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Banking

Monthly Report on Banking and the Financial System

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1. Banking and the Financial System

Credit to the non-financial private sector gathered pace in October

In October 2022, the balance of the outstanding loan portfolio granted by commercial banks to the non-financial private sector (NFPS) grew at an annual rate of 4.4% in real terms (13.1% nominal), higher than the real growth recorded the previous month (3.7%) and the average seen in the first nine months of the year (1.3%). The three portfolios that make up this credit aggregate kept up real growth at annual rates, although consumer credit was more dynamic than the corporate and housing portfolios. Of the 4.4% growth recorded in October, consumer credit contributed 1.8 pp, business credit 1.9 pp and housing credit 0.7 pp.

Loans to companies grew at an annual rate of 3.4% in real terms in October (12.1% nominal), higher than the 3.0% real growth seen in the previous month. For the second consecutive month, credit in local currency saw a positive annual change, gathering pace at a real rate of 2.8% in October, higher than the average of -1.4% observed between January and September.

Outstanding balances denominated in foreign currency, however, significantly slowed after the rebound observed between July and September this year: from an average real rate of 10.5% during those three months, the pace of origination dropped to 5.4% in October. The recovery of corporate finance has been slow and, in constant pesos, the outstanding balance of corporate credit in October is still 7.0% below the level recorded prior to the beginning of the pandemic (February 2020).

Outstanding consumer credit continues to be the most dynamic portfolio. In October it reached a real annual growth rate of 8.3% (17.4% nominal), doubling the average performance seen between January and September (4.1% real annual growth rate). The main source of momentum for this portfolio is credit cards (36.8% of total outstanding consumer credit), whose outstanding balance reached a real annual growth rate of 11.3% in October, the first double-digit real rate observed since July 2013.

Payroll and personal loans also retained their forward movement, with real annual growth rates of 7.1% and 5.6%, respectively. The only portfolio that has not yet been able to recover its pace is automotive loans, where the balance fell by -1.4% in real terms in October.

The vigor shown by formal employment and real wages (where growth stood at 4.1% and 2.5%, respectively, in October) sustained the performance of the various consumer credit segments. However, incipient signs of deterioration are beginning to be observed in certain segments of the portfolio. After remaining at historically low levels, the delinquency rate of consumer credit in October reached 3.0%, slightly higher than the average observed in the first

nine months of the year (2.9%), with the most significant increase in the personal loan portfolio (whose delinquency went from an average of 4.4% between January and September to 4.7% in October).

As to outstanding housing loans, growth remained stable. In October, real annual growth of outstanding balances stood at 3.2%, equal to the average seen in the first nine months of the year, but a recovery with respect to the lower rates recorded in August and September (2.9%). The dynamism of this portfolio has a downward bias as it reacts with a lag to the behavior of formal employment, which, together with the increase in long-term interest rates, would point to a more moderate demand for mortgage loans in future.

As in recent months, the results observed in October suggest that credit demand is biased toward funding households' short-term needs. The growth of consumer and housing finance was supported by the strong performance of the labor market, so a slowdown in the latter would have a negative impact on the performance of these portfolios. However, the corporate portfolio underwent a slow recovery that risks being interrupted if economic activity loses momentum. To date, delinquency rates remain at manageable levels, but it remains critical to maintain prudent origination processes in light of a less favorable economic environment by 2023.

Traditional bank deposit gathered pace in October, driven by time deposits

In October 2022, the balance of traditional bank deposits (demand + time) saw real annual growth of 1.0% (9.5% nominal), reversing the slowdown observed in September and showing a marginal improvement with respect to the real average growth of 0.8% recorded in the first nine months of the year. For the third consecutive month, demand deposits ceased to be the main source of traditional bank deposits growth, contributing only 0.3 pp to the anual rate in October, while time deposits contributed the remaining 0.7 pp.

Demand deposits achieved annual growth of 0.5% in real terms (9.0% nominal), reversing the -0.5% real contraction observed in September, but still well below the average seen in the first nine months of the year (2.5% real). More vigorous consumption (which grew at an annual rate of 7.1% in August, the latest available data) together with higher interest rates for term instruments may be reducing the attractiveness of keeping cash in demand deposits. The recovery observed in October came from deposits denominated in foreign currency, which showed a growth rate of 4.2%, while deposits in local currency saw three consecutive months of decline in October (0.7% real average). This pattern is consistent with the performance of time deposits by currency, which point to a substitution of cash by longer-term savings, which, given the rise in interest rates, have become more attractive.

