



Financial Stability Report

CENTRAL BANK OF PARAGUAY



June 2013

Summary

Current world economic conditions move towards slow recovery. The favorable momentum of countries with emerging and developing economies, as well as some of those with advanced economies, as is the case of the United States of America, has allowed for the sustainment of global growth.

The global growth rate registered in 2012 was 3.2%, lower than the 4% recorded in 2011. Even so, levels very close to the 2012 growth rate are expected this year, esteemed to reach 3.3 percent. In 2014, world economic growth is expected to reach 4 percent.

According to IMF projections, exports in 2013 will experience changes of 2.8% as regards interannual variations in the cases of advanced economies. The trend is to increase significantly in 2014 and may reach a level of 4.6 percent. It is projected that emerging market economies and those of developing countries will record 4.8% of interannual variation and that by 2014 this trend may increase, resulting in an interannual variation of 6.5% in terms of the volume of exports.

It may be observed that Latin American countries in general have maintained a level of sustained growth. For 2013, it is projected that Gross Domestic Product (GDP) will increase by 3.4 percent. Furthermore, hopes are high that 2014 will continue to be beneficial for the growth of these economies, since it has been projected that growth could reach 3.9% of Gross Domestic Product.

At the end of June 2013, a favorable overall performance of Paraguayan economic activities was observed, since in real terms an interannual variation of 7.1% was recorded, this figure being higher than the data recorded for June 2012. In addition, an increase of nearly 14.8% was observed as regards the cumulative rate of variation during the first half of 2013.

The favorable momentum which the Paraguayan industrial sector is currently enjoying is one of the highlights of this report. June 2013 shows peak performance of the manufacturing sector due primarily to the increase in the production of meat, vegetable oils, textiles, and leather, chemical and pharmaceutical products. The increase of investments in Paraguayan companies aims towards the strengthening of our

products while maintaining high standards of quality.

By June 2013, the active and passive interest rates for operations involving national currency (MN) carried out within the banking system presented different behaviors, with increases for the active rate and reductions for the passive one. In contrast, operations in foreign currency (ME) registered reductions for the active interest rates and increases for the passive interest rates.

The external sector indicators allow us to expect a reversal of the trend of the Balance of Payments.

Favorable cumulative results of the Balance of Payments have been registered from 2003 to 2012, thereby producing an increase of USD 4,352 billion in International Monetary Reserves. During the first semester of 2013 there has been a balance of payments surplus of USD 951 million and it is expected that the same trend towards increase, although in less degree, will continue during the second semester.

International Monetary Reserves on December 31, 2012 accounted for 19.5% of Gross Domestic Product. Likewise, International Monetary Reserves allowed for the import of goods (excluding the import of re-exported goods) for an average of 9.2 months during 2012, whereas said indicator for the first semester of 2013 was 7.8 months.

The activity of the Paraguayan financial system remains dynamic.

During the first semester of 2013 the growth rate of the loan portfolios of financial institutions remained stable, at levels similar to those observed in the previous six months. In particular, portfolios related to Industrial and consumer loans are the most dynamic, while Agriculture loans registered a lower degree of acceleration.

In the first half of this year the payment arrears ratio showed an upward trend. As of June 2013, the delay in payment ratio stood at 2.54%, increasing 0.30 percentage points in relation to the close of the previous year.



While there has been an increase in nonperforming loans during the first semester of 2013, this was accompanied by a 12.9% increase in provisioning during the same period. Therefore, delay in payments was minimally affected.

As a whole, the financial system continued to increase the level of financial intermediation (deposits and loans) with the private sector. In particular, credit to the private sector in terms of GDP has advanced with respect to December 2012 and represented 46.5% of GDP.

The measures decided upon by monetary authorities, consisting of higher provisioning for loans and higher capital requirements, are intended to ensure that financial institutions count with sufficient capital which in turn translates as greater stability of the system. Moreover, the importance of the stability of the financial sector in regards to the economy has grown with the relative weight of this sector in aggregate activities and its growing international dimension. For this reason, it is imperative that the country be at the forefront in terms of international standards for the strengthening of the prudential regulatory framework.

As of June 2013, Financial System Assets reached PYG 71,5 trillion, an increase of 12.7% in the first semester. In this context, in nominal terms the balance of the Loan Portfolio grew by 5.6% last semester, while deposits rose 12%, outperforming the previous semester.

