Banking

# Monthly Report on Banking and the Financial System

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## 1. Banking and the Financial System

### Non-financial private sector credit increased its dynamism in November, mostly driven by financing to households

In November 2022, the nominal balance of the outstanding loan portfolio granted by commercial banks to the non-financial private sector (NFPS) grew at an annual rate of 12.8% (4.7% in real terms), slightly lower than the growth recorded in the immediately preceding month (IPMIPM, 13.1%), but higher in real terms. With regard to the monthly real rate, there was also a better performance (1.0 vs. 0.5% in the IPM). For the seventh consecutive month, the three portfolios that make up this credit aggregate grew at an annual rate in real terms, although the corporate portfolio registered a slight slowdown.

This lower growth is due to the dynamics of balances to services as a whole, although the performance of the portfolio shows a high degree of heterogeneity among sectors. By portfolio, the 4.7% growth recorded in November is explained by consumer credit, which contributed 2.0 pp, business credit 1.8 pp and mortgage credit 0.9 pp.

Outstanding business loans (54.8% of the total portfolio to the NFPS) registered a real annual growth of 3.3% in November (11.3% nominal), lower than the performance observed in the IPM (3.4% real). By currencies, the increase in outstanding balances denominated in domestic currency (78.3% of total business loans) reached a real growth of 4.1% in November, the third consecutive month in positive territory, while business loans in foreign currency slowed significantly, registering an increase of 0.5%, much lower than the 5.4% of the IPM.

The lower dynamism of business loans could be associated with the performance of some sectors: In November, sales of commercial establishments registered a slowdown, according to equal store sales registered by ANTAD[1], growing only 6.1% (compared to 10.0% in the IPM). These data point to a continuation of the trend of declining revenue growth rates in the commercial sectors in November that has been observed since September, particularly in wholesale trade.

Outstanding consumer credit (21.8% of the total) reached a real annual growth rate of 9.0% at the end of November 2022 (17.5% nominal), a greater dynamism than that recorded in the IPM (8.3% real annual growth rate). Automotive credit also recorded a real increase in balances for the first time in 30 months. This performance is consistent with auto sales data, which in November 2022 increased 3.9% and the upward trend would be

1: National Association of Supermarkets and Department Stores.

expected to continue toward the end of 2022, as sales in December showed 11.7% growth, the highest in 18 months.

The rest of the consumer credit segments presented higher growth rates than those recorded in October, which may be due to the dynamism of real wages, despite a slightly lower performance by employment during the eleventh month of the year. In the case of the outstanding balance of credit through cards, November registered a real annual growth of 12.3% (higher than the 11.3% of the IPM), representing the highest real rate recorded since February 2013.Payroll loans grew 8.3% in real terms (7.1% in the IPM) and personal loans increased 6.0% in real terms (5.7% in October).

In the case of outstanding mortgage loans (22.5% of the outstanding portfolio to the NFPS), there was greater dynamism for the third consecutive month. In November, real annual growth for outstanding balances stood at 3.9% (12.0% nominal). This trend could be mitigated despite the boost (with a lag) from formal employment, due to the increase in long-term interest rates, which could slow down the demand for mortgage loans.

In summary, the different bank loan portfolios to the NFPS continue to show a recovery, although with a slight deceleration in business loans. Inflation seems to have passed its peak, which, if it continues on a downward trend, could imply a lower impact on household purchasing power due to higher prices and a readjustment of financing needs to less immediate purposes.

The delinquency rate has remained at low levels (2.9% for consumer loans, 2.6% for mortgage loans and 2.1% for business loans in November), largely due to the good risk management performed by the banking system's institutions. The labor market indicators have performed well, contributing to a lower impact on households' purchasing power, even in an inflationary scenario such as that of the present.

## Traditional bank deposits shrink in November due to a drop in term deposits and the stagnation of sight deposits

In November 2022, the balance of traditional bank deposits (demand + term) registered a real annual contraction of -0.3% (equivalent to a nominal growth of 7.5%), reversing the growing trend exhibited since March 2022. In spite of an environment of higher interest rates, which would favor the restructuring of balances toward term deposits, the data show an inverse behavior to that expected, with both types of deposits presenting significantly lower nominal growth rates during the month of November.

