Banking

Monthly Banking and Financial System Report

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1. Banking and Financial System

Lending to the non-financial private sector continues to recover in July

In the seventh month of the year, the balance of the performing loan portfolio granted by commercial banks to the non-financial private sector (NFPS) increased at an annual rate of 3.2% in real terms (11.6% nominal), higher than the average growth recorded in the first half of the year (0.3% real), thus consolidating its recovery. The three portfolios that make up this lending aggregate recorded real growth at an annual rate, although the recovery continues at different paces. Business and consumer loans each contributed 1.2 pp to the growth recorded in July, while housing loans contributed 0.8 pp.

Performing business loans (55.5% of the total NFPS portfolio) posted three consecutive months with real growth rates and a real annual rate of 2.2% in July (10.5% nominal), significantly improving their performance with respect to the first half of the year (a period in which the average real fall totaled -1.9%). Part of the growth recorded in July is due to the exchange rate valuation effect (0.6 pp of the total growth of 2.2% can be attributed to the depreciation observed in July). Even if we discount this effect, there was a significant increase in the balances denominated in foreign currency, which achieved growth of 9.7% in real terms in July, the highest annual rate observed since April 2020. In contrast, credit balances in local currency fell back slightly by 0.5% after remaining in positive territory for two months. More limited access to external sources of financing (such as credit and issuances in international markets) could be encouraging companies to replace them with local banking loans. In particular, the balance of lending to businesses abroad slowed by 3.9% in real terms at the end of 2Q22, a fall higher than the one observed in 1Q22 (when the drop amounted to 2.8% per annum), while the reduction of debt issues placed abroad accelerated from 7.8% to 8.2% in the same period.

Outstanding consumer credit (21.9% of the total) recorded a real annual growth rate of 5.6% in late July 2022 (14.3% nominal), exceeding the performance observed in the first half of the year, when the real growth rate averaged 3.2%. The only portfolio that continues to display a weak recovery is that of car loans, whose balances fell by 4.3% in real terms in July. Automobile sales indicators seem to indicate that the recovery of this loan segment will continue to lag behind, given that it has lost momentum over the last two months. The drops in sales in June and July steepened, with a respective annual variation of -10.2% and -12.0%, a slowdown with respect to the performance in May (when the fall was 5.7%). On the other hand, the dynamism observed in formal employment and real wages continue to underpin the recovery of the other consumer loan segments. The vitality of the outstanding credit balance through cards increased in July, registering 6.3% real annual growth (higher than the 1H22 average of 3.4%), payroll loans rose by a real 6.2%

(vs. the 4.2% average in 1H22) and personal loans went up by 6.7% in real terms (vs. the 1.5% average in the first half of the year).

Outstanding housing loans (21.6% of the total portfolio) are beginning to display a slight slowdown. In July, the real growth of the outstanding balances stood at 3.3%, lower than the figures observed in May and June (3.5% and 3.4%, respectively). This downward trend could drag on, as the portfolio's dynamism reflects the performance of formal employment with a time lag, while the cycle of rising interest rates will also make this kind of financing more expensive.

Although the recovery of the different portfolios has managed to take hold, their drive could be curbed if there is a slowdown in the growth of formal employment, a higher inflation with a negative impact on real wages over a prolonged period of time or conditions that restrict the incentives for private companies to invest.

Demand deposits remain the main source of banks' fund raising, but time deposits begin to gain ground

In July 2022, the balance of traditional demand and time deposits in commercial banks recorded a real annual growth rate of 1.9% (10.2% nominal). Although this result exceeds the average posted in the first half of 2022 (1H22, in which an average 0.8% real growth rate was observed), the recovery appears to be showing signs of stagnation, as the momentum has remained at similar levels over the last three months (with real growth rates close to an annual rate of 2%). Demand deposits contributed 1.2 pp to the dynamism reported in July, while time deposits added 0.8 pp. Although demand deposits continue to constitute the main source of the increase in traditional bank deposits, their importance has declined, while time deposits are beginning to recover their impetus.

Demand deposits registered a real annual growth rate of 1.7% (10.0% nominal), less than half the average figure observed in the first half of the year (3.6% real annual). The reduction in the dynamism of these instruments is partly due to a replacement effect, as several holders have opted to reallocate part of their liquidity to longer-term instruments, given their greater relative attractiveness as a result of the cycle of rising interest rates.

