



Financial Stability Report

Central Bank of Paraguay

December 2012

Abstract

The world economic outlook does not appear to be very encouraging, and there is also a possibility of a very marked trend downward. It is expected that GDP growth for next year will be lower than in previous years.

Global economic growth weakened during 2012, registering only 3.3% for that period. It is expected that Gross Domestic Product (GDP) will reach 3.6% in 2013. However, the possibility of a reacceleration of economic activity would allow for an overall growth of about 4% next year.

According to IMF data, headline inflation has decreased in most regions due to falling commodity prices. However, for those cases in which inflation increased or remained above the target, this was mainly due to exceptional factors, such as rising energy prices and indirect taxes.

It is necessary to highlight the current positive moment of the financial and banking system in Latin America, thus encouraging efforts to continuously improve the quality of the management exercised by representatives, carry out monitoring and update financial regulations on a continual basis, in order to ensure stability.

During the fourth quarter of 2012, Paraguay's GDP had a quarterly contraction of 0.4% in terms of the annual rate, while the cumulative for the year was -0.9%.

The fourth quarter of 2012 showed a slight downturn, closing the year with negative cumulative growth, although this was less than had been expected at the beginning of the reference period. From the point of view of Agricultural production, confirming previous reports, Paraguay's production was strongly affected by adverse weather conditions, particularly drought, which prevailed at the end of 2011 and beginning of 2012. In accordance with the latest estimates provided by the Ministry of Agriculture and Livestock, the year closed with one of the worst declines in recent times as a result of sharp falls in production that were verified for principal crops.

At the end of December 2012, the active and passive interest rates in the banking system for operations involving national currency (MN) have behaved differently, with increases for the active rate and reductions for the passive one. Operations in Foreign currency (ME) recorded downward behavior for both active and passive interest rates.

External Sector Indicators may expect a reversal of the trend of the Balance of Payments.

From 2003 to 2012, favorable results as regards the Balance of Payments have been recorded, thereby bringing an increase of slightly over US\$ 4 billion in International Monetary Reserves. 24.8% of this increase occurred during 2009 (US\$ 996.6 million). While there was a balance of payments deficit of US\$ 204 million during the first half of 2012, the reversal in trend for the second half of the year permitted closing with a marginal increase of US\$ 10.5 million.

International Monetary Reserves enabled the country to import goods (excluding imports of goods to be re-exported), for an average of 9.2 months in 2012. This figure showed an increase compared to the same period last year, as the indicator for the end of 2011 correlated to a value of 8.6 months of imports.

The activity of the financial system remains dynamic.

During the second half of 2012 the growth rate of the portfolio of credit institutions remained stable, at levels similar to those seen six months ago. In particular, the Industrial and Commercial portfolios are the most dynamic, while the consumption mode has lower acceleration. Delinquency indicators and asset quality continued to show a downward trend, while interest income increased during the last semester. This has allowed the utility and solvency levels to remain favorable.

Overall, the financial system continued to increase the level of financial intermediation (deposits and loans) with the private sector. The financial system ended the year 2012 with financial benefits, thereby consolidating its solvency levels. In particular, bank lending to the private sector in terms of GDP recorded significant progress, reaching just over 36.5% of GDP.

The measures decided by the authorities, consisting of higher provisions for credit and higher capital requirements are intended to ensure that banks have enough cushion. In addition, the importance of the stability of the financial sector to the economy has grown with the relative weight of the sector in aggregate activity and its growing international dimension. Therefore, it is imperative to be at the forefront in terms of international standards in order to strengthen the prudential regulatory framework.

In December 2012, financial system assets reached PYG 63.5 billion, an increase of 5.5% for the semester. In this context, the balance of the current portfolio grew 8.7% last quarter, while deposits increased 5.5%, not matching the performance of the previous semester. The system's default ratio through December 2012 was 2.24%, 1.87% higher than that of December 2011.

In the financial system, the number of borrowers increased by 13.9% in semester terms, going from 747,779 as of June 2012 to 851,497 in December 2012. The increase in deposits showed a trend toward migration towards time deposits. The system's liquidity remained high, given the composition of its assets.

