Banking

# Monthly Report on Banking and the Financial System

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## 1. Banking and the Financial System

### The dynamism of traditional deposits returned to positive territory, growing in real terms in March

In March 2022, the balance of traditional bank deposits (demand + term) registered a real annual growth rate of 0.3% (7.8% nominal), following 12 consecutive months of falls and after adjusting for the effect of inflation. Sight deposits continue to be the main driving force behind the dynamism of traditional deposits, and in March, they contributed 2.6 percentage points (pp) to growth, which was partially offset by the -2.3 pp fall in term deposits, which continue to perform weakly, despite the increase in interest rates on these instruments.

Sight deposits reached a real annual growth rate of 4.0% (11.8% nominal), slightly below the buoyancy observed with an annual rate the previous month (4.2%). In March, the real monthly change in this deposit rate showed a growth of 1.5%, higher than the average of 0.4% observed for the first two months of 2022. The holders that contributed most to this greater dynamism were companies, whose sight deposits recorded a real annual change of 7.2%, while the deposits of individuals recorded real annual growth of 3.1%, lower than the growth recorded in February (5.2%). It should also be noted that the balances associated with the non-financial public sector reached a real growth rate of 7.8%, the first growth observed after seven consecutive months of falls. Thus, the balances of other financial intermediaries are the only ones that remain in negative territory, registering a fall of -14.3% in March, accumulating 14 months of double-digit falls in real terms.

Term deposits, on the other hand, continue to show weakness. In March 2022, these savings instruments showed a real contraction of -7.0% (-0.1% nominal), lower than that observed in the previous month (-8.9%) but still far from reaching positive territory. Most sectors holding this type of savings instrument (companies, individuals and other financial intermediaries) have moderated the reduction in their balances with respect to the previous year. In the case of the non-financial public sector, these balances fell more sharply, which could partly explain the observed increase in the holding of sight deposits (substitution toward more liquid savings instruments).

An environment of higher inflation may be encouraging agents to hold more liquid balances to finance their current expenditure despite increases in interest rates, which have been insufficient to offset the effect of higher inflation and provide a positive real return.

## Non-financial private sector credit continued to recover in real terms, supported by household financing

In March 2022, the balance of the outstanding loan portfolio granted by commercial banking to the non-financial private sector (NFPS) registered an annual change of -0.5% in real terms (6.9% nominal), a less severe contraction than the -1.8% figure in the previous month. The contraction in March sets the streak of consecutive months with negative growth at 20. Although the nominal effect of higher inflation has implied a positive growth rate of NFPS total balances in the last 5 months, in real terms, no positive annual variation has been recorded since July 2020.

At the end of the third month of the year, the reduction in the performing loan portfolio seems to have leveled off in its annual comparison and recorded monthly growth in real terms for the first time in 2022 (0.3% vs. -0.4% average Jan-Feb). Business loans contributed -1.9 pp to the decline in March, which was partially offset by the contribution of the consumer and housing portfolios (0.6 pp and 0.7 pp respectively).

Current consumer credit grew at a real annual rate of 2.8% (10.5% nominal), increasing its momentum with respect to the previous month (when real growth of 2.1% was observed). The growth in formal employment indicators has allowed for a more stable performance in private consumption, which is reflected in a greater demand for this type of credit. The credit card and payroll loan segments (63% of the consumer portfolio) are the main drivers behind this recovery, with an annual real growth of 3.3% and 3.8%, respectively. It is noteworthy that for the first time in 44 months, annual growth in personal loans was positive, reaching a real annual growth rate of 1.1%. Only loans for the purchase of consumer durables (ABCD for its acronym in Spanish) continue to experience contractions in real terms at an annual rate (6.5%), with no signs of a recovery in the short term.

The housing portfolio increased its annual growth rates in nominal and real terms in March (11.1% and 3.4%, respectively). The result for the third month of the year shows an increase in the momentum of this portfolio, which has been sustained for four consecutive months. The housing portfolio is the only one that has managed to maintain its real growth throughout the pandemic, although it has shown signs of deceleration. The recovery in employment and the expectation of higher long-term interest rates could be encouraging customers to avail themselves of this type of financing, in anticipation of an increase in the cost of longer-term financing.

Finally, business loans (55.2% of the total portfolio to the NFPS) recorded a fall in real terms of -3.3% (growth of 3.9% nominal), reducing its contraction from that observed in the previous month (-5.0%). In monthly terms, the first real growth of the year (0.5%) was recorded in March. The weakness still observed in the recovery in private investment and the increase in the cost of financing could continue to hold back more vigorous growth for this loan portfolio.

