



Financial Stability Report



Central Bank of Paraguay

June 2012



Abstract

The world economy slowly improves, but still is very fragile. Real Gross Domestic Product (GDP) growth should recover gradually during the period 2012-2013.

The global economy is going through a stage of slow recovery. Global economic growth could decrease this year however, dropping from the 4% registered in 2011 to approximately 3.5% by the end of the year. Notwithstanding, it is expected that world growth will return to about 4% in 2013, thanks to the re-acceleration of economic activities during the course of 2012.

According to the International Monetary Fund, in many of the emerging and developing economies real GDP has been somewhat lower than expected. On the other hand, a surprising rise in GDP has been recorded in the case of advanced economies and it has even been projected that such growth will be close to 1.5% this year and will reach 2% in 2013.

The soundness of the macroeconomic and financial foundations of Latin American countries, as well as the proper handling of Monetary Policy instruments, made it possible to maintain high levels of liquidity and solvency and to surpass in turn the markets of other emerging and developed economies.

Gross Domestic Product for the year 2012, according to first revisions, presents a downward correction regarding the projection made in December 2011. The new estimate is located at - 1.5%, with a degree of variation ranging between 0% and - 2.5 percent.

The correction as presented is largely due to a strong retraction of the primary sector, mainly explained by adverse climatic factors affecting agriculture and by the outbreak of foot-and-mouth disease, detected in September 2011 in the Department of San Pedro. The incident signified the interruption of exports of Paraguayan meat, thereby contracting

livestock activities and industrialized meat production, with repercussions that persisted during the first semester of the present year.

At the end of June 2012, the active and passive interest rates in the banking system for operations involving national currency (MN) have behaved differently, with reductions for the active rate and increments for the passive one. For operations involving foreign currency (ME), an upward movement of interest rates was recorded.

Indicators related to the external sector can expect a reversal of the trend in Balance of Payments.

Favorable outcomes as regards the Balance of Payments were observed from 2003 until 2011, thus producing an increase of almost USD 4.4 billion in the International Reserves of Paraguay. Almost one-fifth of this increase (19.6%) was recorded during 2011, amounting to USD 815.4 million. Although there has been a deficit in balance of payments during the first half of 2012, amounting to nearly USD 184 million, a reversal of trend for the second half of the year is expected.

International monetary reserves allow for the import of goods (excluding the import of goods which are later re-exported), during a period of 8.2 months on the average, through the year 2011. However, by the second half of 2012 that indicator increased to over 10 months due to the slower pace of imports as compared with the same period the previous year.

Financial system activities remain strong.

By June 2012, the financial system, as a whole, had continued to increase the level of financial intermediation for both deposits and credits with the private sector.

The financial system closed the sixth month with accounting profits, thereby consolidating its solvency levels. In particular, bank credit to the private sector in terms of GDP recorded a significant advance, reaching slightly more than 34.8% of Gross Domestic Product.

The measures implemented by authorities, consisting of higher provisioning levels for loans and higher capital requirements, are geared towards ensuring that banks have sufficient protection, as a cushion or buffer. In like manner, the importance of the stability of the financial sector as regards the economy has grown with the relative weight of this sector in aggregate activities and its growing international dimension. For these reasons, it is deemed necessary to be at the forefront in terms of international standards for the strengthening of the framework of prudential regulations.

At the end of June of 2012, the financial system's assets reached PYG 60.2 billion, with a growth of 5.5% for the semester. In this context, the balance of the existing portfolio grew 3.3 per cent in six months, while deposits rose 6.0% percent.

However, this rate does not match the performance of the previous semester. As regards late payments, the ratio of delinquency of the system was 2.44% by June 2012, higher than the 1.87% registered for December 2011.

The number of debtors within the financial system increased by 15.7% in interannual terms, going from 646,055 (June 2011) to 747,779 (June 2012). The increase in deposits evidenced a tendency towards migration to term deposits. The liquidity of the system remained high, given the composition of assets.

Solvency indicators were favorable at the end of the first semester of 2012.

Solvency indicators showed that all banks and finance firms were above the minimum level set by law (effective equity of 10% in relation to the assets and risk-weighted contingencies of the institution).

Complementary Capital, Level 2, was 17.15% in June 2012, this being a level that exceeds the current legal minimum requirement by 6.15% and surpasses the level suggested by Basel by 9.15%. Likewise, the composition of main or core Capital (TIER 1) reached 13.04% by June 2012.

In addition, stress tests indicated an adequate level of aggregate bank solvency.

Stress tests have been carried out in order to estimate the impact of adverse movements upon the solvency of financial institutions.

