TRANSLATION

Financial Stability and Covid-19

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The spread of Covid-19 in Panama is reaching a critical phase and has an increasingly severe impact on national economic activity. Our success as a society in containing the virus comes with a price: the deceleration of the economic activity, regardless of whether reduced mobility is reduced willingly or forced. The effects of this situation are showing how a health crisis, even temporary, can turn into an economic and financial shock, where limited liquidity and market disruptions can be amplified.

Clearly, the top priority is ensuring that health-related expenses are available to protect people's well-being, to care for the sick ones, to protect seniors and to slow the spread of the virus. The government will prioritize fiscal resources to protect jobs and businesses and provide direct assistance to the people most affected. The *"Plan Panamá Solidario"* is the correct initiative. Even with limited room for action due to fiscal constraints, deviations resulting from taxes must and will be corrected in the short-term.

Safeguarding financial stability requires assertive, coordinated and well-communicated action. But, in the current scenario, we observe efforts that, although they may seem aimed at achieving relief or well-being at this juncture, the aid may come with its own problems. For example, allowing financial obligations to be defaulted can undermine financial soundness very quick. Subsidizing loans can be permanently misallocated, while companies that are no longer viable can be kept afloat. The source of liquidity in our banking system comes mainly from the generation of liquid savings in our economy and, on the other hand, from the source of repayment of obligations derived from the loan process. Banks also have access to external sources of financing as a result of their relationships with international correspondent banks and foreign institutional investors. Therefore, we must be very careful not to generate alterations to the sources of liquidity than those that derive from this crisis, which may cause imbalances greater than those we are already seeing temporarily.

Our banking system has high capital and liquidity levels and, therefore, is in a stronger position to absorb the adverse effects of this situation. The preliminary figures as of January 2020, prior to the effects of the Covid-19 crisis, show a slight increase in the allocation of customers' domestic deposits of 2.0% versus the same period of 2019. Similarly, domestic loans to the private sector registered a slight increase of 1.9%, especially in retail banking. Without a doubt, this will be a scenario that will change in the coming months, due to this challenging public health situation.

Therefore, supervisors and banks remain vigilant to the evolution of Covid-19 to ensure that the banking system remains financially and operationally resilient. The Superintendency of Banks is applying a variety of regulatory and supervisory measures to protect financial stability. The first steps aim to provide banks with tools to modify terms and conditions originally agreed upon in bank loans and allow grace periods, changes in terms and adjustments in interest rates. Given the diversity of cases and situations of different debtors, it is not easy or practical to take a "fits for all" measure to mitigate the adverse effects of Covid-19. For this reason, the new regulation, Rule 2-2020, allows both customers and banks, at their own initiative, to agree on the adjustments that are necessary to maintain the viability of the loans and give a break to the real economy.

Basel III standards have allowed us to strengthen the banking system's resilience. The Superintendency required banks to apply capital and liquidity buffers, in times of the best economic cycle, which were designed to be used in periods of stress as the current one. These include the countercyclical capital buffer required through dynamic provisioning. The use of regulatory and supervisory tools should now take precedence over discretionary legal tools. Regulatory tolerance is certainly appropriate for determined circumstances as well.

The effects of Covid-19, as it has also occurred in the past, the effects of the 2008 financial crisis and the profound impact of the 1988-89 political crisis, put the effectiveness of the institutional system and financial stability to the test. The realities show us that we require additional tools to face external shocks, but safeguarding the great competitive advantage of our financial systems.

The Superintendency of Banks of Panama will continue to work in a coordinated manner and with the best communication possible with the Presidency of the Republic, the authorities of the Ministry of Economy and Finance, the Banco Nacional de Panamá, as well as with the business union grouped in the Panama Bankers Association to adopt measures that maintain and protect the financial stability and money of depositors. Particularly, it will be important to move forward to making tools available to strengthen and provide more liquidity to the banking system, so that it is supported with loans to small and medium-sized enterprises, which may be less prepared to withstand long-term business interruptions. Where there is room to stimulate bank liquidity, confidence and aggregate demand will increase for an orderly recovery of our economy.

In conclusion, we call on the conscience of all Panamanian citizens to raise to the occasion and promote an environment of calm, responsibility and social peace so that we can all overcome this crisis.

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