



# FINANCIAL STABILITY REPORT

MAY  
2020



**CENTRAL BANK OF PARAGUAY**

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[www.bcp.gov.py](http://www.bcp.gov.py)

Asunción - Paraguay

## Executive Summary<sup>1</sup>

Since the publication of the last Financial Stability Report (FSR), global economic growth prospects for 2020 have been revised downward, and a recession is expected this year due to the global crisis generated by the spread and declaration of pandemic of the coronavirus (COVID-19). In this scenario, assuming an effective containment of the pandemic by the second semester of the year, in April the International Monetary Fund (IMF) projected a 3% decline in the world economy. This shows a reversal compared to the expectations in October 2019, when the IMF estimated a growth rate of 3.4% in 2020.

As regards the advanced economies, in the United States a 5.9% contraction of its economy is foreseen, which represents a reduction with respect to the previous report, while in the Eurozone the projected growth rate of 1.4% in October 2019 has been cut to -7.5%, according to the last estimate in April. On the other hand, growth prospects for both emerging and developing economies have also been revised downward, although to a lesser extent, dropping from 4.6% annually in October 2019 to -1.1% in April. The expansion of the new coronavirus and the mitigation measures are having a significant impact on the world economy, which has been exacerbated by uncertainty.

In the United States, the Federal Reserve (Fed) has implemented measures in response to the economic situation generated by the COVID-19 pandemic, including the reduction of the interest rates of federal funds in order to face the complex global economic scenario. In this context, Treasury Bond yields have decreased in comparison to the previous FSR report, given the scenario of global uncertainty. Regarding the United States dollar, this currency has registered an appreciation, with its highest value recorded in March.

The scenario continues to be complex for the regional economies, as reflected in the downward revision of the latest growth estimates of Brazil and the complicated panorama that Argentina is experiencing. The great challenge involved in restructuring Argentina's external debt has been compounded by the COVID-19 pandemic. Negotiation with private creditors and with the IMF is a priority for the Argentinean government; moreover, the government foresees to further advance in the revision of its Stand-By agreement with the IMF. In addition, border trade with these countries is temporarily suspended due to the closing of the borders, which has adversely affected businesses that engage in cross-border re-export operations, particularly those dealing with Brazil. In this context, growth estimates for the indicator of Paraguay's trade partners have registered a contraction, likewise showing a downward revision with respect to the previous report.

At the domestic level, the Paraguayan economy experienced stagnation in 2019, explained mainly by the deterioration of climatic conditions and the complexity of the external environment, particularly within the region. During the first two months of 2020, economic activity had maintained favorable growth rates. However, starting in March, this momentum was significantly slowed with the sanitary emergency, the social containment measures, and a more deteriorated external scenario. In such context, in the last twelve months, the non-performing loans (NPL) ratio has shown an increase and the growth pace of the bank loan portfolio has decelerated. With the purpose of attenuating the economic and financial effects resulting from the stoppage of economic activities, due to the spreading of COVID-19, the Central Bank of Paraguay (BCP) and other government financial institutions have adopted a series of exceptional measures to address the finance needs of both individuals and business firms<sup>2</sup>.

In the local banking system, the most liquid components of assets have increased their contribution to the growth of total assets in March. Said behavior has been observed in the context of the greater liquidity facilities provided to the

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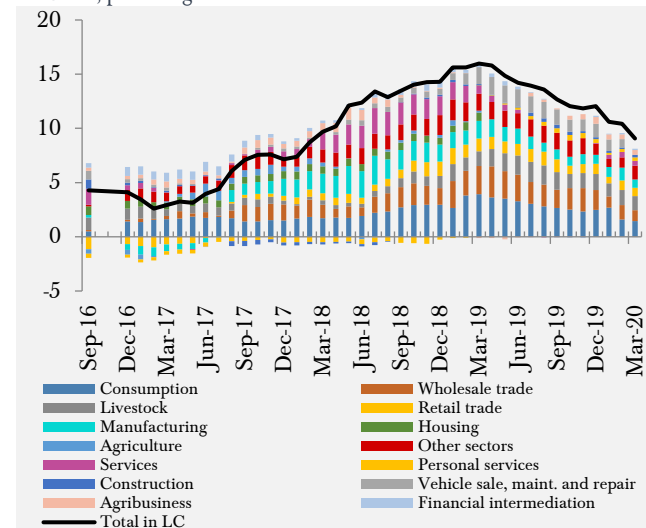
<sup>1</sup> The Spanish version prevails.

