



# FINANCIAL STABILITY REPORT

**MAY  
2021**



**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) in November 2020, the external scenario that has relevance for Paraguay has improved, considering the progress made in the application of vaccines and the return to activities that have permitted a greater dynamism of the global economy. The growth prospects for 2021 have been revised upward for the advanced economies, as well as for the emerging and developing. The main trading partners have also shown a better economic outlook, even though some certain trading partners, particularly those in the region, are facing an intensification of the health crisis which constitutes a downside risk. As regards commodity prices, increases in the prices of most of the agricultural commodities relevant to the country's exports have been registered. However, increases in the prices of petroleum have also been registered, which would offset the expected improvement in the terms of trade, since Paraguay is a net importer of crude oil derivatives. International financial conditions have remained lax, while the perception of risk in the region has remained moderate.

In the previous report, certain signs of the economic recovery of the short-term indicators in the third quarter of 2020 were highlighted, which were consistent with the greater relaxation of the social containment measures, the reopening of more economic sectors, and the support of the counter-cyclical measures that were implemented. That recovery, faster than expected in some sectors, became more robust in the fourth quarter, resulting in a slighter contraction of GDP in 2020 (-0.6%) as compared to the forecasts at the beginning of the Coronavirus pandemic<sup>2</sup>.

In the first quarter of this year, economic activity has maintained a moderate dynamism, in the midst of a worsening of the sanitary emergency; this situation caused the Government to temporarily reinstate restrictive measures on circulation and activities that involve significant social interaction. This situation has been aggravated by the limited access to vaccines against COVID-19 and the slow progress of the National Vaccination Plan. In this context, the uncertainty about the future dynamism of the economy has been heightened, which could increase the risks for the financial system, mainly in the likely case of a greater deterioration of the debt repayment capacity of both individuals and businesses.

In the local financial system, the total assets of banks and financial companies have expanded in a significant manner in the last twelve months, in a context of the greater liquidity in the economy and of credit dynamism, a result, in part, of the financial measures<sup>3</sup> provided to the financial entities by the Central Bank in order to support families, businesses, and the economy during the pandemic situation. More specifically, the increase of assets was the result of the positive contribution of all asset components, although it is highlighted that loan performance ranked in the first place. Since May 2020, the downward trend of the loan portfolio in national currency began to revert, reaching an inter-annual growth rate of 16.4% in the first quarter of 2021, higher than the average in the last five years (10.5%). In foreign currency, loans contracted throughout 2020, exhibiting the lowest level in September of that year (-9.0%). Since then, the data shows its progressive reversion (-2.3% y-o-y in March 2021) as seen in Graphs I and II.

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

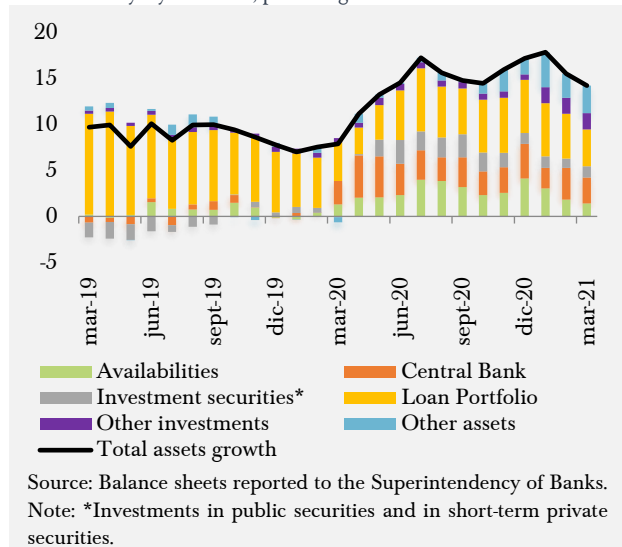
<sup>2</sup> More details about the recent evolution of economic activity may be found in the March 2021 IPoM report. <https://www.bcp.gov.py/informe-de-politica-monetaria-i-14>

<sup>3</sup> More details about the utilization of the financial measures may be found in Box 1 of this report.

