Banking

Monthly Report on Banking and the Financial System

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1. Banking and the financial system

Bank credit to the private sector contracted 7.9% in March, because of the performance of consumer and corporate portfolios

In March 2021, the nominal balance of the performing loans portfolio granted by commercial banking to the non-financial private sector (NFPS) fell 7.9%. The annual rate of reduction in nominal balances was greater than in February, which saw a nominal contraction of 2.0%, accentuating the downward trend observed since May 2020. The year-on-year change in balances reflects a significant base effect, because of the use of credit facilities by companies at the start of the pandemic.

The annual nominal changes in the credit aggregates that make up the country's NFPS were as follows: consumption, -9.2% (compared to -10.3% in the previous month and 3.3% in March 2020); housing, 8.5% (8.4% in the previous month and 9.7% in March 2020); and business, -12.6% (-2.3% in the previous month and 13.5% in March 2020). During March 2021, contributions to the contraction of (-)7.9 percentage points (pp) in bank credit to the NFPS were (in descending order): housing, 1.6 pp; consumption, -2.0 pp; and business, -7.5 pp.

The year-on-year appreciation of the peso during March 2021 exacerbated the decline in the performing foreign currency business portfolio balances during the period. Expressed in pesos, this portfolio showed a nominal change of -32.5% (-9.6% in the previous month and 42.1% in March 2020), while in dollars, this reduction was equivalent to -22.4% (-14.6% in the previous month and 17.3% in March 2020). In turn, existing nominal balances in domestic currency fell (-)4.9% in March (after having fallen (-)0.1% in the previous month and having grown 5.3% in March 2020). Both portfolios show year-on-year contractions as a reflection of a base effect caused by the growth since March 2020 resulting from the use of credit facilities by companies in that period.

Bank deposits continue growing, driven by demand deposits

Traditional bank deposits (demand + term) continued to grow in March, supported by the demand segment and despite the fall in the balance of term deposits over the last 10 months. However, within demand deposits, there were lower growth rates in all segments. Deposits by individuals again showed modest monthly growth. Monthly growth in public sector demand deposits continued to show double-digit growth rates, while deposits by other financial intermediaries continued to fall.

In terms of annual growth, rates remained at the double-digit level for both types of deposit, although with mixed effects. The result was a nominal annual growth rate of traditional deposits (demand + term) of 2.3% (-2.3% real). This figure represents a slowdown compared to the previous month (when it recorded nominal growth of 10.0%), as well as

a performance well below that observed in March 2020, when it grew by 13.8% in the face of demand for liquidity for prudential reasons seen at the start of the pandemic.

This slowdown is partly explained by a base effect resulting from the atypical growth of deposits at the start of the pandemic, reflecting liquidity needs and weak consumption in response to uncertainty about the evolution of the pandemic, its adverse effects on the economy and mobility restrictions. However, that base effect is not present in some segments, such as individuals' term deposits, in which balances still show a double-digit annual nominal contraction.

Similar to the figures observed in recent months, demand deposits contributed 6.8 pp to the 2.3% nominal growth of traditional deposits, while term deposits subtracted (-)4.5 pp from this growth. This implies an additional restructuring of traditional bank deposits toward demand deposits. In turn, deposits in Debt Investment Funds continued to exhibit a slowdown in their annual rate, with nominal growth of 2.0%, influenced by increased risk aversion and a greater preference for liquidity. In addition, the end of the cut cycle in the monetary policy rate reduces the earnings expectations for this type of instrument in the short term.

Demand for credit grew in the first quarter of 2021 (1Q21), except in the credit card and non-financial SME segments

The report on the results of the Survey on General Conditions and/or Standards in the Bank Credit Market (Enban) produced by the Bank of Mexico (Banxico) for 1Q21 contains qualitative information on credit demand and the general conditions and/or standards for credit approval in commercial banking. The reported changes in the indicators for the different portfolios is based on a comparison with the previous quarter.

With respect to the demand for credit during 1Q21, the banks with a larger share[1] reported a contraction in the credit card segment, as well as stagnation in the non-financial SME segment. In contrast, they saw higher demand on average for the loans to large non-financial companies; loans to non-bank financial intermediaries; and automotive, payroll, personal and mortgage loan sectors. In turn, the banks with a smaller share noted a decline in demand in the automotive and mortgage loan segments and that there were no changes in demand in relation to large non-financial firms, non-financial SMEs, non-bank financial intermediaries and credit cards. Increased demand for payroll and personal loans was noted for banks with a smaller share.

