SBP 1998
Superintendencia
de Bancos de Panamá

Dirección de Estudios Financieros

Informe de Estabilidad Financiera

2012

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Foreword

The Financial Studies Division of the Superintendency of Banks has issued a financial stability report, taking into consideration the features of the country, specifically the lack of a Central Bank that usually issues those reports. Nevertheless, this report addresses the issues that are traditionally presented in these surveys.

In brief, this report addresses issues such as the domestic and international economic environment, the structure of the Panamanian financial system, banking performance for the year and banking in Panama. Macro-financial threats and sector vulnerabilities were also identified.

A sensitivity analysis was also carried out on the liquidity categories and the credit portfolio.

The main purpose of this survey is to analyze the financial system's capacity for providing stable financial services throughout the economic cycle.

I. Definition of Financial Stability

At the end of the nineties (90s) and beginning of the 2000s, organizations such as the BIS and the FED presented their definitions, where the BIS stated that financial stability represented an absence of instability, the latter being defined as a situation in which economic behavior is potentially out of balance due to fluctuations in financial assets prices or an inability of financial institutions to meet their contractual obligations. For its part, the FED said that financial stability is understood as the absence of instability, i.e. differences in assets prices and distortions in market function and credit availability.

On the mandate of central banks in financial stability, a survey made by the BIS (Japan, USA, UK, Austria, Mexico, and France, among others) concludes that banks must have:

- Well-designed banking regulations
- Licensing of entities without future problems
- Effective supervision
- Oversight
- Persuasion/Guidance
- Macroprudential regulation

Taking into account all of these aspects, int he case of Panama, financial stability would be focused mainly on the financial intermediation sector of the banking sector.

Achieving a stable model would require:

1. Efficiency and effectiveness
2. Resilience and the capacity for withstanding imbalances in the balance sheets
3. Security and reliability
4. Credibility with the public
5. An appropriate regulatory framework

Under these parameters and domestic environment, in Panama, financial stability is defined as “the situation in which the financial system succeeds in brokering economic savings, redistributes risks in an efficient manner and contributes in this way to macroeconomic stability.”

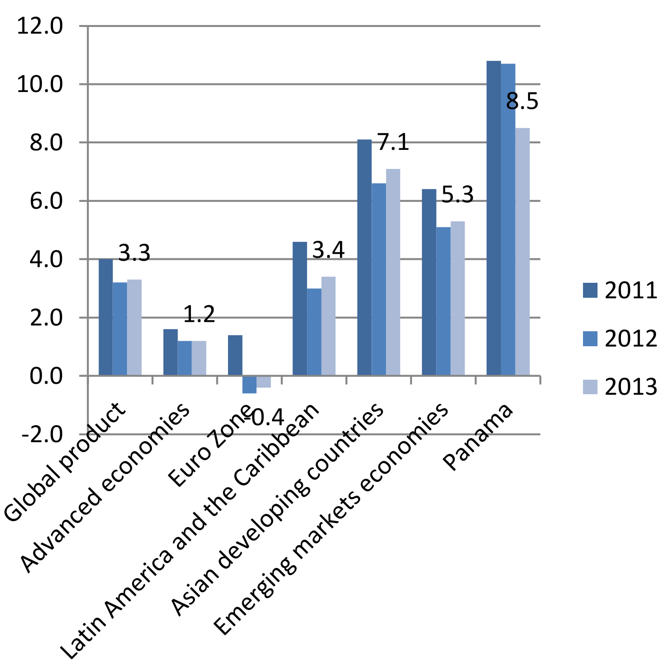
II. International Economic Environment

After slowing down in 2012, global growth is projected to rebound in 2013. However, market concerns persist about the future of the global economy, especially considering the weak performance observed in the economic numbers. Standing out among the factors affecting this uncertain global outlook are: i) the process of restructuring sovereign and bank balance sheets in the Euro Zone; ii) a more moderate recovery than anticipated and unresolved fiscal risks in the United States; and iii) a greater than expected deceleration of economic activity in the main emerging economies, particularly China.

Global product is expected to grow 3.3% in 2013 and 4.0% in 2014. At the same time, growth of the advanced economies is expected to remain at 1.2% and growth in the emerging and developing economies will improve in 2013, increasing approximately 5.3%. In the case of Europe, recovery will be limited by the restructuring of its balance sheets, with growth of -0.4%.

