



FINANCIAL STABILITY REPORT (FSR)



May, 2023



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www.bcp.gov.py
Asunción - Paraguay





Executive Summary¹

Since the publication of the last Financial Stability Report (FSR) in November 2022, an uncertain external scenario is still being perceived, despite the better performance registered for some economic indicators in the international sphere. The GDP growth forecasts remain relatively weak for Paraguay's trading partners, particularly for countries within the region, while inflation remains high and above its target, in both advanced and emerging economies. Consequently, central banks have continued to pursue contractionary monetary policies.

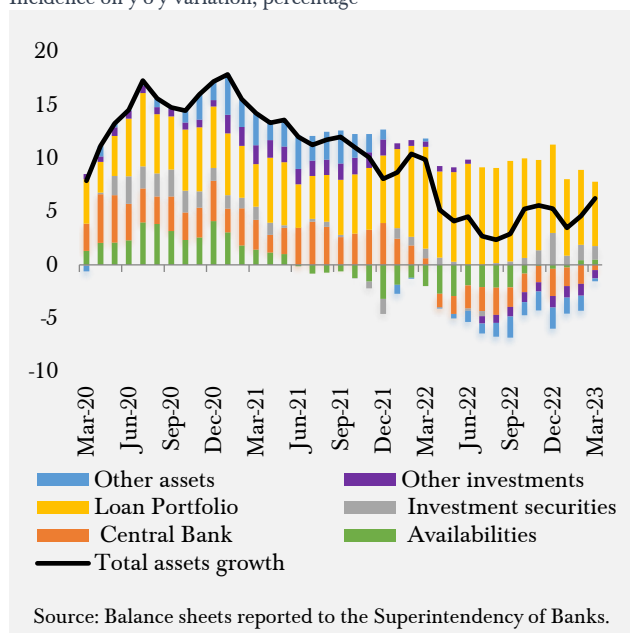
At the domestic level, GDP has shown signs of recovery since the second half of 2022, registering positive year-on-year growth in the last two quarters, stemming from the rebounds observed in the agricultural and electricity sectors. As recently reported in the March 2023 Monetary Policy Report (IPoM)², it is expected that the recovery of these two sectors will continue in 2023, in line with the current favorable weather conditions which are expected to extend into the next months. Likewise, a favorable dynamism of the services sector – particularly transport, commerce, and the hotels & restaurants– is expected. Regarding the evolution of domestic prices, year-on-year inflation continued to decelerate and is expected to continue with this trajectory until it reaches the center of the target range (4%) in early 2024.

In the local financial system, assets have shown more dynamism through greater inter-annual growth, interrupting the deceleration exhibited since the beginning of 2021 with the dis-accumulation of liquid assets held in the pandemic period. The year-on-year increase in the first quarter of 2023 was primarily explained, by the performance of the loans portfolio and, to a lesser extent, by the increase in investments in securities and availabilities. Notwithstanding, the loan portfolio, which accounts 66.4% of assets, has shown a deceleration of its pace of inter-annual growth since August 2022, owing mostly to the lower dynamism of loans granted in foreign currency (Graphs I and II).

Graph I

Assets

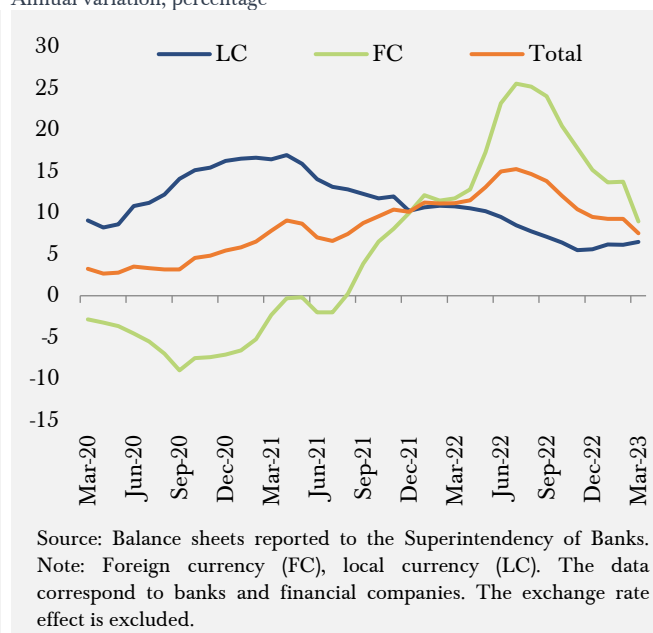
Incidence on y-o-y variation, percentage



Graph II

Loans by currency

Annual variation, percentage



¹ The Spanish version prevails.

