Banking

Monthly Report on Banking and the Financial System

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1. Banking and the financial system

In the third quarter of 2020, the balance of credit to the non-financial private sector (NFPS) began to fall at an annual real rate

In September 2020, the balance of bank credit to the NFPS achieved a nominal annual growth rate of 2.5%, one-third of the momentum recorded in the same month of 2019 (when the growth rate was 7.6%). The nominal growth rate for September was made up of 1.6 percentage points (pp) attributable to the nominal effect of the exchange rate and 3.9 pp associated with the effect of inflation, which offset the fall in real terms of -3.0 pp. With this September result, three months of contraction are accumulated. It should be noted that this credit aggregate had not fallen in real terms since May 2010.

In 2020, the valuation of balances denominated in foreign currency (FC) has had a significant impact on the growth rates of NFPS credit balances. Between January and September, the valuation effect of the exchange rate contributed 30% to the average nominal growth rate of 6.4%, while in the same period of 2019 the valuation effect represented just 3% of the average nominal rate of 9.3%. It must be pointed out that the main source of the accounting effect associated with the valuation of the exchange rate within credit to the NFPS is business loans, as household credit (consumer loans and mortgages) is almost entirely denominated in domestic currency. In particular, FC-denominated credit represents 25% of business loans and is equivalent to 15% of the total amount of NFPS credit.

After discounting the valuation effect of the exchange rate and inflation, NFPS credit averaged a real growth rate of 1.1% in the first nine months of the year, just over a fifth of the average real rate of 5.0% observed in the same period of 2019. It should be noted that between January and September 2020, business loans and mortgage loans boosted the modest growth observed (contributing 1.0 pp and 1.1 pp respectively), while the fall in consumer loans reduced -1.0% to the growth of the total portfolio.

Traditional deposits in the commercial banking sector moderates its growth rate and keeps demand deposits as the main driver

In September 2020, the nominal annual growth rate of traditional deposits (demand + term) was 12.2%, higher than the nominal rate of 6.8% recorded in September 2019. With this result, the average nominal growth of traditional deposits from January to September was 11.4%. It should be pointed out that, as of March 2020, there was a significant acceleration in the balances of traditional deposits that meant double-digit annual nominal growth rates were recorded for seven consecutive months. Part of this momentum is associated with the valuation effect of the exchange rate, which explains 20% of the nominal growth rate.

After discounting the valuation effect of the exchange rate and inflation, the real growth rate for traditional deposits averaged 5.5% between January and September 2020, higher than the 3.1% reported in the same period of 2019. Almost all of the real growth is due to the performance shown by demand deposits, which contributed 5.4 pp to total momentum, while term deposits contributed only 0.1 pp to said growth rate. The lower contribution of term deposits to the growth of total deposit collection is partly explained by the decline in interest rates, which coupled with the liquidity preference led to the substitution of term savings by demand deposits, which positioned themselves as the main driver of growth for banking deposit collection.

Mexico maintains access to the International Monetary Fund (IMF) Flexible Credit Line (FCL)

The Ministry of Finance and Public Credit (SHCP) and the Bank of Mexico (Banxico) reported that the IMF's Executive Board concluded the mid-term evaluation of the FCL granted to Mexico in November 2019 for a period of two years. According to the statement, the IMF states that the Mexican economy has shown resilience to the impacts of the COVID-19 pandemic and confirms that Mexico meets the criteria for access, if necessary and without any conditions, to the resources of the FCL.

In 2017, the Foreign Exchange Commission announced an exit strategy from the FCL and steps were taken in this direction, however, due to the increase in external risks due to the effects of the pandemic, the implications of greater persistence in various sectors and effects on financial markets, the Commission decided to maintain the level of access at about USD 61 billion. It should be noted that the FCL supplements economic policies to address adverse external economic conditions and preserves economic and financial stability.

Companies reduce the use of bank credit as a source of financing and replace it in part with financing from their corporations

According to the results of the quarterly survey prepared by Banxico to assess the credit market, for 3Q20 it is clear that the percentage of companies that accessed some type of financing increased compared to the previous quarter, but decreased slightly compared to the same quarter of 2019. In the last year, there has been a marked reduction in the percentage of companies accessing some type of financing from both commercial banks (the number of companies that accessed financing decreased from 32.6% in 3Q19 to 31.4% in 3Q20) and from banks abroad (companies that accessed financing from this source decreased from 6.4% to 4.5%). On the contrary, in the same period, there was a marked increase in companies that stated that they had obtained financing from companies of the same corporate or parent office, since the percentage of companies that took this alternative increased from 17.9% to 19.5%, while companies that were able to finance themselves through debt issuance increased by just over one hundred percent, going from 1.6% of the companies surveyed in 3Q19 to 3.3% in 3Q20.