In addition, the conflict between Russia and Ukraine has aggravated the bottlenecks in global supply chains, which constitutes an additional downward bias for the performance of business loans, due to the lower revenue flows expected because of these disruptions. As for the consumer portfolio, the persistence of inflation could generate a downward adjustment in the trajectory of private consumption, representing a significant obstacle to the recovery path of the real balances of this portfolio.

## According to the Financial Stability Board (FSB), the balance of risks for the Mexican financial system showed a slight deterioration

The Financial Stability Board presented its annual report, covering the period from April 2021 to March 2022. It highlights the importance of continuing to strengthen a sound and robust macroeconomic framework to achieve a path of sustainable, inclusive and lasting economic growth, leading to higher and more widespread levels of well-being among the population.

The report analyzes the risks that have increased in the financial system due to the national and global environment, such as COVID-19 and its new variants, the persistence of inflation at a global level, as well as the geopolitical conflict between Russia and Ukraine and the response of various countries to this situation. The report also provides more detailed information on risks stemming from the domestic economic context in the short and medium term, policy actions in the areas of public finances and monetary policy, as well as actions taken by the authorities to address local risks. In addition, the report reviews developments in the financial system and analyzes the risks (credit, liquidity, market, technical, financial and operational) faced by the various participants in the financial system. In addition, it reports on the results of stress tests under two macroeconomic scenarios (baseline and adverse) in order to identify, for example, risks arising from business models.

In its credit risk analysis, it highlights that, as of December 2021, the outstanding balance of commercial banks comprises 48% business loans, 19% housing loans, 12% non-revolving consumer loans, 11% government loans, 7% credit card balances and 3% loans to financial institutions. The delinquency rate (IMOR for its acronym in Spanish) for the commercial portfolio registered an average of 1.6% in 2021, closing the year at 1.3%. An average of 3.5% was observed in the housing portfolio during 2021, ending the year at 3.1%. The adjusted delinquency rate (IMORA for its acronym in Spanish) stood at 2.1%, 3.9% and 12.2% as at December 2021 for the commercial, housing and consumer portfolios, respectively. These levels were lower than the ones observed at the end of 2020.

Regarding liquidity risk, the report focuses on the composition of funding sources and the Liquidity Coverage Ratio (LCR) and details that this indicator registered higher levels compared to 2020. As regards its sources, over-the-counter funding represented 71.9% of total bank funding as of December 2021, which shows the continued need for institutions to maintain stable sources of funding. As for unsecured funding, as at December 2021, 83.9% of the total balance corresponds to over-the-counter operations, 7.2% to debt issuances, 5.5% to interbank loans, and 3.5% to subordinated bonds. Secured financing, at the end of 2021, saw a 9.9% increase in the amount for overnight repos and, in relative terms, these transactions went from representing 52.7% to 55.1% of the total amount of secured financing. Turning to the liquidity analysis, commercial banks recorded a quarterly average LCR of more than 100% at the end of 2021, a median of 240% and a minimum of 120%. In 3Q21, Banco Accendo recorded a minimum level of 46%.

With respect to market risk, the average position in debt instruments during 2021 was 82.0% in government securities, 99.8% of which consisted of investments in debt securities. Swaps were the most representative instruments at the end of 2021, with 85.4% of the total, followed by forwards and options, with 10.9% and 3.1%, respectively. As for the concentration of exposure by counterparty at the end of December 2021, a greater weight is observed in foreign financial institutions, brokerage firms and commercial banks.

The report notes that development-banking institutions showed a mixed performance in the various credit segments. The total business portfolio decreased by 4.2%, with growth only in the government portfolio (4.7% compared to December 2020). The IMOR of the total loan portfolio for development banks remained stable during most of 2021 and closed the year at 3.55%, a significant increase over the 1.93% recorded in December 2020. The IMOR of the business portfolio maintained a level of around 1.6% during the first half of 2021, and subsequently showed an increase, reaching a level of 3.3% at the close of 2021, because of the growth in the IMOR of the business portfolio in the last quarter of 2021, which stood at 6.6%.

Lastly, it is important to mention that during the period covered by the report, the balance of risks for the financial system showed a slight deterioration with respect to the previous year's report. This is primarily due to the emergence of new COVID-19 variants, as well as global supply and demand imbalances, inflationary pressures, the materialization of geopolitical risks and a weakening of long-term growth drivers. Likewise, some smaller institutions could face capital shortfalls in light of the proposed scenarios. Therefore, in view of the stress tests, financial authorities will pay special attention to the performance and trend of those banks for which some vulnerability was observed, in addition to following up on the preventive action plans.

