Banking

Monthly Report on Banking and the Financial System

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1. Banking and the Financial System

Sight deposits stabilized their pace of recovery while term deposits still recorded annual rate falls

In April 2022, the balance of traditional bank deposits (sight + term) registered a real annual growth rate of 1.5% (9.3% nominal), remaining in positive ground for the second consecutive month. Sight deposits continue to be the main source of momentum for traditional deposits, and in March, they contributed 2.7 percentage points (pp) to its growth, which were partially offset by the -1.2 pp drop recorded by term deposits, which have moderated their decline, but continue to perform weakly.

Sight deposits registered a real annual growth rate of 4.0% (12.0% nominal), similar to that observed in February and March. In April, the real monthly variation for this type of deposits showed a drop of 1.4%, which partially explains the stability in the annual growth rate. The holders that most contributed to the annual growth registered in April were companies, whose sight deposits registered a real annual change of 7.9% (higher than the 6.4% observed in the previous month), while deposits of individuals accelerated their dynamism from 2.8% in March 2022 to 4.5% in April.

The reactivation of household spending, which has been reflected in a greater flow of income for companies, is supporting the momentum observed in sight deposits. In particular, in April, the ANTAD (National Association of Supermarkets and Department Stores, for its acronym in Spanish) sales indicator registered a real growth rate of 8.1% (maintaining the average observed in the first quarter of the year), while sales revenues in the trade sector also showed an improvement in their annual comparison (growth of 9.2% in the case of retail trade and 7.9% in wholesale).

Meanwhile, term deposits moderated their decline. In April 2022, these savings instruments showed a real contraction of -3.4% (4.0% nominal), lower than that observed in the previous month (-6.7%). At a monthly rate, real growth was 1.6%, the highest variation registered since December 2021. All sectors holding these types of savings (companies, individuals, other financial intermediaries (OFIs) and the public sector) showed a moderation in the fall in their balances with respect to the previous year, but have not yet shown the sort of dynamism that would allow them to reach the balances observed prior to the pandemic: valued at constant pesos, the balance of term deposits in April 2022 is still 15.5% below the level observed in February 2020. The increase in interest rates for this type of instrument has not been enough to trigger greater dynamism, and the recomposition effect of savings toward more liquid instruments continues to dominate, as reflected in the sustained growth of demand deposits.

Non-financial private sector credit registered its first real growth rate after 20 months of declines

In April 2022, the outstanding loan portfolio balance granted by commercial banks to the non-financial private sector (NFPS) registered an annual change of 0.9% in real terms (8.6% nominal), this being the first real growth rate recorded since July 2020, thus concluding a period of declines in the outstanding balance that had lasted 20 months, longer than that observed during the 2009 financial crisis (when the outstanding portfolio contracted for a period of 14 months). With regard to the growth registered in April, consumer and housing credit contributed 0.8 pp respectively, a growth that was partially offset by the decrease in business loans, which subtracted 0.7pp from the dynamism.

Outstanding consumer credit achieved real annual growth of 3.9% (11.9% nominal), increasing its performance compared to the average of the first quarter of 2022 (1Q22, when real growth of 1.9% was observed). The credit card and payroll loans segments (63% of the consumer portfolio) continue to be the main source of recovery, with real growth of 4.9% and 4.6%, respectively. While the recovery of the outstanding balance of personal loans is still lagging, the segment is already registering real annual growth of 3.5% in April. Only loans for the acquisition of durable consumer goods (ADCG) continue to register contractions in real terms at annual rate, intensifying their fall in the fourth month of the year, with an annual change of -1.1%.

The housing portfolio maintained its dynamism by registering a real annual growth rate of 3.4%, the same as that observed in the previous month. The performance of this portfolio seems to indicate that the recovery of employment and the possibility of facing higher long-term interest rates could be encouraging agents to avail themselves of this type of financing.

Lastly, business loans (55.6% of the total portfolio for NFPS) moderated their decline in April, registering a contraction in real terms of -1.3% (growth of 6.4% nominal), lower than the contraction observed the previous month (-3.3%). At a monthly rate, real growth reached 1.8%, the highest recorded since April 2020. The relative improvement observed in investment indicators (as of March, gross fixed capital formation registered a growth rate of 5.9%) could be the source of greater demand for this type of financing; however, the impulse is still insufficient to trigger a sustained recovery in the outstanding balance of this 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 as a result 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.

