Banking

Monthly Report on Banking and the Financial System

Luis A. Espinosa / Alfonso Gurza / Iván Martínez Urquijo / Mariana A. Torán / F. Gerónimo Ugarte
October 2, 2020

1. Banking and the financial system

Bank credit to the private sector continued to lose momentum in July

In July 2020, the balance of existing credit granted by commercial banks to the private sector grew at a nominal annual rate of 4.9% (1.3% real), which is below the nominal rate seen in the previous month (6.5%) and the nominal rate of 8.6% recorded in the same month of 2019, reducing its growth for the third consecutive month. As we saw in the first half of 2020, in July, the growth observed in the private sector portfolio was mainly based on the performance of business loans. Conversely, consumer loans experienced a worsening of the slowdown seen since October 2019, with a contraction in nominal terms for the third consecutive month. Finally, mortgage loans maintained their growth rate and continued to show below double-digit nominal growth rates. Based on this performance, the contribution made by the various components of total bank credit to the growth of 4.9 percentage points (pp) recorded in July was as follows: business loans contributed 4.5 pp; mortgage loans, 1.7 pp; and consumer loans the remaining growth, at 1.3 pp.

Most of the growth in business loans remains associated with the accounting effect of exchange-rate depreciation, while in contrast the usual drivers that could result in higher demand for such financing continue to deteriorate. This is the case with the Gross Fixed Investment indicator and the Index of confidence about the right time to invest. In addition, consumer loan performance is beginning to reflect more clearly the negative effects of formal job losses, as the performance of both the payroll loan portfolio and the personal loan portfolio reached historically low levels in July. For its part, although mortgage lending has slowed its growth rate, it is still not reflecting the sharp contraction in formal employment, as it captures the performance of this indicator with a lag. However, the slowdown is expected to continue and to deepen as the sharp falls in formal employment begin to reduce household repayment capacity.

Traditional deposits continue showing the effect of the upturn seen in the first few months of the pandemic

Bank deposits in July maintained the trend observed over the past two months. The bank's balance of traditional deposits was lower in July compared to the previous month for both the demand and term segments, in real terms. However, the momentum generated in March and April, as a result of the pandemic, has kept the deposit balance at high levels that compare favorably with that observed a year ago. Despite the monthly fall in the savings of individuals on aggregate, it is important highlighting that the demand deposits of these customers showed positive growth in July for the fifth consecutive month, despite the deterioration in employment indicators.

In this context, the bank’s traditional deposits (Demand + Term) in July fell by a nominal rate of 0.2% (-0.8% real) compared to June, influenced by the nominal 1.0% (-1.7% real) fall in term deposits and the nominal 0.4% (-0.3% real) growth of demand deposits. July was the third consecutive month with a negative monthly growth rate for bank deposits in real terms, following the unusual growth recorded during March and April.

Compared with July 2019, traditional deposits increased their growth rate to 12.9% nominal (9.0% real) derived from nominal growth rates of 18.1% and 5.5% (14 and 1.8% real) for the demand and term segments, respectively. The acceleration of the annual growth rate in July, from 12.4% to 12.9%, which can be attributed to a baseline effect, stopped the process of gradual slowdown seen since the peaks observed in April. However, the expectation remains that, as the effects of the recession during the rest of 2020 become more visible, monthly reductions in bank deposits will be reflected in a slowdown in the annual growth rates.

The Financial System Stability Council (CESF) believes that financial conditions will continue to reflect the effects of the pandemic

The CESF updated its risk balance. In the document it highlights that the Mexican banking system is strong enough to cope with the current environment, as reflected by its high levels of capital and liquidity, but considers it necessary for some institutions to diversify their sources of financing. In the case of non-bank financial intermediaries, the statement highlights that the Popular Finance companies (Sofipos) and Credit Unions are facing greater challenges in the current situation, due to serving more vulnerable sectors and having a higher credit risk profile.

Despite the crisis associated with the pandemic, CESF stresses that the financial system continues to deal with the challenge of having good operating conditions in the national financial markets, maintaining the proper functioning of the payment systems and adequately managing the increase in market, credit and operational risks. In addition, it is also necessary to prevent the financial institutions' reaction to the crisis from exacerbating the liquidity and operational problems that could be faced by economic agents. It is also necessary to maintain the flow of credit required by companies, households and some financial intermediaries, as well as to maintain adequate liquidity conditions, in both domestic and foreign currencies. Lastly, it is important to avoid solvent economic agents facing liquidity problems.

Finally, CESF identifies among the main external risks a less vigorous global economic recovery than anticipated and an increase in the volatility of the international financial markets. With regard to domestic risks, uncertainty over the national economic recovery prevails, along with uncertainty associated with additional adjustments to the sovereign credit and Pemex ratings.