Time deposits recorded an annual real rate of 2.1% (10.7% real), thus making five consecutive months of growth. Among the sectors holding this type of savings, the recovery continues to be led by deposits placed by individuals, which in October registered a real annual growth rate of 9.7% (18.9% nominal), the highest rate seen since July 2019. Although at a more moderate pace, corporate time deposits reversed the fall recorded in September and closed October with real growth of 1.6%. By type of currency, contrary to the case of demand deposits, time deposits in local currency showed greater vigor, with an average real growth rate in the last three months of 7.1%, while time deposits in foreign currency accelerated their fall in the same period (-18.4% real).

Debt investment funds ('DIFs'), on the other hand, achieved real annual growth of 4.6% (13.4% nominal) in October, the highest rate since April 2020. They chained together four consecutive months of growth, after a prolonged period of contraction that stretched for 23 months. This recovery occurred in an environment of relative stability in the exchange rate and even with interest rate hikes that could reduce the attractiveness of investing in fixed income funds.

As a result of an environment of economic growth, higher inflation and higher interest rates, a reallocation of savers' resources has been seen. Savers have stopped accumulating resources in cash-equivalent instruments and have reallocated them to instruments that offer a higher yield, such as time deposits or DIFs. Some of the precautionary savings accumulated during the pandemic were diluted as agents resumed their consumption patterns. By the end of October, the balance of total deposits (demand + time + debt funds) was only 3.2% (real) above the level observed in February 2020, when at its peak (April-20) it was up to 10.1% (real) above that level.

In Mexico, total financing fell -2.9% and total financial savings declined -2.7% in real annual terms in 2Q22

The National Banking and Securities Commission (CNBV) published its Report on Financial Savings and Financing in Mexico, with data as of June 2022. According to the document, in 2Q22, total financial savings showed a real annual contraction of -2.7%, and the balance was equivalent to 92.0% of GDP. Likewise, total financing registered a real annual decrease of -2.9%, reaching 92.9% of GDP.

Foreign savings showed a real annual contraction of -11.6%, with a balance equivalent to 22.8% of GDP in June. By destination, foreign funds received by the public sector amounted to 14.5% of GDP, while those raised by the private sector represented 8.3% of GDP. By type of instrument, as a percentage of GDP, securities issued abroad accounted for 11.5%, loans obtained abroad for 5.7% and securities issued in Mexico in the hands of non-residents for 5.6%. These were lower percentages than those recorded at the end of 1Q22.

Domestic financial savings grew 0.7% in real annual terms at the end of 2Q22, although their share of GDP dropped to 69.2% (from 70.2% at the end of 1Q22). Holdings of fixed-income securities and fiduciary stock certificates ('CBFs', 34.6% of GDP) showed a real annual drop of -1.9%, while deposits acquired by financial intermediaries (34.6% of GDP) grew 3.5%. Commercial banks accounted for most of the funds acquired, with balances representing 22.6% of GDP, while Infonavit and development banks represented 5.3% and 3.0% of GDP, respectively.

In terms of finance, the foreign component registered a real annual contraction of -6.8%, with a balance equivalent to 17.2% of GDP. Foreign funding to the private sector (7.9% of GDP) decreased -8.1% in real terms and foreign funding to the public sector (9.4% of GDP) decreased -5.6%. By type of foreign financing, fixed-income securities issued abroad were equivalent to 11.5% of GDP, while foreign loans represented 5.7% of GDP. These were slightly lower proportions than those recorded at the end of 1Q22.

With respect to domestic finance, balances showed a real annual contraction of -2.0%, reaching 75.7% of GDP. In June, by type of finance, the issuance of domestic debt and fiduciary stock certificates (43.1% of GDP) fell -2.0% in real annual terms, a contraction of the same magnitude as that seen in the total credit portfolio (32.6% of GDP).

Total financing to the private sector (42.7% of GDP) was mainly composed of commercial bank credit (17.4% of GDP), followed by credit from other financial intermediaries (10.4% of GDP), debt issuance and fiduciary stock certificates (5.5% of GDP) and development banks (1.5% of GDP). Almost 75.0% of public sector financing (50.2% of GDP) was made up of debt issuance and fiduciary stock certificates (37.7% of GDP), followed by loans from commercial banks (4.2% of GDP), development banks (2.2% of GDP) and other intermediaries (0.03% of GDP).

While the lesser contraction of domestic finance still implies a re-composition to the detriment of foreign sources, this change is smaller than in previous quarters. However, with respect to savings, the foreign component shows the greatest contraction, implying a more radical re-composition of balances than in the case of finance.

The report also presents data from non-financial entities. Non-bank credit cards reduced their balances by -1.4% (real annual rate) in 2Q22, while supplier credit to BMV (Mexican stock exchange) issuers decreased by -4.3%. These real declines could continue to be the result of the recovery of commercial bank finance, which implies a displacement of credit from non-financial entities.

