Banking

Monthly Report on Banking and the Financial System

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1. Banking and the Financial System

At the end of 2020, non-financial private sector credit contracted again in nominal terms

In December 2020, the balance of performing loans granted by commercial banks to the non-financial private sector registered a nominal annual decline for the second consecutive month, which was -1.2% (-4.2% real), higher than the decline registered in the previous month (of -0.8%). With the result of the last month of the year, private sector credit averaged nominal annual growth of 4.7% in 2020, the lowest growth observed since 2010 (when nominal growth averaged 3.1%). The performance of both consumer loans and business loans continued to deteriorate, while mortgage loans managed to maintain their growth rate. The 1.2% annual reduction observed in December was the result of the annual rate contractions of -2.0 percentage points (pp) in the consumer loan portfolio and -0.8 pp in the business loan portfolio. They were partially offset by the 1.7 pp contribution from the mortgage loan portfolio.

At the end of 2020, conditions that could trigger increased demand for financing did not improve. Lockdown measures and restrictions on various economic activities contributed to slowing recovery in lending. In particular, business loans continued to lose momentum due to lower corporate sales revenues and prolonged weak investment. The lack of certainty about restoring a more continuous flow of income in the short and medium term may be conducive to greater caution both in taking and granting more funding. In addition to this, there are no visible actions that will provide greater certainty for investment, so companies are unlikely to be willing to make medium- and long-term commitments to finance new projects.

The slowdown in private consumption, as a result of job losses, lower household incomes, and increased caution in spending due to uncertainty, has been reflected in a sharp loss of dynamism in the granting of consumer loans. The longer it takes to reactivate economic activity and formal job generation, and thus recover household income flows, the more the contraction in the various loan segments is expected to continue to deepen and draw out. In this scenario, there would be negative effects not only on new lending, but also on the quality of the portfolio.

In 2020, bank deposits registered unusual performance within a recessive environment

Deposits were the banking intermediation component whose trend changed the most as a result of the pandemic. Last March marked the start of the continuous increase of this component, which closed 2020 with 10 consecutive months of nominal double-digit annual growth rates, which would have been considered unthinkable in light of the 8.5% fall in

GDP. This unexpected performance could be explained mainly by the heterogeneous distribution of the increase in unemployment as a result of the economic shock, the restrictions on consumption resulting from the pandemic and the preference for liquidity of both individuals and companies. The dynamics of deposits in the coming months will depend largely on pandemic control and the revival of consumption. One of the main questions for 2021 is whether these accumulated balances in the demand accounts, particularly of individuals, could give a direct boost to the economy once confidence gradually returns to consumers as the pandemic is controlled. In any case, if the expectation of a successful vaccination process in 2021 materializes, recent trends in deposits are likely to reverse.

The year 2020 was certainly unusual in bank deposits. Traditional deposits (Demand + Term) recorded an average annual growth rate of 11.3%, the highest since 2017. The unusual part is that, for the first time on record (2007), traditional deposits reached an average annual growth rate of over 10.6%, even though term deposits (35% of traditional deposits) grew, on average, less than 5.0% at the annual rate during the year. This was possible thanks to a historical peak in the average annual growth of demand deposits (15.8%). In turn, this resulted in a historical peak in the average annual growth of deposits in the individuals segment, which was 19.0%. This figure is five percentage points higher than the previous peak in 2015. Behind this unusual behavior of 2020 were the reactions of households and businesses to an extraordinary event such as the pandemic. In previous recessions (for example, the Great Recession of 2008–2009), the combination of a reduction in short-term interest rates, exacerbated by the fall in employment and economic activity, had brought with them a sharp drop in term deposits in favor of demand deposits. However, in that case, the immediate stimulus to deposits after the shock (Lehman Brothers bankruptcy, September 2008) came from the non-financial public sector and other financial intermediaries.

In the fourth quarter of 2020 (4Q20), the percentage of companies using some type of financing declined

Banxico published the results of the quarterly credit market assessment survey for the last quarter of 2020 (4Q20). In this quarter, 82.9% of companies obtained some kind of financing, a lower percentage than in 3Q20 (84.6%) and 4Q19 (85.4%). As for the sources of such financing, some remained unchanged from the previous quarter: 77.1% of the companies that reported receiving financing from suppliers were maintained, 19.5% obtained it from their corporate group or parent company, and 4.2% received it from development banking. Among the sources of financing that showed a decrease were commercial banking (the percentage of companies that obtained financing from this source fell from 31.4% in 3Q20 to 27.1% in 4Q20) and debt issuance (3.30% to 0.5% in the comparison period). The only source that registered an increase was banking abroad, as the percentage of companies that claimed to obtain credit by this route was 5.0%, slightly higher than the 4.5% recorded in 3Q20.

