



FINANCIAL STABILITY REPORT

MAY
2022



CENTRAL BANK OF PARAGUAY

Federación Rusa y Augusto Roa Bastos

www.bcp.gov.py

Asunción - Paraguay

Executive Summary¹

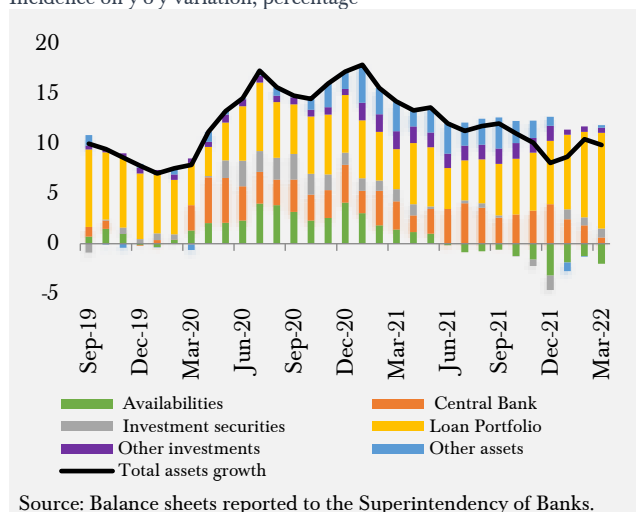
Since the publication of the last Financial Stability Report (FSR) in November 2021, the external scenario of relevance for Paraguay has become less favorable. On one hand, the global economic prospects and those of Paraguay's trading partners have moderated following the outbreak of armed conflict between Russia and Ukraine, even though they remain positive. Likewise, the war has intensified global inflationary pressures due to its impact on the prices of food and energy commodities. The inflationary situation has fostered greater speed for the withdrawal of monetary stimuli, with the assumption of tighter international financial conditions and potentially greater pressures on the currencies of the emerging economies, as compared to the previous report.

Regarding the domestic scenario, the previous report had stressed the rapid recovery of the economy due to an improvement of the local health situation that had allowed for the increased mobility of the population, and consequently, a greater reopening of the economy. In that context, it was expected that the financial risks associated with the debt repayment capacity of business and households would remain limited. However, in the last few months, the short-term economic indicators have revealed less dynamism in activity, explained by the contraction of the agricultural, electricity and water, and livestock sectors, because of drought. In contrast, the services, manufacturing, and construction sectors showed favorable performances due to the satisfactory evolution of the health situation, reflected in the important decrease in the COVID-19 contagion and mortality rates².

In the local financial system, total assets have maintained favorable dynamics, driven especially by their main component, the system's loan portfolio, which has continued to expand since the previous report. While credit operations had shown a certain deceleration in the period May – July 2021, the loan portfolio has recovered its dynamism, due mainly to the boost provided by loans extended in foreign currency. Even though credit extended in domestic currency showed some slowing down in the period May – December 2021, it continues to grow at significant rates, while loans extended in foreign currency have continued to increase, thus maintaining the upward trajectory registered in the previous report (graphs I and II).

Graph I
Assets

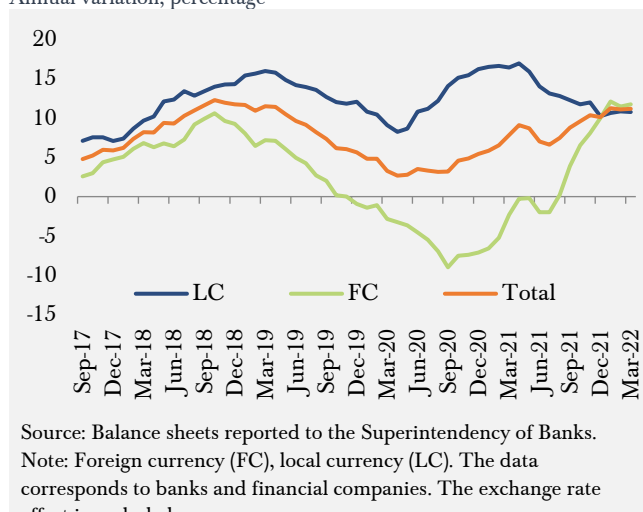
Incidence on y-o-y variation, percentage