Sight deposits registered an annual growth of 0.2% in real terms (8.0% nominal), lower than the 0.5% of the IPM and well below the 2.3% average from January to October 2022. The higher opportunity cost of maintaining liquid resources in the face of rising interest rates, together with households' need for liquid resources to face the inflationary environment, could be consistent with the observed balance dynamics.

In monthly terms, the fall in sight deposits for individuals was -0.3% in real terms, a smaller contraction than those observed since August. An additional element that may have had an impact on these balances was the Buen Fin, in which households may have made use of liquid resources to finance the purchase of goods and services.

Meanwhile, the sight deposits of companies and the non-financial public sector registered positive annual changes (of 2.4% and 19.2%, respectively). In the case of companies, the variation was slightly higher than that recorded in the IPM (2.3%), consistent with the flow of income that sales during the Buen Fin may have represented and a reallocation of their term savings. Demand deposits from other financial intermediaries returned to negative ground in November, registering a contraction of -2.6%.

Although the higher opportunity cost of holding liquid resources should entail a reduction in the balance of these instruments in favor of term deposits, the latter showed an annual decline in real terms of -1.2%, after only five months of real growth.

Among the sectors holding term savings, individual deposits continued their recovery, registering a real annual growth rate of 11.1% in November, higher than the 9.7% observed in the IPM.

In contrast, companies' term deposits fell -5.1% in real terms. In nominal terms, although companies increased their term savings by 2.3%, the result represents a significant slowdown with respect to the IPM and the average of 5.7% nominal in the period January - October 2022. The lower dynamism observed is partly explained by a realignment toward demand deposits (which could be associated with a greater need for liquidity to cover year-end expenditures) and by the valuation effect of a more appreciated exchange rate.

Meanwhile, term deposits in the non-financial public sector and other financial intermediaries (OFI) registered a real annual change of -20.9% and -20.2%, respectively. In particular, the reduction observed in OFI term deposits contributed -1.3% pp to the fall registered in the aggregate annual rate. As in the case of businesses, part of the contraction reflects the effect of the appreciation of the exchange rate on balances denominated in foreign currency, and the rest of the fall could be associated with a greater need of these intermediaries to dispose of their accumulated term resources in view of the higher cost and lower availability of alternative sources of funding.

The lagged response of term savings to interest rate hikes, together with the decumulation of liquid resources, led to a drop in traditional bank deposits during November.

## Update of the balance of risks for the financial system

The Financial System Stability Council (CESF for its acronym in Spanish) updated its balance of risks. Among the challenges facing the Mexican financial system given the current situation, the CESF highlights that world economic activity has shown a moderate recovery, while global inflation continues to be high. In response, monetary policy in various jurisdictions continued to raise their reference rates, causing some volatility in financial markets, particularly in Mexico, where interest rate hikes led to mixed performance and episodes of volatility (reflecting greater uncertainty and risk aversion).

The CESF stresses that risks to financial stability still persist. On a global level, it stresses that inflationary pressures may be prolonged, geopolitical tensions may worsen and the recovery process of the world economy may be delayed due to a greater than anticipated slowdown. At a local level, the risk of a further weakening of domestic demand persists. The main risks identified in this update are associated with a tightening of financial conditions, which could translate into episodes of volatility and a delay in the recovery of economic activity.

At the end of 4Q2022, the Mexican banking system still exhibited a solid position with capital and liquidity levels that exceed regulatory minimums. However, the CESF notes the possible materialization of some of the risks mentioned above, which could increase NPLs in some segments of the banking portfolio.

## Outstanding loans increased in all regions of the country in 3Q22, mainly driven by the momentum of the services portfolio

According to Banco de México's Regional Economies Report[2] and based on the Credit Market Conjunctural Evaluation Survey (EECMC) corresponding to 3Q22, the outstanding portfolio of non-financial private companies in commercial banks presented a real annual growth[3] of 3.0% in 3Q22, the second quarter with a positive interannual change since 2Q20 and the first in which growth was observed in all regions of the country.

Outstanding balances in the Central and Northern regions, which account for 54% and 22% of the outstanding portfolio respectively, contributed 1.19 and 1.15 of these 3.0 percentage points (pp), while 0.53 pp came from the North Central region of the country and 0.17 pp from the Southern region.

