Box 2

RECENT DEVELOPMENTS IN LATIN AMERICAN BANKING SYSTEMS

In 2022 the Banco de España identified five Latin American countries (Mexico, Brazil, Chile, Peru and Colombia) among those deemed to be of material significance to the Spanish banking system.[1] This box reviews recent developments in their banking systems.

The most recent data show that credit to the private sector has performed unevenly across these countries in real terms, with an increase from March onwards in the three larger economies (Brazil, Mexico and Colombia), a slight slowdown in Chile, and a year-on-year fall of around 4% in Peru (see Chart 1). By segment, consumer credit continued to grow at a high rate (partly owing to targeted support measures, such as those in Brazil[2]), the slowdown in mortgages came to a halt and business loans picked up significantly (see Chart 2). The exception was Peru, where business loans declined substantially against a backdrop of mounting political and economic uncertainty. Moreover, in countries for which data are available,[3] loans denominated in foreign currencies grew at far higher rates (roughly double) than loans in domestic currencies. Accordingly, loan dollarisation rose during the semester, although it remained below its pre-pandemic levels.

One of the factors that has played a part in supporting loans to households since the onset of the pandemic is the surge in digital payment methods (especially credit cards) which were even used by governments on occasion to make some of the transfers intended to shore up the incomes of the most vulnerable population groups. After the worst of the pandemic had passed, households continued to use these open credit lines.[4] While the more widespread use of these means of payment does foster people's financial inclusion, it must be noted that, at the current time, in the face of interest rate hikes, these instruments can also expose households to greater financial risk.

In spite of this sustained growth in credit, indicators commonly used to monitor whether this behaviour is excessive do not, as yet, show signs of risk. Nevertheless, it seems appropriate to continue to monitor certain developments in some countries. For instance, the gap between the credit-to-GDP ratio and its long-run trend remained negative and continued to fall throughout the region, with the exception of Brazil (see Chart 3). Growth in loans to households in Brazil was seen especially in riskier categories and those with higher interest rates (such as credit cards). Some sustainability indicators are showing signs of tightening, such as household debt as a percentage of disposable income, which, at over 50%, has reached an all-time high. Similarly, in Colombia, households' debt burden has exceeded an unprecedented 31% of disposable income, driven by consumer credit.

In 2022 H2 deposits fell in real terms, in an environment of high inflation, leading to an upswing in traditional leverage ratios. Banks offset this slowdown in deposits with higher issuances on domestic financial markets and cut their net external leverage.

The solvency and profitability indicators of Latin American banking systems have also not displayed significant signs of tightening. Capital ratios remained stable[5] and above minimum requirements in 2022 Q3 (see Chart 4). In addition, bank profitability in most countries exceeded pre-pandemic levels (see Chart 5), largely owing to the increase in net interest income.

Lastly, heterogeneity has been the most prominent feature of recent trends in non-performing loans (NPLs). NPLs continued to rise in Brazil and Chile as a result of increasing defaults in the loans to households segments (in the case of

1 Each year, the Banco de España identifies third countries (i.e. outside the European Economic Area) that are materially significant to the Spanish banking system for the purpose of the countercyclical capital buffer (CCyB). To this end, the size of Spanish banks' international exposures is analysed pursuant to the European Systemic Risk Board's guidelines. In 2022 eight material countries were identified – the United States, the United Kingdom and Turkey and the aforementioned five Latin American countries. See the section on the CCyB on the Banco de España's website.

2 Beneficiaries of social programmes – such as Auxilio Brasil – pay lower interest rates on their loans and the interest is deducted directly from the benefits they receive under the programme. https://www.gov.br/cidadania/pt-br/auxilio-brasil/credito-consignado.

3 Chile, Mexico and Peru.

4 See, among others, World Bank (2022), "Del dinero en efectivo al pago digital en pandemia"; World Bank (2021), "The Global Findex Database 2021: Financial Inclusion, Digital Payments, and Resilience in the Age of COVID-19"; and IDB (2022), "Accelerating Digital Payments in Latin America and the Caribbean". The most successful digital payments program was implemented in Brazil, dubbed Pix (part of the Brazilian instant payment ecosystem). This tool – created by the central bank at the outset of the pandemic and for which the central bank provides the necessary infrastructure – allows a wide range of transactions involving current, savings or credit accounts to be made using nothing more than a code on a mobile phone. In its two years of existence, this program has seen a high rate of adoption, with 100 annual transactions per capita in October 2022. This compares favourably with rates in other countries that have far more digitalised means of payments, such as Sweden (39) or Denmark (49).

5 With the exception of Colombia, where capital ratios declined owing to the fall in ordinary basic equity as a result of the adaptation to the Basel III accounting standards.

