Financial Stability Report

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Executive Summary[1]

Since the last publication of the Financial Stability Report (FSR), global economic activity has continued to grow, although at a slower pace than forecast and with less uniformity among countries. In addition, uncertainty worldwide remains high, mainly due to downturn risks that are implicit in trade tensions between the United States and China. Meanwhile, the Federal Reserve's monetary normalization process has meant tighter international financial conditions for emerging countries. Given this scenario, global growth projections have been revised downward, dropping from 3.9% to 3.7% for both 2018 and 2019.

Among the advanced economies, the United States has continued to show favorable dynamics, while growth in the Eurozone has become more moderate in the last few months. Among the emerging economies, the weakening of regional economies –above all the significant deterioration of the Argentinean economy– is highlighted. This has led to the real appreciation of the Guarani, mainly affecting Paraguay's border trade. In this context, the growth indicators of Paraguay's trade partners are less favorable with respect to the previous FSR report.

The United States' Federal Reserve has continued with its process of monetary normalization over the last few months, a process that is expected to persist until the end of this year and extend into 2019. In this context, Treasury Bonds yields have increased both for U.S. bonds and those of emerging economies. Likewise, this has resulted in a strengthening of the United States dollar, both globally and regionally.

As regards the local financial system, bank loans have maintained the expansive path of recovery that began in mid-2017, showing even greater dynamism in the last few months. By September 2018, the annual expansion of bank loans extended in domestic currency was explained mainly by the positive contributions of consumption, wholesale trade, and manufacturing. In a similar manner, loans granted in foreign currency continued to register a positive performance, boosted largely by the contribution of wholesale trade, agribusiness, and manufacturing sectors (Figures I and II).

Figure I
Loans in local currency
Incidence, percentage

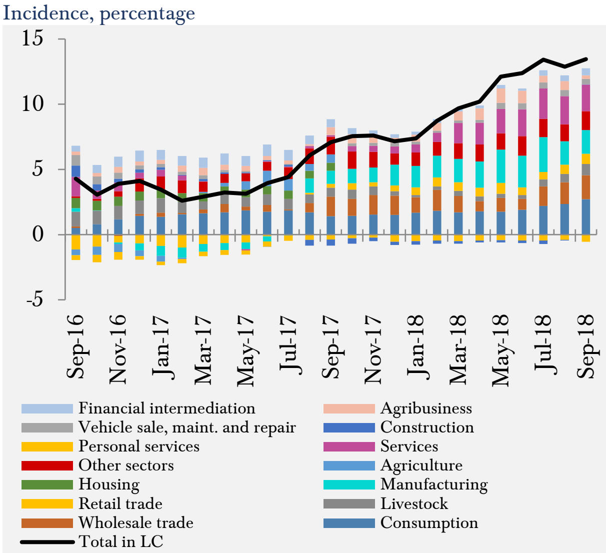
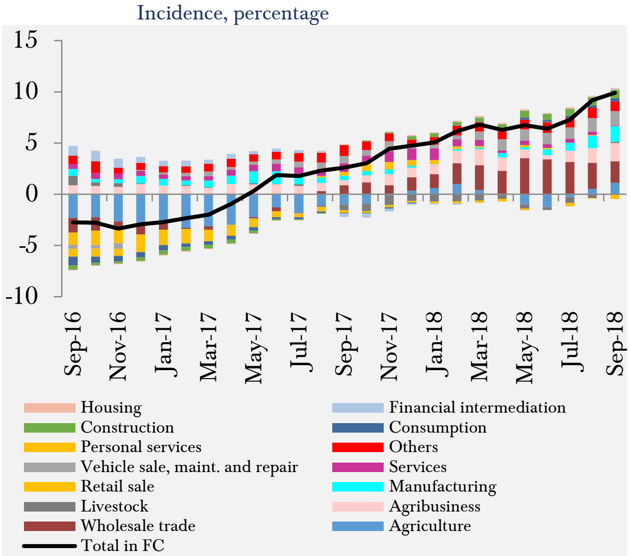