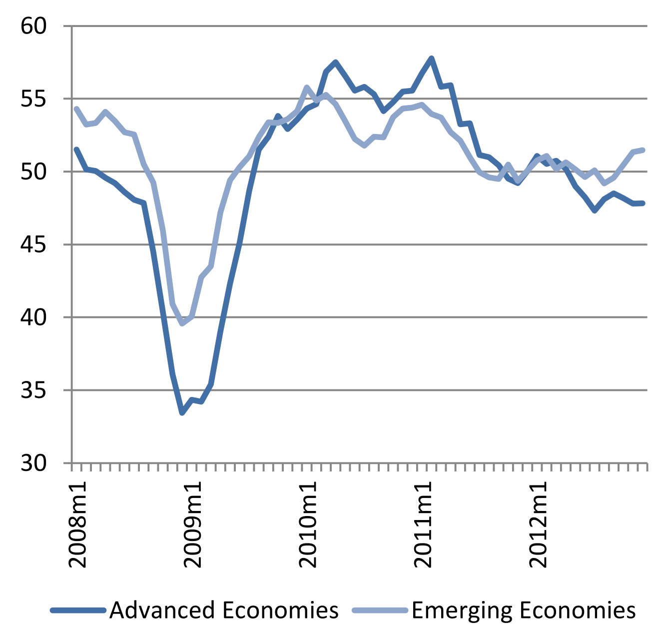
The issue of fiscal insolvency will cast a shadow over the global economy, not only during the rest of 2013, but probably for years to come. In spite of all of the fiscal adjustments and monetary support measures, almost all countries with fiscal problems will end 2013 with a public debt that is above their current level. As a consequence, the downward trend in credit ratings seen in recent months is expected to continue for a great part of the developed world.

Chart II.1: GDP Growth – Various regions (Annualized %)



Source: IMF, World Economic Outlook.

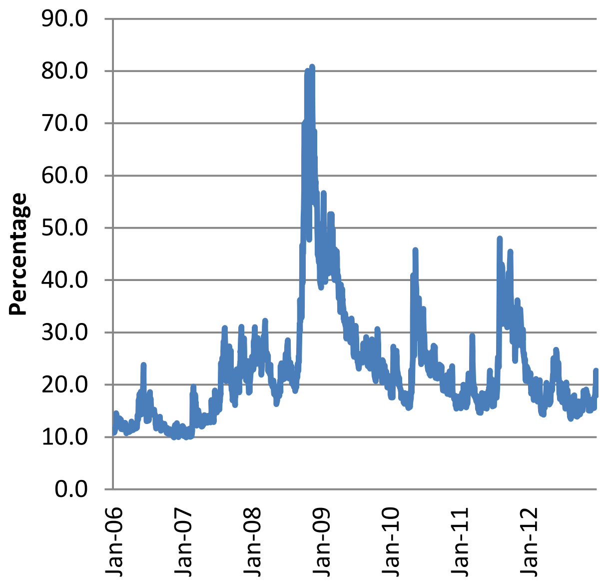
Chart II.2: Purchasing Managers Index for the Manufacturing Sector – (Index)



Source: IMF, World Economic Outlook.

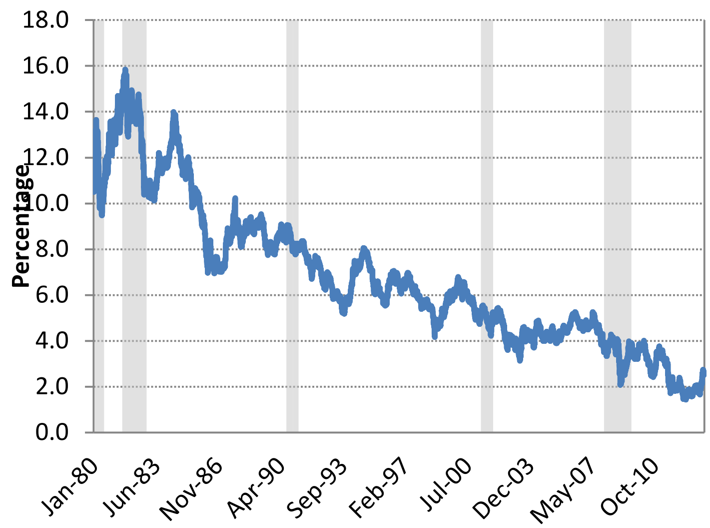
Stock prices have experienced strong downward corrections due to concerns over weaknesses in performance and in the financial sectors of the developed economies. Although the VIX index registering market expectations of future stock volatility has retreated from its recent highs, there is not a high level of trust within the market. As a reflection of increased risk aversion, the interest rates on government bonds from the United States and other developed countries have reached historic lows.

Chart II.3: VIX Volatility Index (Calculated from the S&P 500)



Source: Chicago Board Options.

