Banking

Monthly Report on Banking and the Financial System

Iván Martínez Urquijo / Mariana A. Torán / Gerónimo Ugarte Bedwell / Alfonso Gurza / Crista B. Pérez

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1. Banking and the financial system

Bank credit to the private sector contracted 2.0% in February due to the performance of the consumer and business portfolios

In February 2021, the nominal balance of performing loans granted by commercial banking to the non-financial private sector (NFPS) fell 2.0%. The annual rate reduction in nominal balances was greater than in January, when it presented a nominal contraction of 1.3%, accentuating the downward trend observed since May 2020. The decline in activity at the end of 2020 and January 2021 created an environment of contraction in credit demand that explains the contraction in balances.

The annual nominal changes in the credit aggregates that make up the country's NFPS, were as follows: consumption, -10.3% (compared to -9.6% of the previous month) and 4.8% of February 2020); housing, 8.4% (8.6% in the previous month and 10.5% in February 2020); and business, -2.3% (-1.4% in the previous month and 4.1% in February 2019). During February 2021, contributions to the contraction of (-)2.0 percentage points (pp) of bank credit to the NFPS were (in descending order): housing, 1.7 pp; business, -1.3 pp; and consumption, -2.4 pp.

The depreciation of the peso during February 2021 mitigated the decline in the performing foreign currency business portfolio balances during the period. Expressed in pesos, this portfolio showed a nominal change of -9.6% (-8.5% in the previous month and 7.5% in February 2020), while in dollars, it was equivalent to -14.6% (-14.5% in the previous month and 4.5% in February 2020). In turn, nominal balances in domestic currency fell (-)0.1% in February (after having grown 0.7% in the previous month and 3.0% in February 2020), the first month in negative territory since February 2010.

The performance of bank deposits shows that the demand for liquidity remains

Traditional bank deposits (demand + term) continued to grow in February, supported by the demand segment and despite the fall in the balance of term deposits over the last ten months. However, within demand deposits, variations emerged in terms of their sources of growth. The engine of this segment—individuals' deposits—had its biggest monthly decline since last August, while, businesses' deposits registered an unusual growth for a month of February. However, it was not enough to avoid a monthly reduction in private sector deposits. The factor that most compensated for this reduction was the double-digit monthly growth of public sector deposits, which could be associated with the next electoral process.

In terms of annual growth, rates maintained double-digit levels as a result of the increase in demand for liquidity for prudential reasons that was observed at the start of the pandemic. In particular, in February the nominal annual growth rate of traditional deposits (demand + term) was 10.0% (6.0% real). This represents a slowdown compared to the figure of the previous month) (when it registered a nominal growth of 11.2%). In addition, performance was well above the one observed in February 2020, when it grew 5.9%. This high growth reflects liquidity needs and the weakness of consumption in light of uncertainty regarding the evolution of the pandemic and its adverse effects on the economy.

Similar to the figures observed in recent months, demand deposits contributed 11.4 percentage points (pp) to the 10.0% nominal growth of traditional deposits, while term deposits subtracted (-)1.4 pp from such growth. This implies an additional restructuring of traditional bank deposits toward demand deposits that has been accentuated since October 2019 and is reflected in an increase of 59.4% to 64.9% in demand deposits' share of traditional deposits. In addition, deposits in Debt Investment Funds (FIDS) continued to decelerate at an annual rate, influenced by a possible restructuring of savings toward relatively more liquid instruments.

CESF Annual Report

The Financial System Stability Council (CESF) presented its annual report in which it reiterated that the Mexican banking system as a whole showed sufficient capital and liquidity levels above the regulatory minimum.

In its analysis of the solvency of the banking system, CESF noted that at the end of 2020 the Mexican Banking Capitalization Ratio (ICAP for its acronym in Spanish) of the system stood at 17.7%, a growth of 212 bp compared to 2017, and all banks met the minimum required ICAP. The increase in this indicator during 2020 was due to three factors. Firstly, earnings which, although lower than the previous year, were positive. Secondly, the regulator's recommendation to not pay dividends. Thirdly, the low annual growth of 1.2% of risk-weighted assets (RWAs) in light of the restructuring in favor of government credit and increased investment of resources in government bonds. This restructuring of RWAs resulted in the ratio of risk-weighted assets as a proportion of total weighted assets falling to 60.4%. Previously, it had been between 63.5% and 68.0% in the period from 2017 to 2019.