During 3Q22, with respect to the outstanding portfolio by type of activity, the primary sector showed a contraction only in the Central region of the country, with a real annual change of -0.1%. In contrast, the outstanding portfolio for primary activities in the South grew 17.3%, whereas the growth rates in the North Central and North regions were 12.2% and 8.7%, respectively.

The only decrease in the industrial sector was in the Southern region, with a real annual change of -1.7%, whereas industrial financing increased by 6.3% in the Northern region, 2.1% in the North Central region and 0.5% in the Central region, which registered its first real annual increase in 9 quarters. As for services, all regions registered real annual growth: the Center had the highest increase (3.6%), followed by the North (3.5%), South (3.0%) and North Central (2.5%) regions.

Total business financing continues to accelerate and the regionalization of credit dynamics allows us to observe this pattern in the industry that has presented the higher annual real growth rates than in the previous quarter. In the case of the Southern region, although credit to secondary activities still shows a contraction, it is of a much smaller magnitude than that observed since 1Q21. Financing to services was more dynamic in the Central region, but slowed down in the rest of the regions.

The boost provided by nearshoring for industry (and particularly for manufacturing) is in line with the greater dynamism observed in the Northern and Central regions. Furthermore, the persistence of inflation, which has reduced the purchasing power of households and could already be generating changes in their consumption patterns, would imply a lower value of income flows in sectors such as commerce, with this having an impact on the demand for bank financing by companies in these activities, which could explain the slowdown observed in 3 of the 4 regions covered by the report.

2: Regionalization in the report: the north includes Baja California, Chihuahua, Coahuila, Nuevo León, Sonora and Tamaulipas; the north central includes Aguascalientes, Baja California Sur, Colima, Durango, Jalisco, Michoacán, Nayarit, San Luis Potosí, Sinaloa and Zacatecas; the center is made up of Mexico City, State of Mexico, Guanajuato, Hidalgo, Morelos, Puebla, Querétaro and Tlaxcala; and the south, Campeche, Chiapas, Guerrero, Oaxaca, Quintana Roo, Tabasco, Veracruz and Yucatán.
3: It should be noted that the real change does not take into account exchange rate effects.

# 2. Markets

## Divergence between market and FED expectations and the outperformance of the Mexican Peso stood out in 2022

At the beginning of 2022, there was a debate in the financial markets about the extent to which the Fed's shift to a restrictive tone would indeed be reflected in a monetary tightening cycle of significant magnitude, especially since the possible temporary nature of inflation was still being debated.

By the end of 2022, after a 425 basis points (bp) hike in the federal funds rate, it became clear that the increase in prices was not transitory in nature. However, doubts seem to prevail as to whether the Fed will maintain its restrictive stance for a prolonged period of time, especially given the high probability of a recession for the US economy in 2023. Against this backdrop of inflation and a more restrictive monetary tightening cycle than expected by the markets, losses were recorded for most asset classes. This means that, like in few other episodes, the benefits of diversification were limited in the face of increasing positive correlations between the various asset classes.

The increase in yields along the Treasury curve caused the US government debt benchmark to lose 12.5% in 2022, following increases of 370 bps and 236 bps in the yield to maturity of the 2- and 10-year Treasury bonds, respectively (see Figure 1).

With this significant increase in interest rates, the value of equities also registered a decline, particularly those with future cash flows in a more distant period. As a result, the benchmark for this asset class (*MSCI World*) registered losses of 19.5% in 2022. The Nasdaq 100, which groups together the main technology companies, fell by 33.1%, after a drop of 8.7% in December alone (see Figure 1).

In the case of Mexico, the fact that the monetary cycle began in mid-2021, resulted in lower cumulative interest rate increases in 2022. At the long end of the curve, the yield to maturity of the M10 increased 147 bps, to close 2022 at 9.0%. Losses on the Mexican stock market amounted to 9.0%, which, despite being a negative performance, was notable for its low magnitude compared to developed and emerging markets' indices (-22.4%).

Appetite for the dollar during 2022 was driven by expectations of higher interest rates in the context of a US economy growing faster than the rest of the world's regions. As a result, during 2022, the U.S. currency appreciated 5.1% against emerging countries' currencies and 8.2% against developed countries' currencies. It should be noted that, in December 2022, the dollar lost momentum due to the expectation that the end of the monetary tightening cycle is near and that there could even be cuts in 2023 (see Figure 1). In this context of dollar strength, the performance of the Mexican peso stood out, which appreciated by 5.0% in 2022, making it the currency with the second highest appreciation among emerging market currencies during the year.

