Banking

Monthly Report on Banking and Financial System

Iván Martínez Urquijo / Gerónimo Ugarte Bedwell / Mariana A. Torán / Alfonso Gurza / Crista Pérez
January 20, 2022

1. Banking and the financial system

Private sector deposits grew in October, driven by employment and the rate hike cycle

In October, traditional private sector deposits (sight + term deposits) increased in real terms in both the demand and term deposit segments. This performance may reflect an unexpected combination of macroeconomic conditions because of the pandemic, which differently affect the savings decisions of households and firms.

Business demand deposits grew 6.8% in real annual terms (nominal 13.5%); while demand deposits by households rose 3.9% in real terms (nominal 10.4%). Both components of demand deposits grew strongly in monthly terms, given the background of a reduction in COVID-19 cases and 2.0% real monthly growth in the services sector, according to the economic activity indicator (IOAE) for October 2021. A factor that positively influenced the uptake of demand deposits was the ongoing strengthening of (IMSS) employment, supported by the reform of *outsourcing*. The strong increase in formal employment in the past few months may have more than offset the use of funds by individuals during the month of October.

Moreover, in October, business term deposits recorded their third consecutive month of growth, following a pattern not seen since April 2020. Rising inflation and the monetary tightening cycle could be driving these increases. However, interest rates hikes still does not seem to be a sufficient incentive for individuals to save in term deposits, as they chained their eighteenth negative monthly growth rate in real terms, at -0.5%.

At an annual rate, term deposits recorded a fall of -14.4% in real terms (-9.0% nominal) in October. Specifically, the real annual rate of term deposits by individuals was -10.9% (-5.3% nominal), while for companies it was -10.0 (-4.4% nominal). The magnitude of both rates consistently decreased over the past four months.

Bank credit to the NFPS grew 0.2% in October, after 11 months of nominal contraction

In October 2021, the nominal balance of the outstanding credit portfolio granted by commercial banks to the non-financial private sector (NFPS) grew 0.2% in nominal terms. This was the first month with a positive annual change since November 2020. However, part of the result was due to the effect of higher inflation during the period, since, in real terms, the portfolio fell by -5.7% annually.

The real size of the decline slowed since May 2021, both in total credit to the NFPS, and in the consumer and corporate portfolios. As to consumer credit, the annual growth of nominal balances was 1.4% (-4.5% real), while balances with companies decreased -3.7% (-9.4% real). The home loan portfolio saw a nominal annual growth of 9.6% (3.2% in real terms). As a result of this performance, contributions to the nominal growth of 0.2% percentage points (pp) of bank credit to the NFPS were (in descending order): home loans, 2.0 pp; consumer credit, 0.3 pp; and credit to companies, -2.2 pp.

With respect to the consumer portfolio, the credit card and consumer durables segments performed worse (either with a greater decline or lower growth) than in the immediately preceding month, while payroll and personal loans improved performance, thus driving nominal portfolio growth. Regarding the business loan portfolio, the decrease in real balances was across the board, although the analysis of monthly variations shows nominal and real growth in some sectors. The housing loan portfolio, despite maintaining growth rates in nominal and real terms, for the second consecutive month in October showed a slowdown in real terms, possibly because of the impact on formal employment during the pandemic in 2020.

Balances as of October confirmed that the business portfolio still has some way to go to achieve growth in real terms, while the mortgage and consumer portfolios showed greater vigor, although with wide differences between segments in the case of the latter. In annual terms, the nominal growth rate of credit to the NFPS, partly because of higher inflation, implied a real decline. The volume of that fall continued to decrease for the sixth consecutive month, however, reflecting a slow recovery of demand for bank finance.