² IPoM. March 2023. <https://www.bcp.gov.py/informe-de-politica-monetaria-i14>



Likewise, total liabilities have registered an upward trend since the last report, driven by the recovery of deposits, especially in guaranies, and to a lesser extent, by the increase in loans granted by financial institutions from abroad. Deposits have registered greater year-on-year growth, which could be explained by a considerable better economic environment than the previous year, as well as a higher passive interest rates in both domestic and foreign currencies (Graphs III and IV).

Graph III
Liabilities

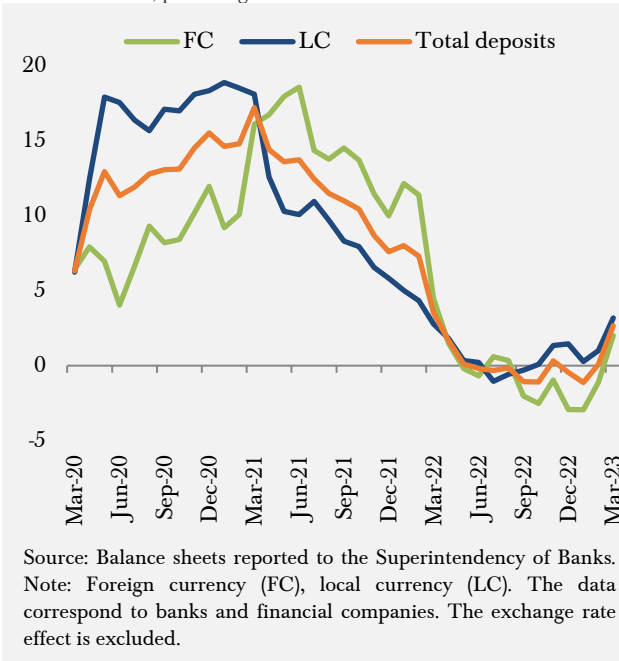
Incidence on y-o-y variation, percentage



Graph IV

Deposits by currency

Annual variation, percentage



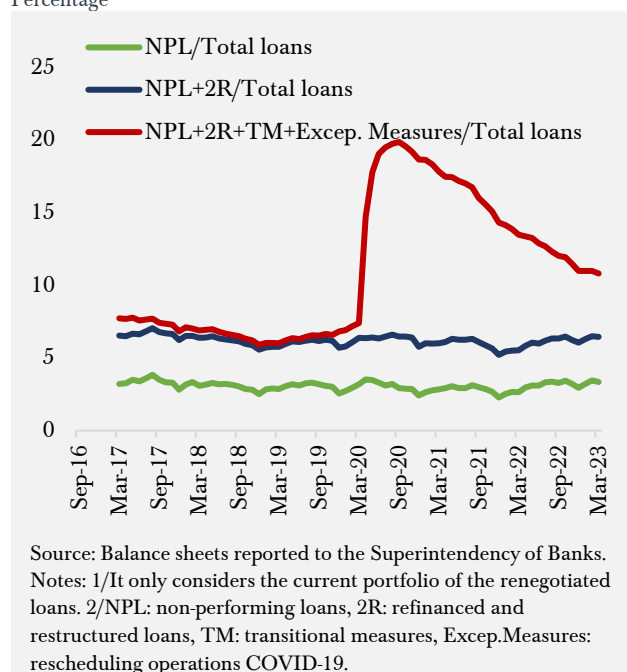
Credit risk has lately deteriorated, as seen by the increase in the total non-performing loan (NPL) ratio, particularly for loans provided in local currency. Debtors' payment ability has been reduced as a result of the recent pandemic and drought. However, the risk of default remains contained due to the use of temporary measures to assist productive sectors affected by adverse weather conditions, as well as credit risk that allows for the coverage of more than 100% of total non-performing loans (Graphs V and VI).