The indicators also differ among banks with a larger or smaller share regarding the expectations for credit demand in 2Q21. On average, banks with a larger share anticipate an increase in loans to large non-financial companies, credit cards and mortgage loans. In addition, these banks are not expecting significant changes in credit demand in the non-financial SMEs and non-bank financial intermediary segments. On average, banks with a smaller share expect an increase in demand for large non-financial companies, non-financial SMEs, non-bank financial intermediaries and credit cards. On average, they do not expect significant changes in the mortgage loan segment.

1: A recursive average that gives more weight to the most recent quarters of each bank's existing credit balance was used to determine which have the greatest share in each module. Only the banks with a share of at least 5% of the balance of the bank loan portfolio of the corresponding segment were included. In all segments considered, the sum of the shares of the group of banks with a larger share represents at least 75% of the corresponding credit market.

Banks with a larger market share reported tighter general conditions and/or credit approval standards in the non-bank financial intermediary segment in 1Q21. In contrast, they noted a relaxation in payroll loans, while general conditions and/or credit approval standards were similar to those of 4Q20 for large non-financial companies; non-financial SMEs; credit cards; and personal, automotive and mortgage loans. Banks with a smaller share noted tighter general conditions and/or credit approval standards for large non-financial firms, non-financial SMEs and non-bank financial intermediaries. These banks reported on average that the general conditions and/or credit approval standards were similar to those of the previous quarter in the personal, automotive and mortgage loan segments, while they were more relaxed in the credit card and payroll loan segments.

With regard to expectations for general conditions and/or credit approval standards for 2Q21, the banks with a larger share expect on average a tightening in the non-bank financial intermediary segment and a relaxation in the rest of the segments. For their part, the banks with a smaller share also expect tighter general conditions and/or approval standards on average in that segment and for large non-financial firms.

The report also includes some short-term monitoring, which clearly describes the increase in the level of capitalization, as well as in the liquidity position and the availability of funds in domestic currency of the banks as a whole. Overall, a reduction on the cost of raising deposits was perceived. The availability of foreign currency funds also increased for the subset of banks with a larger share.

All the banks noted an improvement in the international economic environment, while the banks with a larger share also saw an improvement in the domestic economic environment, employment conditions for households and the confidence of companies and households about economic activity.

In 1Q21, the percentage of companies using some type of financing continued to fall

Banxico published the results of the Quarterly Credit Market Assessment Survey for 1Q21. In the reference quarter, 79.9% of companies obtained some kind of financing, the lowest percentage since records began (1Q09). In 1Q21, some sources of such financing increased compared to the previous quarter: 34.3% of companies reported receiving financing from commercial banking (more than the 27.2% in 4Q20); foreign banking, 5.6% (vs 5.0% in 4Q20); and debt issuance, 1.6% (vs 0.5% in 4Q20). These increases were not enough to offset the observed reduction in supplier financing, which stood at 65.8% (vs 77.1% in the previous quarter), and financing from companies in the same corporate group, which fell from 19.5% to 17.8% in the reference period.

Within the bank credit market, 46.0% of companies reported using bank financing at the beginning of 1Q21, up from the previous quarter (43.9%) but still below the percentage reported in 1Q20 (47.6%). Some 20.8% of companies used new bank credit, up from the 16.8% 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 funds to finance working capital (from 69.2% in 4Q20 to 60.1% 1Q20, reaching a record low). Meanwhile, the percentage of companies that used bank lending to refinance liabilities increased (from 18.5% to 24.8% in the same comparison period). Companies that used new bank credit in 1Q21 declared that they had faced more favorable interest rate conditions. However, companies reported less favorable conditions than in 4Q20 for amounts and terms offered, fees and other expenses, conditions for refinancing loans, credit approval times and collateral requirements.

The pandemic increased the use of electronic means of payment in 2020

In its Annual Market Infrastructure Report, Banxico included some implications of the COVID-19 pandemic on some of the features of such infrastructure during 2020. In terms of payment and transfer services, the number of transactions performed in the Interbank Electronic Payment System (*Sistema de Pagos Electrónicos Interbancarios* — SPEI) increased by 47% between 2019 and 2020. It is worth noting that payments under MXN 8000 increased by 72.2% compared to the previous year, reflecting the greater use of this electronic means of payment because of the pandemic. In addition, the system registered 99.99% availability in 2020, the highest percentage seen in the last 6 years. There was a 12.2% increase in the number of electronic fund transfers (EFT) and a 10.4% decrease in the value of these transactions.