Mexican financial services industry survives the adverse effects of the pandemic without jeopardizing its stability

Banxico published the update to the second half of 2021 of its Financial Stability Report, highlighting that the Mexican financial services industry maintained a robust position after the tough economic environment created by the pandemic. Specifically, the capital (ICAP) and liquidity (CCL) levels of Mexican banks comfortably meet regulatory requirements. Moreover, the results of the stress tests whereby the central bank evaluates banks' resilience and loss absorption capacity showed that the ICAP would allow the system, on aggregate, to survive the simulation horizon with capitalization levels above the regulatory minima. The report states that, although there has not yet been an uptick in the granting of credit, banks are in a position to support the economic recovery due to the resilience shown during the crisis.

The main risks identified in the report for emerging markets notably include a tightening of global financial conditions, due to their adverse effect on capital flows. In addition, in the case of Mexico, the risk of potential increases in sovereign and Pemex risk premia persists, as do potential effects on credit ratings.

In the Center region, aggregate demand factors explain the fall in credit to companies to a greater extent than elsewhere

On December 17, 2021, the Bank of Mexico (Banxico) published its Report on Regional Economies[1], with Q3 21 data. The report tracks the behavior of bank credit to companies during the pandemic, which was characterized by wide differences between regions, especially in the period of portfolio contraction after a general rise in balances at the beginning of the pandemic. According to the Report, the contraction was due to both aggregate demand and supply factors. The former was particularly important in the Center region and the latter in the North and North Central regions, possibly affected by bottlenecks in the face of shortages and rising prices of manufacturing supplies.

The report highlights that the ratio of bank credit to non-financial private companies to GDP increased significantly between 2005 and 2019, from 4.4% to 10.9% of GDP. In 2021, at the national level, the Report estimates a reduction in the ratio of credit to private companies to GDP of 1.1 percentage points (pp) with respect to 2019, mostly due to a decrease in the Center region, where it fell 2.7 pp.

According to the Report, the outstanding portfolio at the end of September 2021 was at levels below those recorded in February 2020 in all regions. This figure reflects an initial period of great vigor at the onset of the pandemic in all regions, followed by a decrease in outstanding balances that has not been reversed. In the Center region, the trend at the end of Q3 21 continues to be downward and, due to its share of total outstanding balances, the trend of the national total behaves similarly.

The report includes estimates by region of a VAR model with the following endogenous variables: real annual change in the outstanding balance of bank credit to companies at the regional level; annual change in regional formal IMSS employment; regional year-on-year core inflation; average bank funding interest rate; national business climate index for the next six months; real annual change in debt of issuers in the domestic market; and annual change in the exchange rate (MXN/USD).

After defining four structural shocks of interest (regional aggregate supply and demand, and bank credit supply and demand), the Report concludes that aggregate demand shocks were the main factor in absolute terms driving the behavior of business credit during the pandemic in all regions except the North, where the aggregate supply factor constitutes the largest contribution to the annual variation of business finance.

The higher demand for bank credit for liquidity reasons contributed positively in all regions, especially at the onset of the pandemic. The Report highlights that in the South region this effect was greater, possibly because the region is more intensive in sectors that were hit hard by the health crisis and had greater credit lines available at the onset. As for bank finance supply shocks, the result was negative for North Central, Center and South Central during 2020. For the North Central and South Central regions, marginally positive contributions were observed in the second half of 2021, although it is known from EnBan[2] as of 3Q21 that the easing of lending conditions was not widespread; in the case of large companies, conditions remain tight.

1: Regionalization in this report: “North” includes Baja California, Chihuahua, Coahuila, Nuevo León, Sonora and Tamaulipas; “North Central” includes Aguascalientes, Baja California Sur, Colima, Durango, Jalisco, Michoacán, Nayarit, San Luis Potosí, Sinaloa and Zacatecas; “Center” is made up of Mexico City, State of Mexico, Guanajuato, Hidalgo, Morelos, Puebla, Querétaro and Tlaxcala; and “South” comprises Campeche, Chiapas, Guerrero, Oaxaca, Quintana Roo, Tabasco, Veracruz and Yucatán.
2: Survey on general terms, conditions and standards in the bank lending market. Banxico.