Credit Risk: upon analyzing the shocks applied to the loan portfolio, the Capital Adequacy Ratio (CAR) of the banking system held a position superior to that required by current legal regulations.

Exchange and Interest Rate Risks: Upon implementing changes, no major variations in the ratio of solvency of the financial institutions were observed.

Liquidity Risk: it was noted that liquid assets could face high drainage of liquidity for five days, before institutions would see the need to initiate the sale of their less liquid assets.

Profitability of the financial sector.

Accounting gains for financial entities as a whole reached 2.62% of Assets and 26.65% of Equity.

These profits amounted to PYG 725.622 million in absolute terms, representing an increase of 3.5% compared to the same period in 2011. The increment may be explained by the increase in financial margins within a framework in which improvements in results are determined by interest rates and services.

In order to measure Financial Inclusion in Paraguay, the main indicators of access to credit and financial services have been analyzed. (See Section 3.2)

It has been observed that even though the Paraguayan financial system has improved in terms of financial depth and banking indexes, when compared with other countries in the region, it still has much room for growth in terms of geographic coverage.

With a view to increasing the effective use of financial services, the BCP through the Superintendency of Banks has approved regulations for Non-banking Correspondents. This will enable a greater segment of the population to gain access to financial services and at the same time provide greater geographical coverage for financial services.

Cooperatives operate under their own regulatory framework.

According to Paraguayan Law 2157/03, savings and credit cooperatives operate under the regulation and supervision of the National Institute of Cooperativism (*Instituto Nacional de Cooperativismo*, INCOOP).

The largest cooperatives in the country, typified as category A, increased the volume of their assets by 2.8% during the first half of 2012, a figure lower than the 5% observed in the same period of the previous year. The assets of the cooperatives included in this analysis totaled nearly PYG 13.4 billion.

In terms of economic actors or stakeholders, the influence of credit operations related to households is outstanding. Consumer loans represent an important part of the overall lending activity of financial intermediaries.

It should be noted that the participation of total consumer credit (banks + finance companies) likewise grew by PYG 1.5 billion in relation to June 2011, structurally implying that its participation was increased to 16% at the end of June 2012, compared to June of 2011 which registered a share rate of 15.3 percent.

The Governmental sector is one of the most active agents within the process of financial stability.

Currently, most securities are held by financial institutions. However, the proportion of securities as regards the composition of total assets of these entities is still very limited. Therefore, the holding of such securities may represent a risk factor for the financial system. In the same manner, the profile of maturities of these bonds and the relatively low amounts of these maturities does not represent a specific threat to the system.

The soundness and financial stability of the business sector are key conditions for the global stability of the financial system.

On June 30, 2012, the total liabilities of companies with regard to the financial system amounted to PYG 30.7 billion. Private Banks represented 95.3% of the total, the National Development Bank (*Banco Nacional de Fomento*, BNF) represented 2.2%, and finance companies accounted for 4.7 percent. This amount represented 74.8% of the total aggregate portfolio of the system, 16.13% corresponded to consumer credit and 9.02 percent accounted for loans granted to the financial sector itself.

At the close of the first semester of 2012, the deposit guarantee limit amounted to PYG 124,367,400 (approximately USD 28,000).

stage will take place in the last quarter of this year.

A brief analysis of the reports submitted to the Deposit Guarantee Fund (FGD) by financial entities reveals that the total deposits of the private financial system at the close of the first half of 2012 amounted to PYG 43.8 trillion, registering a variation of 8% with respect to December 2011.

In the framework of the Project for the Modernization of Payments Systems, the following activities have either culminated or are currently in the process of being carried out:

Paraguayan Law No. 4595/2012 on Payments and Securities Settlement Systems, was promulgated by the Executive branch of government on May 17, 2012.

With regard to the configuration of Software for electronic payments systems and the Central Securities Depository, installation and configuration tasks were carried out in order to provide the services that are inherent to the specialized Information Technology equipment.

Drafts of all proposed regulations were uploaded to the website of the Central Bank of Paraguay, thus bringing them to the attention of the financial system for timely consideration.

Financial System Stakeholders were informed of the certification of “Smart Shelter” security vaults for the Central Bank of Paraguay’s Data Center, thus complying with ISO/IEC 27002 specifications. In terms of security, this infrastructure ranks number 1348 in the world and holds the first position in Paraguay.

Finally, it should be noted that an adjustment in the scheduled timeframe of implementation has been studied, in conjunction with the Supplier Company and financial institutions. Accordingly, the implementation of the first