Box 2

RECENT DEVELOPMENTS IN LATIN AMERICAN BANKING SYSTEMS (cont'd)

Chart 1
Bank loans to the private sector: real (a)

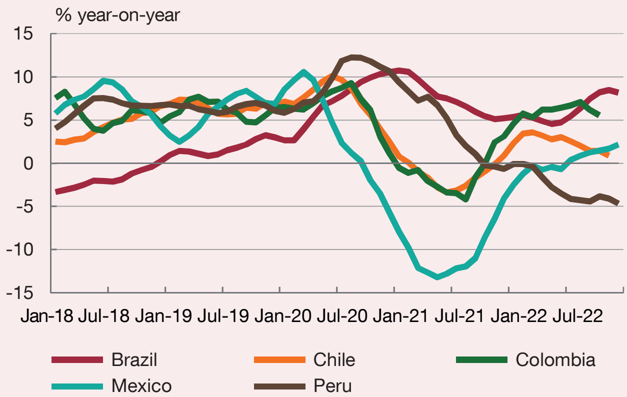


Chart 2
Bank loans to the private sector: real, by type of loan (a)

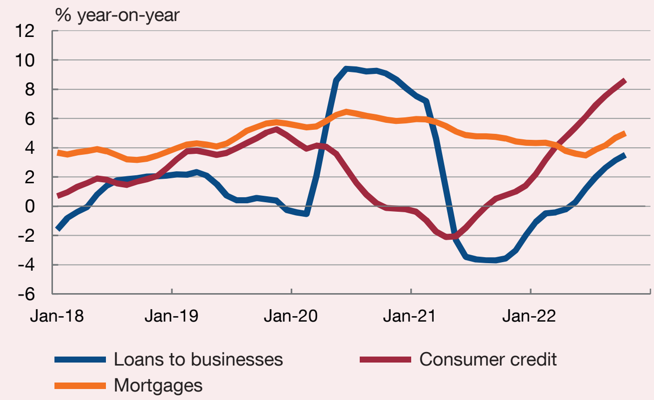


Chart 3
Bank loans to the private sector: difference from the trend

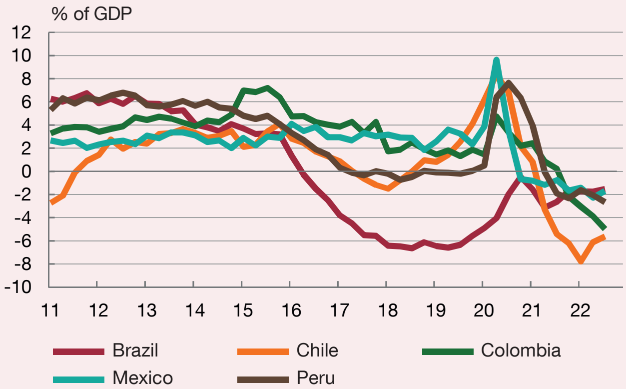


Chart 4
Regulatory capital

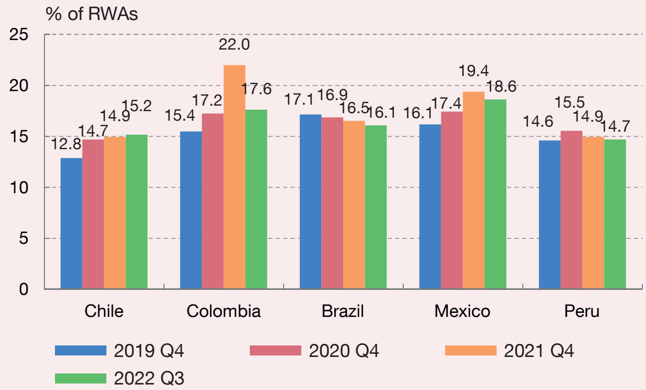


Chart 5
Profitability (b)

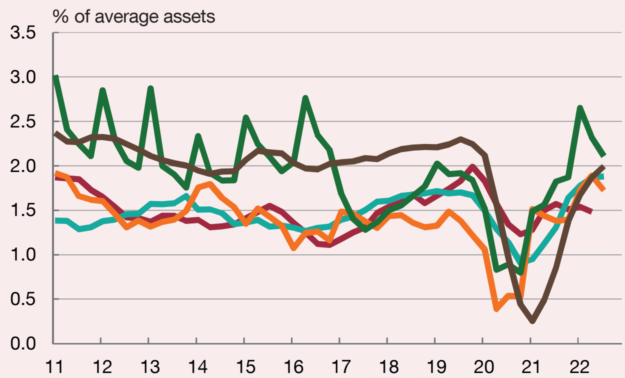
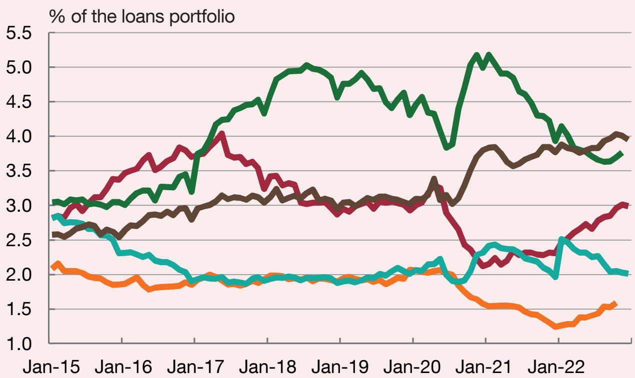


Chart 6
Non-performing loans



Brazil Mexico Chile Colombia Peru

SOURCES: National statistics, Refinitiv, IMF and Banco de España.

a Real credit growth rates are calculated as the difference between the nominal credit growth rate and the inflation rate. The aggregate for Latin America by type of credit is calculated as the average of the year-on-year rates of the five countries, weighted by the purchasing power parity-adjusted GDP.
b Return on average assets (ROA).