As for businesses, the annual rate growth fell with respect to June (from 5.9% to 2.1% in real terms in July), partly reflecting the slowing growth rate of income in some sectors. In June, according to the latest available information, business income recorded lower annual growth than that observed in the previous month: 4.8% for wholesale trade (vs. 8.0% in May), 4.0% for retail trade (vs. 5.2% the previous month) and 2.2% for service sector companies (vs. 3.8% in May). These kinds of holders also increased their savings in time deposits.

In the case of individuals, the 1.5% growth recorded in July is lower than that observed in the previous month (3.1%). A vigorous private consumption (7.2% annual rate in May), the fall in the growth rate of formal employment (from an annual figure of 4.4% in June to 3.9% in July), and replacements with longer-term instruments are likely to be the reasons for this slower growth rate of demand deposits.

For the second month running, time deposits recorded a 2.4% positive annual variation in real terms (10.7% nominal), a significant improvement over the modest real annual growth rate of 0.4% reported in June. The sectors holding these kinds of savings included that of individuals, which recorded a real annual growth rate of 5.3% in July, an improvement on its performance with respect to the previous month (2.9% real), while businesses registered a real annual growth rate (of 1.0%) for the first time in 16 months. Moreover, the time deposits of other financial intermediaries also managed to remain in positive territory, although their dynamism declined (from a growth rate of 1.6% in June to one of 0.6% in July).

The proportion of companies using financing to restructure liabilities increases

In August, Banco de México (Banxico) published the results of the Quarterly Survey of the Cyclical Evaluation of the Credit Market for the quarter from April to June 2022. In its analysis of financing sources by type of provider, it observed a slight fall in the proportion of companies that used supplier financing (from 63.5% in the previous quarter to 63.0%) in 2Q22, while commercial banking loans increased (from 33.7% in 4Q21 to 34.9% in 1Q22). As for other sources of financing, they displayed increases, with the exception of the issuance of debt abroad.

With regard to debt to banks, 47.0% of companies had bank loans at the beginning of 2Q22, a higher percentage than that recorded in 1Q22 (46.0%). Furthermore, 21.0% of companies used new bank loans, a higher percentage than the one registered in 1Q22 (19.5%). As for the use of the new loans, companies reported working capital as the main one (74.6%), while the percentage of those that allocated them to investment decreased with respect to the previous quarter (from 18.1% to 14.0%) and the percentage that used them to restructure liabilities more than doubled in the period under study, rising from 7.1% to 15.3%.

As for the perception of the conditions for access and the cost of bank loans, the results are presented by means of diffusion indexes[1]. With respect to all of the surveyed companies that used new bank loans (21.0%), diffusion indexes indicate less accessible conditions in terms of the amounts (48.1 points), the terms offered (50.3 points) and the credit resolution times (44.5 points). On the other hand, the conditions for refinancing loans (52.2 points), the collateral requirements (45.2 points) and other requirements requested by banks (46.0 points) were perceived as more favorable than in the previous quarter by the companies that were surveyed. Moreover, compared to the previous quarter, a less favorable balance in terms of interest rates (19.2 points) was displayed.

Finally, the survey lists the main limiting factors mentioned by companies when it comes to using new bank loans. They are, in order of importance, the general economic situation (47.0%), the interest rates in the credit market (45.1%), the amounts required as collateral (41.9%), the conditions for access to bank loans (38.7%), access to public aid (38.3%), the willingness of banks to grant loans (36.6%), the company's sales and profitability (35.4%), the company's capitalization (32.4%), the difficulties encountered in servicing the outstanding bank debt (29.1%) and the company's credit history (26.4%).

1: Diffusion indexes measure the perception of the conditions for access to the bank loan market in the current quarter with respect to the previous quarter.

Banks anticipate a tightening of the general credit conditions for large companies and non-bank financial intermediaries

Banxico published the Survey on General Conditions and/or Standards in the Bank Credit Market (EnBan) for 2Q22. EnBan compiles qualitative information from the heads of the policies for granting loans at commercial banks operating in the country related to the evolution of the demand for credit and the general conditions and/or standards for loan approvals in the market.

With respect to the demand for credit, both the banks with greater participation and those with lower participation reported increases in the segments related to large non-financial companies, non-financial small and medium enterprises (SMEs), personal loans, payroll loans and mortgages. In the case of credit card loans, auto loans and loans to non-bank financial intermediaries, banks with greater participation did not perceive any significant changes in demand, while banks with lower participation perceived increases.