With regard to credit risk, the analysis of the report reflects a decline in the commercial portfolio (-3.1% y/y) and revolving consumer portfolio (-9.6% y/y) in favor of credit and government debt, with the latter increasing from representing 26.9% of the portfolio at the end of 2019 to 31.1% at the end of 2020. As part of credit risk, already in the particular analysis of the bank's asset quality, the report points to the rebound in the delinquency rate (IMOR) and the Adjusted IMOR (IMORA) at the end of 2020. Based on the analysis of the number of credits that are 30 days or more overdue, the CESF concluded that this increase in the IMOR is explained by the decrease in the number of total credits and not just by the increase in non-performing ones.

In fact, it confirmed that the Special Accounting Standards Program implemented by the financial authorities helped to stop the rise in delinquency, as its 30-day overdue credit indicator for the total portfolio ended 27.0% below that registered at the start of the pandemic in April 2020. In addition, performing loans accounted for 94% of the total portfolio balance and 88.0% of the total number of loans. It should be noted that by type of portfolio, the only segment with a different behavior was that of SMEs, which recorded a 23.0% increase in the number of loans 30 days or more overdue at the end of 2020.

A significant element that mitigated credit risk was the reorganization of the loan portfolio, which recorded a significant increase during 2020. Reflecting this dynamic, the ratio of reductions and write-offs to the average current portfolio for the non-revolving consumer portfolio rose from 8.6% at the end of 2019 to 9.2% at the end of 2020. In the case of the revolving consumer portfolio, this ratio closed at 13.6% last year. Another indicator for analyzing this dynamic is the indicator of preventive reserves created to deal with the reductions and write-offs of the next twelve months. This indicator, which also increased, seeks to determine the number of months (years) in the future that preventive reserves will cover the expenditure on reductions and write-offs.

For the revolving consumer portfolio, at the end of January 2020, preventive reserves covered approximately the next 11 months of reductions and write-offs carried out. This level is higher than the one observed in the last 15 months, and can be explained by the growth of reductions and write-offs in 2020. For its part, the non-revolving consumer portfolio indicator was at 0.87 years for reductions and write-offs for the coming twelve months in December 2019. In the case of the commercial portfolio, this indicator was 1.9 years in January 2020, a 1.2-year drop from the end of 2017. This is partly explained by an increase of 40.6% in the number of reductions and write-offs compared with the one observed during 2019. Finally, in the case of the housing portfolio, in January 2020, preventive reserves accounted for 1.41 times the reductions and write-offs of the subsequent 12 months. Though this figure remains above one, the decline from levels that were twice as high between March 2019 and January 2020 was notable. This was the result of a 53.0% increase in the number of reductions and write-offs between December 2019 and 2020.

To close the credit risk analysis, the CESF highlighted the slight improvement in the probability of default between the start of the pandemic and the end of 2020 for most portfolios. Among the most notable was the housing portfolio, since in April 2020 58% of loans held a probability of default of up to 3.0%. At year-end, this percentage increased to 63.0%. The exception was the business loan portfolio, for which loans with a probability of default of up to 2.0% went from 80.0% to 69.0% between April and December 2020.

With regard to the liquidity risk of the banking system, the report focused on the review of funding sources and the Liquidity Coverage Ratio (LCR). It concluded that the banking system has adequate liquidity conditions. For the first topic, it emphasized that the banking system increased the proportion of stable financing during 2020 in light of increased precautionary saving and declining consumption by individuals and businesses. At the end of December last year, both demand and term deposits accounted for 67.4% of total bank financing, up 0.7% from December 2019.

Secured financing accounted for 17.1% of total financing, while market financing accounted for the remaining 15.5%. This restructuring of financing sources, coupled with lower interest rates globally, influenced a decline in funding costs in the banking industry. The increased holding of government securities by the bank and the extraordinary measures taken by the financial authorities as a result of the pandemic could influence an increase in the financing periods for repurchasing (secured financing). These types of transactions with a term of 15 to 30 days and over 30 days went from 8.5% at the end of 2019 to 23.3% of the total repurchases at the end of 2020. It should be noted that 96.7% of these transactions were carried out with government securities. In addition, between December 2019 and 2020, there was a 12.3% increase in the repurchases whose counterparty was the public sector authorities.

Regarding the second issue of liquidity analysis, the LCR, the report notes that as of December 2020, all commercial banking institutions had an average quarterly LCR of more than 100%, with a minimum of 113% and a median of 241%. This median compared favorably with the average LCR of 189% recorded in the 4Q of 2019.

