

Research Update:

21 Mexican Financial Institutions Downgraded On Same Action On Sovereign And Increasing Economic Risks For The Sector

March 27, 2020

Overview

- On March 26, 2020, we lowered our long-term foreign currency and local currency ratings on Mexico to 'BBB' (from 'BBB+') and 'BBB+' (from 'A-'), respectively.
- The downgrade occurred because we expect a pronounced hit to the economy following the combined shocks of COVID-19--in Mexico itself and in the U.S.--and lower global oil prices. These shocks, while temporary, will worsen the already weak trend in GDP growth for 2020-2022.
- The outlook on the sovereign credit ratings is negative, indicating the possibility of a downgrade over the coming 12-24 months due to uneven or ineffective policy execution, potentially weakening public finances, or higher off-budget contingent liabilities.
- Therefore, because of Mexico's weakening economic resilience, we've revised our economic risk score for Mexico's banking sector to '6' from '5', reflecting these developments. We now view the trend as stable at the current economic risk level.
- Consequently, we're revising our Banking Industry Country Risk Assessment (BICRA) on Mexico to group '5' from '4', and maintaining our industry risk score at '3' with a stable trend. We are also lowering the anchor for banks operating only in Mexico to 'bbb-' from 'bbb'.
- As a result, we took various rating actions on 22 Mexican financial institutions following the sovereign rating action and our assessment of higher economic risk in the banking system.

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Rating Action

On March 27, 2020, S&P Global Ratings took rating actions on 22 Mexican financial institutions following the sovereign downgrade and after revising Mexico's BICRA Group to '5' from '4' and increasing its economic risk to '6' from '5' that resulted in a lower anchor for banks operating in Mexico (to 'bbb-' from 'bbb'). We now view the current economic risk trend as stable at its current level. Our industry risk assessment and its trend remain unchanged (at '3' and stable,

respectively).

Our rating actions reflect various aspects about how the sovereign ratings and our BICRA affect our view of financial institutions we rate that operate in Mexico. Furthermore, the rating actions reflect the relative strengths or weaknesses of each financial institution's stand-alone credit profile (SACP). Ultimately, most of our rating actions reflect our view that the ratings on financial institutions are constrained by those on the sovereign, because of the large exposure of these institutions to country risk and the highly sensitive nature of their businesses to sovereign stress. For a detailed list of our rating actions, please refer to the last section of this report.

Rationale

We expect a pronounced hit to the Mexican economy in 2020 following the combined shocks of COVID-19--in Mexico itself and in the U.S., its main trading partner--and lower global oil prices. Our revised growth projections include a decline in real GDP of about 2.0%-2.5% in 2020 and the absence of a sharp recovery (growth of slightly over 2.0% in 2021 and 1.8% in 2022-2023). The poor growth performance reflects, in part, the inability of the current administration to improve private-sector confidence and investment dynamics. In this context, the downgrade reflects our revised expectations that real per capita GDP growth will remain below that of peers with similar levels of economic development.

The outlook on the sovereign ratings is negative, indicating the risks of a downgrade over the coming 12-24 months as a result of uneven or ineffective policy execution; potential weakening in public finances, reflecting a difficult trade-off between sustaining GDP growth given Mexico's low non-oil tax base and spending rigidities, and rising pressure on PEMEX, a potential contingent liability for the sovereign. For more detail, please refer to "Mexico Foreign Currency Rating Lowered To 'BBB' And Local Currency To 'BBB+' On Hit To Trend Growth; Outlook Negative," published on March 26, 2020.

The multiple rating actions on the 22 Mexican financial institutions reflect the observed worsening of the sovereign's credit quality and the spillover to the domestic banking industry in the form of higher economic risk (which we revised to '6' from '5'). This resulted in the revision of Mexico's BICRA group and the bank anchor. In addition, our capital and earnings assessment on all Mexican financial institutions are tightening because of the materialization of higher risk weights. Therefore, Mexican financial institutions are navigating under weaker economic and operating conditions that result in lower SACP.

Banking Industry Country Risk Assessment (BICRA)

We have revised our assessment of the economic risks faced by the Mexican banking sector to '6' from '5' (on a scale of 1-10, with '1' the lowest risk) due to weaker economic resilience. At this higher economic risk level, we view Mexico's economic risk trend as stable. On the other hand, we maintained Mexico's industry risk and its trend at '3' and stable, respectively. Consequently, we now classify Mexico in BICRA group '5', rather than '4', and we lowered the anchor for banks operating only in Mexico to 'bbb-' from 'bbb'.

