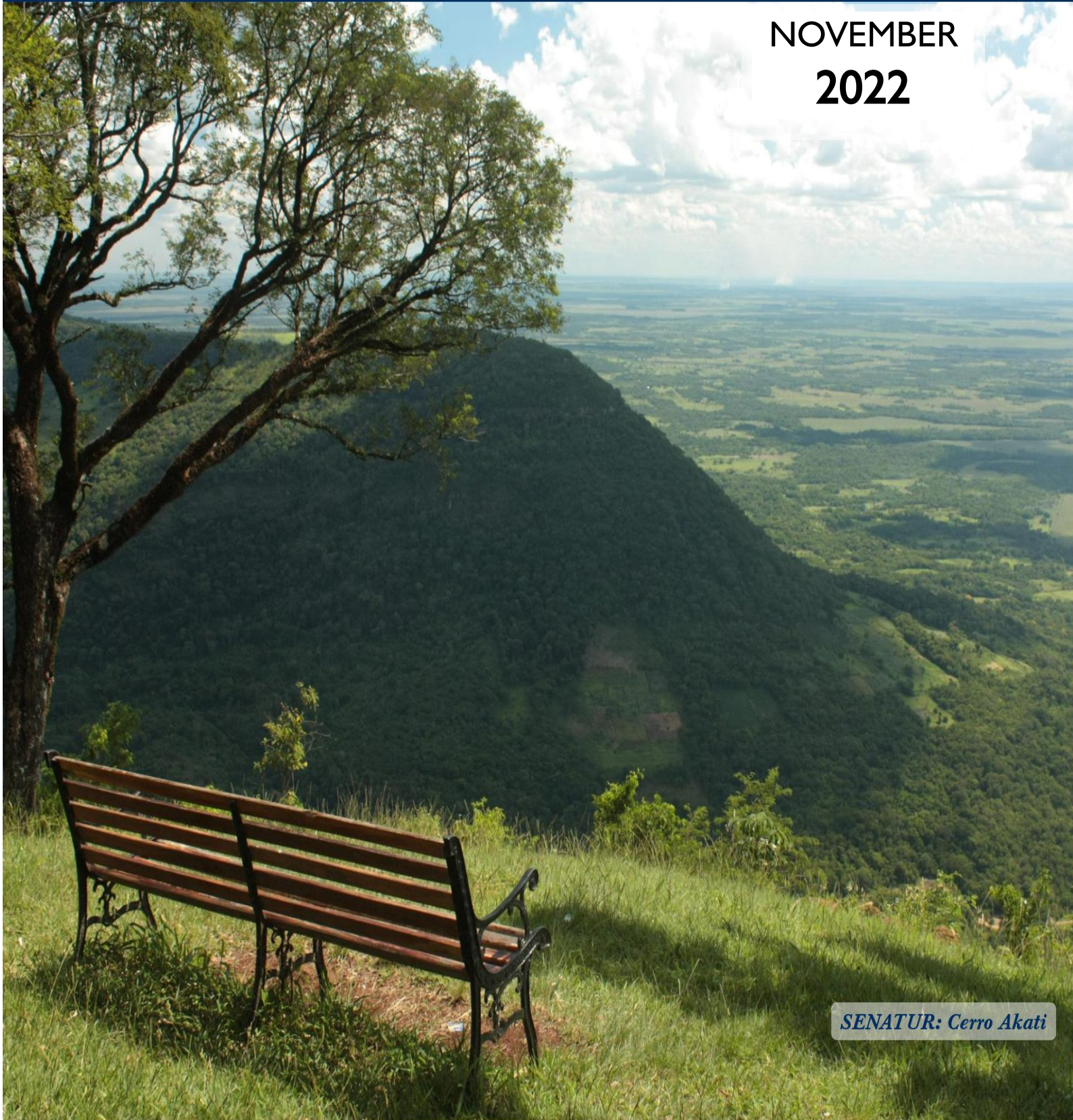




FINANCIAL STABILITY REPORT

NOVEMBER
2022



SENATUR: Cerro Akati

BANCO CENTRAL DEL 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 2022, the external scenario relevant to Paraguay has remained complex. On one hand, the economic prospects of the country's trade partners, although they have improved for 2022, for the upcoming year they have deteriorated. Moreover, an important deceleration of the global economy is foreseen for the next twelve months, in a context of high uncertainty. On the other hand, high inflation rates have led to a greater speed in the withdrawal of monetary stimuli, which implies tighter international financial conditions and potentially greater pressures on the currencies of emerging economies, as compared to the previous report.

