Banking

Monthly Report on Banking and the Financial System

Fernando Balbuena / Luis A. Espinosa / Gerónimo Ugarte / Iván Martínez Urquijo / Mariana A. Torán / Samuel Vázquez

February 3, 2021

1. Banking and the Financial System

In November 2020, private sector credit saw a worsening in its slowdown and its nominal annual change entered negative territory

In November 2020, the outstanding balance of credit granted by commercial banks to the non-financial private sector registered a nominal annual decline of -0.8% (-4.0% real), the first contraction observed in this credit aggregate since April 2010 (when the balance fell by -0.7%). With this result, the trend toward slowdown recently observed in the three segments making up this credit balance is exacerbated: the consumer loan and business loan portfolios with negative annual changes and the mortgage loan portfolio with a gradual loss of dynamism. In the penultimate month of the year, the contribution of the three segments to the variation in total bank credit of -0.8 percentage points (pp) was as follows: mortgage loans contributed +1.6 pp, which was not sufficient to offset the consumer loan contribution of -1.9 pp and the business loan contribution of -0.5 pp.

Business loans continued to lose momentum in the face of weak investment and the impact of the economic contraction on corporate income. While this might require financing to cover expenses associated with working capital, the lack of certainty about the continuity of their income flow in the short and medium term may be encouraging greater caution, in terms of both seeking funding and granting it. Coupled with this, investment continues to weaken and it is unlikely that companies will risk making medium- and long-term commitments to finance new projects given the environment of uncertainty and recession.

Household income, for its part, has begun to reflect the job losses, leading both to greater caution and to less ability to incur different expenditures, as shown by the weakness in the recovery of private consumption and the noticeable loss of dynamism in the consumer loan segment. Finally, while mortgage lending is still showing a positive annual change, the current mortgage loan balance is expected to show a more marked slowdown as the effect of lower employment starts to feed through into a decline in the potential client base. Therefore, if there is a delay in recovering the generation of formal jobs and economic activity (so that the income flows of households and businesses can be restored to the levels seen prior to the pandemic), it is to be expected that the contraction in the different loan segments will be deeper and longer than seen so far and that the quality of the portfolio will be affected by an increase in defaults.

Demand deposits maintain their strength, while term savings continue to lose momentum

Recent trends in bank deposits were reaffirmed during November. On the one hand, demand deposits again showed strength, mainly supported by the savings of private individuals. On the other hand, term deposits for both private individuals and companies continued to decline in response to a combination of lower interest rates and a greater need for liquid assets to cope with the economic downturn. Finally, savings in debt funds fell again following expectations of smaller cuts in the reference interest rate going forward and a market environment that tends to favor investment in riskier assets.

In this way, the balance of traditional bank deposits (Demand + Term) fell by 0.7% nominal (-0.8% real) between October and November, with four of the last five months experiencing negative monthly falls. This pattern of reductions was expected, to some extent, after the unusual monthly increases of 8.1 and 2.3% nominal in March and April, respectively. Growth rates were not expected to continue rising given the high balance reached in April. In terms of the annual growth rate, this behavior has resulted in a slowdown from the 15.7% nominal observed in April (13.3% real) to the 10.5% nominal (7.0% real) recorded in November. As the months of unusual growth come out of the annual comparison, one can expect to see a base effect and this could result in the annual growth rate entering negative territory.

The balance of term deposits (36% of the traditional deposit balance) fell for the fifth consecutive month, after falling by 2.8% nominal (-2.85% real) between October and November. This behavior has been consistent with the lower yield resulting from the cycle of interest rate cuts and the lower availability of resources for savings. As a result, it was new growth in demand deposits (64% of the traditional deposit balance) that mitigated the fall in traditional deposits. This time the monthly growth, between the months of October and November, was 0.5% nominal (0.4% real), giving the sixth consecutive monthly increase. This trend has been considerably above expectations, particularly in the current recessive environment.

Reduction in the number of cards and balance of customers who do not pay in full on credit cards in June 2020

In January 2021, Banco de México (Banxico) published the Basic Indicators Report (RIB) on Credit Cards (CC) with data as of June 2020. The aim of the document is to monitor the terms and conditions of this type of lending. This report includes an analysis of the *comparable portfolio* of CCs, which excludes CCs that have no market conditions (cards granted to employees of the issuer are excluded), have payment problems (cards in arrears or delinquent) or have received any different treatment that alters their original granting conditions (restructured cards).

