TRANSLATION

Current Financial Situation and its Possibility of Resilience in the face of the Covid-19 crisis

By: Amauri A. Castillo
Superintendent of Banks

At the moment of analyzing the economic performance of the last 30 years, we can conclude that the economic and financial system has functioned positively, with several exceptions, where external shocks had some effect on our economy. Having a dollarized economic has been useful to insulate itself from possible devaluations and to maintain inflation much lower than that of the countries of the region. These features, coupled with a properly managed banking system, based on international financial standards, allowed for positive results in recent decades. Notwithstanding the above, in a context as the current one, not having a central bank may represent a difficulty when requiring monetary policies to face the crisis. This situation has led the national government to act quickly and efficiently in obtaining lines of credit and funds from international financial, which are equivalent to the work that a central bank would do.

Although it is true, there is currently great uncertainty on the Covid-19 future behavior, there is a general consensus that, from an economic point of view, it could impact the world economy, mainly in the following areas: directly affecting production, creating disruptions in the supply chain and in the market, and due to its financial impact in companies and financial markets. According to international organizations such as the OECD, if the impact of the pandemic is not widespread, it could reduce to half the world economic growth for 2020, by around 1.5%.

The banking sector, which represents 90% of the financial sector, is made up of 42 general license banks authorized to offer loans and accept deposits in the Republic of Panama. In addition, 18 international license banks authorized to have operations to be concluded and effective abroad, and 10 representation license banks, which are authorized to have presence in the country, but cannot carry out banking operations.

The financial stability of the banking sector is measured by four major variables, which, at any given moment, are interconnected, resulting in the stability or vulnerability of banks. These variables are liquidity, solvency, profitability and portfolio quality. Until February 2020, the banking sector maintained robust financial soundness indicators, where liquidity and solvency reached the double of that required by banking regulations; however, the impact of the Covid-19 crisis on the economy and the financial sector could be severe and affect these indicators if the public health crisis were to continue.

It is worth mentioning that in Panama there are 9 banks identified as systemically important banks, i.e. these banks meet the characteristics established by the current standards provided by the Basel Committee (Bank for International Settlements), in terms of size, interconnection, substitutability, inter-jurisdictional activity, among others. These banks represent more than 70% of total lending operations in the banking system or general license banks. This concentration also occurs in savings accounts, be them current, term or current savings accounts.

The economic performance of recent periods, added to the weak financial performance of the main commercial partners of the region, contributed to a slight growth of the domestic loan portfolio, which was below 1.1% and a significant drop from several years ago, which has reflected in the foreign portfolio of -8.9% during the period between February 2019 vs. February 2020.

The breakdown of the loan portfolio granted in January and February of 2020 is distributed in 4 major activities representing 85% of total, where mortgages account for 32%; commercial, 20%; consumption, 22% (personal loans, car and cards) and construction, 11%. These activities in loan, before positive economic scenarios as those experienced during the 2009 – 2015 period, show a growth pace of up to two digits. After that period, we started to notice a slight growth of loans to these sectors in recent years.

This behavior of the portfolio, influenced by the development to a lesser extent of macroeconomic variables, had an impact on the health of the portfolio, where delinquencies increased considerably. This situation was mitigated by the banks, by establishing reserves of approximately USD 2 billion, which have their prudential and accounting origin, in the Basel standards and the International Accounting Standards Board (IASB), respectively.

In a financial system like Panama's, it will be of great importance that banks keep adequate solvency and liquidity levels, however, a good reserve level along with high operational efficiency levels (efficient management of income and expenses) will be the key as financial resilient factors which will contribute a lot when the economy normalizes.

In conclusion, we must say that the financial tools, as liquidity contingency lines providing funds to the system and securing fund contribution, to reactivate commercial activity, and the use of the dynamic reserve (countercyclical reserve), will be the key for the recovery and take off of the economy and the sustainability of the banks established in Panama.

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