# 2. Financial Markets

## Expectation of higher rates and risks for consumption influence the generalized sale of assets in April

In April, the stance of the monetary authorities, economic data and quarterly corporate results continued to shift the array of assumptions and risks guiding the expectations of financial market participants.

On the one hand, the Federal Reserve further tightened the tone of its communication, in a clear signal that the monetary authority remains behind the curve. In response, the market has already incorporated more than a 50 basis point (bp) increase for the federal funds rate in the next three FOMC meetings, in addition to a faster pace of reducing its balance sheet compared to that seen in 2017.

On the other hand, economic data and quarterly results signaled to market participants that the pandemic is nearing its end. The rebound in services consumption to the detriment of goods consumption in the US, as well as lower revenues and customers for companies whose business model flourished during the pandemic (e.g. Netflix), hint that consumption patterns are closer to those observed at the beginning of 2020.

Likewise, the most recent US consumer confidence data indicate that rising inflation and higher interest rates could affect consumption, the largest component of aggregate demand.

In this environment of an ever-accelerating monetary tightening to curb persistent inflation, financial asset prices recorded one of the largest monthly declines since 2008 in some cases.

The **US Treasury bond** curve again recorded widespread increases in April. The yield to maturity of the two-year bond increased by 38bp, closing the fourth month at 2.71%. On the long side, the yield to maturity on the 10-year bond advanced 60bp, pushing it to close April at 2.93%, its highest level since November 2018 (see chart 1). Consequently, the Treasury bond performance benchmark fell 3.1% in April.

In line with the US curve and in view of the expectation of a hike of around 300bp for the monetary policy rate, government rates also increased in Mexico. The **yield to maturity of the 10-year Mbond** rose 85bp in April, so that at the close of the month this instrument traded at 9.12%, its highest level since November 2018.

**Stock markets** registered generalized losses in April, with the largest falls in the technology sector, due to its greater sensitivity to interest rate increases. The main North American indexes fell by more than the 8.43% drop in the global stock market benchmark (see figure 1).

The main Mexican Stock Index (IPC) fell 9.05% in April (see figure 1), a figure that was below the 5.75% decline in the emerging economies stock benchmark (MSCI EM).

In light of the expectation of higher interest rates being set by the FED and, given the positive differentiation of the US economic performance, there was a greater demand for dollars in April. As a result, the **exchange rate** left behind the levels below 20 pesos per dollar and closed April at 20.43 pesos per dollar, a 2.81% depreciation of the Mexican peso, which exceeded the 2.68% depreciation in the emerging currencies benchmark (see Chart 1).

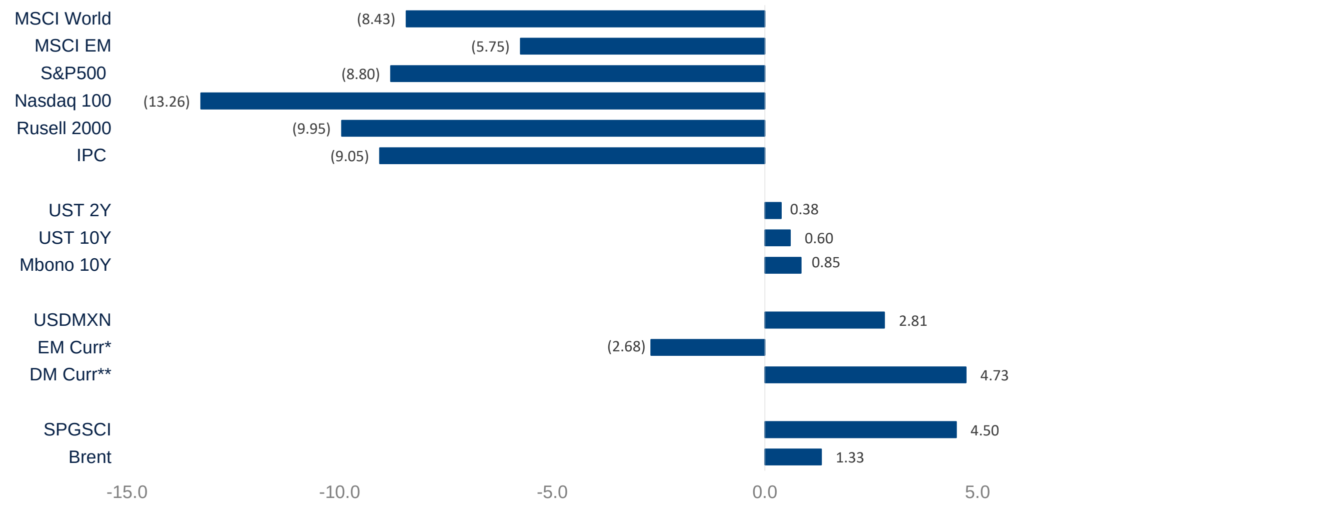
Finally, the global **commodity** benchmark (SPGSCI) appreciated again in April, but at a slower pace and not across the board. Once again, the energy component was the one with the highest gains (7.89%) during the fourth month of the year, primarily driven by gas, as the price of a barrel of Brent oil and the Mexican blend rose by 1.33% and 4.10%, respectively.