In turn, the CoDi digital collection platform reached more than 6.8 million validated accounts at the close of 2020, of which 335,190 made a payment and 274,807 a collection. There were 1.1 million transactions in 2020. Although the number fell in March, it recovered during the second half of the year, reaching a peak in December of 5000 daily transactions for an average amount of MXN 1050.

There was a 5.9% increase in the number of direct debit transactions in 2020 and a 11.3% decrease in the amount transacted. This might suggest that people changed their habits during the pandemic, choosing to reduce expenditure on certain services. Check use continued to decline. This reduction was more marked in 2020 (a 28.3% fall in the number of checks processed and 29.0% drop in the amount). This could be explained in part by social distancing measures that involved the closure of some bank branches or reduced service hours.

2. Financial markets

Shift toward cyclical sector assets, while below-expected labor data strengthened the FED's position

The debate on the nature and timing of price increases remained the main influence on financial markets during May. However, April's job creation data for the US strengthened the FED's stance on a still-distant labor market recovery, favoring the idea of keeping monetary stimuli for a longer period. This delayed expectations of a rise in the federal funds rate and reduced the long-term interest rate. It also tempered the price of the dollar against the currencies of developed and emerging countries.

During the first week of May, and despite lower-than-expected US employment data (almost a quarter), the investors bet on the FED maintaining economic stimuli was reflected in a general rise (with the exception of the Nasdaq) in US stock markets. The reopening enabled by the accelerated vaccination strategy has highlighted labor shortages in sectors such as trade, especially under a direct-transfer scheme that may have generated rigidities in the US labor market, although an expectation of job creation is maintained in the short term.

Likewise, the rapid economic reopening has resulted in higher-than-expected inflation, constituting a cut in the real value of financial assets. The FED maintained its position on the transitory nature of the observed inflation. However, it indicated that, if the economy continues to move rapidly toward the objectives of the committee, it might be appropriate to begin discussing a plan for adjusting the rate of purchase of assets in upcoming meetings. This narrative may have

eased some concerns about the FED being behind the curve. Similarly, supply bottlenecks and the disparity in global reopening were presented as risk factors for economic recovery.

In this context, the yield at maturity of the 10-year Treasury bond fell by 7 basis points (bp) during May, its second consecutive decline in the year, following increases at the close of each month during Q121. The FED adjusted the short part of the curve (2 years) to 0.14 bp, from 0.16 bp at the end of April. This left a slope of the curve between the 2- and 10-year maturity of 144 bp, slightly below the 149 bp at the end of April.

This fall in the long-term interest rate, coupled with the lifting of mobility restrictions and the subsequent rebound in certain sectors with discrete performance during the pandemic, saw most stock markets rise. The S&P500 and the Dow Jones Industrial Average closed the month up, despite a massive mid-month sale, though below the historic highs reached during the first week of May. The Nasdaq 100 recorded a 1.5% drop over the same period, which may reflect pressure due to the transfer of investor capital toward more cyclical company shares.

For mid- and low-cap companies that are more cycle-related (Russell 2000), the end of May was relatively flat, with an increase of 0.1%. In Europe (Euro Stoxx 600) and emerging markets (MSCI EM), growth in the fifth month of the year was less vigorous: 2.1% for both indices. Meanwhile, the IPC (Index of Prices and Quotations for its acronym in Spanish) on the Mexican Stock Exchange reported a 6.0% increase.

The global demand recovery narrative continues to dictate commodity market performance, albeit with less dynamism. This is reflected in the 2.7% growth of the benchmark for this asset class (S&P GSCI) during May, lower than in April, when it increased by more than 8.0%. Within the benchmark, a barrel of Brent crude oil rose 5.0%, while the Mexican export mix increased by more than USD 2.00 per barrel, to close May at USD 63.66 per barrel. The price of gold increased by 5.1%.

In Mexico, inflation rose above analysts' expectations, but the year-on-year increase in the first half of May (5.8%) was lower than in the second half of April (6.1%). This resulted in long-term rates beginning to fall in parallel with falling Treasury bond yields. In fact, the 10-year maturity yield of the 3-year bond shrank 6.52 bp in May, closing at 6.52%, slightly below the 6.88% at the end of April. Likewise, the weakening dollar in the context of reduced yields on US debt implied a 1.3% appreciation of the Mexican peso in May, with the exchange rate closing the month at 19.92 pesos per dollar.

Inflation and the recovery of the US labor market are at the center of market focus in the coming months. Similarly, progress in global vaccination as a condition of multi-regional demand momentum and the reactivation of sectors such as trade and tourism in various regions will dictate global capital-flow patterns.