Household financial assets concentrated in retirement savings accounts: ENIFH

In October and November 2019, Banxico and INEGI jointly conducted the first National Survey on Household Finances (ENIFH) on a sample of 23,000 households across the country. The results were published in November 2021.

As to household assets, the survey points to a population with low participation in capital markets. The information collected shows that the value of non-financial assets represents between 82% and 92% of the total value of total household assets. This is explained by the fact that the value of the main home represents between 59.0% and 67.0% of the total value of non-financial assets for the first nine deciles and between 35.0% and 40.0% for the last decile.

Household financial assets are concentrated in retirement savings accounts and/or Afore (privately managed retirement funds), which represent 63.0% to 93.0% of the total value of this asset class. This result is in line with the fact that compulsory savings are the main component of total savings of the country's residents, according to information on domestic financial assets.

As for demand and term deposits and investment in funds, holdings increase with income level, to such a point that the highest decile concentrates almost all of these assets. This positive correlation is also present with sociodemographic aspects such as level of educational attainment and age.

On the other hand, household debt is concentrated in the highest income deciles. In fact, the average debt of the 5.0% of households with the highest income is about six times the average debt of the 40.0% of households with the lowest income. A similar pattern, although to a lesser extent, is seen with banking products: the highest decile accumulates the highest amount of credit card, auto and mortgage debt.

Finally, as a further sign of high levels of informal economy, reflecting the underdevelopment of domestic debt and capital markets, 65.0% of the surveyed households said that they would resort to a loan from relatives or acquaintances to cope with an unforeseen event. Applying for a bank loan was mentioned by only 18.0% of respondents. One explanation for this preference when facing unexpected events could be the cost of finance.

Limited effects of Covid on pension systems. Population aging is still the main challenge

On December 8, 2021, the Organization for Economic Co-operation and Development (OECD) released the report Pensions at a Glance 2021: OECD and G20 Indicators. Its main takeaway is that unemployment support programs and the economic recovery in 2021 are the main factors driving the limited and short-term effect that the pandemic is expected to have on pension systems.

The effects on benefits for future pensioners could be more lasting if the pandemic permanently affects their working careers, but this pales in comparison to the key challenge for the pension system: the rapid aging of the population.

The median age of the population in OECD countries rose from 33 to 41 years between 1990 and 2020 and is expected to increase by a further six years by 2050, because of increased average life expectancy and a drop in fertility. The average ratio among OECD countries of people over 65 years of age to every 100 people of working age (20 to 64 years) rose from 21 in 1990 to 31 in 2020. It is expected that by 2050 there will be 53 older people for every 100 people of working age.

Mexico has the youngest population among OECD members, with a median age of just over 29 in 2020. However, by 2050 this indicator will have increased by 10 years, as opposed to the six-year increase for the OECD average. These figures contrast with those for Japan, Italy, Germany and Greece, whose median age in 2020 was between 45 and 48 and is expected to range from 49 to 55 by 2050.

As to the ratio of people over 65 to every 100 people of working age, Mexico starts from a lower level, but the acceleration will be faster. In 2020, there were 13 elderly people for every 100 people of working age in Mexico, just under a third when compared to Japan, Italy, Germany and Greece, where there are 36 to 52 elderly people for every 100 of working age.

By 2050, however, Mexico will more than double this ratio, as it is expected to reach a level of 29 elderly people for every 100 of working age. Even so, this will still be the lowest level among OECD countries, surpassed only by countries such as South Africa and Saudi Arabia.

Given the aging population and advances in medicine, from 2000 to 2019 there was an increase in the employment of older people in most OECD countries. The employment rate for workers aged 55 to 64 grew by 18.0% on average between those years for the member countries.

The increase exceeded 30% for European countries such as Germany, the Netherlands and the Czech Republic. Moreover, this increase in employment rates was higher than those recorded for ages 52 to 54 (3.0%) for the OECD average.