Within the bank credit market, it is notable that 43.9% of companies reported having bank indebtedness at the beginning of 4Q20, down from the previous quarter (46.9%) and the same quarter of 2019 (48.6%). 16.8% of companies used new bank credit in 4Q20, down from 19% reported in the previous quarter. With regard to the purpose of the bank financing, a decrease was reported in the percentage of companies that used the resources to finance working capital (from 76% in 3Q20 to 69.2% 4Q20), while the percentage of companies that used bank lending to refinance liabilities increased (from 15.4% to 18.5% in the same comparison period). Companies that used new bank credit in 4Q20 reported having faced less favorable conditions than in the previous quarter for: i) interest rates, ii) amounts and terms offered iii) commissions and other expenses, iv) conditions for refinancing loans, v) credit approval times, and vi) collateral requirements.

The percentage of households that chose to stop paying their debts or credit cards went from 18% to 30% between May and October 2020

The Research Institute for Sustainable Development and Social Equity (IIDSES) of the *Universidad Iberoamericana* (Ibero-American University) through the *Encuesta de Seguimiento de los Efectos del COVID-19 en el Bienestar de los Hogares Mexicanos* ('Follow-up survey on the effects of COVID-19 on the welfare of Mexican households,' or ENCOVID19) presented the results of the data collected on employment, income, mental health and access to food for Mexican households at national level in October 2020. In this respect, ENCOVID19 showed a continuous decline in the unemployment rate[1] from its highest level in May 2020 (15.5%) to October (6.6%). However, households at low socioeconomic levels still had a two-digit unemployment rate (11.0%) in October, compared to medium (7.0%) and high (2.0%) levels. Additionally, the percentage of households reporting a reduction in income with respect to February 2020 (pre-pandemic levels) was 60.0% in October, very similar to the percentage reported in April (61.2%).

In this context, ENCOVID19 revealed some of the strategies that households have used in light of reduced incomes as well as the evolution of these strategies over six months. The percentage of households that chose to stop paying their debts or credit cards went from 18.0% to 30.0% between May and October. Furthermore, in the same period, the percentage of households that resorted to borrowing from acquaintances increased from 24.0 to 37.0%. The increase in these strategies by households is a sign that household incomes are still below their pre-pandemic levels.

Total financial savings increased by 6.4% year on year in real terms during the third quarter of 2020, while total financing expanded at a rate of 4.9%

The National Banking and Securities Commission (CNBV) has published its *Ahorro Financiero y Financiamiento en México* ('Financial savings and financing in Mexico') report with information as of September 2020 (3Q20). Over that period, there was an 6.4% real annual increase in total financial savings – defined as the aggregate balance of deposits of financial intermediaries, the holding of fixed income securities and trust stock certificates, and the foreign funds intermediated through the Mexican financial system – to an equivalent of 111.7% of GDP.

The domestic component of financial savings showed real annual growth of 5.6% and was equivalent to 78.9% of GDP. At a more detailed level, deposits of financial intermediaries (banks, savings and loans cooperatives (SOCAPs), popular finance companies (SOFIPOs), credit unions and development agencies and bodies) registered a real annual change of 5.5% in September 2020 to an equivalent of 39.0% of GDP. Most of the funds obtained in 3Q20 are concentrated within commercial banks (25.3% of GDP), followed by Mexican federal institute for worker's housing [Infonavit] (5.7% of GDP) and development banking (3.7% of GDP).

Foreign savings, meanwhile, showed real annual growth of 8.5% and represented 32.9% of GDP in 3Q20. Foreign savings received by the public sector amounted to 21.5% of GDP and that received by the private sector to 11.4%. The balance consisted of securities issued in Mexico held by non-residents (9.1% of GDP), securities issued abroad (15.5% of GDP) and loans obtained abroad (8.3% of GDP).

1: The definition of unemployment in ENCOVID19 includes an economically active population of 18 years or older that is unemployed, furloughed without pay or cannot go out to seek work because of the pandemic.

As for total financing, defined as the aggregate balance of the loan portfolio granted by Mexican-resident financial intermediaries to the private and public sectors, the outstanding debt in the domestic securities market, and foreign funds received in 3Q20 grew at a real annual growth rate of 4.9%, equivalent to 110.8% of GDP.

Domestic financing showed a real annual change of 1.4% and represented 87.0% of GDP in 3Q20. Domestic financing to the private sector equated to 40.7% of GDP. The main source of domestic financing in the private sector was credit from commercial banks (20.5% of GDP), while in the public sector the main source of domestic financing was from the placement of securities (42.6% of GDP).

In terms of foreign financing (of the private and public sectors) in 3Q20, this reached 23.8% of GDP and showed a real annual increase of 20.1%. Between September 2019 and September 2020, the balance of foreign financing to the private sector grew at a real annual rate of 15.6% and reached the equivalent of 10.9% of GDP, while foreign financing to the public sector rose by 24.1%, accounting for 12.9% of GDP.