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

Solvency indicators showed that all banks and financial companies were above the minimum set by law (11% effective equity relative to assets and Contingent Risk Weighted for each institution).

Complementary Capital, Level 2, at December 2012 was 16.27%, which is a level that exceeds the statutory minimum requirement by 5.27% and is 8.27% higher than the level suggested by Basel. Also, the composition of principal (TIER 1) is 12.19% as of December 2012.

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

In order to estimate the impact of adverse movements on the solvency of financial institutions, officials at the Superintendency of Banks have proceeded to conduct stress tests (stress test).

Credit Risk: Analyzing the shocks applied to the loan portfolio, the Capital Adequacy Ratio (CAC) of the banking system remained above the standard established by current legislation.

Rate Risk and Interest Rate: When changes took place, no major variations in the ratio of the banks' solvency were observed.

Liquidity Risk: It was observed that liquid assets could face a large liquidity drain for four days, before being in the need to start the realization of less liquid assets.

Profitability of the financial sector.

Accounting profits of all financial institutions stood at 2.57% of Assets and 27.59% of Net Worth. Thus, in absolute terms profits reached a total slightly under PYG 1.5 billion, representing an increase of 11.8% over the same period in 2011. This was mainly due to an increase in net interest income in a framework in which improvements resulted from both interest and services.

Cooperatives operate under a special regulatory framework.

According to Paraguayan Law 2157/03, Credit Unions operate under the regulation and supervision of the National Institute of Cooperatives (INCOOP).

The nation's largest unions, classified as A Credit Unions, increased the volume of their assets by 14.3% during the second half of 2012, superior to the level of 12.5% recorded in the same period last year. The Cooperative assets that were subject to analysis totaled PYG 7.2 billion.

The cooperative sector continues to play an important role in the financial system, both as regards financial intermediation as well as for receiving deposits. This sector accounts for 13% in all loan portfolios and 10% of deposits within the total system.

As regards economic actors, we highlight the influence of household credit upon the entire financial system. Consumer loans represent a significant part of the lending activity of financial intermediaries.

The growth that has been noted, from the total consumer credit (banks + finance companies) of PYG 0.9 billion as compared to that recorded in December of 2011, implies that in structural terms said participation increased to 16.2% in late December 2012.

The government sector is one of the most active agents in the process of financial stability.

Currently, most securities are held by financial institutions. However, the proportion of securities in comparison to the total assets of these entities is still very low, so such holdings may represent a risk factor for the financial system. At the same time, the profile of maturity dates of the bonds and the relatively low amounts of these maturities do 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 December 30, 2012, total commitments of firms and the financial system totaled PYG 33.9 trillion. Private Banks accounted for 92.5% of the total, the National Development Bank (BNF) 2.4%, and finance companies 5.1 per cent. This amount represented 76.8% of the total aggregate portfolio of the system. In addition, 16.2% corresponded to consumer credit and 7.02% for loans granted to the financial sector itself).

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

A brief analysis of the reports submitted by banks to the Deposit Guarantee Fund (FGD) reveals that the total deposits of the private financial system, at the end of the second half of 2012 amounted to PYG 45.4 billion, with a variation of 13% with respect to December 2011.

In the framework of the Project of the Modernization of Payment Systems, the activities that have culminated and those that are currently underway are detailed below:

Resolution No. 1, Minutes Record Number 67, Board of Directors of the Central Bank of Paraguay, dated December 127, 2012.

This resolution approves and provides for the entry into force of the GENERAL REGULATIONS OF THE PAYMENT SYSTEMS OF PARAGUAY.

For the efficient operation of the Payments System, this resolution includes guidelines in accordance with the provisions of Paraguayan Law No. 4595/2012. It also regulates the validity of the clearing and settlement operations performed in the Payment Systems, as well as regulate the custody, clearing and settlement of securities and the guarantees provided by participants in said operations.

According to the established schedule, Market tests and the RTSX tests (Real Time Gross Settlement - RTGS), have been performed with the engagement of all participants. Certain aspects which arose are now subject to revision tasks being carried out with the firm CMA. Furthermore, tests have been conducted of the internal interfaces existing at the Central Bank of Paraguay.