Unfortunately, Mexico ranked among the nations with the lowest employment for the elderly segment from 2000 to 2019. According to the document, in Mexico the employment rate for people aged 55 to 64 years barely grew 0.6%, while for people aged 65 to 69 years it decreased 6.3%, the second worst record among OECD countries, only behind Turkey.

In most OECD countries, there is a positive correlation between higher educational attainment among workers aged 55-64 and an increase in their employment rates between 2000 and 2019. However, Mexico is the only OECD country for which workers between 55 and 64 years of age with tertiary education saw their employment rate fall (-7.5%) in the period. The high level of informality in Mexico may have influenced these results.

Given the aging of the population and the absence of increases in retirement age, the pressure to fund pensions is on the rise. From 2000 to 2017, average government spending on pensions for OECD countries increased from 6.6% to 7.7% of GDP, accounting for an average of 18.4% of total government spending for this group of countries.

For Mexico, government spending to fund pension payments in 2017 was 2.7% of GDP, one of the lowest among OECD countries, alongside South Korea and Iceland. This low magnitude is driven by the lower age of the population, but also by the low pension coverage, which is estimated at only 35% of the employed population. Additionally, pension spending accounted for 10.2% of total government spending in 2017, reflecting the low level of tax collection in Mexico.

Finally, the paper highlights the reform of the defined contribution pension system in Mexico adopted in 2020. This reform will raise the level of future pensions through an increase in employer contributions to workers' individual accounts. The contribution will increase from 5.150% to 13.875% of salary between 2023 and 2030, while the worker's contribution will remain at 1.125% of salary.

In summary, the OECD reiterated the urgency of the pension issue and the need to carry out reforms on funding, such as raising retirement age. Mexico's situation may appear favorable in terms of population age but limited economic growth and high levels of informality are factors that significantly aggravate the likely retirement conditions for Mexicans.

2. Regulation

Projects under consultation

9.12 SHCP - Resolution amending and adding the general provisions referred to in article 115 of the Mexican law on credit institutions

The project would enable credit institutions to open accounts for refugees and repatriated Mexicans by means of an official document issued by the National Migration Institute (Instituto Nacional de Migración) that certifies internment or legal right of abode.

It also adds to the Blocked Persons List taxpayers who have not been located or are in the process of disputing the facts attributed to them (art. 69-B of the Mexican Federal Tax Code), and allows credit institutions to exchange information with respect to: (i) known history or activity of customers and users; (ii) statistical information drawn from unusual and 24-hour transaction reports on customers and users; (iii) reports on internal transactions of concern; and (iv) circumstances considered in identifying an unusual or internal transaction of concern.

Finally, it recognizes prepaid cards denominated in local currency in favor of foreign nationals and establishes that banks that offer them must create mechanisms to follow up on their purchase and recharge transactions.

20.12 CNBV- Resolution to resume inspection visits ordered by the National Banking and Securities Commission (CNBV)

The purpose of the project is to inform financial institutions and other regulated entities subject to the supervision of the CNBV of the decision to resume inspection visits suspended due to the COVID-19 pandemic.

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

13.12

The IPAB published the general guidelines that establish programs and schedules for preparation of resolution plans for commercial banks, and their content, scope and other characteristics referred to in Article 120 of the Credit Institutions Law.

For the preparation of Resolution Plans, the IPAB must classify institutions as systemic or non-systemic, based on the CNBV's classification of systemically important banks and various additional operational considerations (volume of guaranteed obligations, guaranteed depositors, number and distribution of branches, importance of the institution in specific geographic sectors). Systemically important banks must comply with an additional section related to the critical functions they perform for third parties that, in the event of an interruption, could affect the stability of the financial system and its ancillary services.

