



FINANCIAL STABILITY REPORT

NOVEMBER
2020



CENTRAL BANK OF PARAGUAY

Federación Rusa y Augusto Roa Bastos

www.bcp.gov.py

Asunción - Paraguay

Executive Summary¹

Since the publication of the last Financial Stability Report (FSR) in May 2020, the relevant external scenario for Paraguay has remained complex, given the deterioration of the global economy and especially that of the economies of neighboring countries, due to the impact generated by the COVID-19 pandemic. At the same time, the growth prospects of emerging and developing economies have been revised downward since the publication of that report. As regards the prices of raw materials, an increase of the prices of agricultural commodities has been observed, which would positively impact the Paraguayan economy. However, the increased in the price of oil would offset the favorable effect in terms of trade, as Paraguay is a net importer of that fuel. Global uncertainty has been attenuated due to the significant advances in coronavirus treatment and the development of vaccines, while international financial conditions have improved in the context of less perception of risk as concerns the regional economies.

At the domestic level, economic activity and demand deteriorated significantly during the second quarter, particularly in April, as a result of the implementation of strict confinement procedures as a preventive sanitary measure to contain the COVID-19 pandemic. Faced with this extraordinary situation, the policies promoted by the National government to support the most affected sectors and reactivate the economy, which together with the series of measures adopted by the Central Bank of Paraguay (BCP) to safeguard monetary stability, the stability of the financial system, and the smooth functioning of the payment system, have contributed to attenuate the negative impact. In this scenario, since the release of the last FSR, solvency has been maintained at levels that surpass the regulatory requirements and the availability of liquidity has increased in accordance with the facilities that have been provided to local entities. In a similar manner, the exceptional measures that granted flexibility for credit reprogramming have generated an increase in the renegotiated loans portfolio, while the profitability of the financial system has decreased. In the recent period, the greater openness of the economy due to the flexibilization of isolation measures has contributed to the better results of the short-term economic indicators in the third quarter. Notwithstanding, the risk persists that new confinement measures might need to be implemented in the case of an acceleration of contagion. Looking ahead, the financial system faces the challenge of continuing to assure the flow of credit, maintaining adequate levels of both capital and liquidity, even in a hypothetical scenario in which the debt repayment capacity of households and businesses might remain deteriorated for a greater length of time.

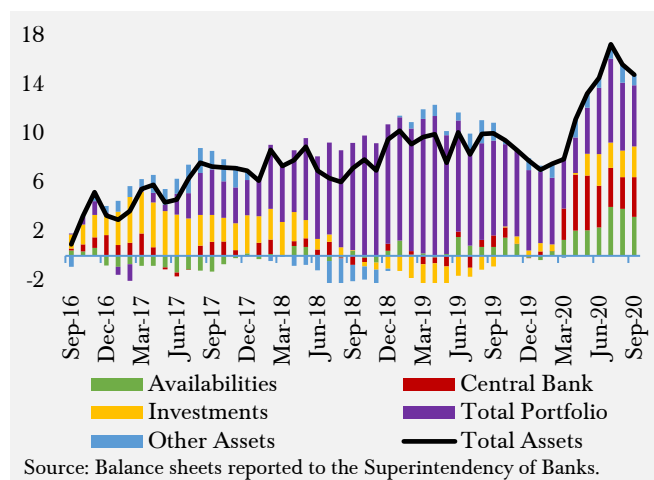
In the local banking system, assets have shown an important dynamism, explained by the positive contribution of all asset components. The greater accumulation of liquid assets by the financial entities is highlighted, in accordance with the greater liquidity facilities provided by the Central Bank, as mentioned previously. In addition, the various financial flexibility measures have made it possible to maintain the flow of credit within the economy. It is important to note that while the pace of the inter-annual growth of total credit has decelerated, as compared to 2019, it would have contracted if the exceptional support measures had not been implemented (graphs I, II, and III).

¹ The Spanish version prevails.