With regard to the general credit conditions and/or standards for loan approvals in 2Q22 (compared to the previous quarter), the two groups of banks reported tighter general credit conditions in the non-bank financial intermediary segment. In the cases of the SME loan, payroll loan, personal loan and car loan segments, while the banks with greater participation reported more relaxed conditions, those with less reported similar conditions. Finally, with regard to loans to large non-financial companies and mortgage loans, both groups of banks recorded conditions that are more similar.

In terms of the expectations for 2Q22, the two kinds of banks anticipate tighter conditions for non-bank financial intermediaries and large non-financial companies. As for non-financial SMEs and credit cards, the banks with greater participation expect more relaxed conditions while the smaller ones expect similar conditions. Finally, with respect to mortgage loans, both groups of banks anticipate similar conditions to those observed in the previous quarter.

Total financial savings fell by -4.3% and total financing declined by -3.0% in real annual terms in 1Q22 in Mexico

On August 19, 2022, the CNBV (National Banking and Securities Commission) published the Report on Financial Savings and Financing in Mexico with data as of March 2022. The report highlights that total financial savings displayed a real annual slowdown of -4.3% in 1Q22, amounting to 95.1% of GDP. Likewise, total financing recorded a real annual fall of -3.0%, accounting for 97.3% of GDP.

External savings displayed a real annual slowdown of -11.2%, accounting for 24.8% of GDP in March. By allocation, the foreign resources received by the public sector were equivalent to 16.0% of GDP, while those received by the private sector accounted for 8.9% of GDP. In terms of their composition as percentages of GDP, securities issued abroad accounted for 12.4%, securities issued in Mexico held by non-residents recorded a 6.3% share and loans obtained represented 6.1%, lower proportions than those recorded at the end of 4Q21.

Moreover, domestic financial savings fell by a real annual rate of -1.6% at the end of 1Q22 and increased their share of GDP to 70.2% (from 69.6% at the end of 2021). Holdings of fixed-income securities and senior trust bonds (34.7% of GDP) recorded a real annual fall of -4.4%, while fund gathering by financial intermediaries (35.6% of GDP) rose by

1.3%. Within this section, commercial banks account for most of the resources received, with balances accounting for 23.5% of GDP, while Infonavit and development banks have respective shares of 5.4% and 3.3% of GDP.

As for financing, the external component registered a real annual downturn of -7.1%, accounting for 18.6% of GDP, assigned to external funding of the private sector (8.4% of GDP), which decreased by -7.2% in real terms, and external funding of the public sector (10.2% of GDP), which fell by -7.0%.

By type of external financing, fixed-income securities issued abroad were equivalent to 12.4% of GDP, while foreign loans accounted for 6.1% of GDP, shares slightly lower than those recorded at the end of 4Q21. With respect to domestic financing, balances recorded a real annual slowdown of -2.0%, accounting for 78.7% of GDP. In March, by type of financing, the issuance of domestic debt and senior trust bonds (45.1% of GDP) fell by -3.9% in real annual terms, while the total loan portfolio (33.7% of GDP) fell by -2.9%.

The total financing of the private sector (44.4% of GDP) was chiefly made up of loans from commercial banks (19.9% of GDP), followed by loans from other financial intermediaries (11.0% of GDP), debt issuance and senior trust bonds (5.8% of GDP) and development banks (1.6% of GDP). 74.2% of the financing of the public sector (52.9% of GDP) was made up of debt issuance and senior trust bonds (39.3% of GDP), followed by loans from commercial banks (2.3% of GDP), development banks (1.2% of GDP) and other intermediaries (0.04% of GDP).

The lower magnitude of the slowdown of domestic financing has led to a recomposition to the detriment of external sources. With respect to savings, those from the rest of the world display the sharpest fall, leading to a recomposition of the balances similar to that of financing. In particular, the increase in deposits has brought about a mitigation of the fall of the domestic savings balances in Mexico.

The report also submits informative data on non-financial institutions. On the one hand, the balances of non-bank credit cards fell by a real annual rate of -1.3% in 1Q22, while, on the other, loans by providers to Mexican stock exchange issuers dropped by -7.2%; the two real slowdowns could be the result of a replacement effect in financing, with the recovery of commercial bank loans displacing financing by non-financial institutions.