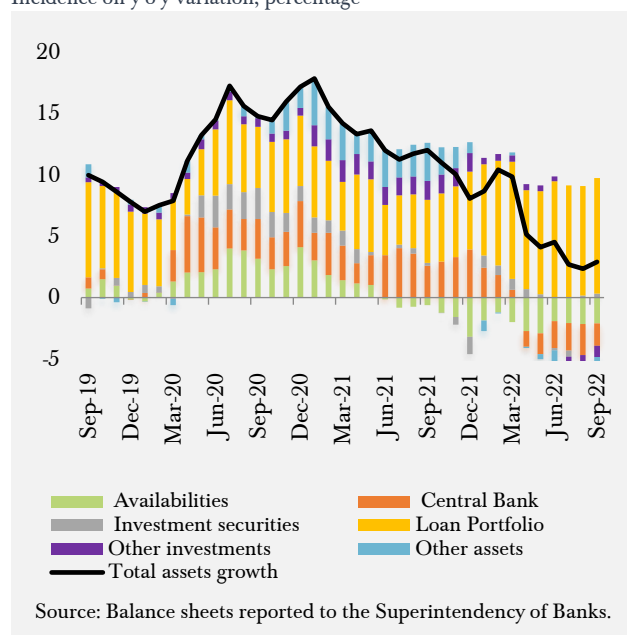
At the domestic level, the macro scenario has also deteriorated as a result of the adverse effects of the drought in the productive sector, the impact of war on domestic inflation stemming from increased prices of food and fuels, and the tightening of financial conditions, reflected in interest rate hikes. However, as recently noted in the Monetary Policy Report², a more favorable GDP result is expected for the third quarter of 2022. This would be driven by the rebound effect of agriculture (initiation of the new 2022-2023 crop campaign in the second half of the year) and the upturn in the generation of electric power by the bi-national hydroelectric entities. Furthermore, less variation in the prices of food items and energy commodities has contributed to the recent moderation of inflation.

In the local financial system, total assets have continued to grow at a moderate pace, following the significant accumulation of liquid assets during the year 2020. By September 2022, the positive variation of assets was mainly driven by the favorable dynamism of the loan portfolio, thus compensating for the fall in liquid assets, among other components. In further detail, the favorable performance of loans is explained especially by the loans granted in foreign currency, resulting from a greater demand by the productive sectors, in order to finance investments that had been postponed during the last two years (graphs I and II).

Graph I

Assets

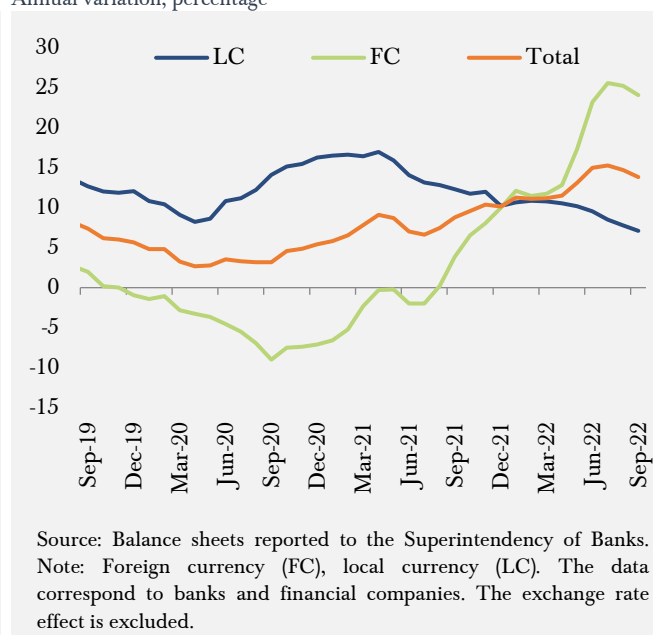
Incidence on y-o-y variation, percentage