Graph I

Assets

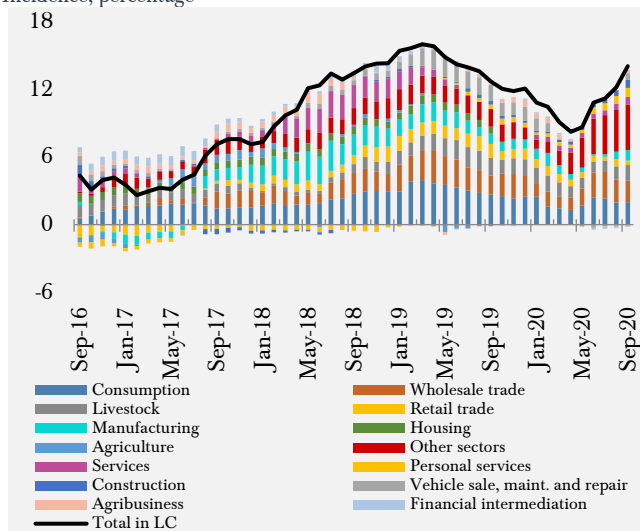
Incidence, percentage



Graph II

Loans in local currency

Incidence, percentage

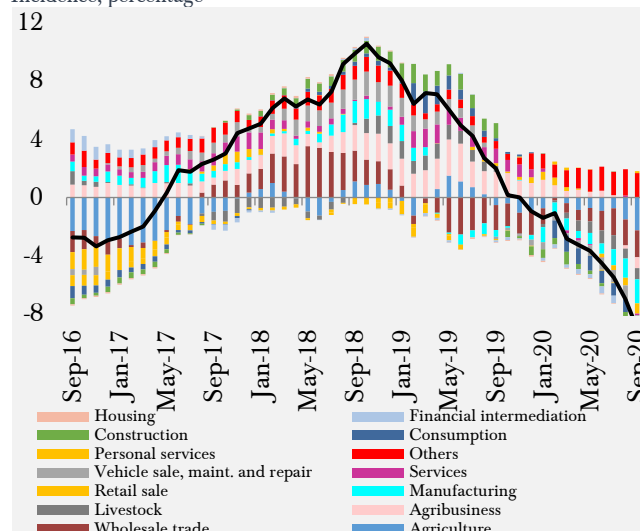


Source: Central Information Unit, Superintendency of Banks.

Graph III

Loans in foreign currency

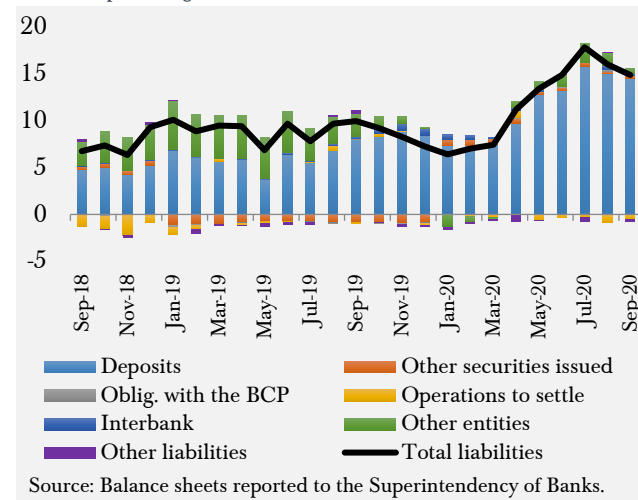
Incidence, percentage



In accordance with the trajectory of assets, the financial system liabilities have shown positive growth rates, reaching levels even higher than those recorded in the previous report. This behavior of liabilities has mainly been related to the growth rate of deposits, which increased 17.7% y-o-y by the third quarter 2020 (50.3% of GDP 2020), due especially to a boost of deposits in local currency and sight deposit accounts. This situation of greater preference for sight deposit accounts might be related, in part, to higher uncertainty in the market, generated by the sanitary crisis resulting from the COVID-19 pandemic (graphs IV and V).