Commercial banking remains the main driver of financial inclusion

The National Banking and Securities Commission published its Financial Inclusion Outlook 2022. The aim of the paper is to show the behavior of financial inclusion in Mexico, in terms of infrastructure for the provision of financial services, financial products, means of payment, remittances and gender gaps, with data as of the end of 2021.

In terms of financial infrastructure, a total of 15,465 branches were reported in 2021, a 4.2% decrease with respect to 2020. Commercial banking was the sector that concentrated the largest number of branches (75% of the total), followed by savings and loan cooperatives (SOCAPs, 14%), people's financial societies (SOFIPOs, 7%) and development banking (4%). Contrary to the case of branches, in 2021 an increase was observed in other access channels, such as correspondents, whose number rose to 48,845, showing growth of 5.8% compared to 2020, ATMs, which increased by 1.7% compared to 2020 to reach a total of 60,435, and PoS terminals, which showed an increase of 5.1% in the same comparison period. With these results, the percentage of municipalities with at least one access point increased from 76% in 2018 to 79% in 2021.

In terms of financial products, there was an increase from 2020 to 2021 in both deposit and finance instruments. The number of deposit accounts amounted to nearly 135.2 million contracts, which represented an increase of 3.2% with respect to 2020. Commercial banking accounted for nearly 110 million deposit accounts (81%), followed by SOCAPs (11%), SOFIPOs (4%) and development banking (4%). The number of loans to individuals increased by 5.9% with respect to 2020, reaching nearly 58.3 million loans in 2021. Of these loans, 93% were granted by commercial banks.

As to transactions, during the reference period the amount of transfers increased from 157.1% of GDP to 165.1%. Most of the transfers were made through internet banking, amounting to 87.7 billion pesos, equivalent to 53% of the total. The number of electronic transactions and transfers saw a significant increase, reaching a total of 6,675.6 million transactions in 2021, representing an increase of 21% over the transactions registered in 2020. The largest number of transactions were carried out through PoS terminals, followed by ATMs.

2. Financial Markets

Overreaction in risk asset prices to October US inflation data?

The lower-than-expected inflation data for the month of October in the United States was the main catalyst for the behavior of financial markets in November, while keeping as a backdrop the expectation of a recession by 2023.

The above-expected reduction in US price growth, both in the headline and core indicators, reinforced the expectation that the inflation peak is behind us and that the reduction could consolidate in the coming months. This was reflected in a reduction in the level of the federal funds rate by the end of the Fed's tightening cycle, which, in turn, brought with it a significant bout of increased risk appetite.

This move in the futures markets took place even though a week earlier the Fed Chairman emphasized that while the magnitude of federal funds rate increases could be reduced the FOMC expected the end-of-cycle rate level to be higher than its forecasts showed last September.

Among market participants, the cut in the expectation of the federal funds rate at the end of the cycle to levels below 5.0% as of November 10 translated into a drop in the US government curve. After having increased 10 basis points during the first nine days of November, following the inflation data, the yield to maturity of the two-year Treasury bond fell 27 bp and closed November with a 17 bp drop to a level of 4.31% (see graph 1).

At the long end of the curve, the fall was even more pronounced, as the yield to maturity of the 10-year Treasury bond fell 49 bp after the inflation figure and 44 bp during November, so that this instrument closed the month at 3.61%. The greater fall at the long end of the curve suggests that, in addition to the reduction in inflation, the market is discounting lower growth in the medium term.

In the Mexican curve, the reduction in inflation during the month of October to 8.4% also contributed to the sense that the peak of the price increase was behind us, which, together with the movement of the US curve and expectations of lower growth in 2023, was reflected in an accumulated drop of 62 bp during November in the yield to maturity of the 10-year Mexican bond.

Unlike the US economy, core inflation in Mexico rose again in October, which intensified the debate about how soon Banxico should disengage from the Fed.

Supported by this fall in interest rates, the main stock indexes recorded increases for the second consecutive month. Similar to what happened in the fixed-income market, there were two distinct periods within the month of November, separated by the announcement of the US inflation figure on November 10 (see chart 1). After this data point was released, the best performance was recorded by the Nasdaq index with an increase of 10.8%, practically 2.4 percentage points above the benchmark for this asset class (MSCI World).

Nevertheless, throughout November, the emerging markets equity index grew the most (14.6%), its highest monthly growth since 2009 and more than double MSCI World (see chart 1). In addition to the issue of a lower expected level of interest rates in the United States, this performance was influenced by the expectation that China will relax its zero-COVID policy in the coming months and allow the slowdown in global growth to be less pronounced.