Overall, the balance of CCs represented 37.0% of the total consumer lending balance as of June 2020. The total balance of the CC portfolio fell 9.8% in real terms compared to June 2019. The delinquency rate (IMOR) for CCs (5.4%) showed a slight worsening from June 2019 (5.2%). However, the IMORA (Adjusted IMOR) showed a marked deterioration. To June 2020 this index stood at 17.1%, compared to 15.5% in June 2019. This deterioration could reflect the impact of the pandemic on the quality of the CC lending portfolio in the first half of 2020.

Similarly, in June 2020 there were 25.7 million cards with a balance of MXN 346.1 billion, of which 75.1% of the cards (19.3 million) and 92.4% of the balance (MXN 319.9 billion) corresponded to cards included in the comparable portfolio. This portfolio is made up of two groups of customers: i) customers who pay in full (customers who pay their entire balance by the cut-off date); and ii) customers who do not pay in full (customers who pay a portion of the outstanding balance).

In June 2020, the percentages of the number and balance of credit cards included in the comparable portfolio accounted for by customers who do not pay in full (45.4% of cards and 70.5% of the balance) were lower than in the same month of 2019 (48.8% of cards; 72.1% of the balance); indicating an increase in the number of cards and balance accounted for by customers who pay in full compared to the same month of 2019. The weighted average effective interest rate (TEPP) of the total comparable portfolio in June 2020 was 24.3%, below the rate recorded in the same month of 2019 (25.8%). In particular, the TEPP of customers who do not pay in full fell from 35.9% in June 2019 to 34.5% in June 2020.

The comparable payroll loan portfolio showed an annual contraction of 18.1% in June 2020

Similarly, Banxico published the Basic Indicators Report (RIB) for Payroll Loans in the first month of 2021, which contains data up to June 2020. The report contains indicators of the payroll loan offer that allows for a comparison between the conditions under which the loans are granted. In June 2020, the total number of payroll loans stood at 4.8 million and the total balance of the loans was MXN 256.1 billion, representing a real annual fall of 2.0% from June 2019. Also, the payroll loan balance represented 25.2% of the total credit balance granted to consumption. The IMOR for this type of loan was 2.7% in the reference period, that is, there was a reduction from 2.9% in June 2019. As for IMORA, in June 2020 it reached 10.7%, up from 10.2% in the same month of 2019.

Like the CC report, there is an analysis of the offer terms and conditions of comparable payroll loans. This involves forming the *comparable portfolio* which excludes loans granted to employees of the issuer, those in arrears or delinquent, those that involve collateral when taken out and those that were contracted interest-free or for less than two months.

The RIB indicates that the comparable payroll loan portfolio of June 2020 consisted of just over 3.5 million loans (74.0% of the total number of loans on that date) and the balance of these amounted to MXN 182.7 billion (71.3% of the total balance). This shows a 18.1% fall in the number of loans and a 24.4% real decrease in the balance of comparable payroll loans as compared to June 2019. The average term and interest rates of the total comparable payroll loans were 49 months and 25.4% respectively, while in June 2019 the term (47 months) and the average interest rate (24.5%) were lower.

Of the comparable loans, 1.8 million were granted in the last year (July 2019 to June 2020), 26.2% fewer than the number of comparable payroll loans granted in the previous year (July 2018 to June 2019); and their balance was MXN 115.5 billion, a real 30.3% fall from those taken out from July 2018 to June 2019. The comparable portfolio granted in the last year is split into: i) loans up to MXN 40,000; and ii) loans of more than MXN 40,000. In June 2020, 17.2% of the payroll loan balance was accounted for by customers from the first category and the remaining 82.2% by customers from the second category; as a result, these percentages showed a higher concentration of customers from the second category compared to those registered in June 2019: first category, 21.1%; second category, 78.9%.

In general, the RIB data indicate a sharp contraction in the granting of payroll loans, with loans in the first category (loans of up to MXN 40,000) suffering the greatest contraction from July 2019 to June 2020 (-43.3 real) compared to the previous year.

The balance of the comparable personal loan portfolio registered a real annual fall of 9.2% in February 2020

Banxico also updated its Basic Indicators Report (RIB) on Personal Loans with data up to February 2020. Under the same principle as the RIBs for credit cards and payroll loans, the indicators allow for the comparison of the offer terms and conditions for these loans. The *comparable portfolio* for these loans excludes loans that are delinquent, restructured or granted to former bank employees, those not denominated in the domestic currency, those that required the invoice of a good as collateral and loans that are interest-free or reported an original amount greater than MXN 1 million.