The number of borrowers in the financial system increased by 23.1% in semi-annual terms, going from 851,497 in December 2012 to 920,768 in June 2013. The structure of deposits presented a migration towards time deposits. The system's liquidity remained high, given the composition of its assets.

Patrimonial Solvency indicators in 2013 were favorable at the end of the first semester.

Patrimonial Solvency indicators showed that all banks and financial companies were above the minimum level established by law (12% effective equity with respect to the Risk Weighted Assets and Contingencies of the institution).

The capital adequacy ratio (Tier 2 Supplementary Capital) as of June 2013 was 16.83 percent, a level that exceeds current legal minimum requirements by 4.83% and is 8.83% higher than the minimum levels suggested in Basel guidelines. Also, the Principal Capital indicator (Tier 1) was 13.20% in June 2013, 8% higher than the current legal minimum requirement.

Stress tests indicate an adequate level of aggregate bank solvency.

In order to estimate the impact of adverse movements against the solvency of financial institutions, Central Bank staff members have proceeded to conduct stress tests.

Credit Risk: Upon analyzing shocks applied to loan portfolios, the Capital Adequacy Ratio of the banking system remained above the legal minimum requirement.

Foreign Exchange and Interest Rate Risks: When changes in foreign exchange and interest rates were carried out, no major variations were observed in the solvency ratios of the financial entities.

Liquidity Risk: It was observed that liquid assets could face draining of high liquidity for five days before being obliged to make use of less liquid assets.

Profitability of the financial sector.

Accounting profits of financial institutions overall stood at 2.71% of Assets and 28.35% of Net Worth.

Thus, in absolute terms, profits reached a total of PYG 0.9 trillion, representing an increase of 22.9% in relation to the same period in 2012. This was mainly due to an increase in the financial spread in a framework in which the improvements of results are due to interest rates as well as services.



Cooperatives operate under a regulatory framework of their own.

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

The country's largest cooperatives, Credit and Loan Cooperatives and Production oriented Cooperatives, both classified as category A, increased the volume of their assets by 8.2% and 2.1% respectively during the first half of 2013.

The cooperative assets that were subject to analysis totaled PYG 7.9 trillion for Credit and Loan Cooperatives and PYG 7.5 trillion for Production oriented Cooperatives.

The cooperative sector continues to play an important role in the financial system, both in granting loans and attracting deposits, as it accounts for 18% of all Credit Portfolios and 12% of Deposits within the entire system, according to data provided by the INCOOP.

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

The reported growth of total consumer credit (banks + finance companies) which amounted to PYG 1.3 trillion as compared to data recorded in June 2012, implies that in structural terms said participation increased to 16.7 % at the end of June 2013, as compared to the 16.1% which was registered in June 2012.

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

Most public securities are currently held by financial institutions. However, the proportion of these securities in relation to total assets held by financial entities is still very low and therefore might represent a risk factor for the financial system. At the same time, the maturity date 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.

At the end of the first semester of the year, total obligations of companies with respect to the financial system totaled PYG 35.7 trillion. Private Banks accounted for 92.6% of the total, the National Development Bank (BNF) 2.3%, and finance companies 5.1 percent. This amount represented 75.5% of the total aggregate portfolio of the financial system (the remaining 16.7% corresponds to consumer credit and 7.8% constituted placements of securities in the financial sector itself).

By the close of the first semester in 2013, 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 sector financial system covered by the FGD amounted to PYG 51.1 trillion at the end of the first half of 2013. This represents an increase of 13% with respect to December 2012.

In the framework of the project for the modernization of Payment Systems, the activities that are currently underway and those that have been completed are detailed in Resolution Number 1, Minutes Record Number 67, dated December 27, 2012, Board of Directors, Central Bank of Paraguay.

This Resolution approved and provided for the entry into force of the GENERAL REGULATIONS OF PAYMENT SYSTEMS IN PARAGUAY (SIPAP).

This Resolution regulates the validity of clearing and settlement operations performed in the Payment Systems and also establishes norms for the custody, clearing and settlement of securities and of the guarantees that support such operations.



All procedures needed for the efficient functioning of the payments systems of Paraguay shall be communicated through appropriate administrative channels. All participating entities and/or involved domestic sectors must adjust operations as needed in order to comply with these regulations.

In coordination with the above mentioned Resolution, the Board of Directors of the Central Bank of Paraguay issued Resolution Number 20, Minutes Record Number 65, dated September 12, 2013 "Payments System of Paraguay - SIPAP - Interaction with Operators of Means of Payment" (OMP with SIPAP).