Box 2

RECENT DEVELOPMENTS IN LATIN AMERICAN BANKING SYSTEMS (cont'd)

Brazil, in credit cards and personal loans in particular), but remained below their pre-pandemic levels (see Chart 6). Conversely, NPLs declined in Mexico (fundamentally among loans to businesses) and Colombia (which saw a drop in non-performing business and mortgage loans and a rise in consumer loans), although in the latter country, they did so from a very high initial level. Peru is a particularly unusual case, where the non-performance ratio has been rising steadily since early 2011 and, following a surge during the pandemic, still shows no signs of falling. In November 2022, it stood at 4%, an 18-year high. Ultimately, this is due to the rising trend in the non-performance rate among micro, small and medium-sized enterprises. Conversely, non-performing consumer credit and mortgage loans fell in Peru throughout 2022.

Besides the analysis of the recent behaviour of the main indicators of the banking sector in Latin American countries of material importance to the Spanish banking system, the central banks or supervision authorities in these countries also flagged a series of risks to their banking systems in their regular financial stability reports. In particular, these reports, corresponding to the second half of 2022, identified some risks that were common to all of these economies and others that were more nationally specific.[6]

In terms of the former, economies in the region were affected by risks that tended to be external in origin. According to the region's supervisors, risks linked to the war in Ukraine are foremost, along with the global uptick in inflation, the tightening (also global), of financial conditions, the increased volatility of capital flows around the world (and the risk of disorderly capital outflows from the region) and the slowdown of the Chinese economy. There are two additional sources of risk that these reports have repeatedly highlighted in recent quarters: climate change and new technological developments in the financial sector, both challenges of an international nature.

Figure 1 summarises the main exceptional risks for the Brazilian, Chilean, Colombian, Mexican and Peruvian banking systems according to their national supervisors.

6 The aforementioned reports are available online: Financial Stability Report (Brazil), Reporte de Estabilidad Financiera (Mexico), Financial Stability Report (Chile), Reporte de Estabilidad Financiera (Colombia), and Reporte de Estabilidad Financiera (Peru).

Box 2
RECENT DEVELOPMENTS IN LATIN AMERICAN BANKING SYSTEMS (cont'd)

Figure 1
The central banks of the main economies in the region highlight specific risks

BRAZIL

Political risk

Political uncertainty associated with the presidential elections and the various proposals by the candidates regarding the loosening of fiscal rules.

Credit risk

Excessive granting of credit in recent quarters. In particular, the quality of loans to microenterprises and to households has worsened.

CHILE

Credit risk

The increase in non-performance was particularly noticeable among small enterprises that restructured their loans during the pandemic. Similarly, real estate companies' payment capacity has dropped as a result of narrower operating margins, owing to falling sales at a time of increased borrowing costs. Lower-income households have faced a slowdown in job creation and falling wages in real terms, which has caused their non-performing loans to rise.

Currency risk

The peso has depreciated exceptionally severely with an unusually high degree of volatility, above the average of comparable economies. This has increased the probability of distortions in the financial markets. In order to mitigate these risks, the Central Bank of Chile intervened in the currency market between July and September.

COLOMBIA

Credit risk

Households' debt-to-disposable income ratio stands close to its historic high, as do metrics available for the debt burden. Consequently, the Superintendencia Financiera de Colombia (Financial Superintendency of Colombia) has increased credit provisions in this segment.

Systemic risk

Colombian credit institutions are highly exposed to Central America through their subsidiaries (16.8% of all the financial system's assets). There are significant fiscal challenges in some jurisdictions that may affect financial intermediation work. However, it is thought that, in terms of their solvency, banks will remain resilient in the face of adverse external scenarios.

SOURCE: Banco de España.

Box 2

RECENT DEVELOPMENTS IN LATIN AMERICAN BANKING SYSTEMS (cont'd)

Figure 1
The central banks of the main economies in the region highlight specific risks (cont'd.)

MEXICO

Credit risk

Financial situation of state companies: (1) Petróleos Mexicanos (Pemex) has suffered losses in recent quarters, faces a high liquidity risk and is highly dependent on the Federal Government; (2) the Comisión Federal de Electricidad (Federal Electricity Commission) has been negatively affected by the rising cost of fuels as a result of the war between Russia and Ukraine.

PERU

Political risk

The political uncertainty has caused business confidence to deteriorate, which has delayed private sector investments. Conversely, measures approved by the legislative body allowing the early withdrawal of provisional funds could lead to a sharp fall in the prices of fixed and variable income assets, thereby affecting the value of insurance companies, investment funds, banks and pension fund administrators.

SOURCE: Banco de España.