Banking

Monthly Report on Banking and the Financial System

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1. Banking and the Financial System

Performance of time deposits restrains stronger recovery in conventional bank deposits

In November 2021, the balance of **conventional bank deposits (demand + time)** saw nominal annual growth rate of 5.1% (-2.2% real), the highest rate since March this year, when the double-digit growth streak that lasted 12 months after the start of the pandemic finally tapered off. At a monthly rate, the performance of conventional deposits reached a year-to-date high, with nominal growth of 2.9% compared to October. As in recent months, these results are supported by the strength of demand deposits, which contributed 6.3 pp to the growth of conventional deposits and were enough to offset the 1.2 pp contraction in time deposits.

Demand deposits grew at a nominal annual rate of 9.9% (2.4% real), while their monthly rate stood at 1.7%. This was one of the highest monthly growth rates reported over the course of 2021. The main boost came from business demand deposits, which grew at an annual rate of 15.7% in November. Close to half of this growth is explained by higher inflation (7.8 pp), plus the depreciation of the exchange rate in that month (2.5 pp). Stripping out these accounting effects, real growth was 5.4%. This strength could reflect better performance of economic activity, since the IGAE index for November saw annual growth (with original figures) of 1.7%, higher than that reported the previous month.

The second source of growth came from individuals, whose demand deposits grew at a nominal rate of 14.2% in November. Stripping out the effects of inflation and the exchange rate, real growth was 6.1%. This uptick may arise, on the one hand, from reallocation of term investments to more liquid instruments, and, on the other, from the growth in formal employment (4.4% in November). This performance may be supporting a gradual recovery of household income.

Time deposits softened their fall in the eleventh month of the year, reporting an annual nominal contraction of -3.6%. At a monthly rate, the nominal growth was 3.1%, the highest recorded since April 2020. All segments of this type of deposit showed relative improvement, with time deposits from other financial intermediaries standing out. In the aggregate, after stripping out the accounting effect and the exchange rate (6.2 pp and 1.2 pp respectively), the real drop amounted to 11.3%, remaining at double-digit levels for the ninth consecutive month. The rise in interest rates (200 basis points between January and November 2021) still seems insufficient to promote greater dynamism in this type of savings product, partly because the increase in inflation keeps real interest rates in negative territory, which limits its attractiveness.

Finally, **debt investment funds** reported nominal annual growth of 2.2% in November, returning to positive territory after seven months of contraction. However, at the real rate, they still showed an annual drop of -4.8%, slightly lower than the average seen between January and October 2021 (-5.1%).

The lag in the increase in liability interest rates and a stable exchange rate that holds in the perception of volatility could allow a stronger recovery of this savings alternative in the short term.

In November, bank lending to the non-financial private sector grew 3.0% in nominal terms, which implies a lesser real contraction than in previous months

In November 2021, the nominal balance of the **outstanding loan portfolio granted by commercial banks to the non-financial private sector** grew by 3.0% annually (-4.1% in real terms). In real terms, this decrease in balances was smaller than in September and October (-7.3% and -5.7%, respectively), which suggests a continuation of the finance recovery path, while underscoring the adverse effect that inflation generates in real balances.

The **business lending portfolio** showed slight growth in nominal balances in November, with an increase of 0.1% (-6.8% real). Wide differences between sectors in the financing recovery path has been a constant in recent months, and November was no exception. Regarding services, nominal balances in sectors such as hotels, transportation and professional services showed significant growth in November, with annual nominal rates of 8.4%, 7.1% and 5.8%, respectively. By contrast, the fall in balances continues in sectors such as real estate services, mass media and commercial activities, with annual contractions of -52.0%, -4.6% and -3.1%, respectively.

Regarding secondary activities, the nominal balances of mining, manufacturing and construction slowed their fall, with annual decreases of -9.6%, -1.0% and -0.8%, respectively, while the electricity, water and gas industries displayed an annual contraction of the balances that was higher than in the immediately previous month, falling -11.4%. Financing to the primary sector continues to accelerate, with an annual variation of nominal balances of 4.7%. In fact, November was the third month in a row when figures were both positive and higher than in the immediately previous month.

In the **consumer portfolio**, most segments showed growth in nominal terms, which may reflect a relative improvement in consumption and employment indicators as well as the effect of higher inflation. In fact, in real terms, the durable goods portfolio is the only one that shows growth. Payroll loans show almost zero growth and the other segments remain in negative territory.

The **housing portfolio** maintained positive growth rates in nominal and real terms, although with a real slowdown for the third consecutive month. This could reflect the lagged effect of the decrease in formal job creation, which amounted to job destruction during the first months of the health crisis, but which was already a phenomenon seen since 2019.