The peso's performance was supported by an early start of the monetary tightening cycle in Mexico, a favorable relative comparison in fiscal and external sector terms with respect to its peers, as well as expectations that the end of the Fed's monetary cycle is near. As a result, the exchange rate closed at 19.5 MXN/USD.

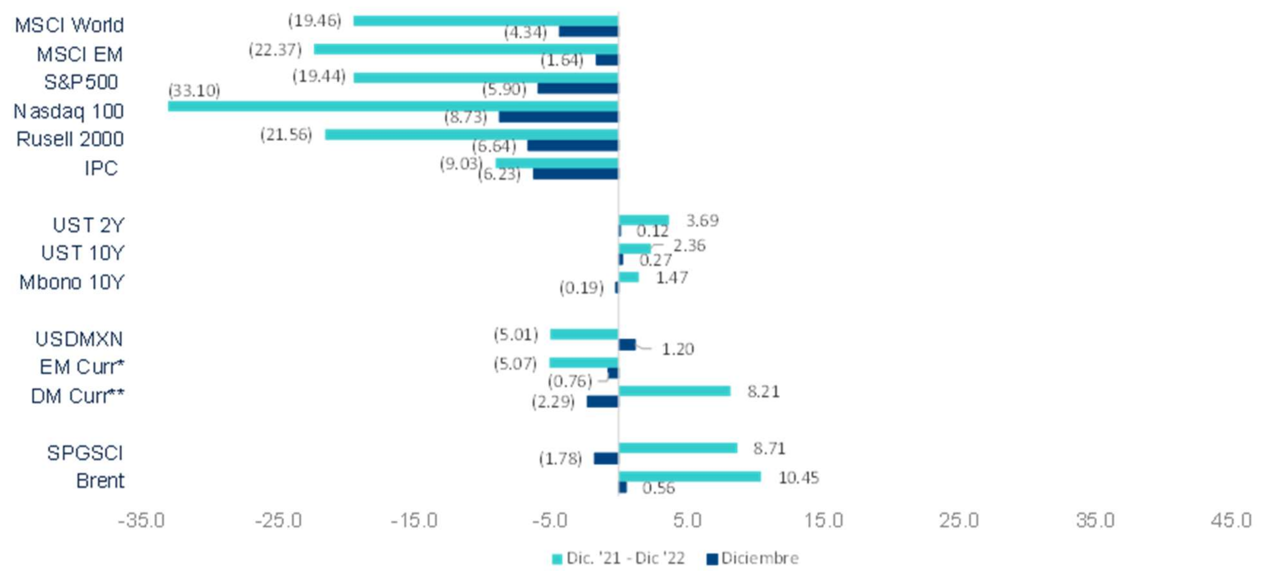
It is worth noting that this appreciation, in addition to the aforementioned prospect of the Fed slowing the pace of rate hikes and nearing the end of the hiking cycle, influenced the USD 3.6 billion increase in non-resident holdings of government instruments during 2022. This increase is the first recorded since 2019.

One of the few asset classes that posted gains during the year was commodities. The conflict in Ukraine and the positive correlation of this asset class with inflation allowed the benchmark (SPGSCI) to post gains of 8.7% in 2022, supported by rises in food (7.0%) and the energy subsector (14.2%).

In brief, inflation and the Fed's decisive response were not anticipated by the markets, which was reflected in a significant variation in the correlations of asset price yields. 2023 starts again with a discrepancy between market expectations and the projections and tone of the Fed's communication. The discrepancy centers on the degree of monetary tightening that the central bank will maintain to bring inflation back to its target, especially in the face of what appears to be an impending recession.

The solution to this discrepancy will depend on the performance of the labor market, especially the answer to the question of how likely it is to reduce the demand for labor without significantly increasing unemployment. From this answer, other questions regarding inflation, the length and depth of the recession and, with it, the possible trajectory for risk asset yields may begin to become clearer.