In our view, Mexican banks now face higher economic risks due to the continued weakening economy, which has led to lower economic resilience. This is illustrated by the economic slump of 2019, which eroded the private sector's business and investment confidence, and by the continued worsening of the energy sector. Lower economic resilience is also demonstrated by the even weaker economic prospects for 2020, exacerbated by the global turbulence resulting from

COVID-19 (as a result of the coronavirus outbreak, we are now forecasting a contraction in the U.S. in 2020, acting as a drag on Mexico) and plummeting oil prices (damaging the government-owned energy company Petroleos Mexicanos [PEMEX] and increasing the government's contingent liabilities). In this context, we expect the Mexican economy to contract about 2.0%-2.5% this year and then to slightly recover in the next three years (growth of slightly over 2.0% in 2021 and 1.8% in 2022-2023).

Under this context, we expect credit expansion to remain modest in 2020-2021, in real terms, due to low credit demand from the corporate and commercial sector and from households. Despite the weak economic outlook for 2020-2021 and forecast modest credit growth and lower interest rates, we expect Mexican banks to maintain adequate asset quality and profitability metrics, based on their continued conservative growth strategies and lending practices. In our opinion, economic imbalances will remain very limited because we expect slow credit expansion and house prices to moderate in 2020-2021 amid lower housing demand and considering the inventories available for the next 12-24 months.

We are revising our economic risk trend on Mexico's BICRA to stable from negative. This is because although we expect weak economic conditions to persist in 2020, we don't expect asset quality metrics to significantly deteriorate (including nonperforming assets [NPAs] and credit losses) and anticipate profitability to remain adequate (despite lower interest rates and potentially higher reserve requirements), based on banks' conservative growth strategies and lending practices. In our opinion, the current economic risk level already captures a potential deterioration in these metrics. However, we'll remain alert to a potential worsening in the trajectory of Mexican banks' asset quality metrics and profitability, which if significantly above our expectations in the next 12-18 months, could lead us to revise Mexico's BICRA economic risk trend to negative from stable.

In our view, Mexican banks benefit from the institutional framework that's in line with international standards. This allows the industry's capitalization, funding, and liquidity levels to remain sound. Nonetheless, we still see room for improvements. For instance, we believe the banking regulator would benefit from more extensive coverage of the financial system and from tougher oversight of non-bank financial institutions (NBFIs), including those that don't only issue debt in the domestic market, along with a focus on fraud prevention. The Mexican banking system remains highly concentrated, and barriers to entry are high. We expect healthy competitive dynamics to remain a key characteristic of Mexico's banking industry. While competition from fintech start-ups could pressure the profitability of existing financial institutions, we expect to see a collaborative relationship between commercial banks and fintech companies rather than a rivalry. Mexican banks are mainly funded through "sticky" (i.e. high customer retention) and fragmented deposit bases. This has allowed banks to deliver sound profitability, despite recent periods of high interest rates. The domestic debt capital market also will continue to enhance the banking system's financial flexibility. Because of these factors, the trend in Mexico's industry risk remains stable.

Outlook

The negative outlook on the global scale ratings on 12 Mexican financial institutions (these ratings are all capped by the sovereign rating) reflects the possibility of a downgrade on Mexico over the coming 12-24 months due to uneven or ineffective policy execution, potentially weakening public finances, or higher off-budget contingent liabilities.

We revised the outlook to stable from negative on the global scale ratings on four Mexican financial institutions. We expect their capital and earnings assessment to remain unchanged in the next 12 months, and forecast their risk-adjusted capital (RAC) ratios to remain in their current

rating category.

We maintained the negative outlook on the long-term ratings on Banco Compartamos, reflecting pressures on asset quality given the current economic conditions, potentially weakening its risk position and resulting in a lower SACP.

