Banking

Monthly Report on Banking and the Financial System

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1. Banking and the Financial System

As of September 2021, the fall in the balance of loans to the non-financial private sector (NFPS) slowed down, but has yet to return to positive territory

At the end of the third quarter of 2021 (3Q21), there was a year-on-year contraction in the nominal balance of current loans granted by commercial banks to the NPFS of -1.7% (-6.3% real). This was a reduction in the fall seen in nominal terms since November 2020, which reached a low in April 2021 (-8.9%). With September's figures, the average annual change in credit to the NFPS stood at -4.7%. This decline comprised -8.4 percentage points (pp) attributable to a fall in real terms and a drop of 1.1 pp due to the nominal effect caused by the year-on-year exchange rate appreciation — declines which could not be offset by the 4.8 pp associated with year-on-year inflation.

Unlike 2020, in 2021, balances denominated in foreign currency (FC) have had a negative impact on the change in nominal current loan balances granted to the NFPS, reflecting the appreciation in the exchange rate observed since March 2021. During the year, the exchange rate valuation effect contributed 27% to the average nominal contraction of -4.7%.

After filtering out the exchange rate valuation effect and inflation, average lending to the NFPS in real terms fell -8.4% in 3Q21. The corporate portfolio has contributed most (7.1 pp) to this reduction, with consumer loans removing a further 2.1 pp from the total. In contrast, mortgage loans remained the only portfolio to grow in real terms (0.7 pp) in 2021 — partially offsetting the performance of other portfolios. The change in the year-on-year balance of current loans to the NPFS in September, followed 15 months of falls in real terms, which reached their lowest levels between March and May 2021, reflecting in part the base effect, which corresponds to the first few months of the public health crisis and the availability of credit facilities.

After recording the heaviest real-term drop in April 2021 (-11.8%) and beginning a gradual recovery reducing the size of the contractions, the current balance of the portfolio has yet to reach pre-pandemic levels. In pesos in September 2021, the average balance in the first nine months of the year was MXN 4.642 trillion — down 8% on the average amount in 2019. In the case of corporate lending, average current loans between January and September stood at MXN 2.623 trillion — 10% below the average level in 2019, while for consumer lending, the average for the first nine months of the year was MXN 985 billion — 14% lower than the average balance in 2019. Only the housing portfolio showed an improved performance; with an average amount of MXN 1.034 trillion — up 9% on 2019.

The fall in traditional deposits in commercial banking were offset to some extent by the increase in demand deposits

In September 2021, traditional bank deposits (demand + term)—discounting the effect of inflation and the exchange rate—recorded a real annual change of 3.6% (1.0% nominal), registering a contraction for the seventh consecutive month in real terms. With this result, average traditional deposits declined -1.4% in the first nine months of the year, considerably below the 5.7% growth seen in the same period in 2020. This fall largely resulted from fewer term deposits, which contributed -5.8 pp to the overall decline and was not offset by the positive 4.3 pp provided by demand deposits.

As a result, over-the-counter deposits—the most stable source of funds—increased its share of the total sources of bank financing; up from 64.7% at the end of 2020 to 67.0% in September 2021. Because of this greater availability of customer deposits, the need for funding from other sources was reduced: between December 2020 and September 2021, the share of both market financing (19.1% to 17.1%) and guaranteed financing (16.3% to 15.9%) fell. This change in the breakdown of funding sources, against the background of a rise in interest rates, continued to limit the increase in bank funding costs.

In September, the nominal annual growth rate of traditional deposits stood at 1.0%. Although this figure is significantly less than the double-digit ones seen between March 2020 and February 2021 (12.2% average), the decrease largely reflects a base effect associated with the strong growth in the balances recorded in March 2020, when a greater preference for liquidity began to be observed, with a major depreciation recognized which affected the valuation of balances denominated in foreign currency. Although the base effect of the real rate component appears to have spiked since April 2021, the appreciation in the exchange rate has had an opposite accounting effect in 2020, contributing to a decline in the balances. The component that has held its position—and gradually gained ground—is inflation, thereby offsetting the contractions in the real and exchange rate elements.