Supply-side factors account for the recent fall in supplier credit: Quarterly Report April – June 2022 (Banxico)

Given the reduction in supplier credit in the wake of the COVID-19 pandemic, Banxico devotes one section of its Quarterly Report April – June 2022 to examining the factors that determine the use and granting of supplier credit by private non-financial firms in Mexico.

Based on *probit* models, Banxico identifies sales, bank lending access conditions, the ratio of liquid assets and liabilities, and bank loan cost conditions as the determining factors in the demand for supplier credit.

During 2021, the increase in sales drove up the demand for this kind of credit; however, loan access conditions remained restricted, in addition to the fact that the reduction of assets due to the pandemic increased the credit risk of companies. Thus, the net effect of these factors on the demand for supplier credit between 2020 and 2022 is ambiguous.

As for the factors that account for the likelihood of a company granting financing to its customers, the analysis identifies the access to financing of both commercial banks and their own suppliers, as well as the increase in production costs.

Thus, in the 2020-2022 period, the reduced access to bank financing by companies, as well as the lower margins due to the increase in production costs, may account for the fall in the granting of credit to suppliers.

Overall, Banxico concludes that supply factors account for most of the fall observed in the percentage of firms that used supplier credit in Mexico after the pandemic.

Main ENAFIN 2021 results

The CNBV (National Banking and Securities Commission), in partnership with the INEGI (National Institute of Statistics and Geography), submitted the results of the National Survey of Enterprise Financing (ENAFIN 2021), which includes a study conducted between August and September 2021, with 2020 as the reference period. The purpose of this survey was to compile information on the knowledge of, access to and use of financing and other products by micro, small, medium-sized and large companies in the construction, manufacturing, trade and private non-financial services sectors in Mexico.

With regard to financial products and services, the ENAFIN 2021 report shows that 84% of companies in the country have a deposit account with regulated financial intermediaries, with medium-sized companies the leaders in terms of holding them (93%), followed by large companies (90%), small companies (88%) and micro companies (79%); on the other hand, 16% of companies that do not have a deposit account report that the main reason is to make use of their cash (52%), a fact that is cited more by micro companies (61%) and small companies (40%). Companies have diversified the banking products they hold, as 71% of companies have a business checkbook account and 51% have a deposit account, in comparison with the respective figures of 47% and 23% recorded in 2017. As for holding business credit cards, the percentage has more than doubled with respect to 2017. One of the most significant changes observed is the rise in the use of digital banking services; online banking increased to 61%, while mobile banking stood at 34% in comparison with 2017, when the respective rates stood at 40% and 6%. In addition to banking services, companies use other financial products and services such as financial factoring, although only 3% of them reported using this service and it tends to be used more by medium-sized companies (13%). Another service is financial leasing, which has been used by 13% of the companies, most notably medium-sized companies (32%). In turn, insurance is one of the non-bank financial products used most often by companies (56%), particularly large corporations (91%).

In terms of financing, 47% of companies have applied for credit at some time since they began their operations. This percentage has increased by 7 percentage points (pp) compared to 2015 and marginally with respect to 2018. By size, the companies that have used this means of financing most often are medium-sized ones (71%), followed by large (57%), small (49%) and micro (41%) enterprises. As for the sources of financing, regardless of their size, most companies turn to commercial banks to make their first application for credit (66%), while only 5% of companies turn to non-bank financial intermediaries (NBFIs) for their first application.

Companies that have never applied for financing (53%) are of particular interest in terms of financial inclusion. The main reasons for not doing so are that they regard themselves as self-sufficient or they have other means (34%), followed by a lack of interest (29%). The ENAFIN 2021 report indicates that the participation of companies in the credit market is still limited and that companies perceive financing as costly, because of the level of the rates or due to factors limiting access to financing. Furthermore, the formalities and requirements of the process are listed as some of the potential obstacles for companies when it comes to applying for financing. Digitalization has facilitated the diversification of the means of payment accepted by companies; although cash is still the most widely-accepted means (79%), electronic transfers are now accepted by more than 70% of companies and, in particular, 61% of micro-enterprises and more than 90% of medium-sized and large companies now accept this kind of payment.