The **NPL rate** of the business lending portfolio in November 2021 was 1.77%, slightly higher than in the immediately previous month (1.81%) and than in November 2020 (1.86%). The consumer portfolio exhibited an NPL rate of 3.23% in November 2021 (3.36% in the immediately preceding month and 4.95% in November 2020). The NPL rate of the housing portfolio stood at 3.25%, similar to the 3.26% seen in the immediately previous month, but slightly higher than that observed in November 2020 (3.16%).

Usually, November implies a nominal improvement for NFPS financing, either due to higher growth or lower year-on-year contractions in balances. However, real performance still saw shrinkage in almost all portfolios and segments, and a slowdown in components that had shown strength, such as lending for residential housing. The outbreak of the omicron variant in November and its potential impact on the consumption and business activity pathways could be an obstacle for the recovery of financing.

In November there were signs of improvement, but a sustained recovery in employment and consumption indicators at the national level is necessary to translate these signs into real growth rates for bank funding for households and companies.

The tightening of financial conditions poses a challenging scenario for emerging countries: IMF

As part of its *World Economic Outlook* update, the IMF dedicated a few lines to the matter of financial stability. The *leitmotif* of the report is the tightening of financial conditions as a result of an increase in inflationary risks.

This especially influences the performance of emerging economies (EM), given that they not only face their own cycles of monetary tightening in the face of higher-than-expected inflation levels, but their external sources of financing are affected by the rise in interest rates in developed countries.

Proof of this is that at the beginning of 2022 the spreads of emerging nations' dollar bonds increased, while the reduction of local currency bond holdings by foreign investors continued.

The report points out that the tightening of global financial conditions could lead EM countries to face a rise in real interest rates, which would complicate the outlook for countries with high fiscal needs and deficits.

2. Financial Markets

Search for a new equilibrium for risk asset prices led to high volatility in January

Price volatility in the financial markets during the first month of 2022 was related to the search for a new equilibrium among market participants in the face of changing assumptions guiding their expectations.

On the one hand, the more hawkish than expected tone of the recent Federal Reserve communication made it clear that the era of low interest rates and high liquidity will soon come to an end. This meant a faster than expected withdrawal of one of the main underpinnings of high-risk asset valuations over the past few years, resulting in a series of risk-off episodes.

On the other hand, the strength of U.S. economic activity data and strong corporate results at the end of 2021 seem to support the idea expressed by the Fed Chairman that there is room to raise interest rates without affecting the performance of the labor market and the economy as a whole.

This, for the time being, has reduced the risk perception of a possible "policy error" by the U.S. central bank and boosted risk-taking, especially after the fall in prices, toward the last days of January.

Given this change in context, the most natural move was the **rise in expectations for the U.S. benchmark rate**. According to the futures market, the implied 30-day Fed funds rate for the month of December 2022 went from 75 to 123 basis points (bp) between the last Fed meeting of 2021 and January 31, 2022.

This rise in benchmark rate expectations quickly translated into a 45 bp increase in the yield to maturity of the 2-year Treasury bond, which closed January at 1.18%, its highest level since February 2020. Meanwhile, at the long end of the curve, the yield on the 10-year Treasury bond rose by 27 bp to 1.78% at the end of January. With these changes, the slope of the curve (2Y10Y) fell to 60 bp, reaching its lowest level since October 2020.

U.S. long-term real rates have risen in recent weeks, which could be interpreted as a reflection of market participants discounting that inflation will ease and that the rate hike will not significantly affect economic growth. A possible vote of confidence for the Fed.

In Mexico, the interest rate swap market is pricing in a hike of just under 200 bp for the reference rate toward the end of 2022, with a 50 bp increase for the first meeting on February 10.

On the long end of the curve, the yield to maturity of the 10-year bond closed at 7.68% in January, after an increase of 10 bp with respect to the close of December. This rise tended to subside during the last week of January, influenced by the slowdown in inflation during the first fortnight of January 2022.

In the **stock markets**, this search for a new equilibrium for expectations was clearly verified. Until January 26, the date of the meeting of the Federal Open Market Committee, the main equity indices registered significant falls, which led them, in some cases, such as the Nasdaq 100 index, to enter into correction territory (see Chart 1).

However, favorable corporate results and the strong data on the growth of the U.S. economy during 4Q 2021 reignited demand for risk assets. This translated into significant gains at the end of the month (see Chart 1). Still, this was not enough to prevent a widespread loss for this asset class for January as a whole.

In the **currency market**, expectations of higher interest rates in the U.S. translated into a 0.9% appreciation of the dollar against the currencies of other developed countries in January. For the average of EM currencies, the increase in commodity prices drove an appreciation of 1.5% against the dollar at the end of the first month of the year. The Mexican peso failed to reverse the losses of the first weeks of the month, and ended with a depreciation of 0.52%, which led the exchange rate to trade at 20.64 pesos per dollar by the end of January.