We placed the ratings on three NBFIs on CreditWatch with negative implications to reflect the higher risk weights that we apply to estimate our RAC ratios for financial institutions, which relate to the higher economic risk for Mexico's BICRA, currently at '6'. Given the capital base of these companies and higher risk weights, we expect their RAC ratios to be under pressure considering their current category. We believe there's a one-in-two likelihood that their respective forecast RAC ratios could fall, leading us to lower the ratings. We expect to resolve the CreditWatch placement within the next 90 days once we analyze the impact to these entities' capitalization levels.

We placed our 'B+' issue-level ratings for Alpha Holding on CreditWatch with developing implications. We could raise the debt ratings if an expected capitalization improves our forecast RAC ratio. On the other hand, we could lower the debt ratings if financial weakness surpasses the firm's capital improvements or if local authorities deny the proceeds from its new shareholder. Our global scale long-term issuer credit rating (ICR) on Alpha Holding remains unchanged at 'B-' and on CreditWatch with positive implications. The ICR on Alpha Holding reflects its status as a non-operating holding company and therefore the ratings on the company are two notches below its consolidated operating entities' creditworthiness. We believe there's a one-in-two likelihood that we could raise or affirm the ICR on Alpha Holding, because we don't see the ratings dropping to the 'CCC' category in the next 12 months. We could raise the rating if the proceeds from its potential capital injection are sufficient to strength Alpha Holding's capital base.

Asigna, a Mexican clearinghouse operator, is the only financial institution with a global scale long-term rating above the sovereign level ('BBB+'), but we're revising its global scale outlook to negative from stable because we only consider a one-notch differential between the ratings on it and those on the sovereign. Although Asigna passes our ratings above the sovereign stress test for a hypothetical default of Mexico, tougher operating conditions have shortened the gap by which it passes this test. In our opinion, if the sovereign's negative outlook results in a downgrade, it could further affect Asigna's business and pose higher liquidity risks for the company and its members. In our opinion, the stress test results still demonstrate the capacity of Asigna's financial safeguards to absorb a substantial portion of all uncovered losses in the event that some clearing members default. Therefore, our global scale negative outlook reflects that a one-notch differential is consistent with our view that if we were to downgrade Mexico, we would do the same on Asigna.

Upside scenario

We could revise the outlooks to stable on the 12 Mexican financial institutions with ratings that the sovereign rating caps in the coming two years if we were to revise the outlook on Mexico to stable.

Ratings Score Snapshot

BICRA SCORE SNAPSHOT*

Mexico

	To	From
BICRA group	5	4
Economic risk	6	5
Economic resilience	Very high risk	High risk
Economic imbalances	Very low risk	Very low risk
Credit risk in the economy	High risk	High risk
Industry risk	3	3
Institutional framework	Intermediate risk	Intermediate risk
Competitive dynamics	Intermediate risk	Intermediate risk
System-wide funding	Low risk	Low risk
Trends		
Economic risk trend	Stable	Negative
Industry risk trend	Stable	Stable

*Banking Industry Country Risk Assessment (BICRA) economic risk and industry risk scores are on a scale from 1 (lowest risk) to 10 (highest risk). For more details on our BICRA scores on banking industries across the globe, please see "Banking Industry Country Risk Assessment Update," published monthly on RatingsDirect.

Related Criteria

- General Criteria: Hybrid Capital: Methodology And Assumptions, July 1, 2019
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- General Criteria: Methodology For National And Regional Scale Credit Ratings, June 25, 2018
- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Guarantee Criteria, Oct. 21, 2016
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria | Financial Institutions | General: Nonbank Financial Institutions Rating Methodology, Dec. 9, 2014
- Criteria | Financial Institutions | General: Key Credit Factors For Financial Market Infrastructure Companies, Dec. 9, 2014
- Criteria | Financial Institutions | General: Issue Credit Rating Methodology For Nonbank Financial Institutions And Nonbank Financial Services Companies, Dec. 9, 2014

- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 19, 2013
- Criteria | Financial Institutions | Banks: Assessing Bank Branch Creditworthiness, Oct. 14, 2013
- Criteria | Financial Institutions | Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Criteria For Assigning 'CCC+', 'CCC', 'CCC-', And 'CC' Ratings, Oct. 1, 2012
- Criteria | Financial Institutions | Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Mexico Foreign Currency Rating Lowered To 'BBB' And Local Currency To 'BBB+' On Hit To Trend Growth; Outlook Negative, March 26, 2020
- Mexican Commercial Banks: Still The Main Source Of Funding To Local Governments, But Gradually Diminishing, March 4, 2020
- Global Credit Conditions: COVID-19's Darkening Shadow, March 3, 2020
- Banking Industry Country Risk Assessment Update: February 2020, Feb. 21, 2020
- Banking Industry Country Risk Assessment: Mexico, Jan. 8, 2020
- Credit Conditions Latin America: Political Challenges Will Prevail In 2020, Dec. 3, 2019
- Mexican Banks Absorb The Fallout From Slower Growth, But Could Struggle In 2020, Nov. 20, 2019
- Debt Markets Provide A Bigger Slice Of Rated Mexican FinCos' Funding, Nov. 5, 2019
- Mexico's Development Banks Have Financial Flexibility To Support Loan Growth, Oct. 8, 2019
- S&P To Publish Economic And Industry Risk Trends For Banks, March 12, 2013
- Analytical Linkages Between Sovereign And Bank Ratings, Dec. 6, 2011

Ratings List

Downgraded; Outlook Action

	To	From
Nacional Financiera, S.N.C.		
Issuer Credit Rating		

Research Update: 21 Mexican Financial Institutions Downgraded On Same Action On Sovereign And Increasing Economic Risks For The Sector

Foreign Currency	BBB/Negative/A-2	BBB+/Negative/A-2
Local Currency	BBB+/Negative/A-2	A-/Negative/A-2
National Scale	mxAAA/Stable/mxA-1+	mxAAA/Stable/mxA-1+
Certificate of Deposit	BBB/A-2	BBB+/A-2
Senior Secured	mxAAA	mxAAA

Banco Nacional de Comercio Exterior S.N.C.

Issuer Credit Rating		
Foreign Currency	BBB/Negative/A-2	BBB+/Negative/A-2
Local Currency	BBB+/Negative/A-2	A-/Negative/A-2
National Scale	mxAAA/Stable/mxA-1+	mxAAA/Stable/mxA-1+
Senior Secured		
Global Scale	BBB	BBB+
National Scale	mxAAA	mxAAA

Banco Nacional de Mexico S.A.

Issuer Credit Rating		
Global Scale	BBB/Negative/A-2	BBB+/Negative/A-2
National Scale	mxAAA/Stable/mxA-1+	mxAAA/Stable/mxA-1+
Senior Unsecured	mxAAA	mxAAA

BBVA Bancomer S.A.

Issuer Credit Rating		
Global Scale	BBB/Negative/A-2	BBB+/Negative/A-2
National Scale	mxAAA/Stable/mxA-1+	mxAAA/Stable/mxA-1+
Subordinated Debt	BB	BB+

Banco Mercantil del Norte, S.A.

Issuer Credit Rating		
Global Scale	BBB/Negative/A-2	BBB+/Negative/A-2
National Scale	mxAAA/Stable/mxA-1+	mxAAA/Stable/mxA-1+
Senior Unsecured	mxAAA	mxAAA
Junior Subordinated Debt	BB	BB+
Junior Subordinated Debt	BB-	BB

Banco Mercantil del Norte, S.A. (Cayman Islands Branch)

Senior Unsecured	BBB	BBB+
Junior Subordinated Debt	BB-	BB

HSBC Mexico S.A.

Issuer Credit Rating		
Global Scale	BBB/Negative/A-2	BBB+/Negative/A-2
National Scale	mxAAA/Stable/mxA-1+	mxAAA/Stable/mxA-1+

Banco Nacional de Obras y Servicios Publicos S.N.C.

Issuer Credit Rating		
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Global Scale	BBB/Negative/A-2	BBB+/Negative/A-2
National Scale	mxAAA/Stable/mxA-1+	mxAAA/Stable/mxA-1+
Senior Secured	mxAAA	mxAAA

Banco Inbursa S.A.