Graph II

Loans by currency

Annual variation, percentage



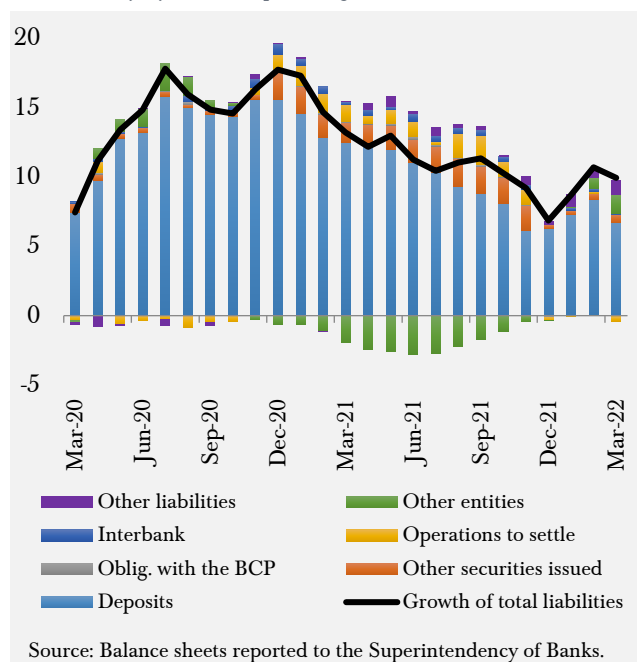
¹ The Spanish version prevails.

² More details about the recent evolution of economic activity may be found in the March 2022 IPoM. <https://www.bcp.gov.py/informe-de-politica-monetaria-ii4>

Since the last FSR, total liabilities continued to show a favorable performance, albeit growing at a more moderate rate, following the significant increase observed during the pandemic that was driven by the impetus of sight deposits, preferred by depositors for precautionary reasons. Total deposits in the financial system, while continuing to increase with positive rates since the last FSR, have continued with the downward trend registered since April 2021. On the other hand, deposits in guaranies have shown an year-on-year deceleration ever since February 2021, after the significant increase recorded during the most critical stage of the pandemic, and in a similar manner, deposits in foreign currency have registered less dynamism since July 2021. Notwithstanding, in first quarter 2022, the inter-annual rate stood at levels similar to those observed before the health crisis (graphs III and IV).