Chart II.4: Return on United States Bonds (in percentages)

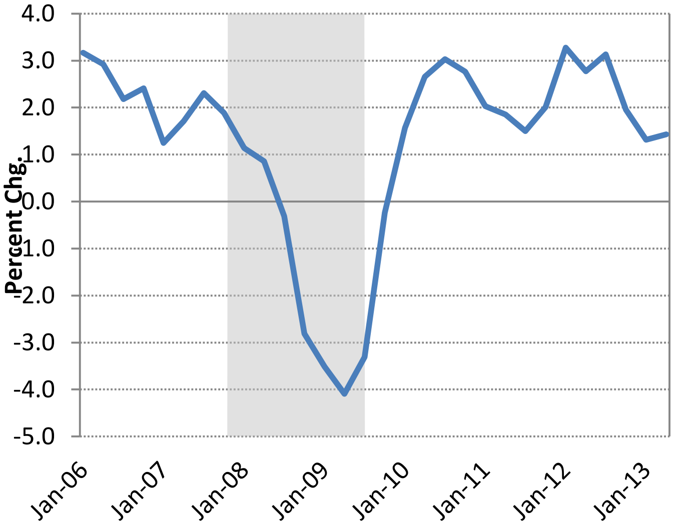


Source: FED

In the United States, although the recession probability indicator of the St. Louis Fed indicates that the probability that the U.S.is in a recession is close to zero, several trend indicators have been weaker than expected. The GDP grew at an annual rate of 2.2%, while the manufacturing sector activity index stood at 54.0 in December, up from 52.8 in November, though this does not preclude industrial activity in the United States from contracting[1],as it did in November 2012. The growth of the American economy is expected to be modest for the next couple of years, slowed down by domestic indebtedness and unsatisfactory global demand, as well as renewed Euro Zone financial stress and economic weakness. To this we should add adverse internal elements such as the depressed real estate market, high household indebtedness, and the high unemployment rate, which ended 2012 with an average rate of 8.1% (the lowest in four years).

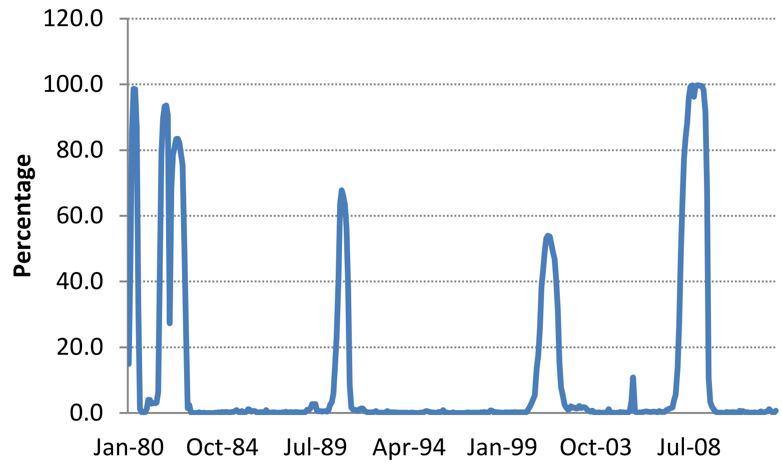
[1] An index Reading below 50 basis points implies a contraction of the activity in the sector, while a reading above this threshold represents and expansion in activity.

Chart II.5: United States: Quarterly GDP Growth
(in annualized percentages by quarter)



Source: FRED St. Louis Fed.

Chart II.6 Probability of United States Recession
(in percentages)



Source: Marcelle Chauvet and Jeremy Piger/FRED

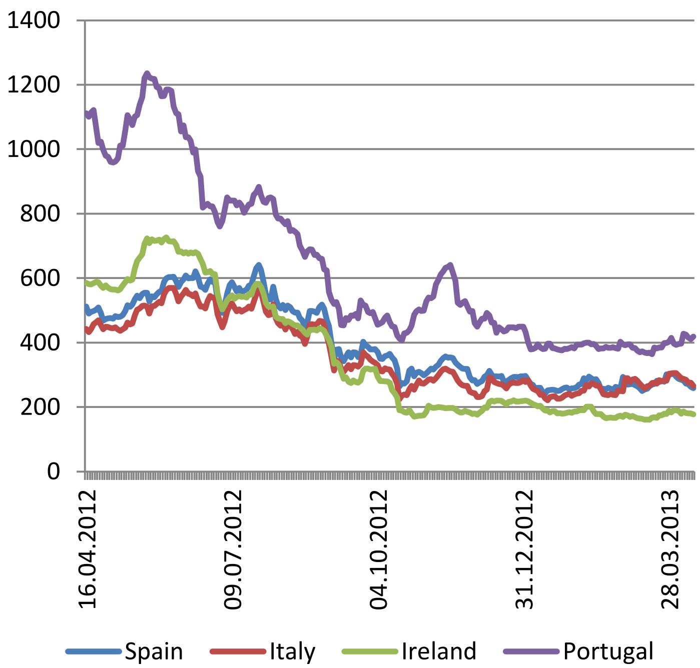
Furthermore the uncertainty over the fiscal accounts persists, because of both the magnitude of the automatic cuts and the political difficulty of reaching a formula that would permit moving towards a sustainable debt in the medium and longterms. These cuts, along with an increase in the tax burden at the beginning of 2013, are expected to result in a weakening of that country's economy, especially during the first half of 2013. For this reason, it is probable that the unemployment rate in the US will stall above 7.5% for all of 2013 and that labor indicators will deteriorate. It is also worth noting that under the 2.0% goal, it is probable that the FED will have more reasons for continuing to purchase bonds at the current rate of US$85 billion per month during 2013.