Finally, in the **commodities market**, increases occurred almost across the board. This was reflected in the 11.16% increase in the benchmark for this asset class (SPGSCI). Within the benchmark, the energy sub-index registered the highest increase during January with a rise of 17.04%, followed by the agricultural goods and industrial metals components, with increases of 4.80% and 2.50%, respectively.

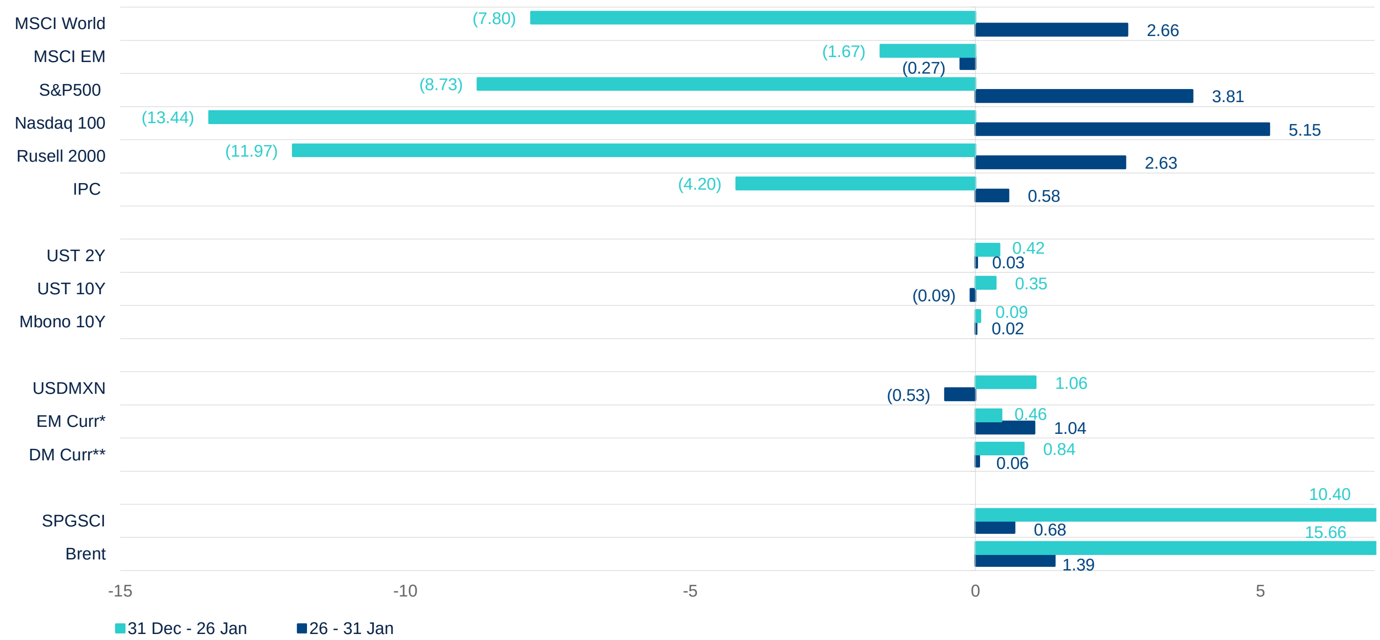
This rise in commodity prices was influenced by low temperatures in the northern hemisphere and geopolitical tensions in Ukraine.

For the time being, market participants seem to favor a **scenario in which the expected growth of the U.S. economy will be sufficient to deliver strong corporate earnings, even in an environment of higher interest rates and lower liquidity.**

However, setting a new equilibrium for market expectations is a gradual process that will depend mainly on the stickiness of inflation, the way in which the monetary authorities communicate and implement the monetary tightening cycle and, most importantly, the mechanism for tapering the assets on their balance sheet.

Given an inflationary outlook not seen for decades and with price risks still posed by pandemic disruptions and geopolitical conflicts, it seems premature to think that high volatility was a January-only issue.

Chart 1. **PRICE PERFORMANCE OF THE MAIN FINANCIAL ASSETS** (% CHANGE IN LOCAL CURRENCY)



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

3. Regulation

Drafts under consultation

25.01 Decision amending Appendix 1 of the provisions relating to the ordinary fees that commercial banking institutions are required to pay to the Institute for the Protection of Bank Savings referred to in Article 22 of the Bank Savings Protection Law.

The draft updates Appendix 1 of the provisions on the ordinary fees that multiple banking institutions are obliged to cover, in accordance with the accounting standards updated by the CNBV, so that the reports for both agencies are consistent.

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

11.02 The CNBV published the resolution informing banks and other regulated entities subject to its supervision of the determination to resume inspection visits, which had been suspended due to the COVID-19 pandemic.

Creating Opportunities

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