**Graph I**

**Assets**

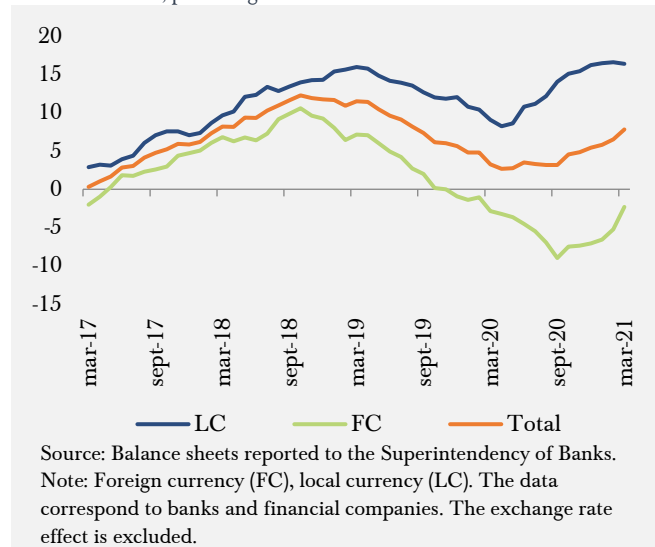
Incidence on y-o-y variation, percentage



**Graph II**

**Loans by currency**

Annual variation, percentage

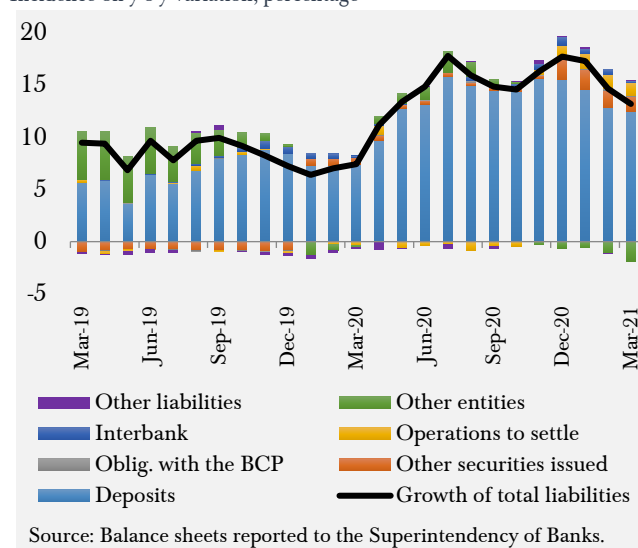


On the other hand, the liabilities of the financial system showed a greater dynamism towards the end of 2020, although later, in line with the lower dynamism of economic activity in the first months of 2021, a slightly lower growth rate than observed in the previous report has been registered. This behavior of liabilities is especially influenced by the deposits (47.6% of GDP 2021), which have been registering a greater boost since the last FSR (17.2% by March 2021), especially in the category of sight deposit accounts. Even though uncertainty regarding the evolution of the pandemic and its impact on the economy persists, the preference that depositors have for deposits made in the local financial market is highlighted (Graphs III and IV).

**Graph III**

**Liabilities**

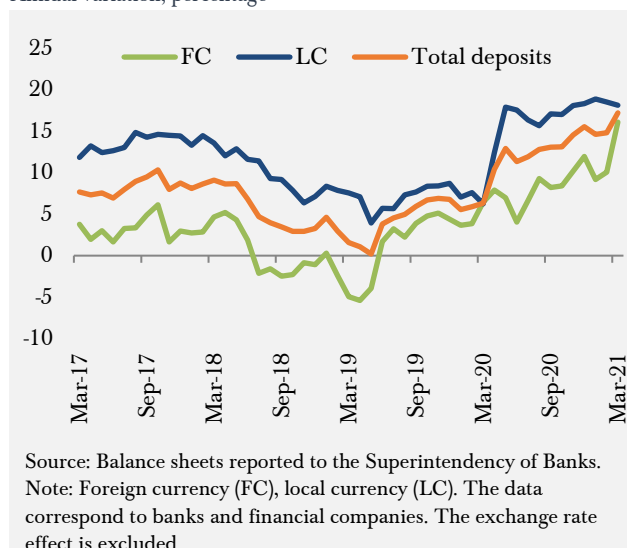
Incidence on y-o-y variation, percentage