Graph II

Loans by currency

Annual variation, percentage



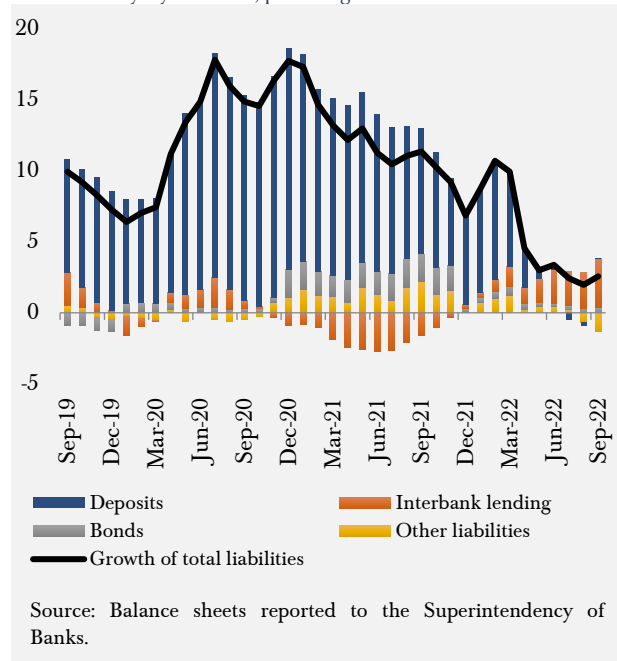
¹ The Spanish version prevails.

² Monetary Policy Report. September 2022. <https://www.bcp.gov.py/informe-de-politica-monetaria-i14>

In a similar manner, liabilities continued to decelerate year-on-year, due to the decrease in deposits. Meanwhile, the increase of loans between financial entities, mainly from abroad, explained the growth of total liabilities (graph III and IV).

Graph III
Liabilities

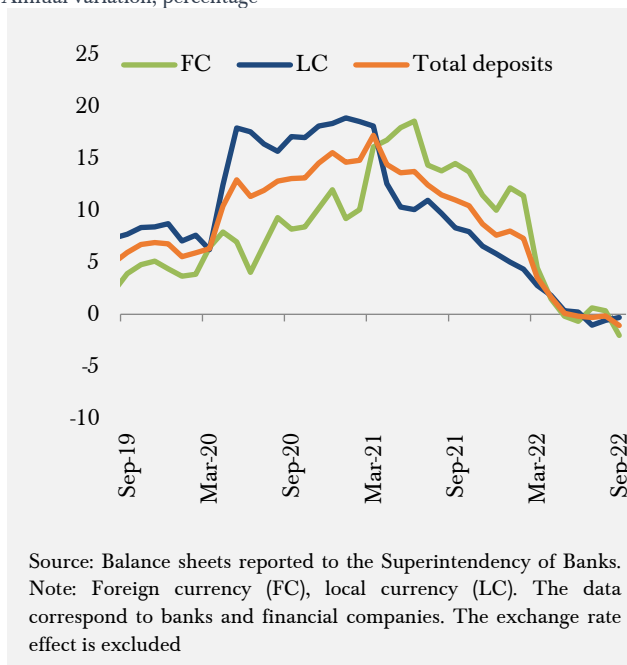
Incidence on y-o-y variation, percentage



Graph IV

Deposits by currency

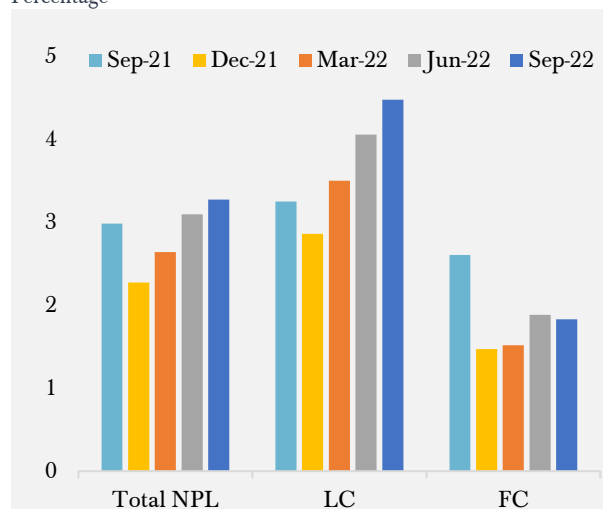
Annual variation, percentage



On the other hand, some credit risk indicators have shown deterioration in a weaker macroeconomic environment. This has been reflected in the increase in the total non-performing loan rate, especially for loans extended in local currency. Even so, it is important to highlight that the application of temporary measures to support the agricultural and livestock production sectors (both affected by severe drought) was successful in curbing greater levels of non-compliance. In addition, within the portfolio of exceptional COVID-19 measures, the ratio of loans in arrears increased. However, these loans represented only one-third of the system's non-performing loan portfolio. On the other hand, provisioning for credit risk made it possible to cover more than 100% of total non-performing loans (graph V).