The rise in the food component also softened in April (2.33%) compared to previous months, while expectations of lower growth in China, following the resurgence of COVID 19, particularly influenced the demand for industrial metals. As a result, the price of this component fell 7.56% in April (see figure 1).

The Fed's May meeting will help to outline in greater detail the assumptions for financial assets, particularly because the main elements of the Quantitative Tightening (QT) will be announced. However, the main question hanging in the air will continue to be whether the Fed will be able to reduce inflation without triggering a recession in the US economy.

Although historical data point to the contrary, it should be noted that the economic conditions of households and businesses, as well as the geopolitical environment (e.g. conflict in Ukraine, slowdown in China) after the pandemic are not comparable to previous episodes. To a large extent, this signals that central banks are beginning their journey into **completely uncharted territory**.

Figure 1. **TREND IN THE PRICES OF THE MAIN FINANCIAL ASSETS, APRIL 2022**
(CHANGE AS A % IN LOCAL CURRENCY)




*JP Morgan Emerging Markets Currency Index. For this index, a reduction (increase) implies a depreciation (appreciation) of a basket of emerging economy 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 with data from Twitter

# 3. Regulation

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

Circular **5/2022 addressed to the Entities Subject to the Supervision of the Bank of Mexico (Banxico).** It amends the exemptions and provisional measures in relation to the COVID-19 pandemic, terminating the period of suspension for ordinary visits.

Circular **6/2022 addressed to Financial Institutions and Intermediaries Subject to Regulation and Supervision of the Bank of Mexico.** It amends Circular 13/2012. It expands the legal acts that can be carried out through the Electronic Attention Module for automated procedures for the exchange of information and communications to the Entities. It also allows for the resolutions and procedures related to the review and revocation appeals to be known, presented and consulted through said system.

Circular **7/2022 addressed to Credit Institutions and Brokerage Firms, regarding the Rules for holding syndicated auctions of government securities aligned with environmental, social and corporate governance criteria.** It issues the rules for holding syndicated auctions of government securities in domestic currency, aligned with environmental, social and corporate governance (ESG) criteria: types of auctions and bids, allocation of bids, and results and settlement of the auctions.

ESG government securities must be rated by a securities rating agency and by an ESG Criteria Rating Agency, and in turn, comply with the Green Bond Principles, the Social Bond Principles and the Sustainable Bond Guide. By way of request, the SHCP will determine the banks and brokerage firms that may act as ESG Dealers and, if applicable, must enter into the respective contract with Banxico in order to participate in the auctions.

## Projects under consultation

15.03 **Circular 1/2022 addressed to participants of the electronic banking payment system and other parties interested in acting as such (amending Circular 14/2017).**

The project continues with the modifications to the SPEI system within the framework of its expansion and inclusion of indirect participants. On this occasion, the amount of Low Value Transfer Orders and CoDi Transfer Orders is increased from 8 to 21 thousand pesos. This change is replicated and extended for the purposes of the time periods applicable to the accreditation and return of SPEI transfer orders, as well as to determine the requirement of additional identity verification elements, among other adjustments.

15.03 **Circular 3/2022 Payment systems administered by Banxico. Amendments to Circular 13/2017.**

It requires banks to keep for at least 5 years information on international fund transfers made at the request of customers and users without using SPEI.

15.03 **Circular 4/2022 Operations of credit institutions, regulated multiple purpose financial companies that maintain equity links with credit institutions and the National Agricultural, Rural, Forestry and Fishing Development Financial Institution (Financiera Nacional de Desarrollo Agropecuario, Rural, Forestal y Pesquero). Amendments to Circular 3/2012.**

It establishes the obligation for banks to inform the Bank of Mexico of the association or disassociation between telephone numbers and accounts, for the purpose of making transfers, as well as to obtain the express consent of the account holders to provide their data.

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