In February 2020, the total number of personal loans was 14.2 million, with a total balance of MXN 242.9 billion, reflecting a real annual fall of 5.8%. In the reference period, the personal loan balance represented 20.1% of the total lending balance granted to consumption. The IMOR of this type of loan was 6.7%, higher than in February 2019 (6.3%); moreover, the IMORA of February 2020 (16.5%) was higher than in 2019 (15.1%).

In addition, the comparable portfolio of personal loans consisted of just under 8.5 million loans (59.9% of the total number of loans at that date). Their balance amounted to MXN 138.7 billion (87.1% of the total balance) as at February 2020, representing a real fall of 9.2% compared to February 2019. The average personal loan amount granted per customer in February 2020 was MXN 24,239, which was 11.0% lower in real terms than the average amount granted in the same month of 2019.

Of the comparable loans, 6.6 million of them were granted in the last year (March 2019 to February 2020). The balance of these comparable loans granted in the last year was MXN 89,139 billion (representing 64.3% of the total comparable personal loans balance on that date). The comparable portfolio for the last year has three segments: a) amount less than MXN 5,000; b) original amount between MXN 5,000 and MXN 30,000; and c) amount greater than MXN 30,000. In February 2020, 6.0% of this balance of personal loans was accounted for by customers in the first category, 28.4% by customers in the second category and the remaining 65.6% by customers in the third category; showing an increase in the concentration in customers in the second category compared to those registered in June 2019 (24.7%).

Housing construction projects fell by 3.2% in 2020

According to data from the National Housing Register (RUV), the number of registrations for building houses fell by 3.2% in annualized figures at the end of 2020. However, it is important to note that the biggest impact of the pandemic occurred during the first nine months of the year, with an average contraction of 21.2%.

While there was lower activity than in 2019 throughout the year, in the fourth quarter of 2020 there was a slight rebound in the number of projects. Between October and December, 44,744 were added to the platform; this is an increase of 6.4% over the same period in 2019. This slight progress in the latter part of 2020 was due to a steady decline in the stock of new homes. While in 2019, the production of houses stood at a total of 181,000 units, in 2020 the figure was 158,000, representing a fall of 13.0% in annualized figures.

Building firms correctly anticipating a contraction in demand as a result of the pandemic led to there being fewer projects, giving the market the opportunity to absorb the production from 2019.

As a result, we believe that the rebound in house-building projects is favorable, as it arises in response to a lower stock level, which also reflects the health of the portfolio balance for housing developers. According to Banxico data, the current balance of bridge loans for house construction grew by an average of 5.0% in real terms in 2020, while the past due portfolio fell by 37%. As a result, portfolio delinquency has remained stable and in December stood at 1.3%.

However, in order to consolidate the revival of the market, employment needs to accelerate its recovery, particularly in the segments earning less than 5 times the minimum wage. In the lending market, the conditions are ripe for taking on more mortgage lending and lending for construction.

Differences between sectors in credit and debit card expenditure patterns

On January 13, the National Commission for the Protection and Defense of Users of Financial Services (CONDUSEF), based on information from Banxico, presented the results of the evolution of debit and credit card purchases by expenditure category at the end of 2020. The amount of expenditure shows a fall in annual terms in the period from April to July 2020 for cards as a whole, with nominal growth of just 0.1% and a total amount of MXN 2.56 trillion at the end of the year.

Debit card expenditure showed nominal growth from July after contracting 14.2% in April, 5.2% in May and 3.4% in June, to close the year with nominal growth of 6.0% and total spending of MXN 1.59 trillion. In contrast, monthly credit card spending contracted year-on-year until year-end, showing a nominal 8.3% contraction and a total expenditure of MXN 0.96 trillion.

Of the 29 expenditure category headings, 11 showed a nominal increase in the amount of card expenditure, while 18 showed a decrease in the amount. The strongest contractions occurred in the travel agencies and air transportation headings, with contractions of 60.8% and 48.3%, respectively, largely a result of the restrictions on the mobility of people during the pandemic, followed by day-care centers, restaurants and hotels, which showed contractions in the total amount of expenditure on cards of 45.3%, 43.2% and 40.6%.

In contrast, it should be noted that essential activities, as well as those related to health and telecommunications, increased during the period. For telecommunications, the annual growth rate of nominal expenditure was 10.3%, while for doctors and dentists, hospitals and pharmacies the growth rates were 4.3%, 9.0%, and 26.6%, respectively.

According to our analysis, the greatest impact of the health crisis has been seen in the sectors related to leisure and tourism, as well as in the subsectors of activity linked to the mobility of people. It is expected that aggregators (payment apps), with 39.6% growth, as well as activities in the health services and mass media subsectors, mentioned above, will see an increase in demand due to the change in consumer preferences toward teleworking and home entertainment, along with an emphasis on health care.