With regard to bank financing, 46.9% of companies indicated that they had bank credit at the beginning of 3Q20, a higher percentage than the 45.6% reported in the same quarter of 2019. However, only 19.0% of companies took out new bank loans in 3Q20, lower than the percentage recorded in the same period of the previous year (when this percentage was 20.6%). With regard to the destination of bank credit, we can see a notable increase compared with the previous year in the percentage of companies that declared they used financing for working capital (from 70.3% to

76.0%) as well as a fall of more than half in the percentage of companies that used financing for investment (from 22.0% to 10.3%).

High capital levels and ample liquidity have allowed the financial system to function properly despite the pandemic

On November 25, the Bank of Mexico published its July-September Quarterly Report. This report includes an analysis of the stability of the financial system, which indicates that the high levels of capital and ample liquidity have allowed the financial system to continue to function properly and deal with the impacts caused by the pandemic. However, the analysis warns that risks remain and must continue to be monitored. In terms of the solvency of Commercial Banks, the capitalization index (CI) increased to 17.2% in September, from 16.5% in June. This increase reflects a higher capital requirement level and fewer risky assets.

The conditional value at risk (CVaR) at 99.9% confidence level as a proportion of the loan portfolio (which provides a measure of credit bank risk) also increased in the third quarter of 2020. This indicator went from 9.8% in June to 10.9% in September, in line with the increase in risk in business and consumer credit portfolios. Additionally, the net risk capitalization ratio increased from 10.58% in June to 10.69% in September, thus remaining above the regulatory minimum. This data shows the ability of banks to absorb unexpected losses due to the credit default of their portfolios. With regard to the non-performing loans (NPL) rate of the credits granted by commercial banks to the non-financial private sector, this went from 2.48% at the end of the second quarter to 2.41% in September, a decrease that reflected the write-offs of past due loans granted by some institutions.

The report shows stable conditions with regard to the market risk of commercial banks, specialized retirement fund investment companies (SIEFOREs) and investment funds, but remains cautious as to whether these conditions will continue. The banking market risk, observed through CVaR at 99% confidence level as a proportion of net capital, saw a marginal increase during the third quarter of the year, reaching 3.8% in September, compared to 3.7% recorded in June 2020. Once again SIEFOREs reported positive accrued returns as of September 2020; however, retirements due to unemployment continued to increase in the same period. With respect to investment funds, there is less volatility in returns for the system as a whole compared to what was observed in March and April 2020. It is worth mentioning that, as of September, equity funds recovered all net flows compared to the previously observed outflow; in turn, debt funds maintain a positive cumulative net flow.

With regard to Pemex, in the third quarter there was an annual net loss of MXN 775 billion, which represents a lower annual loss than that reflected in the second quarter. This can be explained by lower operating expenses, lower taxes and lower duties paid by the company. The report highlights the placement of USD 1.5 billion in debt in international markets with a term of five years and a coupon of 6.875%, which made it possible to gather the funds required for the company's refinancing program. Finally, the spread of Pemex's 5-year credit default swaps (CDS) increased in September, remaining above the CDS level of other oil companies with a similar rating.

Housing prices rose by 5.0% in 3Q20

On November 10, the SHF (Federal Mortgage Company) published data on the Housing Price Index for the third quarter of the year. As we mentioned in our report for August, we anticipate that, given the contraction of the economy and lower momentum in the mortgage market, the appreciation of housing prices could close the year at rates nearing 5% — something which is already starting to be seen.

At the end of the third quarter of 2020, housing prices increased 5% nationwide, compared to the same period of the previous year; while, in accumulative for figures between January and September, appreciation stood at 5.9%. This slowdown continues to reflect the contraction of the mortgage market so far this year, which as of August saw a 13% decrease in the amount of financing granted.

At the segment level, as of September the price sub-index corresponding to low-cost housing increased by 6.2%; while middle-income housing grew by 5.8%. On the other hand, for metropolitan areas, the highest appreciation rates were recorded in the Metropolitan Zones of Guadalajara and Tijuana, with rates of 8.2% and 8.1%. The Metropolitan Zones of León, Monterrey and Puebla-Tlaxcala saw price increases of 7.1%. Finally, prices in the Metropolitan Zones of Querétaro and Toluca increased by 6.2% and 5.8% respectively.

The slowdown in housing prices and historically low mortgage interest rates provide favorable conditions for obtaining mortgage loans.

2. Financial markets

COVID vaccine progress boosts appetite for risk. The appreciation of the peso brings the exchange rate to its lowest level since March

In November, there was a significant increase in risk appetite, mainly resulting from more progress being made than expected in the development of vaccines against COVID-19. The new information regarding the high efficacy of some of the vaccines in development not only strengthened, but also led to an escalation of the narrative of economic recovery that has prevailed in the markets. This is despite the fact that cases and hospitalizations for COVID are currently rising significantly. In line with this narrative, the valuations of risk assets were additionally increased in view of the expectations of higher cash flows in advance for 2021 and for the medium term, which supplement the significant support of the monetary and fiscal stimuli, which are expected to last for a long time.