Figure 1. **PERFORMANCE OF THE PRICES OF THE PRINCIPAL FINANCIAL ASSETS DURING DECEMBER AND 2022** (% 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

**BANXICO- Draft Provisions to amend Circular 3/2012, in order to establish the dates as of which the use of the TIIE will be restricted to terms longer than one banking business day, as well as to amend the methodology for its calculation.**

In line with the recommendations of the Financial Stability Board (FSB), the Basel Committee on Banking Supervision and the International Organization of Securities Commissions (IOSCO), the use of the Interbank Equilibrium Interest Rate in domestic currency (TIIE) is restricted to terms longer than one banking business day, and its calculation methodology is adjusted to be based on market facts.

As of January 1, 2024, credit institutions, Related SOFOMES and the National Agricultural, Rural, Forestry and Fishing Development Financial Institution (Financiera Nacional de Desarrollo Agropecuario, Rural, Forestal y Pesquero), will not be able to use the 91 and 182-day TIIE to enter into or extend transactions, and will only be allowed to use it until the termination of the contracts in effect as of that date. Similarly, the 28-day TIIE may not be used as of 2025 (except for contracts in effect as of January 1 of that year and until their termination).

**BANXICO- Draft Provisions to amend Circular 14/2007, in order to establish the dates as of which the use of TIIE will be restricted to terms longer than one banking business day.**

Adds the definition of the Funding TIIE and eliminates references to the Interbank Equilibrium Interest Rate in domestic currency (TIIE) to the “General provisions to regulate interest rates, assets and liabilities, commissions and advance and prepayments of the operations carried out with their Clients, credit institutions and regulated multiple purpose financial companies”, as provided for in Article 4 of the Law on Transparency and Regulation of Financial Services, in line with the restrictions imposed by the draft amendments to Circular 3/2012 mentioned above.

**CNBV- Resolution amending the General Provisions applicable to credit institutions (Large Exposures)**

The draft incorporates the Basel Committee’s international standard on the matter, updating the Common Risk regime applicable to institutions. Other amendments include the definition of Large Exposures (financing or guarantees for amounts equal to or greater than 10% of the basic part of net capital), and adds to the definition of Common Risk the concept of "economic interdependence" between legal person counterparties of the institution, relating to the source of income or expenditure, single source of income, guarantees, sales, source of funds and of repayment, and so forth, provided that the sum of the financing and payment obligations covered by guarantees or other transactions that such persons have entered into, in their capacity as guarantors or protection providers, exceeds 5% of the Institution's Tier 1 Capital.

It also revises the diversification regime for active operations, establishing, among other aspects, a limit for each of the Large Exposures of 25% of Tier 1 capital (15% between Local and Global Systemically Important Institutions). It also specifies the recognition of hedging techniques and the governance and management of these risks.

The obligation to report to the CNBV on the gross and net large exposures resulting from the application of the permitted mitigation techniques, those exempted from the limit and the 20 largest exposures regardless of their amount is established. A specific regulatory report is added to determine the amount exempted from the deduction in the core capital of prepayments and deferred charges.

## Publications in the DOF (Official Gazette of the Mexican Federation)

12.02 Resolution amending the General Provisions establishing the accounting criteria to be applied by participants in the derivatives contracts market published on 12.04.2018. It postpones the entry into force of the FRS for clearing houses and clearing members participating in the derivatives contracts market listed on stock exchanges, originally scheduled for 01.01.19, and postponed 3 times.

12.13 Circular 15/2022 aimed at participants in the Interbank Electronic Payments System (SPEI) and other parties interested in acting in this capacity. It amends Circular 14/2017 regarding SPEI rules, adjusting wording and references; of note are changes (i) removing the prohibition for Participants and Indirect Participants to use trademarks, notices or trade names of which they are the holders or of which they have been granted a license for their use, when offering services for sending and receiving funds transfers through SPEI; ii) the addition of an exception for sending remittances when crediting funds to accounts used by account holders for their subsequent dispersal to the accounts of their final beneficiaries or for the crediting of funds to accounts for the settlement of buying and selling of foreign currencies derived from sets of remittances processed by the respective customers; iii) the broadening of thresholds for the mandatory termination of indirect participation services (in the event of an increase in transaction volume); and iv) that SPEI compliance officers and information security officers may carry out complementary activities, provided they are of a similar nature.