Figure II
Loans in foreign currency
Incidence, percentage



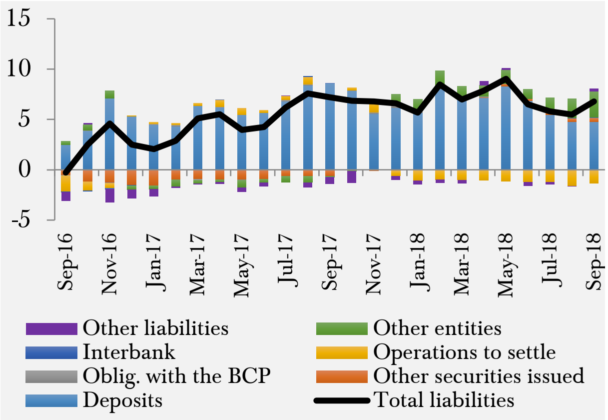
Source: Central of Information Office. Superintendency of Banks.

In accordance with the expansion of assets, the liabilities of the financial system have continued to increase, although with a slightly decreasing trajectory in recent months, consistent with the lower dynamism of bank deposits. In this respect, deposits increased 5.7% y-o-y by September of this year, explained especially by the increase of demand deposit accounts. Deposits in local currency have shown a slower pace of expansion since the last FSR, while bank loans

[1] The Spanish version prevails.

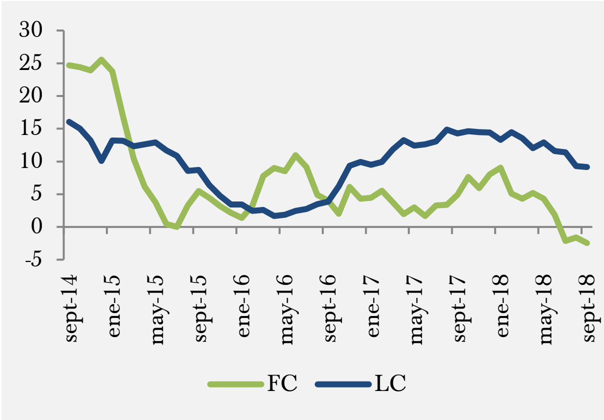
extended in foreign currency have shown deceleration in the last few months, registering a negative annual variation of 2.5% in September 2018 (Figures III and IV).

Figure III
Liabilities
Incidence, percentage



Source: Balance sheets reported to the Superintendency of Banks.

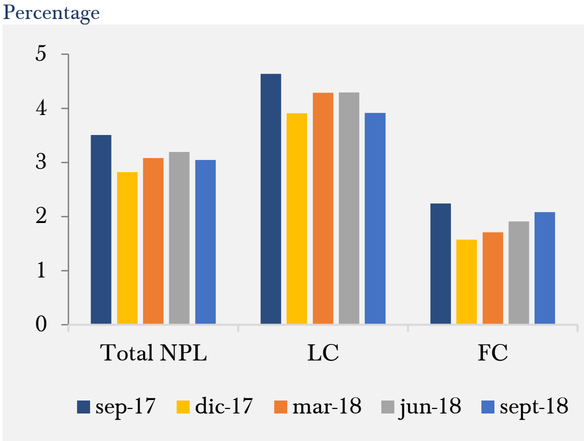
Figure IV
Deposits by currency
Annual variation, percentage



Source: Balance sheets reported to the Superintendency of Banks.
Note: Foreign currency (FC), local currency (LC) The data correspond to banks and financial companies.

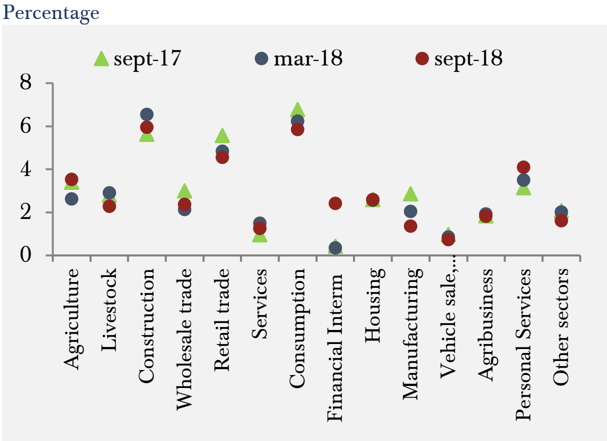
Non-performing loans (NPL) ratio of the financial system have decreased since the last report, standing at 3% in September 2018, explained, in part, by the reduction of the non-performing loan portfolio in annual terms (-1%). In terms of currency, NPL-ratio in local currency declined, but the NPL ratio for loans extended in foreign currency increased, in comparison with data given in the previous report. By sectors, the majority registered lower NPL rates than those observed in September 2017 (Figures V and VI).