**Graph IV**

**Deposits by currency**

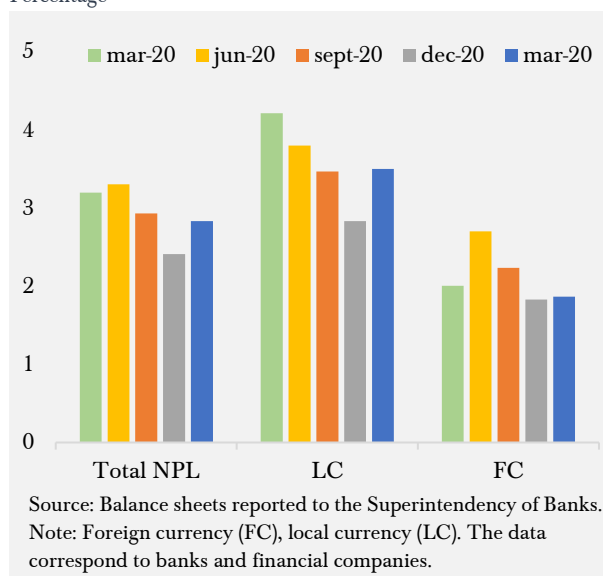
Annual variation, percentage



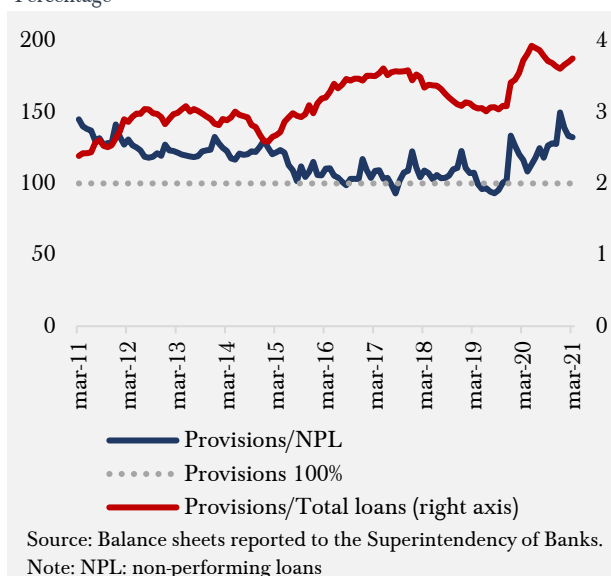
The credit risk indicator has shown an improvement since the last report, as reflected in the decrease of the total non-performing loans ratio as well as disaggregated by sectors. Notwithstanding, the exceptional credit measures have had an impact on this dynamic of non-performing loans. On one hand, by allowing for the temporary postponing of debts

through rescheduling of loans, and, on the other hand, by providing the boost for credit supply through the granting of new loans, as a part of the support measures implemented by the Central Bank of Paraguay<sup>4</sup>. In this context, the introduction of the rescheduling operations has significantly modified the structure of the total loan portfolio, representing 11.3% of the total (Graph II.5 of Box II). In this manner, the renegotiated portfolio constitutes 26% of total loans, increasing by 23.5% in inter-annual terms by March 2021, explained largely by the rescheduling of loans and by restructured loans, and attenuated by the negative contribution of renewed credits. Regarding credit risks coverage, provisioning has continued to represent more than 100% of the non-performing loans, and it must be mentioned that this coverage ratio has increased as compared to the last FSR (Graphs V and VI).