Supplier financing and new credit usage increased in 1Q22

In May, Banco de México (Banxico) published the results of the Quarterly Survey for the Evaluation of the Credit Market, which covers the period January - March 2022. The survey includes an analysis of sources of financing by type of provider, bank credit, perception of the conditions of access and the cost of bank credit, and limiting factors according to companies for using new bank credit, in order to learn about the performance of financing for companies.

In its analysis of financing sources by type of provider, it highlights that supplier financing and commercial banking are the two sources most used by companies. In 1Q22, there was an increase in the proportion of companies using supplier financing (from 60.9% in the previous quarter to 63.5%), while commercial banking credit decreased slightly (from 33.9% in 4Q21 to 33.7% in 1Q22). Other sources of financing increased, with the exception of banks headquartered abroad.

Regarding bank indebtedness of companies, 46.0% of companies had bank loans at the beginning of 1Q22, a lower percentage than that recorded in 4Q21 (48.4%). In addition, 19.5% of companies used new bank loans, a higher percentage than that recorded in 4Q21 (17.8%). As to the destination of the new credits, companies reported working capital as the main use (77.2%), while the percentage of those that have used it for investment decreased slightly with respect to the previous quarter (from 18.9% to 18.1%).

As regards the perception of the conditions of access and cost of bank credit, results are presented through diffusion indexes. For the total of the surveyed companies that used new bank loans (19.5%), the [1]diffusion indexes indicate more accessible conditions in terms of amounts (56.0 points) and terms offered (54.8 points). However, the conditions for refinancing credits (46.7 points), credit resolution times (45.0 points), collateral requirements (40.5 points) and other requirements requested by the banks (42.6 points) were perceived by the companies surveyed as less favorable than in the previous quarter. In addition, compared to the previous quarter, there was a less favorable balance in terms of conditions and other expenses associated with bank credit (31.8 points) and interest rates (23.6 points).

Lastly, the survey lists the main limiting factors mentioned by companies for using new bank loans. In order of importance, they were: interest rates in the credit market (47.4%), the general economic situation (43.8%), the amounts required as collateral (42.8%), the access conditions to bank credit (40.7%), access to public support (38.5%), the willingness of banks to grant credit (36.1%), the company's sales and profitability (34.9%), the company's capitalization (32.3%), difficulties in servicing current bank debt (27.2%) and the company's credit history (25.9%).

Banks perceive a greater demand for credit to large companies and non-financial SMEs

Banxico published the Survey on General Conditions and/or Standards in the Banking Credit Market (EnBan), which was conducted between March and April 2022 and covers the period January - March 2022. The EnBan collects qualitative information from among those responsible for credit granting policies in commercial banks operating in the country about the performance of credit demand and general conditions and/or credit approval standards in the market.

With respect to demand for credit, both the banks with the largest and smallest shares reported an increase in the segments of large non-financial companies, non-financial SMEs and personal loans. In the case of credit card loans and non-bank financial intermediaries, the banks with the highest participation did not perceive significant changes in demand, while the banks with the lowest share perceived an increase. For payroll and mortgage loans, neither of the two groups of banks reported changes in demand. Finally, for auto loans, while the smaller banks did not perceive a change in demand, the larger banks reported a decrease.

In relation to general credit conditions and/or approval standards during 1Q22 (compared to the previous quarter), both groups of banks reported tighter general credit conditions in the non-bank financial intermediaries segment and similar conditions for mortgage and payroll loans. Whereas for the SME, credit card, personal and automotive lending segments, the larger banks reported more relaxed conditions and the smaller banks reported similar conditions.

1: The diffusion indexes measure the perception of the conditions for accessing the banking credit market during the current quarter compared to the previous quarter.

Finally, in the case of credit to large non-financial companies, banks with a higher share reported similar conditions to those of the previous quarter, while those with a lower share reported tighter conditions.

Regarding expectations for 2Q22, both types of banks anticipate tighter conditions for non-bank financial intermediaries and similar conditions for mortgage credit. For non-financial SMEs and credit cards, larger banks expect more relaxed conditions, while smaller banks expect similar conditions. Finally, for large non-financial companies, while banks with a higher share expect similar conditions, those with a lower share expect tighter conditions.