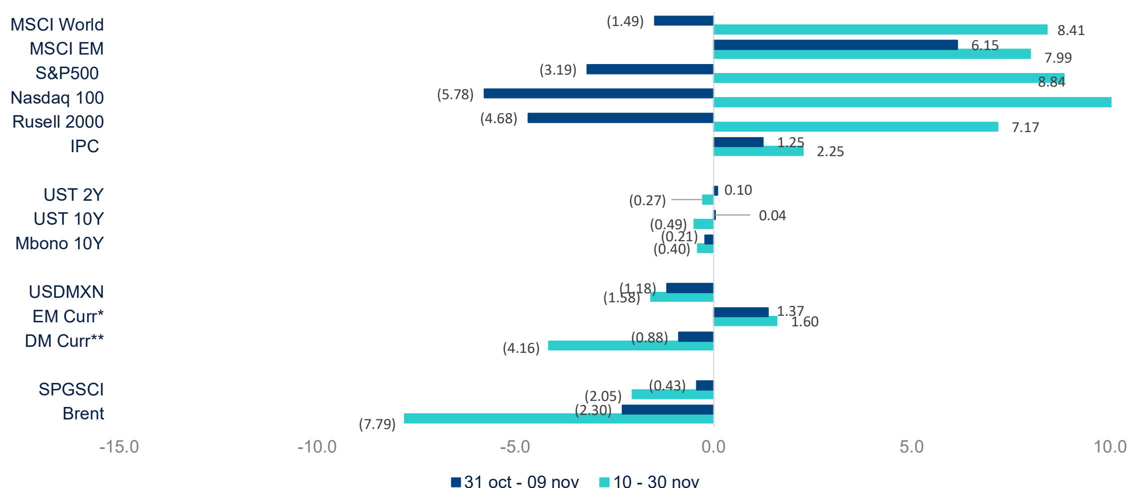
Expectations of a slower rate hike cycle in the short term for the federal funds rate and forecasts of a recession in the US economy seem to have prevailed in the foreign exchange market and materialized in a generalized weakening of the dollar (see chart 1). Among emerging market currencies, which appreciated by 3.0% during November, the Mexican peso was the fourteenth most appreciated currency (2.8%), which led the exchange rate to close November at 19.27 pesos per dollar, its lowest level since February 2020.

Finally, commodity prices during November seemed to reflect expectations of lower economic growth going forward. The benchmark of this asset class chained its fifth consecutive month of decline (-2.5%), driven mainly by the energy sub-index with a 5.7% drop in November. It is worth noting that the Mexican blend fell 10.6% during the penultimate month of the year, to close at USD 72.8 per barrel, just four dollars above the forecast price for 2023.

The October inflation data in the United States is undoubtedly favorable for the outlook of risk asset prices. However, such an emphatic market reaction seems premature after a single below-expected inflation figure, without a significant tightening of the labor market and even leaving aside the warning that the end-of-cycle interest rate will be higher.

In this context, the Fed faces a considerable challenge: by emphasizing that, even though the pace of the next rate hikes will be slower, it is expected that the rate at the end of the cycle will be more restrictive and could remain at that level for longer, the Fed Chairman has triggered a favorable reaction in the markets, which has translated into a loosening of monetary conditions. This behavior makes it harder to achieve the inflation target. The balance of risks to asset prices improved at the margin.

Chart 1. **Performance of the prices of the main financial assets during November** (% change in local currency)



Source: BBVA Research with data from Bloomberg.
*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.

3. Regulation

Draft amendments under consultation

28.11 **Banxico - Draft amendments to Circular 13/2012, regarding operators for the fee registration system (Electronic Service Module)**

The draft amendment aims to incorporate to the rules related to the Electronic Service Module several definitions and processes to accredit or revoke representatives, qualified representatives and operators for the performance of acts in Banxico's Fees Registration System (RECO).

07.11 **CNBV - Decision modifying the general provisions applicable to Financial Technology Institutions**

The proposal updates the current secondary regulatory framework applicable to FTIs with respect to accounting standards and the integration of financial information as a consequence of the adoption of IFRS 9. The draft updates the manner and terms on which FTIs will deliver their regulatory reports and other financial information to the CNBV; it also sets out the content of the analysis and comments on financial information to be included in the annual report and proposes measures to reinforce the control environment in terms of internal valuation models, among other matters.

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

08.11 Circular 13/2022 Amendments to Circular 27/2008, regarding credit offering platforms administered by Banco de México. Establishes that credit report inquiries may be authorized by customers through the platforms. Authorization will be granted only once, for all the entities chosen by the customer.

08.11 Circular 14/2022 Amendments to the rules to be followed by financial institutions in their repurchase transactions. Incorporates fiduciary stock certificates issued by the Fondo Nacional de Infraestructura (FONADIN) as eligible securities for repurchase transactions.

28.11 General provisions that indicate the days in 2023 on which financial institutions subject to CNBV supervision must close for business and suspend operations (01.01, 06.02, 20.03, 06.04, 06.04, 07.04, 01.05, 16.09, 02.11, 20.11, 12.12, 25.12 and Saturdays and Sundays).

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