Issuer Credit Rating		
Global Scale	BBB/Negative/A-2	BBB+/Negative/A-2
National Scale	mxAAA/Stable/mxA-1+	mxAAA/Stable/mxA-1+
Senior Unsecured		
Global Scale	BBB	BBB+
National Scale	mxAAA	mxAAA

Instituto Para La Protección al Ahorro Bancario

Issuer Credit Rating		
Foreign Currency	BBB/Negative/A-2	BBB+/Negative/A-2
Local Currency	BBB+/Negative/A-2	A-/Negative/A-2
National Scale	mxAAA/Stable/mxA-1+	mxAAA/Stable/mxA-1+
Senior Unsecured		
Global Scale	BBB+	A-
National Scale	mxAAA	mxAAA

Instituto del Fondo Nacional de la Vivienda para los Trabajadores (Infonavit)

Issuer Credit Rating		
Global Scale	BBB/Negative/A-2	BBB+/Negative/A-2
National Scale	mxAAA/Stable/mxA-1+	mxAAA/Stable/mxA-1+

Scotiabank Inverlat, S.A.

Issuer Credit Rating		
Global Scale	BBB/Negative/A-2	BBB+/Negative/A-2
National Scale	mxAAA/Stable/mxA-1+	mxAAA/Stable/mxA-1+
Senior Unsecured	mxAAA	mxAAA

Fondo Especial de Asistencia Técnica y Garantía Para Créditos Agropecuarios (FEGA)

Issuer Credit Rating	BBB/Negative/A-2	BBB+/Negative/A-2
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Banco Compartamos S.A. Institucion de Banca Multiple

Issuer Credit Rating		
Global Scale	BBB-/Negative/A-3	BBB/Negative/A-2
National Scale	mxAA+/Negative/mxA-1+	mxAAA/Negative/mxA-1+
Senior Unsecured	mxAA+	mxAAA

Credito Real, S.A.B. de C.V., SOFOM, E.N.R.

Issuer Credit Rating		
Global Scale	BB/Stable/--	BB+/Negative/--
National Scale	mxA/Stable/mxA-1	mxA+/Negative/mxA-1
Senior Unsecured	BB	BB+

Subordinated Debt	B	B+
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Financiera Independencia S.A.B. de C.V. SOFOM E.N.R.

Issuer Credit Rating		
Global Scale	B+/Stable/--	BB-/Negative/--
National Scale	mxBBB-/Stable/mxA-3	mxBBB+/Negative/mxA-2
Senior Unsecured	B+	BB-

Banca Mifel, S.A., Institución de Banca Múltiple, Grupo Financiero Mifel

Issuer Credit Rating		
Global Scale	BB-/Stable/B	BB/Negative/B
National Scale	mxA-/Stable/mxA-2	mxA/Negative/mxA-1
Junior Subordinated Debt	B-	B

Engencap Holding, S. de R.L. de C.V.

Issuer Credit Rating	BB-/Stable/--	BB/Negative/--
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Downgraded; CreditWatch Action

	To	From
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Unifin Financiera, S.A.B. de C.V.

Issuer Credit Rating		
Global Scale	BB-/Watch Neg/--	BB/Negative/--
National Scale	mxA-/Watch Neg/mxA-2	mxA/Negative/mxA-1
Senior Unsecured	BB-/Watch Neg	BB
Subordinated Debt	B-	B

Mexarrend, S.A.P.I. de C.V.

Issuer Credit Rating		
Global Scale	B+/Watch Neg/--	BB-/Watch Neg/--
National Scale	mxBBB-/Watch Neg/mxA-3	mxBBB+/Watch Neg/mxA-2
Senior Unsecured	B+/Watch Neg	BB-/Watch Neg

Operadora de Servicios Mega, S.A. de C.V. SOFOM, E.R.

Issuer Credit Rating		
Global Scale	BB-/Watch Neg/--	BB/Negative/--
National Scale	mxA-/Watch Neg/mxA-2	mxA/Negative/mxA-1
Senior Unsecured	BB-/Watch Neg	BB
Short-Term Debt	mxA-2	mxA-1

CreditWatch Action

	To	From
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Alpha Holding S.A. de C.V.

Issuer Credit Rating		
Global Scale	B-/Watch Pos/--	B-/Watch Pos/--
Senior Secured	B+/Watch Dev	B+/Watch Pos
Senior Unsecured	B+/Watch Dev	B+/Watch Pos

Ratings Affirmed; Outlook Action

	To	From
Asigna Compensacion y Liquidacion		
Issuer Credit Rating		
Global Scale	BBB+/Negative/A-2	BBB+/Stable/A-2
National Scale	mxAAA/Stable/mxA-1+	mxAAA/Stable/mxA-1+

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