CNBV updates financial inclusion publications, highlights support for small and medium-sized enterprises (SMEs)

In September, the National Banking and Securities Commission (CNBV) published its Quarterly Financial Inclusion Bulletin, which brings together various indicators on the support programs, financial impacts, access to financial services and digital financial innovations for micro, small and medium-sized enterprises (MSMEs). With regard to support programs, it reports that of the 8.3 million commercial banking loans benefiting from the application of the Special Accounting Criteria (CCE), 3.3 million belong to SMEs and individuals with business activity. It also highlights three main actions by the financial authorities in recent months to increase financing facilities for MSMEs during the pandemic: (1) the provision of facilities so that financial institutions grant loans on a remote basis (CNBV); (2) the delay in the application of certain regulatory measures (CNBV); and (3) the reduction of the one-day interbank interest rate (Banxico) from 7.0% to 4.5%, making it easier for financial intermediaries to reduce the cost of financing. Regarding Federal Government business loans to formal and informal companies (announced in April) by the end of August, the Mexican Social Security Institute (IMSS) had granted 196 thousand loans to companies and the Ministry of Economy had granted 984 thousand loans to individuals through the use of information from the Welfare Census.

In the section on the impact of the pandemic on SMEs, the bulletin gives some results (for April) from the Survey on the Economic Impact generated by COVID-19 (ECOVID-IE). This shows that 93.2% of companies have been affected in at least one way. In more detailed terms, it reports that 31.1% of micro-enterprises implemented the deferral of loan repayments. In addition, the bulletin shows the results of the Economic Census 2019 in terms of access for SMEs to financial services. In 2018, 11.6% of micro-enterprises (1–10 workers) had at least one loan, compared with 25.9% of small enterprises and 38.9% of medium-sized enterprises (51–250 workers).

In addition to the bulletin, the CNBV published the Annual Financial Inclusion Overview 2020. This document provides information on financial infrastructure, accounts, loans, retirement savings accounts, insurance, transactions and consumer protection in order to provide an insight into where we are in relation to financial inclusion.

Among the main findings of this document, it should be noted that the number of branches increased by 1.1% between December 2018 and December 2019 and there was a 4.1% growth in deposit accounts from 2018 to 2019, reaching a figure of 125,997,791 accounts in the last quarter of 2019. In addition, the number of accounts administered by pension fund managers was 65,837,742 in 2019, an increase of 4.7% compared to 2018. In more detail, people aged between 18 and 34 years held 37.8% of all accounts managed, while people in the 35 to 49 years age range accounted for 36.9%. The two ranges together account for around 75% of all accounts managed by pension fund managers.

On the possible disconnect between risk asset prices and the economic outlook: BIS Quarterly Review

In its September quarterly report, the Bank for International Settlements (BIS) reviewed the recent performance of the equity and credit markets, raising the issue of a possible disconnect between the behavior of risk asset prices and the global economic outlook, which suggests that pre-pandemic levels are unlikely to return until the end of 2021.

The rise in the main stock indexes after the fall in March has been remarkable, to the extent that, at the end of August, the main US indexes (S&P500, DJIA and NASDAQ) were higher than the levels observed in February. However, this increase has not been homogeneous, since it has been concentrated in the technology and health care sectors (both sectors of the S&P500 have higher prices than those seen on February 19 and their price/earnings ratio is in the highest 10% of their historical distribution [1973–2020]) on the basis that these sectors will benefit from the structural change induced by the pandemic. In fact, at the beginning of September, less than half of S&P500 shares were above the prices reached at the end of February (February 19), while the shares of the six largest tech companies were 40% higher than the levels seen in mid-February.

At the same time as this recovery in the stock market, there has been a significant reduction in spreads in the corporate debt markets, despite the economic outlook pointing to lower income and lower cash flows to repay liabilities. After a sharp increase in March, the spreads of both Investment-grade and High Yield corporate debt have fallen to levels around their long-term median (2005–2020). This reduction has been of such magnitude that the average corporate debt spreads during 2020 are close to their record minimum level over the last 20 years for both types of debt. In response to this reduction in spreads, corporate debt issues increased from April and by mid-August the cumulative issuing of corporate debt at the global level was 55% higher than in the same period in 2019.

The upturn in risk asset prices in response to the prospect of global economic downturn can only be understood in the light of unconventional monetary policy measures and unprecedented fiscal support. The monetary authorities in the major developed countries have stressed in their statements the position of keeping rates at minimum levels for a long time. This is in addition their asset purchases programs, which have been of such magnitude that the balance sheets of the Federal Reserve (Fed) and the European Central Bank (ECB) are now at 30% and 50% of their GDP, respectively. This is despite the Fed reducing its asset purchases from USD 700 trillion per month in March and April to USD 80 trillion since May in response to the stabilization of the financial markets. For their part, the tax authorities in many countries have launched support programs, which in the case of the US economy (USD 3 trillion) and the European economy (EUR 750 billion) have reached unprecedented levels. Overall, these measures have avoided interruptions to the flow of credit, episodes of liquidity shortages and a sharp fall in aggregate demand.