If a bank is considered systemic by the IPAB but not by the CNBV, the IPAB must integrate the resolution strategy and methods under both assumptions. Resolution Plans are updated according to the category to which they belong - 3 years for banks under the systemic assumption and 2 to 5 years for the rest - in accordance with their operating characteristics.

15.12 The CNBV published a decision that modifies the general provisions applicable to banks in order to replace the fixed exchange rate set by Banxico to establish the equivalence of the local currency with the dollar in transactions denominated in foreign currency with an exchange rate that considers a wider sample window in order to be consistent with the close of the trading day.

16.12 Banxico published Circular 10/2021, addressed to banks, brokerage firms, investment funds and retirement fund managers, regarding the rules for auctions for the purchase of Bondes D and sale of Bondes F. Rules are made on bidders, auction notices, prices, bids, allocation, results and settlement of the auctions, among other matters.

27.12 Banxico published Circular 11/2021, addressed to banks and brokerage firms, regarding modifications to the procedure to act as government securities market-makers.

The percentages for market-makers or UDIBOND market-makers to commence or stop operating are modified; the maximum amounts that they may acquire as a whole or individually are modified; the restriction on the right to purchase options in syndicated auctions is eliminated; the term for notifications is clarified; and exceptions to the suspension of the right to carry out securities lending transactions are added.

29.12 Banxico published Circular 12/2021 addressed to banks, regulated multiple-purpose financial entities that maintain equity links with banks, and Financiera Nacional de Desarrollo Agropecuario, Rural, Forestal y Pesquero, amending Circular 3/2012 and Circular 13/2021, addressed to banks and regulated multiple-purpose financial entities, regarding amendments to Circular 14/2007.

In both cases, new benchmark interest rates are incorporated, considering the recommendations made by the Financial Stability Board (FSB) and the International Organization of Securities Commissions (IOSCO), in line with the transition to new benchmark rates that comply with best practices and global standards.

30.12 The CNBV published a decision that amends the general provisions applicable to banks (Internal Models, Annexes 15 and 15 bis).

Clarifications are made on models based on internal ratings, highlighting that institutions must only request authorization from the CNBV to modify their internal models when such change produces "a negative percentage variation of 20% or more in the amount of the expected loss estimate in any segment or risk grade of the rating system, or a negative percentage variation of 10% or more of the total amount of the expected loss on the portfolio to which such model applies."

30.12 The CNBV published an amendment to the general provisions applicable to banks, published on March 13, 2020 (Annexes 33 and 36, IFRS 9).

Changes are made to Annex 33 to clarify the application of accounting criteria and to adapt the form and deadlines for the presentation of regulatory reports contained in Annex 36 as a result of the adoption of International Financial Reporting Standard 9 "Financial Instruments" (IFRS).

31.12 The CNBV published an amendment to the general provisions applicable to banks (loan-loss reserves).

The temporary administrative facilities established during the pandemic relating to recognition in supplementary capital of total additional reserves are made permanent. Reserves created in excess of reserves calculated in accordance with the methods established by the CNBV are included in the definition of the latter, subject to limits depending on whether internal models or the standard method are used.

Creating Opportunities

DISCLAIMER

This document and the information, opinions, estimates and recommendations expressed herein, have been prepared by Banco Bilbao Vizcaya Argentaria, S.A. (hereinafter called "BBVA") to provide its customers with general information regarding the date of issue of the report and are subject to changes without prior notice. BBVA is not liable for giving notice of such changes or for updating the contents hereof.

This document and its contents do not constitute an offer, invitation or solicitation to purchase or subscribe to any securities or other instruments, or to undertake or divest investments. Neither shall this document nor its contents form the basis of any contract, commitment or decision of any kind.