12.13 Circular 16/2022 aimed at SPEI participants and others interested in acting as such, regarding the Amendments to Circular 1/2022 (Transitory Rules). It defers previously established dates of entry related to:

- From 12.14.22 to 02.21.23. The required speed in sending CoDi Transfer refunds and refund processing notices .
- From 06.03.22 to 02.28.23. Presentation of the risk management report.
- From 09.20.22 to 05.25.23. Application of the new values related to the maximum amounts for Charge Messages (from 21,000 pesos to 1,500 UDIS).
- As of 06.19.23: i) assignment of CLABE sets to Participants' customers providing services materially equivalent to Indirect Participation Services; ii) designation of the substitutes of the SPEI regulatory compliance officers and the SPEI information security officers; iii) obligations and transfer instructions corresponding to the provision of Indirect Participation Services; and iv) signing of a new Indirect Participation contract or amendment agreement with the additions related to information security in its technological infrastructure.
- From 12.15.22 to 07.20.23. Submission to Banxico of the annual report on Indirect Participation Services rendered.
- From 09.20.23 to 12.08.23. The required speed in sending CoDi Transfer Orders that Participants process as Indirect Participation Services, as well as in sending refunds and the refund processing notices.

12.13 Circular 17/2022 addressed to Credit Institutions and other companies that professionally provide fund transfer services, regarding Amendments to Circular 3/2022 (Transitory Rules). It defers the entry into force of the obligations related to the rendering of indirect participation services in SPEI regarding: (i) control measures that allow the certification and validation of the identity of their respective customers; (ii) the supervision of compliance with the terms and conditions established for the provision of such services, as well as the verification of the technical requirements, protocols, procedures, forms, terms, conditions, deadlines, schedules and other operating restrictions and obligations, and that any scheme of Charge Messages be carried out through CoDi transfer orders; iii) the assignment of CLABE sets; iv) the receipt of credit confirmations; and v) the storing of information related to international fund transfers for at least 5 years (from 12.15.22 to 06.19.23).

12.13 Circular 18/2022 addressed to Credit Institutions, Regulated Multiple Purpose Financial Companies that maintain patrimonial links with Credit Institutions and the National Agricultural, Rural, Forestry and Fishing Development Financial Institution, regarding the Amendments to Circular 4/2022 (Transitory Rules). It defers the entry into force of the obligations applicable to the sending of funds transfers identifying the beneficiary with only the ten digits of the account holder's cell phone number through payment systems for electronic funds transfers (from 06.23.22 to 02.23.23).

14.12 Circular 19/2022 addressed to Credit Institutions, Brokerage Firms, Investment Funds, Multiple Purpose Financial Companies that maintain equity links with a Commercial Banking Institution, General Deposit Warehouses, and the National Agricultural, Rural, Forestry and Fishing Development Financial Institution (Financiera Nacional de Desarrollo Agropecuario, Rural, Forestal y Pesquero). The rules applicable to the Unique Product Identifier (UPI) and the Unique Transaction Identifier (UTI) in derivative transactions in over-the-counter markets are issued, establishing:

(i) purpose; (ii) structure, general conditions, applicability, reports for UTIs, among others; and (iii) characteristics, recognition of suppliers, reports and penalties for UPIs.

14.12 Circular 20/2022 addressed to Credit Institutions, Brokerage Firms, Investment Funds, Multiple Purpose Financial Companies (SOFOMEs) with equity links to Commercial Banks, General Deposit Warehouses, and the National Agricultural, Rural, Forestry and Fishing Development Financial Institution, regarding the Amendments to Circular 4/2012. Adds the definitions of Unique Product Identifier (UPI) and Unique Transaction Identifier (UTI), as well as several obligations for their use.

12.29 Agreement whereby Credit Institutions and Regulated SOFOMEs, are informed of the Standardized Account Statement Format for credit cards for natural persons, as well as its completion guide, published by Condusef.

This is the format provided for in the rules on Registration before CONDUSEF published in the DOF on 10.14.2022, which includes, among other features: essential information for the payment decision, repayment scenarios, the summary of charges and credits for the period to determine the payment so as not to generate interest, annual cost indicators of the card (such as the amounts of interest paid, total fees paid and yearly or administration fees paid), level of card use (with balances, credit limit and credit available for cash withdrawals and balance transfers), information on other credit lines, the balance on which interest was calculated for the period (with details of the applicable annual interest rate and amount of interest), the distribution of the last payment, as well as details of the movements separated by type of charge (interest-free months, interest-accruing months, preferential rate or revolving balance).

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