Expectations of a stronger recovery in 2021, supported by a possible vaccination against COVID arriving sooner than previously expected, was reflected by a shift in the stock market toward securities with greater links to the economic cycle. Thus, the Russell 2000 index, which groups together the small- and mid-cap stocks of the North American market, registered a growth of 18.3% in November, higher than the growth of 10.8 and 11.8% of the S&P500 and the NASDAQ indexes, respectively. This rise in the Russell 2000 index was also higher than the 12.7% growth of the global equity benchmark (MSCI ACWI) and the 9.2% growth rate of emerging markets (MSCI EM). It is important to note that growth of the Consumer Price Index (CPI) in November exceeded the latter by 3.7 percentage points.

For the fixed income market, the likely takeover of the House of Representatives by the Republicans after the US elections led to a significant drop in yields due to the elimination of the so-called Reflation trade, which discounted a strong fiscal stimulus that could have led to higher growth and inflation. However, following news about vaccine efficacy, the search for returns led to the sale of this asset class, further increasing returns. Thus, in November, the yield to maturity of the 10-year treasury bond fell 3 base points (bp), while the short part of the curve (2Y) remained stable at 0.15%. In Mexico, the yield to maturity of the 10-year Mbono registered a 50 bp fall during November, driven by risk appetite, the fall in treasury bond yields and the 40 bp collapse of the sovereign risk (CDS spread).

The commodities market also looked very optimistic. The benchmark for this asset class (SPGSCI Index) grew by 13.2% in November. In particular, the price of Brent oil grew 27.0%, while the Mexican mix once again exceeded USD 40.0 per barrel after rising by 32.0% in November. In line with the reduction in medium-term uncertainty due to the vaccines, gold fell 5.6% during the penultimate month of the year.

Furthermore, in the foreign exchange market, the dollar generally weakened up against the search of higher yields. Against developed currencies, the dollar depreciated 2.3% in November, while the fall stood at 3.8% against emerging market currencies. Within this group, the performance of the Mexican peso stood out, whose 4.7% appreciation placed it seventh in terms of the currencies that have appreciated the most in the penultimate month of the year. With this appreciation, the exchange rate fell below 20.2 pesos per dollar for the first time since last March, although so far this year it still has a depreciation of 5.5%.

The trajectory of the rapid economic recovery supported by monetary and fiscal stimuli was strengthened by the good news about the vaccine and consequent hope for less uncertainty in the medium term. At the moment, the markets consider that the increase in infections does not put economic recovery at risk or significantly delay it, therefore, despite economic restrictions caused by the second wave of COVID infections, the prices of risk assets continue to register new all-time highs. There are still significant doubts about the speed of production and distribution of vaccines, however, it seems that the appetite for risk will continue to be the dominant force among investors for the rest of 2020.

Analysis of the recent performance of the yield curve and sovereign risk: Bank of Mexico quarterly report

In its July-September quarterly report, the Bank of Mexico analyzes the recent dynamics of Mexico's yield curve and sovereign risk compared to its peers in emerging countries (Brazil, Chile, Colombia, Peru, Russia, South Africa, Thailand and Turkey). By analyzing the main components, the central bank concludes that, despite the fact that the official interest rate remains higher than that of several emerging countries (e.g. Brazil, Colombia, South Africa), between March and October 2020, Mexico's government yield curve saw a clear reduction and a larger one than that observed in most of the emerging nations contained in its analysis. Likewise, the analysis shows that, compared to March 2020, Mexico's government yield curve has increased less than in other emerging economies. This result could suggest, according to the central bank, that risk premiums in our country have not changed as much.

Along the same lines as the previous result, although in a different section of the July–September quarterly report, the central institute uses a value at risk (VaR) model to analyze the historical breakdown of Mexico's sovereign risk premium. This breakdown allows the contribution of each of the determining factors of the sovereign risk premium to be quantified in each period of time. The analysis concludes that the rebound in sovereign risk between March and April was mainly due to global risk aversion. Subsequently, once financial conditions were relaxed and bolstered by extraordinary monetary and fiscal measures, idiosyncratic factors began to become more marked. In the case of Mexico, the analysis finds that, between June and August, idiosyncratic factors have contributed to reducing the sovereign risk premium. This could be related, according to the central bank, to the appreciation of the exchange rate and the improved performance of the national financial markets after the measures adopted to provide liquidity.

3. Regulation

Adjustments to CNBV Regulatory Facilities

On November 6, the National Banking and Securities Commission (CNBV) limited the eligibility of loans for restructuring and associated benefits to "balances drawn as of April 15, 2020," which was added to the previously established requirements: having been granted and being in force as of March 31, 2020, the borrowers not being Related Persons and loans whose payment, due no later than January 31, 2021, is affected by the pandemic.

Finally, on November 9, the CNBV extended the benefits of "soft marks" before Credit Information Companies (CIC) to restructures that the banks carry out outside of the program promoted by the CNBV (through Institutional Restructuring Programs or IRPs), provided that such programs are broadly in line with the provisions of the CNBV proposal in respect of periodic payment, term and nominal amount. Thus, reports to the CICs associated with the IRPs will state that the borrower's payment problems were due to the effects of the pandemic, avoiding the stigma associated with a restructuring under other circumstances.