Figure V
Non-performing loans
Percentage



Source: Balance sheets reported to the Superintendency of Banks.
Note: Foreign currency (FC), local currency (LC) The data correspond to banks and financial companies.

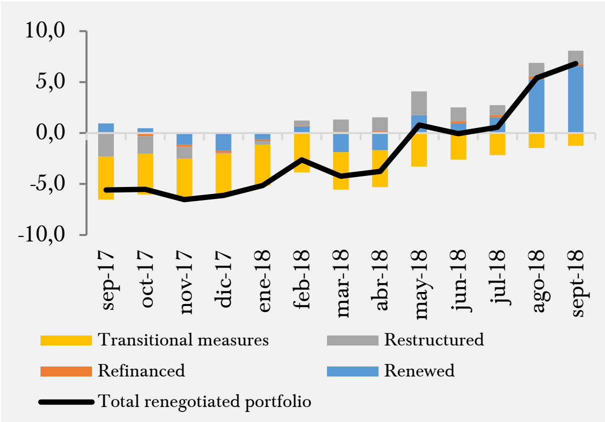
Figure V
Non-performing loans by sectors
Percentage



Source: Central of Information Office. Superintendency of Banks.

The renegotiated loans portfolio has been increasing since the publication of the previous FSR, an increase that has been mostly influenced by the renewed portfolio. As regards credit risks coverage, the financial system's portfolio of non-performing loans has remained fully covered by total provisioning in comparison to the previous FSR report (Figure VII).

Figure VII
Renegotiated portfolio
Incidence, percentage



Source: Balance sheets reported to the Superintendency of Banks.

On the other hand, an increased indebtedness of households with banks and financial companies has been registered in the reference period. By September 2018, the annual expansion of this variable stood at around 7.9% y-o-y, explained largely by debts related to consumption, and to a lesser degree, to mortgage debts. In addition, a certain improvement in the quality of credit extended to households has been observed, which was reflected in the marginal decrease of the NPL ratio. As regards the balance of credit card debts, this has presented positive growth rates in annual terms, since January of this year. However, as compared to the balance registered before the implementation of the Credit Card Law, it has contracted 7.6% (September 2015).

With respect to the market risk, the spread in bank interest rates was reduced, in guaranies, due to the decrease of lending rates in all the economic sectors. On the other hand, the spread of bank interest rates in foreign currency has increased in annual terms, explained mainly by the decline of average deposit rates. The risk of foreign currency mismatches has been controlled at the aggregate level, as the system registered a positive foreign exchange position in September 2018.

As regards financial stability indicators, credits and deposits represent 36.8% 39.7% of the Gross Domestic Product (GDP), respectively. With respect to the previous report, credit largely continues to be funded by deposits, in both local and foreign currency. The ratio of external funding with relation to deposits has increased slightly, going from 20.1% to 21.5%. With respect to the credit-to-GDP gap, which measures the sustainability of credit increases, the credit/GDP ratio at the end of the second quarter 2018 continues below its long-term level, generating a negative gap.

With respect to the financial soundness indicators, solvency stands at levels that comfortably surpass the minimum capital adequacy requirements. The ratio of core capital to risk weighted assets and contingencies (RWA) stood at 13.5% in September 2018, and the ratio of regulatory capital to RWA was 17.8% during the same period, both indicators standing well above the legal minimum requirements. Likewise, the system's leverage ratio, measured as the ratio of Tier I capital with respect to total assets, exhibits a rising trend and is above the Basel III minimum requirement (3%). Profitability has remained at levels similar to those provided in the previous FSR report, with ROE and ROA standing at around 20.1% and 2.3%, respectively.

At the same time, the performed stress tests indicate that the financial system, comprised of banks and financial companies, maintains a position of adequate solvency in the case of external shocks, even though there is little likelihood of such an occurrence.

Lastly, the payments system has continued to operate normally, in a fluid and efficient manner, reflecting the current preference for electronic payments instruments. In this sense, electronic transactions continue to show an ascending trajectory, while the use of checks for payments has decreased in the recent period.