However, there is still a substantial margin for these flows to continue recovering.

Regarding the banking sector, commercial banks, which have the highest share of assets in the total financial system, maintain abundant liquidity and capital levels with respect to regulatory minima. This increases their capacity to absorb unexpected shocks or risks that could materialize in the short and medium terms. Also, their potential vulnerabilities remain limited. With respect to credit and market risk, our analysis concludes that, in contrast to what was published in the previous *Report*, credit risk for consumer and corporate portfolios slightly worsened, due to increases in both the probability and the correlation of default. However, this risk remains small and contained. As for market risk, it increased slightly due to changes in portfolio positions in instruments that are more sensitive to interest rate adjustments.

The results of solvency and liquidity stress tests indicate that overall, commercial banks are resilient. Both of these stress tests assume adverse but possible scenarios that institutions could face. The purpose of credit stress tests is to evaluate the resilience and loss absorption capacity of Mexican banking institutions. This *Report* considers three sets of macroeconomic scenarios consistent with the macrofinancial risks presented herein, as well as three sets of historical scenarios qualitatively similar to crisis episodes that the Mexican economy has faced in the past. The results show that the current capitalization levels of Mexican banking institutions would allow the financial system, both at the aggregate level and in the six scenarios considered, to conclude the stress horizon well above regulatory minimums, including capital buffers. However, at the individual level, in some of the simulated scenarios, the capitalization of certain banking institutions, representing a low percentage of assets in the system, could be more affected.

Development banks and other development financial institutions remain financially sound, both in their capitalization and liquidity levels. Despite reducing their credit exposures and increasing their loan loss

reserves this group of entities shows a favorable evolution in their balance sheet and financial statement items.

The regulated and non-regulated non-bank financial intermediaries' sector (OIFNB, for its acronym in Spanish) continues to face significant challenges due to tighter financial conditions. Although this sector's assets represent a relatively low fraction of the financial system, these entities are a source of financing for individuals engaged in business activities, particularly unbanked Small and Medium Enterprises (SMEs).

In addition to the risks described above, business continuity risks of financial institutions are also monitored, as well as the performance of financial market and payment systems infrastructures managed and operated by Banco de México, due to their systemic importance. At the end of the third quarter of 2023, the Financial Markets and Payment Systems Infrastructure Availability Index remained at high levels, and payment system services were not interrupted by any incident.

Meanwhile, cyber risks to the global financial system continue to be relevant, given the increase in the frequency and sophistication of cyber-attacks. They are also one of the main non-financial risks to the global financial system, with a high potential for causing a systemic event and, therefore, affecting

financial stability. Banco de México identified opportunities for improving resilience. Specifically, the coordination of actions and communication among institutions would enable a collective sector-wise response, to identify, contain, investigate, and remediate cyberattacks. Nevertheless, for the period covered by this *Report*, cybersecurity status was favorable, based on Banco de México's indicators of the Mexican financial system's cybersecurity.

In addition to the risks mentioned above, Banco de México has continued to actively conduct analyses to measure the economic and financial impact of climate-related risks on financial institutions and the overall financial system.

Finally, during the period covered by this *Report*, Banco de México was not required to implement any additional macroprudential policy measures to counteract the emergence of systemic risks. The Central Bank remains alert and monitors the evolution of risks and vulnerabilities that could negatively affect financial stability, in order to implement actions to mitigate them and preserve both the stability of the financial system and the proper functioning of the payment systems. The above will be done, according to its constitutional and legal authority, in strict compliance with the legal framework, and in coordination with other financial authorities.



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