Finally, with regard to market risk, the CESF noted that during 2020, assets subject to this type of risk increased by 5.4%, which is explained by nominal-rate transactions and foreign exchange transactions. In fact, throughout the past year, there was a gradual increase in the banking portfolio's debt instruments to the extent that, in December, 83.1% of the portfolio was invested in government instruments. It should be noted that within the debt portfolio of the banking system, securities with a maturity of up to one year increased from 29.1% to 33.8% of the total portfolio. However, the duration of the portfolio remained at 1.5 years at the end of 2020, a level similar to that of the end of 2019, in light of the purchase of medium-term bonds. Because of the latter, and supported by the Value at Risk (VaR) at 99% confidence, the CESF concluded that all banks in the system show acceptable levels of market risk.

Overspending promotes the use of informal financing, while having an account increases formal financing and credit card use

In the El Crédito en México: Productos, Instrumentos y Evolución [Credit in Mexico: Products, Instruments and Evolution] report of the National Banking and Securities Commission (CNBV), data from the 2012, 2015 and 2018 editions of the Mexican National Financial Inclusion Survey (ENIF) were presented in order to analyze the structures and determinants of the various types of financing in Mexico.

According to the document, the percentage of the adult population that received funding was 51.0% in 2012, while in 2018 it was 57.0%, an increase of 6 percentage points (pp). By source type, in the same period, the percentage of the adult population that obtained financing in informal instruments (instruments not regulated or supervised by any government entity) increased from 34% to 39%, an increase of 5 pp. With regard to financing in formal instruments, in 2018, the percentage of the adult population reporting this type of savings was 31.0%, which represented an increase of 4 pp over 2012.

The report includes an econometric model (Probit model) to identify socio-demographic determinants of access to financing. Specifically, the model was applied in three cases: informal possession of credit, formal possession, and the use of credit cards., The following were used as independent variables: number of years completed in school, age, being the head of the household, having formal employment, living in an urban location, being female, having a monthly income lower than (greater than or equal to) 5300 pesos, having a bank account, keeping a budget or record of income and expenses, overspending, making the household savings and spending decisions, having a formal loan, and having an informal loan. According to the report, the variable that has the greatest marginal effect on the probability of having financing in informal instruments is overspending (income not sufficient to cover expenses). In particular, overspending increases the probability of taking out informal financing by 21.4%.

With regard to the determinants of financing in formal instruments, having an account represents a 15.9% increase in the probability of financing through these instruments, while being formally employed increases it by 10.8%. In reference to the probability of using a credit card, being an accountholder increases it by 9.7%, while having an income greater than or equal to 5300 pesos raises it by 6.8%.

The report presents financing data by federal state in absolute figures and as a percentage of the adult population. For the use of total financing, Sinaloa (73.3%) and Sonora (71.1%) represent the highest proportions of the population, while Guanajuato (42.8%) and Hidalgo (49.4%) are the states with the lowest percentage of the population that has financing. In the case of informal instruments, Guerrero (55.7%) and Sonora (47.9%) top the list, with Guanajuato (27.5%) and San Luis Potosi (31.7%) having the lowest proportions of the population using informal financing. With regard to the formal instruments, Sinaloa (51.2%) and Coahuila (45.5%) constitute the highest proportions of use, while Chiapas (16.3%) and Morelos (20.6%) represent the lowest.

2. Financial markets

Reiterated accommodative stance by the Fed, economic data and corporate reports in line with expectations support risk assets.

The debate on the nature and magnitude of the US economy's price increase in an environment of globally differentiated economic recovery remains at the center of financial market movements.

For most of April, market participants seem to have been looking for an additional catalyst to justify the rapid increase in long-term interest rates observed over recent weeks, especially given the reiterated accommodative message from the Federal Reserve (the Fed) based on claims that the recovery of the labor market is still a long way away and that the expected increase in prices is of a transitory nature.

This, among other factors, was reflected in low trading volumes in stock markets at the beginning of the month, and especially in the reduction in long-term interest rate levels compared to the end of March, even with economic data pointing to the US economy growing close to 7.0% during 2021. Toward the end of April, the increase in COVID-19 cases in India and the difficulties with increasing the rate of vaccination in the US reminded market participants of the remaining underlying risks of economic recovery.

In this context, the yield at maturity of the 10-year Treasury bond fell 13 basis points in April. This was its first monthly decline of the year, following a growth of 83 basis points (bp) in the first three months of 2021. The Fed held the short part of the curve (2 years) anchored at 0.16 bp, which meant that the slope of the curve between the maturity of 2 and 20 years fell from 174 bp in March to 145 bp in April.