Gradual recovery of financing to the private sector, supported by a resilient banking system

In its first Quarterly Report of the year, Banxico illustrates how the effects of the economic reactivation after the pandemic have been reflected in a slow but steady recovery of financing, particularly in households, without this having changed the good risk management by banking institutions.

The increase in the annual flow of financing to the non-financial private sector in 1Q22, coming entirely from domestic sources, was channeled more to households through payroll and credit card loans than to companies (for more details see Mexico Banking Outlook, First Half of 2022).

The recovery in employment has supported both the demand and supply side (easing of conditions) of credit to households. However, the still weak demand for corporate credit to invest in fixed assets, high cash reserves and tight credit conditions have slowed the recovery of corporate financing.

Given this backdrop of recovery in financing to the private sector, banks maintain very high capitalization levels, even considering the adjustment for risk, mainly due to an increase in their core capital.

Credit risk decreased in 1Q22 (from 11.06% to 8.98% of the loan portfolio) due to lower probabilities of default, while market risk increased slightly (from 4.04% to 4.21% of net capital) due to higher interest rates on government bonds.

Therefore, the central bank concludes that banks show a greater capacity to absorb potential operational and default risks in their portfolios.

In Mexico, total financing fell -3.4% in real annual terms in 4Q21, while financial savings fell -4.4%

On May 16, 2022, the National Banking and Securities Commission (CNBV) published the Report on Financial Savings and Financing in Mexico, with data as at December 2021. The report highlights that, in 4Q21, total financial savings presented a real annual contraction of -4.4%, and reached 94.6% of GDP. Likewise, total financing registered a real annual decrease of -3.4%, reaching an amount equivalent to 95.0% of GDP.

Foreign savings showed a real annual decline of -9.9%, reaching 25.0% of GDP in December. By destination, foreign savings received by the public sector amounted to 16.2% of GDP, while those captured by the private sector represented 8.8% of GDP. In terms of their composition as a percentage of GDP, securities issued abroad accounted for 12.2%, securities issued in Mexico by non-residents 6.5% and loans obtained abroad 6.3%, all of which are lower than those recorded at the end of 3Q21.

Domestic financial savings fell -2.2% in real annual terms at the end of 4Q21 and its share of GDP dropped to 69.6% (from 72.9% at the end of September). Holdings of fixed-income securities and fiduciary stock certificates (CBFs, 35.3% of GDP) registered a real annual decline of -2.7%, while deposits from financial intermediaries (34.4% of GDP) shrank -1.8%. Within this section, commercial banks accounted for most of the funds raised, with balances representing 22.9% of GDP, while Infonavit and development banks represented 5.3% and 3.3% of GDP, respectively.

There was a year-on-year contraction in foreign financing (18.5% of GDP) of -2.4%. This resulted from a -5.0% fall in real terms in foreign financing to the private sector (8.3% of GDP) and foreign financing to the private sector (10.2% of GDP) of -0.3%.

By type of foreign financing, fixed-income securities issued abroad were equivalent to 12.2% of GDP, while foreign loans represented 6.3% of GDP, similar to those recorded at the end of 3Q21. With respect to domestic financing, the balances presented a real annual contraction of -3.6%, reaching 76.4% of GDP. In December, by type of financing, domestic debt issuance and trust certificates (43.1% of GDP) fell -3.9% in real annual terms, while the total loan portfolio (33.3% of GDP) contracted -3.1%.

Total financing to the private sector (43.9% of GDP) was mainly composed of commercial bank credit (17.4% of GDP), followed by credit from other financial intermediaries (10.9% of GDP), debt issuance and trust certificates (5.6% of GDP) and development banks (1.6% of GDP). Almost 92% of public sector financing (51.1% of GDP) was made up of debt issuance and trust certificates (37.5% of GDP), followed by loans from commercial banks (2.2% of GDP), development banks (1.2% of GDP) and other intermediaries (0.04% of GDP).

Within foreign financing, the only component that grew in 4Q21 was foreign issuance by the Federal Government (United Mexican States Bonds), mitigating the fall in the total.

The greater magnitude of the contraction in domestic financing has brought about a fall of 18 bp compared to foreign sources. With respect to savings, although the contraction also occurred in the domestic components of savings, those coming from the rest of the world presented the largest drop, implying a recomposition of balances that is contrary to that of financing.