<sup>2</sup> For more details, see box 1 of this report.

financial institutions by the Central Bank. In contrast, the loan portfolio has reduced its incidence, undergoing a deceleration of the pace of growth for bank loans extended in local currency, as well as a contraction of loans granted in foreign currency (graphs I and II).

**Graph I**  
**Loans in local currency**

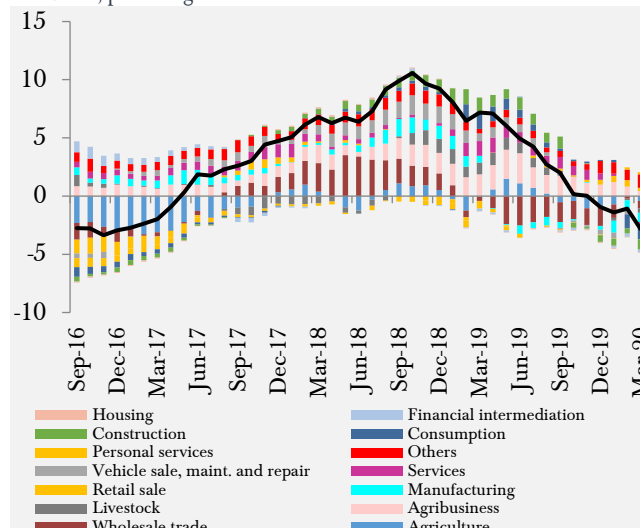
Incidence, percentage



Source: Central Information Unit. Superintendency of Banks.

**Graph II**  
**Loans in foreign currency**

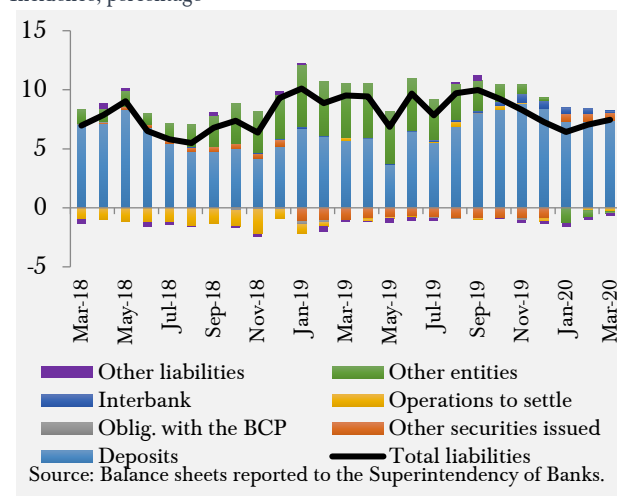
Incidence, percentage



The liabilities of the financial system have continued to expand, although at a slower pace than observed in the previous report, due to a lower dynamism in the growth rate of deposits, especially in local currency, and the negative contribution of other items that constitute the liability. With respect to deposits, these increased 9.2% y-o-y in the first quarter of the year, a growth rate attributed mainly to the increase of Certificates of Deposit (CDA), current accounts, and sight deposit accounts. According to currency type, deposits in local currency had shown signs of greater dynamism since the last report, but later showed a slower pace of growth in the first quarter of this year (6.2%). Deposits in foreign currency have revealed a greater growth rate than the one observed in the previous FSR report, registering an annual variation of 6.4% by March 2020 (graphs III and IV).