Since the preceding FSR, the growth of loans issued to households by banks and financial institutions has slowed slightly, but it remains dynamic. The non-performing loan rate has decreased, but it remains higher than levels seen prior to the pandemic. Regarding local corporate indebtedness, bank debt in this sector has continued to decline since the last report, due to adverse weather conditions and higher costs of credit owing to the increase in interest rates. However, it continues to grow at a favorable rate, driven especially by loans granted in United States dollars³. In terms of the quality of the business loan portfolio, the NPL rate has remained at low levels, particularly in foreign currency, thanks to the Central Bank of Paraguay's temporary flexibility measures, which have allowed the renegotiation of loans, mainly those related to the agriculture and livestock sectors.

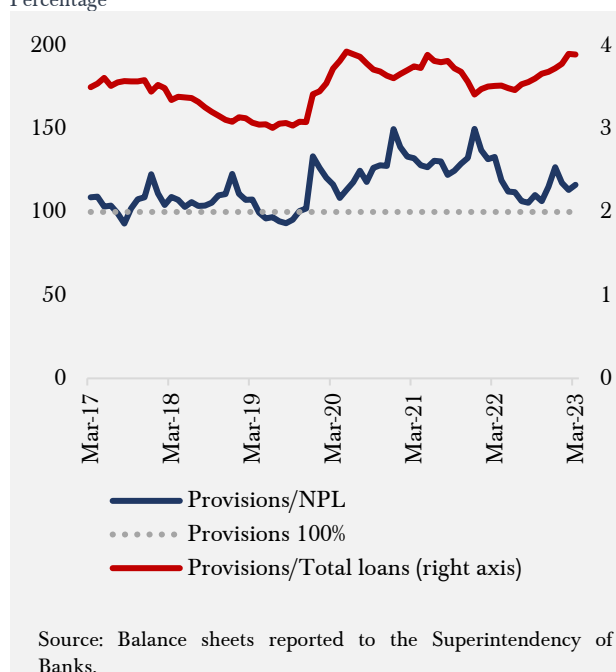
³ For a more detailed analysis of the evolution of corporate indebtedness since the beginning of the pandemic, see Chart II of this report.



Graph V
Credit quality
Percentage



Graph VI
Provisions
Percentage



Since the last FSR, liquidity has shown an increase due to greater demand by banks and financial companies for liquid assets, such as monetary regulation instruments, in the context of a recovery in deposit dynamics, a slowdown in credit, and an increase in external uncertainty which was exacerbated by the financial tensions (which implied bank failures) in certain advanced economies in early March. However, these tensions have dissipated recently due to the timely measures implemented by the central banks in those countries. Given this scenario, liquidity risk remains quite limited. On the other hand, the exchange risk associated with currency mismatching has remained under control at the aggregate level. Regarding market risk, since the publication of the last report, the interest rate spread has continued to increase in local currency as well as in foreign currency.

Profitability indicators have shown an upward trajectory since last year. Thus, the financial system’s profitability has continued to improve, driven mainly by the increase in net interest margins. As a result, in March 2023, the ROA and ROE indicators stood at 2.1% and 16.3%, respectively, still below pre-pandemic levels. Concerning the aggregate solvency indicators of banks and financial companies, the values recorded comfortably surpass the minimum established in the regulations. Thus, in March 2023, core capital (Tier 1) and total regulatory capital accounted for 14.0% and 19.4% of risk-weighted assets and contingencies, respectively.

The findings of the stress tests reveal that the solvency of the financial system, formed by banks and financial institutions, remains above the minimum regulatory requirements, even when facing the simulation of extreme shocks with a low probability of occurrence.

Finally, the payment system has continued to function normally, fluidly, and efficiently, reflecting on a worldwide scale the increased use of digital payment methods by economic agents and the achievements made in recent years in terms of financial infrastructure for payments.

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