However, these are not the only effects of these measures. Expectations of short-term rates at near-zero levels for a long time and the abundance of liquidity have been reflected in a significant fall in government interest rates, particularly in the US. In addition to record minimum levels in the nominal curve, at the beginning of September real long-term yields (10 years) in the US hit record lows of about -1.2%, while in the middle part of the curve (5 years), real yields, also in negative figures, were below those of their German counterpart for the first time since 2015. The effects of the measures mentioned above were not only seen in rate levels, since the volatility of government interest rates in the US has fluctuated around its record low since August.

In the current economic environment, this reduction in the levels and volatility of government interest rates in developed countries has led to a search for returns and risk taking through a reduction in the cost of funding and its risks. Add to this the weakening of the USD, which in turn is the result of this environment, and you have a combination of factors in unusual quantities that have fueled the prices of risk assets.

The BIS report not only analyzes the factors that explain this possible disconnect between risk asset prices and the economic environment, but also tries to quantify them. Through a comparative statics exercise on a share price model using the discounted value of dividends over time (constant growth model), it quantifies the effect of the significant fall in the structure of interest rates between February and September 2020 on the price increase of the S&P500 and Euro Stoxx 50. The report concludes that, other things being equal, if the prevailing interest rates at the start of September had been those observed in February (before the pandemic), the prices of the S&P500 and Euro Stoxx 50 would be about 50% and 20% lower, respectively. In other words, other things being equal, only about a half and a fifth of the rally observed between February and September in the S&P500 and EuroStoxx 50, respectively, can be attributed to the reduction in interest rates.

The more lax financial conditions and the fiscal support have undoubtedly influenced the increase in risk-taking. However, in light of the BIS report, these appear to be limited factors in explaining recent gains in risk assets, particularly in the economic context of a pandemic. The degree to which this strong price upturn exacerbates risks to the global economy will be the subject of numerous studies in the coming months.

2. Financial markets

Tech stocks correction and the volatility of the peso stand out in the performance of the financial markets in September

September in the financial markets was marked by three main events. First, the tech stocks price correction at the beginning of the month, which could be associated more with profit taking than with a protracted episode of risk aversion. Second, the slowdown in the pace of recovery in the global economy and the significant increase in the cases of COVID in Europe, which has led investors to focus more attention on the discussions about a new round of fiscal stimuli in the US. Third, the formal start of the US election season, which has generated greater demand for hedging in the markets given the scenario of a possible post-election dispute. All these events, together with the Fed's reaffirmation of medium-term risks to economic activity, resulted in a month of losses in the prices of the main risk assets.

After five consecutive months of growth, which saw them reach new record highs at the end of August, the major US stock indexes saw a correction, mainly influenced by profit-taking for tech stocks. In fact, the Nasdaq fell 5.2% during September, while the S&P500 fell 3.9%. Both falls were higher than the 3.6% fall during that month for the global stock benchmark (MSCI World). It should be noted that the fall in the US indexes was concentrated in the early days of the month and later there were lateral movements and even some gains at the end of September, which supports the idea that the movement was associated with profit taking. Given its much lower weight for the technology sector, the emerging markets stock benchmark (MSCI EM) fell 1.8% and within these markets, the IPyC had a positive differentiation with a gain of 1.7% during September.

In the exchange rate market, September saw a recovery of the US dollar following low levels, particularly against developed currencies, during August. The US currency had gains of 1.7% against the currencies of emerging countries, while the growth against the currencies of developed countries was 1.9%. The Mexican peso registered high volatility during September and ended the month with a depreciation of 1.0%. During the first half of the month the peso took advantage of the weakness of the dollar and appreciated 3.5%. However, following the Fed meeting on September 16 and, above all, the increased volatility in the exchange markets as a possible US post-election conflict looms, the peso lost 4.7% during the second half of the month. It should be remembered that the purchase of hedging has intensified among market participants in response to the risks associated with the US electoral process, especially after the unexpected outcome in 2016. This increased demand for hedging has resulted in an increase of about 5.0 percentage points in the implied volatility of the Mexican peso, which ended the month at 18.2%. This entire environment led to the exchange rate losing the appreciation that had resulted in it standing at below 21.0 pesos per dollar (ppd) in the middle of the month, to close September at 22.1 ppd.