The monthly traditional deposits growth rate has had a mixed performance, with reductions recorded in three of the nine months so far in 2021. The average monthly growth rate between January and September 2021 was 0.1% (-0.5% real), significantly lower than the 1.1% (0.6% real) observed in the same period in 2020. Despite this lower monthly growth rate, the balances remain around MXN 6.5 billion — above those experienced at the start of the pandemic (MXN 5.9 billion in February 2020, discounting the effect of inflation and the exchange rate).

The inertia shown by term deposits in responding positively to the rise in interest rates appears to indicate that an eventual increase in this kind of saving may not be enough to offset the slowdown in demand deposits. As a result, without a new wave of infections (that might involve a restriction of activities or incentivize the accumulation of cash for precautionary reasons), we could see an additional slowdown in deposits in the short term.

In Mexico, total financial savings was down -5.5% in 2Q21, while total financing fell -3.5%

On November 5, 2021, the National Banking and Securities Commission (CNBV) published its Financial Savings and Financing in Mexico (Reporte de Ahorro y Financiamiento en México), with data through June 2021. The report highlights that in 2Q21, year-on-year total financial savings fell -5.5% in real terms and represented 98.2% of GDP. Meanwhile, year-on-year total financing declined -3.5% in real terms — the equivalent of 99.7% of GDP.

There was an annual fall in real foreign financial savings of -14.4%, which led to it representing 26.5% of GDP in June. By destination, foreign savings received by the public sector amounted to 17.4% of GDP and that received by the private sector to 9.1%. A breakdown, by percentage of GDP, shows that securities issued abroad accounted for 12.5%, securities issued in Mexico held by non-residents for 7.6% and loans obtained abroad for 6.5%.

Real annual domestic financial savings declined -1.8% and was equivalent to 71.7% of GDP at the end of June 2021; the real annual growth rate for the holding of fixed income securities and trust certificates (36.9% of GDP) increased by 0.7.%; and deposits of financial intermediaries (34.9% of GDP) fell -4.3%. Within this segment, most of the deposits are concentrated within commercial banks (25.3% of GDP), followed by Infonavit (Instituto del Fondo Nacional para la Vivienda de los Trabajadores – Mexican federal institute for worker's housing) (5.4% of GDP) and development banking (3.3% of GDP).

There was a year-on-year contraction in foreign financing (18.9% of GDP) of -17.7%. This resulted from a -17.7% fall in real terms in foreign financing to the private sector (8.6% of GDP) and foreign financing to the private sector (10.4% of GDP) of -12.9%. By type of foreign financing, fixed income securities issued abroad represented 12.5% of GDP and foreign loans were equivalent to 6.5% of GDP.

There was a real annual decline of 0.3% in domestic financing balances, which amounted to the equivalent of 80.8% of GDP. In June, by type of financing, domestic debt issuance and trust certificates (46.0% of GDP) had a real annual growth rate of 4.7%, while the total loan portfolio (34.8% of GDP) experienced a year-on-year fall of -6.3% in real terms. Private sector financing (36.7% of GDP) mainly comprised commercial banking credit (17.7% of GDP), followed by other financial intermediaries credit (11.8% of GDP) and debt issuance and trust certificates (5.3% of GDP). Over 92% of public sector financing (44.1% of GDP) was made up of debt issuance and trust certificates (40.7% of GDP), followed by commercial bank credit (2.2% of GDP) and development bank credit (1.2% of GDP).

The report explains that the reduction in the percentages of GDP, both of saving and financing, is influenced by the fall in 2Q20 GDP, which led to an increase in the figures during the base period used for comparison.

The percentage of firms obtaining financing rose in 3Q21

Bank of Mexico (Banxico) published an update to its Credit market assessment survey, with data as of 3Q21. Compared to the previous quarter, the percentage of companies that reported having obtained some kind of financing increased from 80.6% to 82.6%: the second consecutive quarter of growth, after the record low of 79.9% in 1Q21. By source of financing, the highlights were the rise in the number of companies that reported having obtained funding from commercial banks (up from 32.7% in 2Q21 to 36.1% in 3Q21), the increase in financing provided by suppliers (up from 65.5% to 67.4%) and that granted by development banks (up from 4.1% to 4.5%). There was a fall in the rest of the sources of finance, compared to the previous six months in the same base period (foreign banks, companies from the same corporate group, debt issuance).