Housing prices rose by 5.4% in 4Q20

On February 15, Federal Mortgage Company (SHF) published data on the Housing Price Index for the fourth quarter of 2020. As mentioned in previous reports, the contraction in demand for mortgage loans would be reflected in lower appreciation rates during 2020, resulting in rates close to 5.0% at the end of the year.

In the fourth quarter of 2020, housing prices increased 5.4% at the national level compared to the same quarter of the previous year. In cumulative figures for the whole year, appreciation was 5.8%. While a slowdown occurred during 2020, the contraction in demand for mortgage loans was not as severe as expected. Thus, housing appreciation may already have reached its turning point and could regain a moderate acceleration during 2021.

At the segment level, the price sub-index corresponding to low-cost housing increased by 6.2%; while middle-income housing grew by 5.6%, both in accumulated figures for 2020. On the other hand, for metropolitan areas, the highest appreciation rates in 2020 were recorded in the metropolitan areas of Guadalajara and Tijuana, with rates of 8.1%. In turn, the metropolitan areas of Monterrey and Puebla-Tlaxcala had price increases of 7.1%, while León and Querétaro recorded rates of 6.9% and 6.0% respectively. Finally, housing prices in the metropolitan areas of Toluca and Valle de México increased 5.5% and 2.7% respectively.

The combination of the slowdown in housing prices and historically low levels of mortgage interest rates during 2020 provided a good incentive to acquire mortgage financing. Thus, the impact of the economic crisis on this market was less significant than during the 2009–2010 crisis. However, the path to recovery will depend on the time it takes for formal employment to recover, especially among the top earners, which is the backbone of the banking sector.

2. Financial markets

Risk asset prices hit as long-term interest rates surge. The peso closes February at its weakest level of the year

During February, rising real long-term interest rates and expectations of inflation were incorporated into the narrative of economic recovery in the financial markets.

Since last November, when the results of the effectiveness of the Pfizer-BioNtech vaccine were released, market participants pushed forward a rapid economic recovery, supported by fiscal and monetary stimuli. While inflationary risk had been part of the conversation, it was considered to have a low probability, albeit with a significant expected loss, given its possible adverse effect on monetary easing and asset valuation.

By the second half of February, assumptions about the likelihood of this risk changed. January economic activity data in the US was significantly above expectations (e.g. retail sales came at 5.0% MoM, four times higher than market consensus) as a result of the progress of vaccinations and the stimulus cheques received at the end of December. This added to the narrative's assumption of rapid economic recovery, which was reflected in quarterly growth expectations of 3.8% on average for the first quarter of the year.

However, considering that the equivalent of 9.0% of GDP will be added to this robust growth at the beginning of the year through another fiscal stimulus, which is already pending approval in Congress, inflation expectations spiked in all its terms and, in particular, real interest rates increased significantly. As shown, the real Treasury bond rate has increased by 23 basis points (bp) since the end of January. As a result, the 10-year Treasury bond yield was 1.6% on February 25, its highest level in one year and an increase of 44 bp with respect to the end of January. Though during the last week of the month, the Fed Chairman reiterated his intention to keep rates low for an extended period time, the fact is that the market narrative seems to have changed toward a vigorous recovery accompanied by an increase in prices. However, this is seen as a symptom of a positive reflation of the global economy.

This inclusion in the narrative of higher-than-expected inflation and interest rates adversely influenced equity prices during the second half of February. Among the most affected indices was the Nasdaq 100, which fell 6.4% during the second half of February. The tech business sector is highly sensitive to interest-rate movements, in part because it is estimated that most of their profits will be achieved several periods in the future, in addition to the record prices they have reached.

After the Nasdaq, the most significant declines in the second half of the month were for the emerging markets benchmark (MSCI EM) with a fall of 6.3%, followed by the Russell 2000 (-3.9%), the S&P500 (-3.1%) and the EuroStoxx 6000 (-2.2%). The Mexican stock market managed to maintain a slight gain of 0.88%. It should be noted that, despite these declines during the second half of February, considering the month as a whole, all the above indices showed progress: Russell 2000 (+6.1%), CPI (+3.7%), S&P500 (+2.6%), EuroStoxx 600 (+2.3%), Nasdaq 100 (+0.9%) and MSCI EM (+0.7%).

The aforementioned increase in interest rates accentuated the attractiveness of the US dollar among investors. The dollar appreciated 0.3% against developed currencies in February, while appreciation against emerging-markets currencies was 0.5%. The Mexican peso depreciated 1.4% against the dollar, making it the sixth most depreciated currency among emerging market currencies during the second month of the year. The exchange rate thus stood at 20.9 pesos per dollar at the end of February, its lowest level in 2021, after a 4.5% weakening of the peso during the second half of the month. It cannot be ruled out that this negative performance of the Mexican peso has been influenced by the proposal and subsequent approval in the lower House of the reform on the electrical industry.