**Graph III**  
**Liabilities**

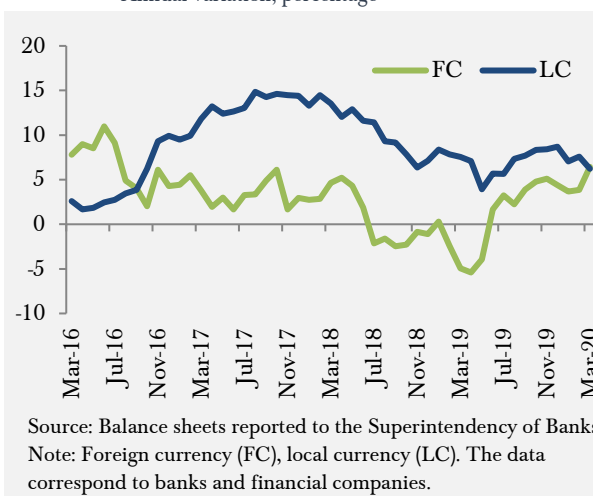
Incidence, percentage



Source: Balance sheets reported to the Superintendency of Banks.

**Graph IV**  
**Deposits by currency**

Annual variation, percentage

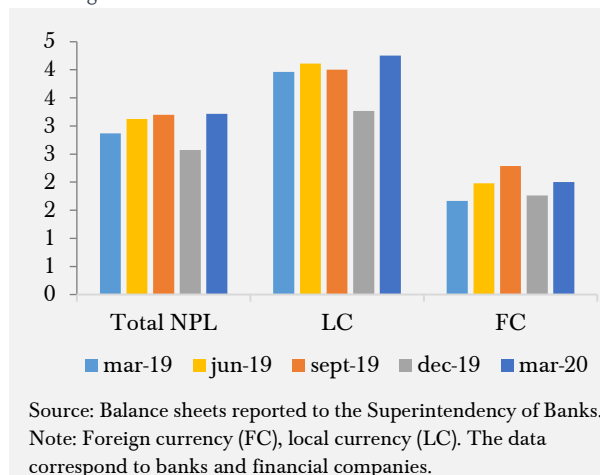


Source: Balance sheets reported to the Superintendency of Banks.  
Note: Foreign currency (FC), local currency (LC). The data correspond to banks and financial companies.

As regards credit risk, the Non-performing loans (NPL) ratio of the financial system has increased in comparison to the previous year, although it has remained stable since the previous FSR report, standing at 3.2% in March 2020. In terms of currency, the NPL ratio for loans granted in US dollars has decreased, while the NPL ratio for loans granted in local currency has increased with respect to the last FSR published in November. By economic sectors, total non-performing loans have increased in most of the sectors, compared to the previous report and to the same month in 2019 (graphs V and VI).