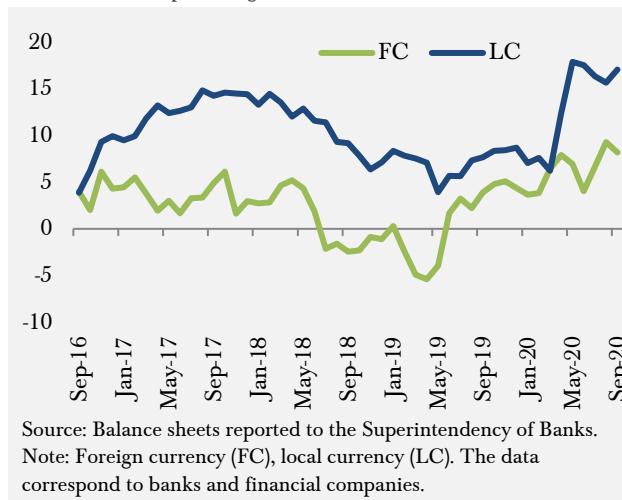
Graph IV
Liabilities

Incidence, percentage



Graph V
Deposits by currency

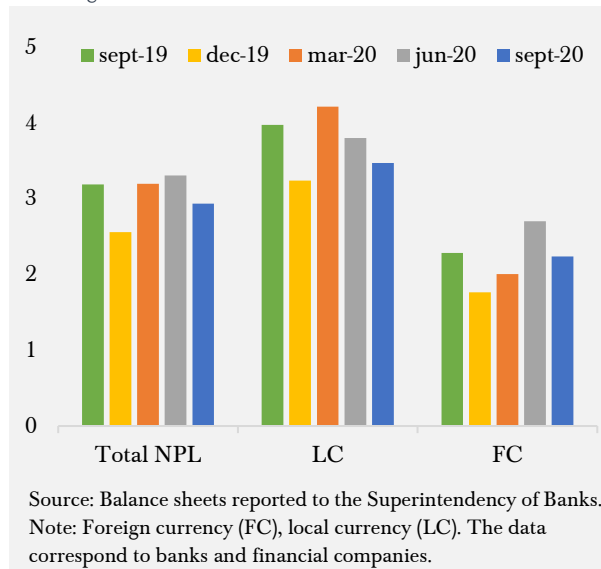
Annual variation, percentage



As regards credit risk, the Non-performing loans (NPL) ratio of the financial system has shown improvements, especially in local currency, although the substantial increase of the renegotiated portfolio since the previous FSR report is highlighted. This is a result of the exceptional measures implemented by the BCP to support the economy in the context of the pandemic. By economic sectors, total non-performing loans presented interannual reductions in most of the sectors by the third quarter of 2020 (graphs VI and VII).

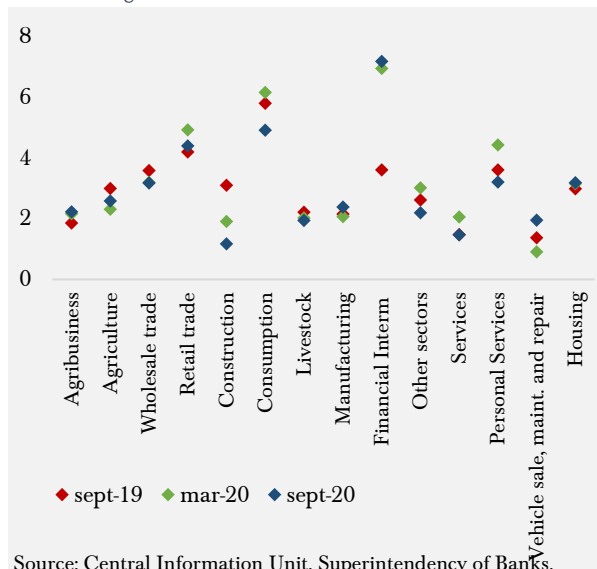
Graph VI
Non-performing loans

Percentage



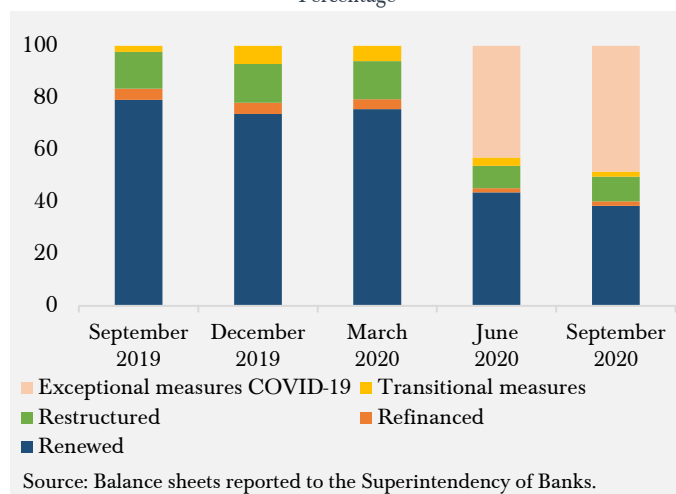
Graph VII
Non-performing loans by sector