In relation to the health conditions stemming from the COVID-19 pandemic (keeping in mind that the results refer to 2020, the year in which the effects were most severe), at least 8 out of 10 companies reported having undergone a fall in income or sales (83%), with micro and small companies those most affected (84%). Furthermore, total or partial closures during the pandemic affected 79% of companies, with micro and small companies those most affected (78% and 81%, respectively). Around 7 out of 10 companies reported cost increases (72%), particularly medium-sized firms (79%) and large companies (77%). Finally, about 54% reported defaults and delays in payment among their customers due to the pandemic hygiene measures, with this proportion rising to 71% in the case of medium-sized companies. Moreover, according to the ENAFIN 2021 report, branch closures were the main negative impact related to financial services (23%). The increase in the use of digital media was chiefly due to the need to mitigate the effects of the pandemic, with social networks the medium that was most widely-used (38%).

2. Financial Markets

The Fed’s restrictive measures in August once again tighten the financial conditions after the gains in July

A month after the major financial assets posted gains, leading to a reduction in the tightening of the financial conditions, the Fed made clear to the market participants that its primary objective is to reduce inflation and that there will be costs in terms of activity and employment in order to fulfill it. To some extent, this message helped to align expectations with economic fundamentals and cemented the ephemeral nature of July’s returns.

In fact, the restrictive nature of the speech by the Chairman of the Fed in Jackson Hole and its influence on the rise in the prospects of an interest rate hike resulted in losses for the main risk assets, which, in most cases, exceeded the gains recorded following the US inflation data below expectations in July.

In particular, the main indexes in the stock markets closed August with losses after recording some gains during the first three weeks (see Graph 1). Among them, the Nasdaq 100 underwent a fall of 6.51% following the Jackson Hole speech (26 on August 31), resulting in a 4.64% drop in the month as a whole.

Although this movement could be put down to the high degree of sensitivity of technological stock prices to interest rate variations (given that a large number of their flows are expected in remote periods), it is worth highlighting that the global benchmark for this asset class (MSCI World) fell by 5.10% after the Jackson Hole meeting and by 4.33% in August as a whole. The Mexican Stock Exchange Index (IPC) fell by 6.70% during the month, following a 5.88% drop in the wake of the message by the Fed.

In the US fixed-income market, rates continued to rise after the beginning of the month following the better-than-expected US job figures, although they accelerated a week before the Jackson Hole meeting due to the expectations of restrictive measures (see Graph 1).

Thus, the yield to maturity of the two-year Treasury Bond closed with a rise of 61 base points (bps), ending August at 3.49%, its highest level since 2007, while the monthly rise of the 10-year node stood at 54bp, with the closing figure of 3.19% well below the June high of 3.47%. These movements steepened the downward slope, reflecting the expectations that there will be less economic activity, but also that the Fed will achieve its objective.

Influenced mainly by these movements, the 10-year Mbono yield ended August at 9.06%, a rise of 48bp for the month. The higher-than-expected inflation in the first half of August did not have a significant effect. With the expectations of growth in the coming years falling and the IRS still discounting rates close to 10.0% by year-end, the likelihood of the Mbono rising above the levels of around 9.30% registered in June appears lower.

In the foreign exchange market, the dollar rose again in August, particularly against the currencies of developed countries (2.64%), as the energy crisis has weakened the Euro. With respect to emerging market (EM) currencies, the rise was lower (0.73%) and, within this group, the Mexican peso underwent a considerable increase of 1.14%.