The report also presents informative data from non-financial entities. Non-bank credit cards increased their real annual balances by 2.1% in 4Q21, while supplier credit to BMV issuers increased by 2.0%; both real growth rates could imply a substitution effect in financing that would partially explain the lag in the recovery of commercial bank credit observed in the credit card and corporate credit segments at the end of 2021.

2. Financial Markets

Volatility rose as recession worries stole the spotlight in May. The Mexican peso hit its highest level since 2020.

During the month of May, there was a shift in the attention of financial market participants to the possibility of a recession in the next two years because of the monetary tightening cycle.

Although U.S. inflation in April stood at 8.3% YoY, the fact that it moderated for the first time in eight months focused the conversation on the possible "peak" of the price increase. This in turn was supported by an easing of inflation expectations, as measured by the 5 and 10-year inflation breakevens, which during May fell 39 and 28 basis points (bp), respectively.

This shift in the inflation conversation focused the narrative on the possibility of a recession as a result of rising interest rates, a theme that has been present, albeit somewhat subdued, in the face of historical experience, which indicates that recessions in the United States have often been preceded by cycles of monetary tightening.

Concerns about economic growth were reinforced by some signs of weakness in the US consumer and other economies. These signals included lower-than-expected results from US supermarket chains, weak activity figures in China following measures to contain COVID-19, and rumblings from investment bank and technology company executives about the challenging outlook.

In this environment, in which concerns of market participants seemed to shift from supply shocks to a consequent weakness in global demand, risk asset prices registered high volatility.

The main **stock indexes** continued with losses for most of the month, however, the possibility of a pause in the Fed's hiking cycle, based on the interpretation of the minutes of the most recent meeting, generated a recovery in the last week of May.

As a result, the US indexes significantly reduced the losses suffered in previous months and even moved away from negative monthly figures in some cases. Nevertheless, so far in 2022, the main stock indexes have maintained losses of up to 22.78% in the case of the Nasdaq (see Figure 1).

The Mexican Stock Exchange's IPC registered a monthly increase of 0.65%, above the 0.14% rise of the emerging markets benchmark (MSCI EM). So far, in 2022, the IPC continues to stand out as one of the indexes with the lowest losses (see Figure 1).

In the face of concerns about weak growth, **fixed income securities** exhibited higher demand. The US curve recorded a 16 bp drop in yields for the 2-year bonds, while the long end of the curve fell by 9 bp, bringing the yield on the 10-year Treasury bond to 2.84% at the end of May.

The yield to maturity of Mexico's 10-year bond fell 47 bp (see Figure 1), closing June at 8.65%, after having reached 9.18% at the beginning of May. It should be noted that market expectations indicate that Banxico could raise the rate to levels above 9.0%, which influenced the last auction of the month, when the 364-day Cete was issued at 9.07%.

The reduction in yields influenced a **milder strength of the dollar**. The US currency depreciated 1.17% against the currencies of developed countries and 1.38% against emerging market (EM) currencies. Among the latter, the

Mexican peso stood out as the fourth most appreciated currency among its peers (3.77%), with the exchange rate closing May at 19.66 pesos, its lowest level since the beginning of 2020.

It is still of significance that, in this environment with losses in the main asset classes, the five most appreciated currencies in EM so far this year (Ruble, Real, Colombian Peso, Peruvian Sol and Mexican Peso) correspond to countries with a relevant share of its exports devoted to raw materials.