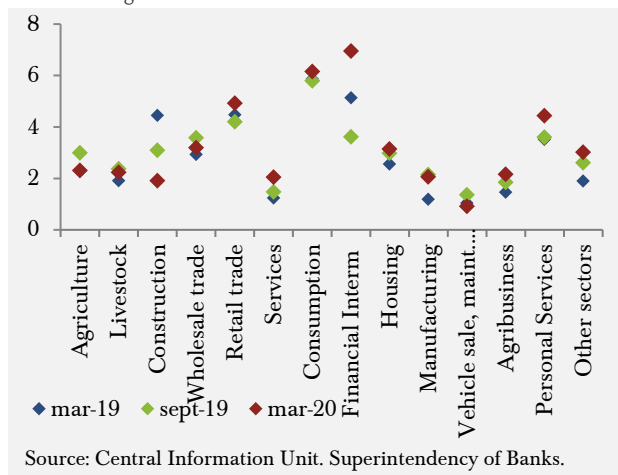
**Graph V**  
Non-performing loans

Percentage



**Graph VI**  
Non-performing loans by sector

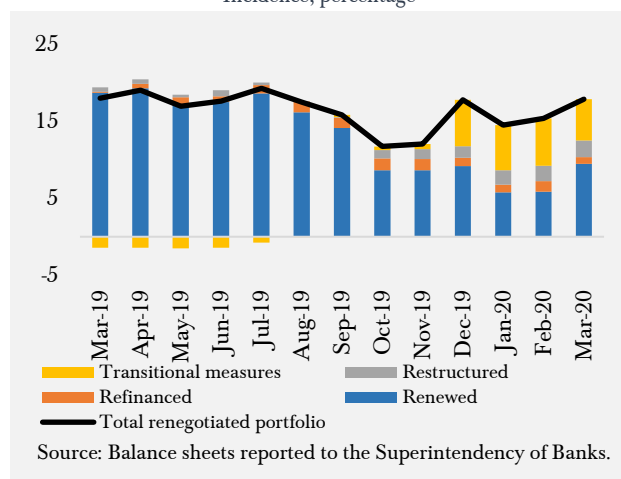
Percentage



On the other hand, since the previous FSR, the renegotiated loans portfolio has been showing greater dynamism in its growth rate, reaching an increase of 17.8% y-o-y by March, explained especially by the incidence of renewed loans, followed by transitional measures, and the portfolio of restructured loans. Regarding credit risks coverage, total provisioning represented 116.1% of the non-performing loans by March 2020 (graph VII).

**Graph VII**  
Renegotiated portfolio

Incidence, percentage



As regards the users of credit, loans extended to households, for consumption as well as household indebtedness, have been decelerating, while the NPL-ratio has increased. Given the current economic situation, in which people's incomes have deteriorated, it is expected that the NPL-ratio will increase in the next months. Corporate debt in banks and in financial companies has continued to increase since the last report, although at a slower pace. By the first quarter of 2020, corporate indebtedness had increased 4.7% y-o-y and represented 63.1% of total loans in the financial system (26%

of GDP). The increase of this portfolio is mainly explained by the positive incidence of loans granted to the wholesale trade, agribusiness, livestock production, and agricultural sectors. In relation to the quality of this portfolio, the NPL-ratio has deteriorated since the last report, standing at 2.1% by March 2020 (1.7% by September 2019).

In relation to the market risk, the interest rate spread in local currency has increased slightly, while the interest rate spread in United States dollars has decreased slightly compared to the previous report (data up to September 2019). The liquidity risk resulting from the maturity mismatch is offset by the holding of other instruments that provide extra funding. In addition, the Central Bank of Paraguay has issued a series of measures intended to provide additional liquidity to the financial system in the context of the crisis caused by the spread of COVID-19.

With respect to the financial stability indicators, the ratio of total credit extended by banks and financial companies represents 41.2% of the GDP and deposits represent 45.0% of the GDP in nominal terms; both indicators are above the levels registered in the previous FSR. Credit continues to be funded mostly by deposits, both in local currency and in dollars. Regarding non-traditional financing, external funding represented 21.9% of the deposits in US dollars by the first quarter of 2020, slightly above the level registered in the previous report. With reference to the credit-to-GDP gap indicator, by the first quarter of 2020, the credit to GDP ratio has remained above its long-term level, generating a positive gap of less magnitude compared to the levels recorded in 2019. Looking ahead, the magnitude of the gap will depend largely on the evolution of credit, according to the financial measures adopted.

As regards the financial soundness indicators, the solvency indexes remain at levels that comfortably surpass the minimum capital adequacy requirements. With respect to this, the ratio of core capital to risk weighted assets and contingencies (RWA) stood at 13.8% by March 2020, while the ratio of regulatory capital to RWA stood at 19.9% during the same period. The leverage ratio, measured as the ratio of Tier I capital with respect to total assets, stood at 8.6% in the first quarter of 2020, far exceeding the Basel minimum requirement (3%). Regarding profitability, ROE and ROA indicators have stood below the levels registered in the previous report, standing at 18.7% and 2.2%, respectively (21.0% and 2.4% in the previous FSR).

At the same time, the stress tests performed at banks and financial companies indicate that the financial system maintains a position of adequate solvency, following the simulation of extreme shocks, but with low probability of occurrence.

Finally, the payments system has performed normally, in a fluid and efficient manner. In particular, during the period of confinement, the economy's chain of payments has operated with no interruption, guaranteeing the provision of physical and electronic means of payments.