At the beginning of 3Q21, some 46.5% of companies had bank credit (up from the 43.6% reported in 2Q21). In addition, 19.3% of companies said they had used new bank credit in 3Q21 vs 7.4% in 2Q21. Looking at the destination of this new credit, there was an increase in the number of firms that reported using it for investment (29.6% vs 21.3% in the previous quarter) — the highest percentage since 1Q12. The destination with the second highest increase on 2Q21 was debt restructuring (up from 8.1% to 10.8%). On the other hand, there was a reduction in 3Q21 in the percentage of companies who said they used the new loans for working capital and foreign trade transactions.

Turning to companies' perception of credit market conditions, those that obtained new loans in 3Q21 reported more favorable conditions with regard to the amounts offered, but less favorable ones in relation to terms, collateral requirements, approval times, refinancing, interest rates, fees, and other requirements.

Renewal of the International Monetary Fund (IMF) Flexible Credit Line (FCL)

Together with the Ministry of Finance and Public Credit (Secretaría de Hacienda y Crédito Público — SHCP), Banxico announced that the IMF's Executive Board had renewed the Flexible Credit Line (FCL) granting Mexico access to the equivalent of USD 50 billion. This precautionary instrument strengthens the country's international reserve assets, complementing the tools the authorities already have available in case of adverse economic conditions.

The communique indicates that, considering the strength of their economic policy framework and commitment to economic and financial stability, the Mexican authorities will once again resume their gradual and orderly exit from the LFC. This strategy was announced in 2017 and first implemented in 2018; however, it was put on hold in 2020, due to the increased external risks resulting from the pandemic.

It is worth noting that in its assessment, the IMF highlighted that Mexico has managed to maintain macroeconomic, fiscal and financial stability.

The recovery in demand for automotive loans, lags behind that of other credit segments

Banxico published the results of the Survey on General Conditions and Standards in the Banking Credit Market (EnBan) for the period, July-September 2021. Of particular note is that in 3Q21, all banks, on average, reported a drop in the demand for automotive loans. On the other hand, there was an increase in the demand of those segments associated with large companies, SMEs, credit cards, payroll loans and mortgage loans. Looking at expectations of credit demand in 4Q21, commercial banking, as a whole, expects a rise in all segments.

In comparison with 2Q21, in the period, July-September 2021, the banks with a larger market share reported a relaxation in general conditions and/or credit approval standards for the SME, credit card, payroll loan and mortgage loans, while for large companies, automotive loans and personal loans segments, they remained similar. By contrast, banks with a smaller market share, reported tighter credit approval conditions for large companies, and similar conditions for the SME, credit card, automotive loan, payroll loan, personal loan and mortgage loan segments.

Banks with a larger market share forecast a relaxation in credit granting conditions in 4Q21 banks for the SME and credit card segments and no change in those of large companies and mortgage loans. Meanwhile, banks with a smaller market share do not expect any movements to be significant in those segments where changes are anticipated.

2. Financial Markets

The Omicron variant and a hawkish tone of the Fed's communication prompted risk aversion in financial markets

Since the second quarter of this year, financial asset prices have largely been supported by two assumptions. First, that the global economy is on a robust recovery path after the falls experienced in 2020 — the direction of which has not been put at any particular risk by the persistence of the pandemic. Second, that the spike in inflation is only temporary — so interest rates are very likely to remain low for some time yet.

Although certain doubts have been expressed during the last few months about the overall validity of these assumptions—especially that relating to inflation—it can be seen by the level of asset prices, that market participants have considered them in their decision-making processes.

However, November closed with two events that once again brought these assumptions into question. First, confirmation of the arrival in Europe of the new COVID-19 variant: Omicron. Second, the hawkish tone adopted by the Fed Chair in his speech to the US Senate, where he explicitly said that it could be time to remove the adjective "transitory" from the description of the current rise in inflation and that it would be advisable to speed up the reduction in bond purchases.