Investors who have access to this document should be aware that the securities, instruments or investments to which it refers may not be appropriate for them due to their specific investment goals, financial positions or risk profiles, as these have not been taken into account to prepare this report. Therefore, investors should make their own investment decisions considering the said circumstances and obtaining such specialized advice as may be necessary. The contents of this document is based upon information available to the public that has been obtained from sources considered to be reliable. However, such information has not been independently verified by BBVA and therefore no warranty, either express or implicit, is given regarding its accuracy, integrity or correctness. BBVA accepts no liability of any type for any direct or indirect losses arising from the use of the document or its contents. Investors should note that the past performance of securities or instruments or the historical results of investments do not guarantee future performance.

The market prices of securities or instruments or the results of investments could fluctuate against the interests of investors. Investors should be aware that they could even face a loss of their investment. Transactions in futures, options and securities or high-yield securities can involve high risks and are not appropriate for every investor. Indeed, in the case of some investments, the potential losses may exceed the amount of initial investment and, in such circumstances, investors may be required to pay more money to support those losses. Thus, before undertaking any transaction with these instruments, investors should be aware of their operation, as well as the rights, liabilities and risks implied by the same and the underlying stocks. Investors should also be aware that secondary markets for the said instruments may be limited or even not exist.

BBVA or any of its affiliates, as well as their respective executives and employees, may have a position in any of the securities or instruments referred to, directly or indirectly, in this document, or in any other related thereto; they may trade for their own account or for third-party account in those securities, provide consulting or other services to the issuer of the aforementioned securities or instruments or to companies related thereto or to their shareholders, executives or employees, or may have interests or perform transactions in those securities or instruments or related investments before or after the publication of this report, to the extent permitted by the applicable law.

BBVA or any of its affiliates´ salespeople, traders, and other professionals may provide oral or written market commentary or trading strategies to its clients that reflect opinions that are contrary to the opinions expressed herein. Furthermore, BBVA or any of its affiliates' proprietary trading and investing businesses may make investment decisions that are inconsistent with the recommendations expressed herein. No part of this document may be (i) copied, photocopied or duplicated by any other form or means (ii) redistributed or (iii) quoted, without the prior written consent of BBVA. No part of this report may be copied, conveyed, distributed or furnished to any person or entity in any country (or persons or entities in the same) in which its distribution is prohibited by law. Failure to comply with these restrictions may breach the laws of the relevant jurisdiction.

This document is provided in the United Kingdom solely to those persons to whom it may be addressed according to the Financial Services and Markets Act 2000 (Financial Promotion) Order 2001 and it is not to be directly or indirectly delivered to or distributed among any other type of persons or entities. In particular, this document is only aimed at and can be delivered to the following persons or entities (i) those outside the United Kingdom, (ii) those with expertise regarding investments as mentioned under Section 19(5) of Order 2001, (iii) high net worth entities and any other person or entity under Section 49(1) of Order 2001 to whom the contents hereof can be legally revealed.

The remuneration system concerning the analyst/s author/s of this report is based on multiple criteria, including the revenues obtained by BBVA and, indirectly, the results of BBVA Group in the fiscal year, which, in turn, include the results generated by the investment banking business; nevertheless, they do not receive any remuneration based on revenues from any specific transaction in investment banking.

BBVA Bancomer and the rest of BBVA Group who are not members of FINRA (Financial Industry Regulatory Authority), are not subject to the rules of disclosure for these members.

"BBVA Bancomer, BBVA and its subsidiaries, among which is BBVA Global Markets Research, are subject to the Corporate Policy Group in the field of BBVA Securities Markets. In each jurisdiction in which BBVA is active in the Securities Markets, the policy is complemented by an Internal Code of Conduct which complements the policy and guidelines in conjunction with other established guidelines to prevent and avoid conflicts of interest with respect to recommendations issued by analysts among which is the separation of areas. Corporate Policy is available at: www.bbva.com / Corporate Governance / Conduct in Securities Markets".

ENQUIRIES TO:
BBVA Research – BBVA: Paseo de la Reforma 510, Colonia Juárez, C.P. 06600 Mexico City, Mexico.
Tel.: +52 55 5621 3434
bbvaresearch@bbva.com www.bbvaresearch.com