2. Financial markets

Volatility in the stock markets put a halt to optimism at the end of January. The exchange rate closed above 20.5 pesos per dollar

During January, the rebound in cases and deaths from the second wave of COVID-19 resulted in economic figures pointing to a short-term slowdown in economic recovery. In the US, December retail sales figures and January unemployment claims figures showed the weakness of the services sector and the labor market, while in Europe the economic indicators point to a possible new recession.

In this context, January involved two different phases in the financial markets. The first, which covered the first three weeks of the year, was characterized by renewed optimism about the economic recovery, helped by the Democrats achieving a majority in the US senate and Joe Biden's inauguration. As a result, market participants positioned themselves according to the so-called "reflation trade," which implies expectations of higher overall growth and inflation supported by significant short-term fiscal stimuli.

The second stage, from January 22 to 29, was characterized by high volatility leading to a significant fall in the price of risk assets. On balance, however, the narrative of medium-term economic recovery can be expected to continue dominating in investor decisions despite the short-term deterioration.

In the stock markets, the reflation trade led to further increases in the indexes, with some bias toward low-cap stocks. Thus, during the first three weeks of January, the Russell 2000 Index, which groups together the small- and mid-cap stocks of the North American market, registered growth of 9.8%, higher than the growth of 2.3% and 5.1% in the S&P500 and the NASDAQ indexes, respectively. This rise in the Russell 2000 Index was also higher than the 2.4% growth of the global equity benchmark (MSCI World) and the 7.8% growth rate of emerging markets (MSCI EM).

However, during the last week of the month, the mood among market participants became more negative in the face of growing doubts that the Biden administration could obtain approval for a new fiscal support package close to its proposal of USD 1.9 trillion. In addition, downward movements in the prices of risk assets were exacerbated by the volatility resulting from the collective action, through social media, of numerous retail investors in favor of some shares in the US market characterized by their large short positions. This prompted some Hedge Funds to record significant losses and feedback the volatility by selling positions in other companies to meet the margin calls and buy the stocks in which they held short positions (short squeeze).

In this way, during the last week of the month, virtually all stock market indexes registered losses which were so large that for January as a whole the MSCI World fell by 1.0% and the S&P500 by 1.1%. The NASDAQ managed to maintain gains of 1.4%, while the Russell 2000 and MSCI EM managed to hold on to gains of 5.0% and 3.0%, respectively. The Mexican Stock Index diverged in a negative way, with a fall of 2.4%.

In the fixed income market, the first three weeks of the year were characterized by generalized increases in long-term interest rates consistent with the expectation of higher growth and inflation. In particular, the yield on maturity of the 10-year Treasury bond (T10) rose 17 basis points (bp), while in Mexico, the yield on maturity of the 10-year Mbono (M10) rose by 7bp. In the last week of the month the T10 and M10 fell two and one basis points, respectively. The cut in the Mexican long rate occurred despite a 13bp increase in sovereign risk (CDS spread 5Y).

In the commodity market, there was only a slowdown in price increases during the last week of January, so the benchmark for this class of assets (SPGSCI Index) grew by 5.3% in January. In particular, the price of Brent oil rose 7.9%, while that of Mexican mix exceeded USD 50.0 per barrel for the first time since January 2020, after registering an 8.5% increase during the first month of the year. However, the fact that gold saw a continuous fall during the month which stood at 2.5% could indicate that the volatility seen at the end of January has not overshadowed expectations of a vigorous recovery in the medium term.

Finally, in the exchange market, the narrative of the dollar's weakness was questioned by a strength that was heightened during the last week of January. The dollar appreciated 0.8% against the developed currencies in January, while gains were 1.5% against the emerging market currencies for the same period. Within this group, the Mexican peso stood out for performing differently, in a negative way, with a depreciation of 3.3% (3.0% during the last week), which made it the fourth most depreciated currency during the first month of 2021. With this depreciation the exchange rate closed January at 20.57 pesos per dollar, a level not seen since November 12.

The slowdown in global economic growth during the last quarter of 2020 and the beginning of 2021, as a result of the second wave of contagion, does not seem to be jeopardizing the narrative of medium-term economic recovery that, together with the expectation of low rates for a long time, have underpinned the prices of risk assets. As 2021 progresses, these strong expectations will have to materialize, so market movements will be particularly sensitive to progress with vaccinations and the early passage of the anticipated US fiscal stimulus package. The foundation for the recovery in the second half of the year will have to begin to be built with figures in the short term.