Though for now we know little of the effects of the Omicron variable, the high transmission rate seen in South Africa was rapidly reflected in an increase in the risks to economic growth — given the possible restrictions that governments could introduce this winter. In addition, this latest episode of the pandemic could exacerbate the shortages (e.g. bottlenecks) already being experienced in the global economy: thereby also tending to put upward pressure on prices.

If we add the hawkish and unexpected tone of the Fed's Chair to this current scenario, we should not be surprised about the rise in risk aversion in the last few days of November; which pushed VIX to levels of 27.0% — the highest since January 2021.

With this increase in risk aversion, the **main stock market indices** recorded losses of over 2.0% during the final week of November (see Figure 1) — meaning that almost all of them ended the month in the red. The increased risks to economic growth and expectations of more restrictive financial conditions particularly hit emerging market equities (MSCI EM), which not only fell 3.3% in the last week of the month, but was also down 4.1% during November as a whole — almost 2.0% more than the global equity benchmark (MSCI World).

The US T-bond yield curve flattened. At the short end of the curve, the spike in inflation and the Fed's more restrictive stance led to a 7bp increase in November, which contributed to the UST2Y's yield to maturity closing at 0.6%.

The US Treasury yield curve fell by 11 bp (-19 bp in the last week of the month), which meant its yield to maturity closed November at 1.4% (see Figure 1). It is important to point out that this flattening is an indication that the markets have confidence that the Fed's restrictive stance will contain inflation and trust its mid-term forecasts — even though this could lead to lower growth.

In Mexico, the fall at the long end of the US curve and the risks to growth were the key factors in risk aversion, which led the yield to maturity of the 10-year Mbono to end November at 7.5% — up 1bp from the previous month. It should be noted that the M10 was already trading at 7.8% prior to the appearance of the Omicron variant.

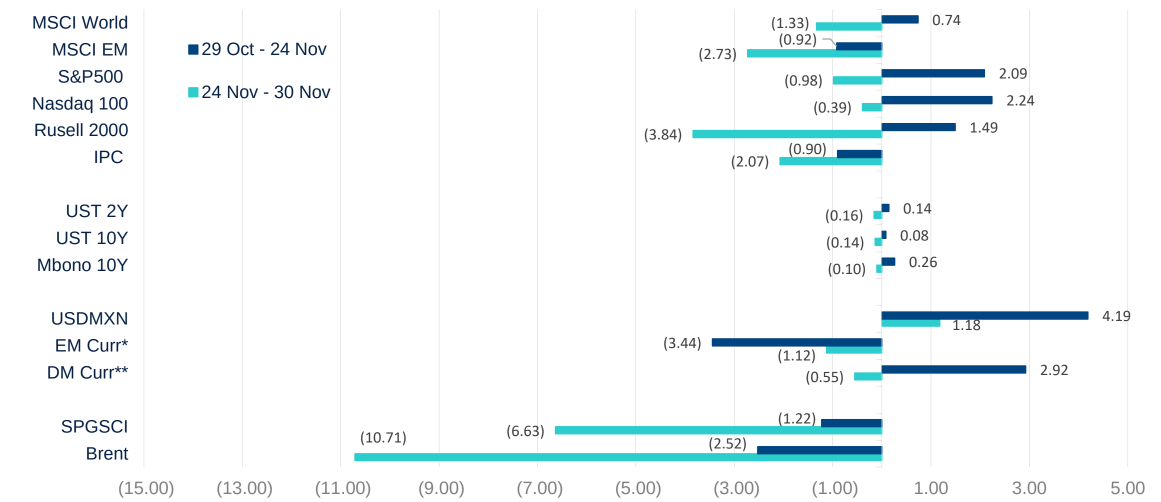
For the Mexican peso, idiosyncratic risks preceded global risk aversion. The unexpected change in the nomination of the next central bank governor—against a backdrop of an inflation rate of over 7.0%, the highest in the last 20 years—impacted the depreciation of the Mexican peso and saw the exchange rate reach 21.90 on November 26: its highest level since September 2020. Risk aversion then added a further slight additional shock and the Mexican currency ended November with a depreciation of 4.3% — the fourth highest among emerging market currencies.