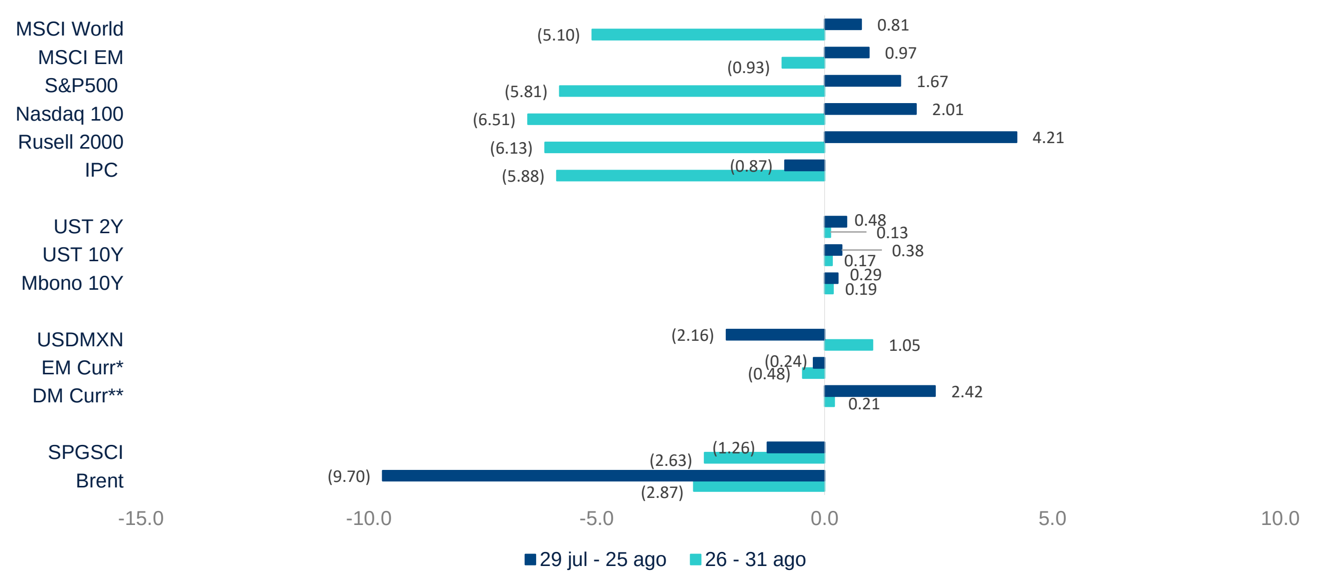
This rise was the third largest among its peers in August, which resulted in the exchange rate ending the month at 20.14 pesos per dollar. A favorable relative position in terms of risk-adjusted return in comparison to its peers and debt levels in line with its rating may be behind this performance, among other factors.

Some of the lower inflation observed in July in the USA was influenced by the fall in commodity prices, which have been affected by the lower expectations of growth, particularly in China. During August, only the food component underwent an increase (3.07%), which led to the benchmark of this asset class falling by 3.86% (see Graph 1), its third downward month in a row. The falls in the components included energy, with a downturn of 6.26% for the month, influenced by the 12.29% drop in the price of Brent oil and that of 12.58% in the case of the Mexican oil mix.

The degree of persistence of inflation and the consequences for economic activity of the initiatives of central banks to control it will continue to be the main topics of debate in the coming months. The recent announcement by the Fed appears to send signals to the market that significant easing of the financial conditions, without any evidence that inflation is trending downward and in keeping with its forecasts, is not aligned with its goals.

As a result, given the context of a weak global economy and in the absence of any inflation and employment data that clearly suggest a soft landing, the risks run by financial asset prices appear to be skewed downwards.

Graph 1. **PERFORMANCE OF PRICES OF MAIN FINANCIAL ASSETS DURING AUGUST**
(% VARIATION 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

Projects under consultation

CONDUSEF - Provision regarding registrations with CONDUSEF

On 11/23/21, a draft consolidating in a single regulatory body the different obligations of financial institutions in terms of registries and implementing a tool and identity code was made public; as a result, all obligations are brought together on a single platform, eliminating the practice of entering into collaboration agreements to join CONDUSEF's Electronic Management System.

Furthermore, the period for the submission of reports regarding Financial Service Providers, registrations and updates of Collection and Complaint Agencies is increased from quarterly to monthly, while the deadlines for such submissions and for correcting omissions and errors are reduced from ten to five business days.

On August 22, a new version of the project was submitted, addressing some of the remarks made by the industry, including the following: the holder of the CONDUSEF identity code is expected to be able to authorize and provide access to different officials; it establishes the times for collection calls from 8:00 am to 9:00 pm each day (the original version set-up a schedule from 8:00 am to 7:00 pm, Monday to Friday); and it establishes the obligation to deliver to CONDUSEF, for inclusion in the REUS, a list of customers who have rejected the use of their information for marketing or advertising purposes (instead of the complete customer database originally envisaged), replacing the obligation to have recordings as proof of receipt of complaints and claims with a logbook.

Finally, a standardized format for account statements is proposed for credit cards whose adherence contracts are registered in the RECA.

Publications in the DOF

08/22 Circular 8/2022 of Banco de México, addressed to institutions subject to the supervision of Banco de México, amending Memorandum 44/2020, which resumes the deadlines for the filing, processing and resolution of appeals for reconsideration and review, in view of the evolution of the effects of the COVID-19 pandemic.

08/22 Memorandum 9/2022 of Banco de México, amending Memorandum 39/2020, which adjusts the Long-Term Local Scale Credit Ratings Table and the Short-Term Local Scale Credit Ratings Table of Memorandum 39/2020, in view of the adjustments made by Moody’s to the nomenclature of its ratings.

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