This fall in the long-term interest rate, coupled with a season of corporate reporting that mostly outperformed expectations, influenced further increases in stock markets. The S&P500 advanced 5.3% in April, bringing it to a new historic peak. The Nasdaq 100 recorded a 6.1% advance over the same period, which is consistent with the increased sensitivity to long-term interest-rate movements and, of course, with strong corporate results from most technology companies in the first quarter of the year.

For low-cap and more cycle-related companies (Russell 2000), this kind of impasse in reflation trade meant more modest growth of 3.8% in April. In Europe (Euro Stoxx 600) and for emerging markets (MSCI EM), growth in the fourth month of the year was less vigorous, 2.4% and 3.7%, respectively. In the case of the IPyC of the Mexican Stock Exchange, profits were 2.6%.

The commodity market is dominated by the narrative of the global demand recovery, reflected in the 8.0% growth in the benchmark of this type of assets (S&P GSCI) during April. Within the benchmark, the barrel of Brent oil rose 5.9%, while the Mexican mix increased by almost USD 3 per barrel to close April above USD 60 per barrel. Gold increased by 3.5%.

In Mexico, the rise in inflation above analysts' expectations has influenced long-term rates to remain high despite falling Treasury bond yields. In fact, the maturity yield of the 10-year Mbono increased 1 bp in April to close at 6.85%. Moreover, in line with the weakening of the dollar due to a reduction in US debt yields, the Mexican peso appreciated 2.5% in April, allowing the exchange rate to close April at 19.9 pesos to the dollar. The appreciation of the Mexican peso was above that of emerging-country currencies (2.3%), although below the gains of developed-country currencies (2.8%) against the dollar.

The US economy grew 6.4% at an annualized rate during the first quarter of 2021, supported by 10.7% growth in consumption. Growth in the second quarter is expected to exceed the first, given the total reopening of activities in several US states. Higher-than-expected economic data and corporate reports have been accompanied by constant signs of growth in the input prices faced by companies. In addition, inflationary expectations originating from the bond markets maintain an upward trend. . Given the signs of increasing prices within a context of repressed demand and the lingering bottlenecks in some sectors, concerns about the Fed being behind the curve could rise rapidly. The narrative of unprecedented fiscal aid, high liquidity and near-zero interest rates for the entire forecast horizon could soon begin to be watered down.

3. Regulation

Ministry of Finance and Public Credit (SHCP): Follow-up to migrant and family support program

On April 13, the Ministry of Finance and Public Credit submitted for consultation a resolution amending the general provisions referred to in Article 115 of the Law on Credit Institutions. The aim is for localities where credit institutions can receive dollars from their clients to be able to include municipalities and towns in which the amounts of remittances per capita are high compared to others, and the absolute value amounts of such remittances are significant with respect to the total remittances the country receives.

CNBV: Recommendations on the payment of dividends

On April 16, the National Banking and Securities Commission issued an official communication voiding the recommendation contained in a previous statement, concerning the abstention from paying dividends, share buybacks or any other mechanism to reward shareholders.

The new recommendation states that institutions may pay dividends up to 25% of the sum of the 2019 and 2020 results, subject to the following:

- The Capital Adequacy Assessment (ESC) processes for 2021 and 2022 must not require a preventive action plan.
- Institutions that do not establish a dividend payment scenario in the ESC must provide a justification for the change of decision.
- The Capitalization Ratio after the dividend decree must not be less than 13%.
- A report must be submitted showing that the reserves are sufficient to withstand the expected losses for the year following the payment of dividends.
- The calculation of dividends with respect to the earnings in 2019 should be net of dividends paid in 2020.
- Local systemic institutions must justify that the dividend decree is consistent with the aligned strategy to comply with the entry into force of the regulation of the international standard of Total Loss-Absorbing Capacity (TLAC).

If this recommendation is not followed, a written notice must be given to the CNBV within 7 business days, signed by the Managing Director, explaining the reasons.

CNBV: Total Loss-Absorbing Capacity (TLAC) Proposal

On April 19, the CNBV published a consultation on the adoption of the international TLAC standard. The aim was to improve financial stability and mitigate the risk represented by banks of local systemic importance, adapting the regulations applicable to the absorption of losses and the internal recapitalization capacity of these entities during a resolution process, without interrupting their critical functions and without the need to make use of public resources.

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