After several months of reflecting the problems of scarcity and shortages in the global economy, **commodity prices recorded the heaviest falls** among the various asset classes, due to the perceived risk of the increasing spread of the new Omicron variant. The benchmark SPGSCI lost 11.2% in November, after a drop of 10.1% in the last week of the month (see Figure 1).

As has been the case recently, the greatest sensitivity was seen in the energy sub-index, which fell 18.6% in November. In line with this fall, the Brent barrel price declined 16.4%, while the Mexican mix closed November down 14.3%, at USD 66.5 per barrel.

As a result, 2021 is drawing to a close with serious doubts about the assumptions that have helped sustain the growth in risk asset prices. There has been a clear change in the tone of the Fed's communication, but it remains to be seen to what extent this is reflected in a change of stance at its next meeting on December 15. Although for the moment uncertainty is the dominant factor in the markets, in a high-inflation scenario, the appearance of the Omicron variant is without doubt complicating the outlook for risk asset prices and increasing the chances of the Fed making a policy mistake.

Figure 1. **Trend in the prices of the main financial assets** (% in local currency)



*JP Morgan Emerging Markets Currency Index. For this index, a reduction (increase) implies a depreciation (appreciation) of a basket of emerging market currencies against the USD. **DXY Index, for this index a reduction (increase) implies a depreciation (appreciation) of the USD against a basket of developed countries currencies.
Source: BBVA Research based on Bloomberg data.

3. Regulation

Projects in consultation

CONDUSEF - Regulation on reporting to CONDUSEF

11.23 The aim of the project is to consolidate the different registration obligations of financial institutions into a single regulatory document. For this, a new tool and ID code will be implemented, through which all obligations will be gathered in a single platform, while eliminating the practice of requiring a collaboration agreement in order to join the Electronic Management System.

In addition, there is an increase, from quarterly to monthly, in the frequency of reporting to the Financial Services Providers Register and to the Collection Agencies Register; also, the period for presentation of these reports and for correcting any omissions or errors they might contain, is reduced from ten to five business days. An annual fee of MXN 25,000.00 will be charged to all entities covered by this regulation for administration costs.

CNBV – Resolution amending the General Regulations applicable to Credit Institutions

The temporary regulatory waivers set up during the pandemic related to the recognition of total additional reserves in supplementary capital have been made permanent. For this, reserves constituted in excess of those calculated in accordance with the methodologies established by CNBV are now included in the definition of total additional reserves, subject to the limits applicable to the use of internal models or the standardized approach.

Publications in the DOF (Diario Oficial de la Federación – Official Gazette of the Mexican Federation)

11.22 Bank of Mexico published Circular 8/2021 aimed at Credit Institutions, the National Agriculture, Rural, Forestry and Fisheries Development Bank, Brokerage Firms, Regulated Multiple Purpose Financial Institutions (SOFOMES ER), Electronic Money Institutions and Collective Financing Institutions, which modifies Circular 36/2010 on Fee Registration.

It establishes the Fee Registration System and includes electronic money institutions and collective financing institutions within the financial institutions covered by it. Likewise, it updates the procedure which Circular 36/2010 refers to, establishing: i) a single procedure for the registration and increase of fees; ii) the requirement for recently authorized financial institutions to carry out their registration 45 business days before the start of operations; iii) a request to include those categories not already registered; and iv) the addition of an obligation for financial institutions to confirm each year those fees that they need to maintain.

11.22 Bank of Mexico published Circular 9/2021 aimed at Credit Institutions, the National Agriculture, Rural, Forestry and Fisheries Development Bank, Brokerage Firms, Regulated Multiple Purpose Financial Institutions (SOFOMES ER), Electronic Money Institutions and Collective Financing Institutions, which modifies Circular 13/2012 on the Electronic Service Module. Its purpose is to: i) improve the efficiency of the registration process through the use of electronic media; ii) standardize the obligations of electronic money institutions and collective financing institutions in relation to fee registration with those of credit institutions and regulated multiple purpose financial institutions; and iii) provide greater transparency to the actions or events that give rise to the charging of fees through the use of a taxonomy that facilitates the administration of their registration.

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