In the domestic fixed income market, long-term rates also rallied, influenced by movements in the US Treasury curve. The yield on the 10-year Mbono increased 65 bp, to close February at 6.3%, its highest level since last November. This rise occurred while sovereign risk, measured by the 5-year CDS, registered a marginal increase of 12 bp during the month. It should be noted that the entire change in the 10-year Mbono took place during the second half of February. This shift in the long part of the curve, along with the depreciation of the exchange rate, was reflected in a further reduction in foreign holdings of Mbonos, which stood at USD 600 million during the first eleven days of February (latest information available).

Commodities also registered a significant increase in February and fueled inflationary expectations. The benchmark for this asset class increased by 10.7% in February, and stands already above the pre-pandemic level. Behind this indicator, the price of oil was one of the components with significant increases, given the expectation of higher demand this year. The Brent rose 18.3% during the second month of 2021, while the Mexican mix closed at USD 60.0 per barrel, a monthly increase of 19.0%. With this, the Mexican mix is already at a higher price than that the one recorded in January 2020.

At present, the narrative of market shifts consists of three main ideas. The first is that the end of the pandemic is closer, which will result in a faster and more robust economic recovery from vaccinations and the release of "pent-up" consumer demand. Second, the recent increase in inflation expectations is far from being a factor that would jeopardize the scenario of short-term rates at extraordinarily low levels for an extended period of time. Third, the rise in real and nominal interest rates reflects a positive symptom of a global reflation that, for the time being, does not put the economic recovery at risk.

This narrative will be modified to the extent that these assumptions are validated or not in the coming months. Whatever the case, the elements that had remained absent were already added to the narrative in February, and asset prices are likely to be particularly sensitive to economic data and FED's wording around them.

3. Regulation

Financial authorities and credit institutions announce a support program for migrants and their families

On February 8, the Ministry of Finance, the National Banking and Securities Commission (CNBV), the Bank of Mexico (Banxico), and the Mexican Banking Association (ABM) announced a support and banking program for migrants and their families, with the aim of giving them access to better exchange rates, as well as reducing the costs, time and risks of cash transactions.

Through the *Banco del Bienestar*, banking services will be provided to migrants in the US and their families in Mexico through the remote opening of accounts, which can be done using their Mexican consular registration card or passport.

For its part, the following actions that Banxico will carry out are notable:

1. Development of a platform that allows banks to verify the identity of migrants and mitigate money laundering risks;
2. Provision of resources to banks with proven difficulties in repatriating dollars, in order to prevent their purchases from being rejected and affecting their users;
3. Development of a website and information app for migrants, on financial products and solutions according to their needs;
4. Regulating the issuance of pre-paid cards in pesos for people entering the national territory, and
5. Issuance of rules by commercial banks to expedite the acceptance of foreign currency seized by the State, complying with the requirements of their correspondents abroad.

For its part, the ABM undertook to submit to the financial authorities a request to establish new N2 accounts for migrants, opened remotely through a Mexican consular registration card or passport, without commissions and offering the best exchange rate available to preferred clients. In addition, it will present a financial education program for migrants, which will be disseminated through consulates, as well as a plan to increase geographic coverage in underserved municipalities.

The Committee on Banking Liquidity Regulation extends support measures to the banking industry

The Committee extended (until September 1, 2021) the validity of the exceptions to the Joint Liquidity Rules issued on April 14, 2020, providing an additional six months for it to be phased out, considering that elements of uncertainty associated with the pandemic persist, and that the exceptions have contributed to the orderly functioning of the markets.

Banxico: extension of the validity of banking support measures

On February 26, the Bank of Mexico issued Circular 1/2021 which extends the validity of the following rules until September 30, 2021:

1. Rules applicable to financing granted by the Bank of Mexico to cover ordinary additional liquidity needs (Circular 15/2020);
2. Rules applicable to securities lending operations with the Bank of Mexico to improve liquidity (Circular 16/2020);
3. Rules applicable to repurchasing government securities with the Bank of Mexico in order to cover liquidity needs (Circular 17/2020);
4. Rules applicable to repurchasing corporate securities with the Bank of Mexico in order to cover liquidity needs (Circular 18/2020);
5. Rules applicable to the provision of resources to credit institutions in order to channel credit to micro, small and medium-sized enterprises and to individuals (Circular 20/2020);
6. Rules applicable to Bank of Mexico financing guaranteed by the bank's qualified credit assets, to be channeled to micro, small and medium-sized enterprises (Circular 25/2020).

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