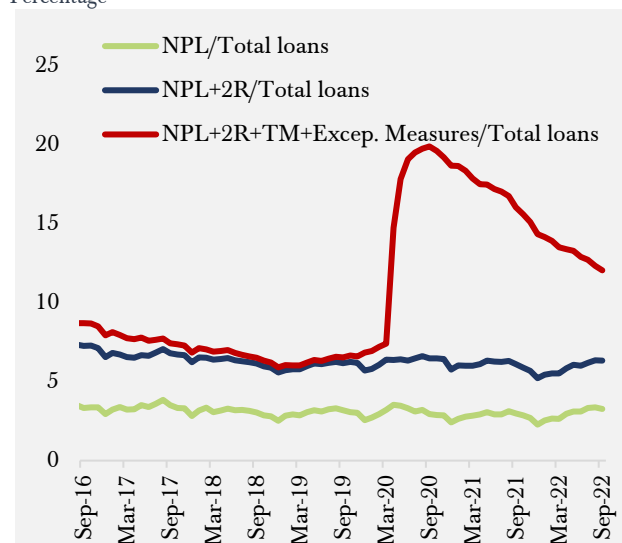
As regards borrowers, the inter-annual growth of loans granted to households has accelerated since the beginning of 2021. This behavior could be attributed to interest rates that were still slightly below the pre-pandemic levels and less uncertainty this year regarding household income flows, following the restrictions on mobility imposed by health measures, among other factors. At the same time, credit quality has improved in the last twelve months. However, the non-performing loan rate is still at levels above the pre-pandemic period. As regards corporate indebtedness, since the last report, credit extended in United States dollars has continued to grow in almost all the sectors, while loans extended in Guaranies continued to register decreasing rates in inter-annual terms. As regards the quality of the business loans portfolio, the non-performing loan rate remained at levels similar to the same period of the previous year. In part, this resulted from the application of transitory measures to support sectors affected by the drought, whereby the calculation of late payment rates was interrupted through the renegotiation of loans, especially those related to the agriculture and livestock sectors (graph 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

As pointed out in the previous report, the banking system's liquidity has decreased, due to the withdrawal of liquidity facilities during the pandemic period, the increase of inflation, and interest rates that affect the holding of liquid resources. However, the liquidity risk remains quite limited. Likewise, the exchange risk due to currency mismatching remains controlled at the aggregate level, since both financial companies and banks presented a positive exchange position in foreign currency. As regards market risk, since the publication of the last FSR report, the interest rate spreads have increased in local currency as well as in foreign currency.

So far this year, the profitability of the system continued to recover, driven by the increase in financial margins, the main source of income for banking institutions, in a scenario in which loans have maintained favorable dynamics and deposits have fallen. Thus, profitability continued to improve significantly as compared to the sharp drop verified in the year 2020. Notwithstanding, the ROE and ROA indicators still stand below the pre-pandemic levels. Regarding the aggregate solvency indicators of banks and financial companies, the levels registered comfortably surpass the minimum established in the regulations. In September 2022, core capital (Tier 1) and total regulatory capital represented 14.6% and 18.0% of the risk-weighted assets and contingencies, respectively.

The stress tests performed in the financial system, comprised of banks and financial companies, indicate that aggregate solvency remains at levels above the minimum regulatory levels, even when facing the simulation of extreme shocks, although with a low probability of occurrence.

Finally, the payments system has performed in a fluid and efficient manner. Transactions carried out through the payment system have continued to increase, in line with the positive dynamics exhibited during the pandemic. Although the lockdown periods during the health crisis have ended, economic agents continue to show greater demand for payment instruments that allow for the realization of digital transactions. Likewise, this is in line with the functioning of the Instantaneous Payments System (SPI), which facilitates interbank transactions 24 hours per day, seven days per week.

Financial Stability Report
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