Percentage



The structure of the renegotiated loans portfolio has been affected significantly by the introduction of the exceptional measures to support those sectors most affected by the pandemic. Thus, this portfolio represented 15.2% of the loan portfolio and accumulated 15.6 trillion guaranies as of September 2020 (6.6% of GDP 2020). It is mainly composed of restructured loans (84.3%) to trade, consumption and services sectors. Regarding credit risks coverage, total provisioning represented 126.6% of the non-performing loans by third quarter 2020, showing an increase since the previous report (116.5%) (graph VIII).

Graph VIII
Renegotiated portfolio
Percentage



Disaggregated according to the users of credit, the pace of loans extended to households has increased, explained largely by the greater expansion of consumer loans. Regarding the credit quality, the NPL-ratio has decreased as a result of the flexibilization granted by financial entities to households for the refinancing of debts, thereby preventing a large portion of the portfolio from falling in arrears. Corporate debt in banks and in financial companies has increased as a percentage of GDP (27.2% of GDP 2020). Since the last report, the growth rate of business loans had shown a rebound, but which later attenuated due to the loss of dynamism in recent months, in line with the deterioration of activity reported in the second quarter of 2020. In this regard, corporate indebtedness represented 63.0% of total loans granted and increased 6.6% y-o-y by September 2020, an increase mainly explained by the positive incidence of loans granted to the services and livestock production sectors and mitigated by contractions in the manufacturing and agricultural sectors. In relation to the quality of this portfolio, the total NPL-ratio has remained with no variation in interannual terms, although increases have been verified in the majority of the economic sectors.

In relation to the market risk, the interest rate spread in both local currency and in United States dollars has been decreasing gradually, since the previous report, in line with the monetary flexibilization measures implemented by the Central Bank of Paraguay. The liquidity risk resulting from the maturity mismatch is offset by the holding of other instruments that provide extra funding. In addition, the BCP has issued a series of measures intended to provide additional liquidity to the financial system in the context of the sanitary crisis caused by the COVID-19 pandemic. In this regard, the liquidity of banks and finance companies increased 37.1% y-o-y by September 2020, accumulating a balance of USD 3.28 billion (9.3% of GDP 2020), composed mainly by Monetary Regulation Instruments and Treasury Bonds (77.8% of the total).

With respect to the financial stability indicators, financial deepening measured by the ratios of total credits and deposits in relation to GDP, improved in the third quarter 2020, compared to the levels registered in the same period of 2019. Likewise, deposits continued to be the main source of financing of the loans, both in local currency and foreign currency. Regarding alternative financing², represented by external funding, this has decreased as a percentage of deposits in US dollars (18.7% as of September 2020), reflecting a greater preference towards traditional financing through deposits from individuals and businesses. With reference to the credit-to-GDP gap indicator, by the second quarter of 2020, the credit to GDP ratio remained above its long-term level, generating a positive gap of a similar magnitude to that verified in the previous FSR.

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

² In the recent period, innovative businesses offering financial services such as the provision of alternative sources of access to credit, through digital platforms, have arisen in the financial market (See Table II of this report).

contingencies (RWA) stood at 14.6% by September 2020, while the ratio of regulatory capital to RWA stood at 19.2% 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 third quarter of 2020, far exceeding the Basel minimum requirement (3%). Regarding profitability, ROA and ROE indicators have shown a downward trajectory during 2020, standing at 1.9% and 15.5%, respectively, in September (2.2% and 18.7% 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. During the period of confinement as well as in the recent months, the economy's chain of payments has operated with no interruption, guaranteeing both the provision of physical and electronic means of payments.