3. Regulation

Plans under consultation

CNBV – Resolution amending the general provisions applicable to credit Institutions (women's grants)

As a follow-up to the announcement made at the 84th Banking Convention regarding the creation and promotion of financial products and services from a gender perspective, this draft would recognize the lower default rate observed among women, reflecting it on the credit risk provision methodologies for non-revolving consumer credit and home mortgage portfolios.

The project introduces a factor that lowers the probability of default to between 4% and 2% for non-revolving consumer credit and to 3% for home mortgages, in both cases provided that the borrower is female. In addition, the rule incorporates an adjustment factor that can reduce home mortgage Loss Given Default by up to 7% when at least one co-borrower is female.

These changes would apply to loans granted after the amendment enters into force.

CNBV – Resolution amending the general provisions applicable to credit institutions (Articles 1 and 2 bis 17)

The proposal reduces the consumer portfolio's credit risk weight from 100% to 75%, while also including in it microloans for capitalization purposes.

Moreover, the proposal reduces the home mortgage portfolio capital weight from 100% to 70% and reformulates its treatment by removing down-payment level, insurance and guarantee considerations in favor of the new concept known as the “CVV Ratio”, that is the ratio of the unpaid balance over the value of the home (loan-to-value). Thus, instead of determining the capital weight based on the size of the down payment with respect to the value of the house, the weight would now be determined on the basis of the loan-to-value ratio, and would range between 20% and 70%, based on the CVV Ratio being between 50% and 100% or more. It should be reiterated that these weighting factors would be lower than those applicable under the current rule.

In line with the above, real and personal guarantees will continue to be recognized for the purpose of determining exposure amounts, but without affecting the risk weighting or the CVV Ratio that determines it.

Similarly, regarding home mortgage loans granted by Infonavit and Fovissste (public mortgage issuers) for remodeling or improvement of homes for non-sale purposes, in which the borrower's housing sub-account balance and future contributions are used respectively, as collateral and as a source of payment, the risk weight is reduced from 50% to 20%, when the amount outstanding accounts for no more than 50% of the sub-account balance, and from 75% to 30%, when it accounts for more than 50% but less than 80% of said sub-account balance (previously 85%). In addition, while previously a breach of the conditions regarding the absence of liens and of full access to the sub-account and

contributions would have put the weight of the loan at 100%, under the proposal, the capital charge in this scenario would be of up to 70%.

Lastly, the proposal incorporates a specific treatment for loans to MSMEs (loans to micro, small and medium-sized enterprises), defined as loans granted to legal entities or individuals whose annual net income or sales do not exceed 14 million UDIs (*Investment Units* — a CPI-indexed unit of account). These loans would receive a credit risk weighting factor of 85%, potentially falling to 75% for direct loans that, combined, account for no more than 1% of the total portfolio of MSME loans and do not exceed 4 million UDIs. This is all provided that the borrower does not have an external rating granted by a rating agency, in which case this rating would define its capital weight.

The reductions in capital weights are in line with the CNBV's announcement at the last banking convention of making the facilities introduced during the pandemic permanent. According to the authorities, these measures seek to encourage institutions to target new loans to favored sectors (MSME, consumer, microloan and home mortgage) and to reduce active rates. Their ultimate effect on the granting of loans and interest rate levels will have to be assessed in the future.

Publications in Mexico's Official Journal of the Federation (DOF)

Various regulations relating to the measures announced under the plan to support migrants and their families were published:

- May 7 The SHCP (*Secretaría de Hacienda y Crédito Público* — Secretariat of Finance and Public Credit) published a resolution amending the General Provisions referred to in Article 115 of the Credit Institutions Law, regarding the inclusion of municipalities and boroughs with large remittances to the localities where credit institutions can receive dollars from their legal person customers.
- May 12 Banco de México published Circular 2/2021, amending Circular 3/2012, on demand deposits in domestic currency by Mexicans residing abroad and prepaid bank cards in domestic currency for foreigners.
- May 14 Banco de México published the rules applicable to the contingent financing of the Banco de México secured with US dollars or government securities, granted to banks that acquire dollars in cash as part of their ordinary transactions and are unable to send them to a foreign financial institution for their disposal.
- May 21 The CNBV published a resolution amending the General Provisions Applicable to Credit Institutions, concerning the migrant support program, regarding means of physical and remote identification.

CNBV announces domestic systemically important banks

May 26 The CNBV issued its annual update of the list of domestic systemically important banks. The list remained unchanged, with Scotiabank and HSBC in grade I (0.60%); Banorte in grade II (0.90%); Citibanamex and Santander in grade III (1.20%) and BBVA in grade IV (1.5%).

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