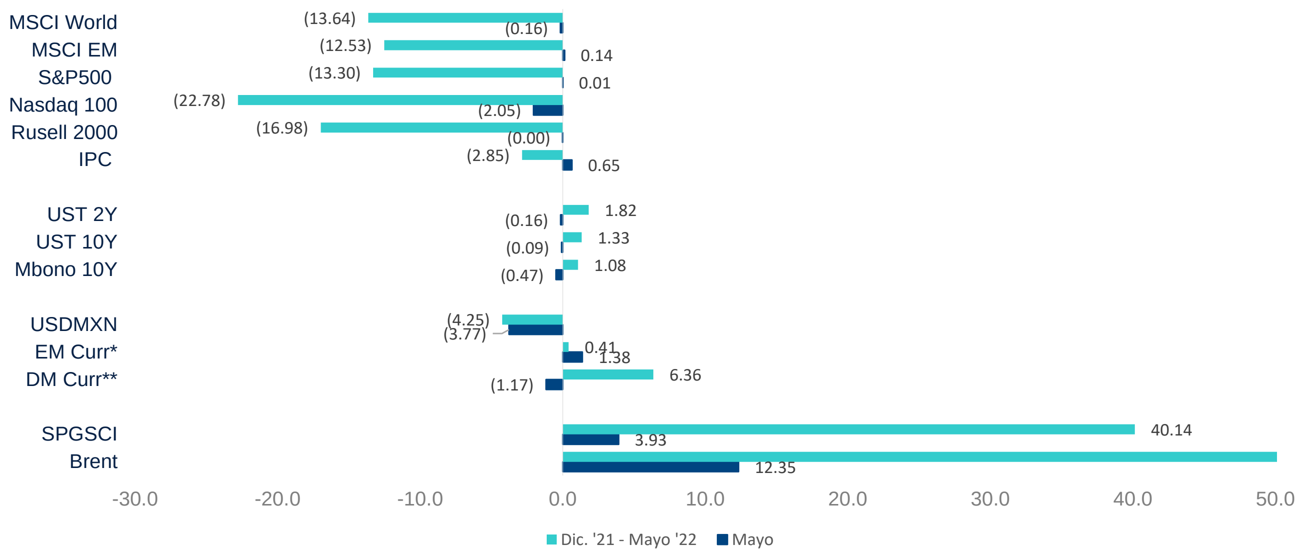
In fact, **commodities** continue to be the asset class with one of the most attractive yields during the year (see Figure 1), even though a slowdown was observed in May. The benchmark for this asset class (S&PGSCI) had a monthly return of 3.93%, which was supported by the 7.96% rise in the energy component, and more than offset the fall in the other components (see Figure 1).

Within the energy component, Brent crude oil rose again in May (12.3%) to over USD 120 per barrel, while the Mexican mix surpassed USD 113 per barrel at the end of the fifth month of the year, after increasing 11.58% on a monthly basis.

The change in the inflation narrative among market participants seems premature, considering that the inflationary shocks of the magnitude the world is currently facing have shown persistence and high volatility in the past. In the event that April was not the "peak" for US inflation, attention is likely to markedly return to the pricing issue, the path of rate hikes, and with it, a more worrisome tone for growth.

If the data in the coming months reinforce the idea that inflation is on a slow but steady downward trajectory, the focus will be on the extent to which activity growth data weakens without turning negative, as this would suggest that the US economy would be able to withstand the rate hike cycle.

Figure 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 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 Bloomberg

3. Regulation

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

Resolution **modifying the general provisions applicable to credit institutions.** Modifies the parameters for the determination of Loss Given Default for the Foundation internal-ratings based approach for the commercial portfolio, moving from fixed percentages for senior unsecured positions and subordinated positions (currently with values of 45% and 75%, respectively) to a more granular scheme based on the months elapsed since the classification of the position in Stage 3, increasing the risk sensitivity of the variable.

Draft amendments under consultation

25.05 **Draft amendments to the general rules contained in Circular 27/2008 of Banco de México, regarding credit offering platforms administered by Banco de México.**

This establishes that authorizations to consult credit reports granted once may be used by all participants of the platforms or applications administered by Banxico to, on a single occasion, make the consultation before the credit bureaus so that they may offer credit to the respective client, provided that the latter have given their explicit authorization.

26.05 **Resolution amending the general provisions applicable to credit institutions (Appendix 69)**

This draft amendment would modified the requirements of the Contingency Plans that must be applied in situations that threaten the solvency or liquidity of the Institutions, increasing their detail and adding, among others:

i) information on organizational changes; business or equity links; characteristics of their infrastructure, and of its business group or parent company;

ii) definition of roles and responsibilities related to the Plan; monitoring of indicators; recovery actions implementation, follow-up, assessment and continuous improvement;

iii) details of the internal and external communication strategy; definition of actions to be taken in the face of negative reactions from the market and appointment of communication managers;

iv) minimum quantitative requirements to be considered (capital, liquidity, profitability, asset quality, external rating, share price), their action thresholds, and details of actions to be taken; and

v) possibility of using the capital and liquidity stress tests for the purposes of the required annual test of the Plans (provided these place the institutions in categories III, IV or V for the Capitalization Ratio and Liquidity Coverage Ratio, as well as in II, III or IV for the Net Stable Funding Ratio).

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