In the fixed income market, different movements were observed in line with increased risk aversion in general. In the case of US Treasury bonds, during September there was higher demand that fed through into a 2.0 basis point (bp) fall in the 10Y yield to maturity (YTM), which closed the month at 0.68%. It should be noted that, in view of the correction to tech stocks at the beginning of the month, the 10Y YTM was at 0.63%. In the short end of the curve there were no movements, so the slope between the 2 and 10 years closed at 68.0 bp. By contrast, in Mexico, during September, the YTM of the 10-year Mbono rose by 5.0 bp, closing the month at 6.1%. This upward movement was in line with the 34.1 bp increase in the 5-year CDS spread and with inflation figures, that were higher than expected by analysts. It should be remembered that the markets, like most analysts, had discounted that the monetary policy rate would close the year at around 4.0%.

The increase in COVID cases in Europe during September to some extent raised fears about a reduction in global demand, which was reflected in commodity prices. The benchmark for this asset class (S&P GSCI) fell by 2.2% during September, influenced by the 9.6% fall in the Brent oil price and the 4.2% fall in the price of gold. The price of the Mexican mixed crude fell 9.1% during the ninth month of the year, to again stand below USD 40 per barrel (USD 37.1).

Risk asset prices continue to be supported by repeated expectations of long-term low interest rates and high liquidity from central bank asset purchases. However, the narrative of a rapid economic recovery has recently been weakened by figures that point to a slower than expected recovery in US employment, and by the increase in COVID cases in Europe, mainly. Add to this the uncertainty over a potential post-election conflict in the US, and together this creates a scenario that heightens short-term volatility and could be a potential catalyst to align risk-asset prices with the fundamentals.

3. Regional Economies

Lending growth slows down in all regions of the country in 2Q20

According to the Bank of Mexico's Regional Economies Report[1], the portfolio in commercial banks of private non-financial companies showed a real annual increase of 6.3% in 2Q20, a considerable slowdown from the 10.4% recorded in 1Q20. Bank financing in the Center region of the country, which accounts for 58.0% of lending, contributed 3.6 of these 6.3 percentage points (pp), while 0.6 pp is attributable to the South region and 2.0 pp to the North of the country. The North Center region accounts for 15.0% of the portfolio in commercial banking and it shrunk by 0.03% during the reference period.

The slowdown in lending intermediation described in the document covers a period that includes the phase with the most severe mobility restrictions and closures of economic activities due to the COVID-19 pandemic.

For the portfolio by type of activity, during 2Q20, the agricultural sector showed a greater increase in the North Central and South regions of the country, with real growth rates of 13.9% and 16.2%, respectively. It should be noted that by type of activity and region, the existing agricultural portfolio in the South was the only one that experienced real growth.[2] The industry exhibited the highest growth in the North and South regions, for the second consecutive quarter, with real rates of 11.0% and 13.9%, respectively.

According to BBVA Research's analysis, the dynamics in the different regions point to the greater contraction in the real sector due to the health crisis having taken place in 2Q20. The recovery horizon for the states will depend on both the local development of the pandemic and on the sectoral composition of state economic activity. The Mexico Regional Sectoral Outlook report for the second half of 2020, includes an analysis of the regional situation, as well as growth forecasts by state, based on these parallel drivers of economic performance.

1: Regional classification in the report: The North includes Baja California, Chihuahua, Coahuila, Nuevo León, Sonora and Tamaulipas; the North Center considers Aguascalientes, Baja California Sur, Colima, Durango, Jalisco, Michoacán, Nayarit, San Luis Potosí, Sinaloa and Zacatecas; The Center is made up of Mexico City, Mexico State, Guanajuato, Hidalgo, Morelos, Puebla, Queretaro and Tlaxcala; and the South, Campeche, Chiapas, Guerrero, Oaxaca, Quintana Roo, Tabasco, Veracruz and Yucatan.
2: It should be noted that the real variation does not include exchange rate effects.

4. Regulation

New Covid-19 emergency support measures

On September 23, the Ministry of Finance and Public Credit and the National Banking and Securities Commission announced new measures to promote loan restructuring. Restructuring operations will require a reduction of at least 25% of the regular repayment, an extension of the remaining repayment period of up to 50% of the original term, as well as a maximum increase of 15% in the amount of total nominal repayments. They can also include a reduction in interest rates and capital write-downs. In return, credit institutions offering such restructuring would obtain benefits in terms of provisioning and capital.

Banxico: extension of the period for the application of facilities in response to the Covid-19 crisis

On September 15, Banxico announced the extension of the period for the application of the facilities announced on April 21 until February 28, 2021, which it formalized through Circular 35/2020. On September 11, it also published Circular 33/2020 and Circular 34/2020, which adjust the conditions for the repo transactions of credit institutions contained, respectively, in the Rules for the provision of resources to financial institutions to channel credit to MSMEs and individuals and the Rules applicable to financing guaranteed by the bank's qualifying credit assets to be channeled to MSMEs.