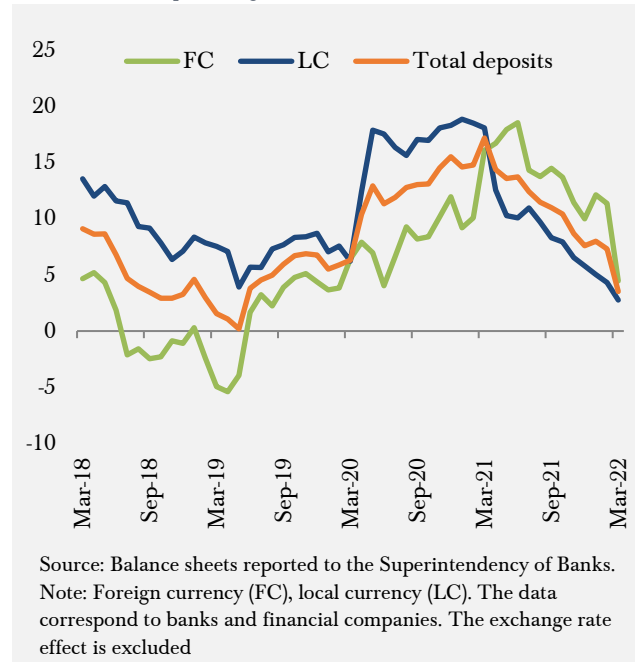
Graph III
Liabilities

Incidence on y-o-y variation, percentage



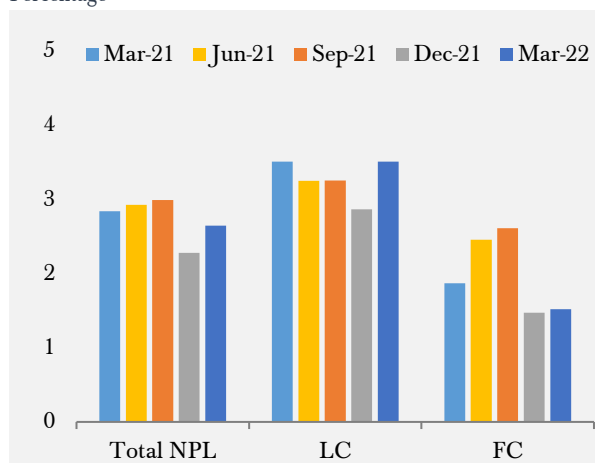
Graph IV
Deposits by currency

Annual variation, percentage



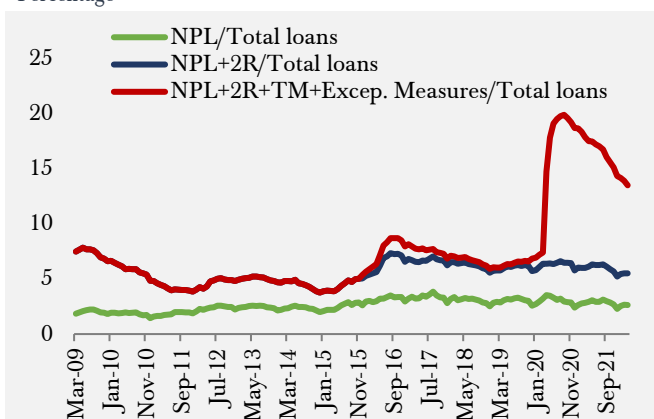
In a context of moderation of economic activity, because of the impact of the drought and of risks derived from the external sector, although offset by the positive evolution of the health situation, the credit risk indicator has shown improvement, as reflected in the reduction of the total non-performing loan ratio. This situation is explained, in part, by the application of the exceptional measures to support credit that were implemented during the COVID-19 pandemic, that extended the due date of loan payments, and by the recent implementation of the transitional measures oriented towards the agricultural and livestock sectors that were adversely affected by the drought. Regarding credit risks coverage, provisioning represents more than 100% of total non-performing loans (graph V and VI).

Graph 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.

Graph VI
Credit quality
Percentage



Source: Balance sheets reported to the Superintendency of Banks.
Notes: 1/It only considers the current portfolio of the renegotiated loans. 2/NPL: non-performing loans, 2R: refinanced and restructured loans, TM: transitional measures, Excep.Measures: rescheduling operations COVID-19.

On the other hand, household debt at banks and finance companies has represented 7.3% of GDP, a relatively low level as compared to emerging economies (51% of GDP)³. Since the last FSR report, total household debts have continued with an upward trajectory (as highlighted in the previous report), while credit quality has improved slightly, due to the loss of dynamism of past-due loans. It is highlighted that there has been a certain recovery of the payment capacity of households. As regards the indebtedness of businesses, this has represented 29% of GDP, standing below the business indebtedness of emerging economies (112.5%)⁴. The credit granted to businesses by banks and finance companies has continued to grow as compared to the last FSR, driven mainly by loans extended in foreign currency. The quality of corporate loans has improved since the last report, explained partially by the establishment of transitional measures to support sectors affected by drought; these measures interrupted the calculation of past-due maturity dates through the renegotiation of debts, especially for those sectors related to agriculture and livestock.

As regards market risk, the interest rate spread has increased for both local currency and foreign currency since the publication of the last report. The liquidity risk, a product of maturity mismatches, is offset by holdings of other types of instruments that could provide additional liquidity. Notwithstanding, it is mentioned that some indicators have shown a reduction of the banking system's liquidity, due to the gradual withdrawal of the financial support measures and the upwards adjustments of the monetary policy rate, although these still stand above the pre-pandemic levels.

Regarding the financial stability indicators, financial deepening, as measured by the ratio of total loans in relation to GDP, showed an increase as compared to the previous report, standing at 44.6% annualized through March 2022. Meanwhile, the ratio of total deposits in relation to GDP represented 49.6% annualized through March (50.9% by March 2021), showing a decrease due to the deceleration of the pace of growth of deposits. The greatest proportion of credit continues to be funded by deposits, although there has been a recent moderation due to the greater financing of non-traditional liabilities. As regards the credit-to-GDP gap indicator, the credit to GDP ratio has remained above its long-term level at the close of 2021, generating a positive gap, albeit below the level registered in 2020.

As regards banking performance, the solvency indicators show that financial institutions comfortably surpass the minimum capital adequacy requirements. Thus, the ratio of core capital (Tier 1) to risk weighted assets and

³ In the case of Paraguay, debt data only includes loans granted by banks and finance companies, and excludes loans granted by cooperatives, loan companies or other sources of household financing.

⁴ The information used for Paraguay includes only the loans granted by banks and finance companies.

contingencies (RWA) stood at 15% in March 2022, while the ratio of total regulatory capital (Tiers 1 and 2) to RWA represented 20.5% of RWA, far above the minimum required level of 12% established in local regulations. On the other hand, the leverage ratio, measured as the ratio of Tier I capital to total assets, was 9.3% in the first quarter of 2022, standing above the Basel III minimum requirement (3%). Regarding profitability, the ROA and ROE indicators, which had remained relatively stable during 2021 after the significant decrease observed since the beginning of the pandemic, showed a certain improvement starting in December 2021. This is explained by the increase of other operative margins, even though a reduction, but of lesser extent, has been recorded for the financial margins.

The stress tests performed in the financial system, comprised of banks and financial companies, indicate that the system maintains a position of adequate solvency, following the simulation of extreme shocks, although with a low probability of occurrence.

Finally, during the recent period the payments system has performed normally, in a fluid and efficient manner. The transactions carried out through the payment system have continued to increase, in line with the favorable dynamism that had already been verified during the pandemic. While the periods of confinement have ended, economic agents continue to show greater demand for payment instruments that allow the realization of digital transactions. On May 23, 2022, the launching into production of the Instantaneous Payments System (SPI) module is foreseen, allowing for instant interbank transactions through the SIPAP, 24 hours per day, and seven days per week (24/7). This project constitutes progress of great relevance for the country's payment system and would both decrease the costs and increase the security and transparency of transactions.

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