**Graph V**  
Non-performing loans  
Percentage



**Graph VI**  
Credit quality  
Percentage



From the perspective of the users of credit, loans extended to households, both consumer loans as well as for home ownership, have been decelerating, while the credit risk has increased. Given the current situation, in which household finances continue to be affected by the worsening of the sanitary crisis, it is assumed that the recovery of employment and the capacity to generate income might still be delayed for a certain period of time. This is due to the increase of the levels of contagion that has led to the saturation of the national health system and brought about the return of non-pharmaceutical measures, such as the restrictions on mobility. Thus, in this context, the non-performing of household loans might tend to increase in the near future. As regards corporate debt, the growth rate of business loans granted by banks and financial companies has remained dynamic, as pointed out in the previous report (27% of GDP 2021), explained mainly by the impulse given by the credit measures to support the sectors most affected by the sanitary crisis. The total NPL-ratio and by economic sector has verified a reduction in -annual terms, resulting from the rescheduling of loans to avoid the non-payment of debts.

In relation to the market risk, in a context of monetary policy flexibility, the interest rate spread in both local currency and in United States dollars has been decreasing gradually, since the beginning of the pandemic in March 2020, due to a greater decrease of the lending rates as compared to the borrowing rates. The liquidity risk resulting from the maturity mismatch is offset by the holding of other instruments that provide extra funding. In this regard, the liquidity of the financial system increased 27% y-o-y by March 2021, accumulating a balance of around USD 3.99 billion (10.4% of GDP 2021), composed mainly by Monetary Regulation Instruments (47.4%), Treasury Bonds (29.1%), and the Permanent Deposit Facility (23.2% of the total).

<sup>4</sup> More details about the exceptional credit measures may be found in Box II of this report.

As regards the financial stability indicators, the indicator of financial deepening, measured by the ratio of total credits in relation to GDP, has remained stable. On the other hand, the deposit-to-GDP ratio indicator has improved since the last FSR, explained especially by the positive dynamics of deposits registered since the start of the pandemic. It must be highlighted that deposits continue to be the main source of financing of the credit extended in both local currency and foreign currency. Given the boost of deposits, the ratio of external alternative funding for deposits, in US dollars, has decreased to stand at 18.3% by the first quarter of 2021, reflecting a greater preference for traditional financing. As regards the credit-to-GDP gap indicator, the first quarter of 2021, the credit to GDP ratio has remained above its long-term level, generating a positive gap that is above the levels verified in the same quarter last year. Looking forward, the breadth of this gap might increase, to the extent that credit exhibits a greater dynamism in relation to the evolution of economic activity.

As regards the financial soundness indicators, the solvency indexes remain at levels that comfortably surpass the minimum capital adequacy requirements and exceed the levels verified in March 2020. With respect to this, the ratio of core capital (Tier 1) to risk weighted assets and contingencies (RWA) stood at 16.5% in March 2021, while the ratio of total regulatory capital (Tiers 1 and 2) to RWA stood at 22.4% during the same period. The leverage ratio, measured as the ratio of Tier I capital with respect to total assets, was 9.5% in the first quarter of 2021, well above the Basel minimum requirement (3%) and higher than the level registered one year ago. Regarding profitability, ROA and ROE indicators continued to show a downward trajectory during the last months of 2020, as well as so far in 2021. The decrease in the profitability of the financial system is attributed in great measure to the economic effects of the pandemic on financial margins, as a result of the reduction of the interest rate spread, the lesser payment capacity of debtors, and the postponement of payments for rescheduling, among others.

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, although with a low probability of occurrence.

Finally, the payments system has performed normally, in a fluid and efficient manner. During the period of strict confinement as well as in the recent months, the provision of physical and electronic means of payment has been guaranteed, thus assuring that the chain of payments of the economy has continued to function with no interruptions.