Currently, the IMF foresees that the US economy will grow 1.9% this year and 3.0% in 2014, in a forecast that assumes that the Congress will act to avoid an abrupt fiscal adjustment.

In the Euro Zone, available indicators show that GDP contracted in 2012, with the weakening of activity extending to some of the main economies of the region. The Euro Zone, for example, ended contracting 0.6 per cent in 2012, dragged by the downward trend in Italy (-2.3 percent,-0.7 percent for 2013) and Spain (-1.5 percent,-1.3 percent for 2013), while the strong countries of the zone barely reached positive numbers, such as Germany with 0.9 percent for 2012 (0.9 percent for 2013 too), and France with 0.1 percent for 2012 (0.4% for 2013). Currently, the IMF forecasts the economy in the Euro Zone to contract 0.4% in 2013 and grow only 1.1% in 2014.

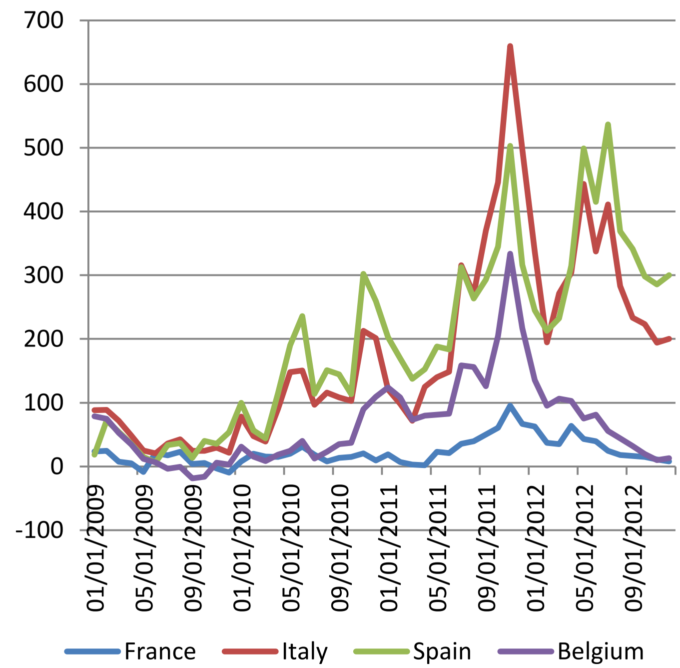
Notwithstanding the above, it is important to note that the spread for the sovereign bonds of peripheral economies (with respect to Germany) and sovereign risk premiums for Spain, Italy, Belgium, and France have diminished significantly. The measures announced by the authorities of the ECB contributed to improving conditions in the international financial markets, although these markets have shown a certain volatility. Along these lines, it is worth highlighting that the spread for public bonds from these countries over the German bond is still high, which reflects continuing concern over the debt and competitiveness of these countries. It is necessary to mention that the combination of recession, fragmented financial markets, corporate and household deleveraging, and weak fiscal solvency are threatening to create an extended period of weak growth in Europe that should be watched carefully..

Chart II. 7: Sovereign Risk Premiums (Measured by 5-year CDS in basis points)



Source: Bloomberg.

Chart II. 8: Spread of European Sovereign Bonds (In basis points over the German Bond)



Source: Thomson Reuters.

Most of the major emerging economies have seen a slowdown in recent months, but with fairly positive results. Japanese Gross Domestic Product (GDP) grew 2.0% in 2012, and it is expected to grow 1.6% in 2013. New data confirms the positive outlook and suggests that this performance is based on household consumption and public demand. Japan should have emerged from recession in the last quarter of 2012 (+0.3%), after six months with negative figures.

The Chinese economy registered an expansion of 7.8% in 2012, its slowest pace since 1999, because domestic demand did not compensate for the deceleration in exports during the current international crisis. An average expansion of 8.0% is forecast for the Chinese economy in 2013, as long as the new leaders maintain high employment rates and avoid increases in housing prices and inflation that could undermine the reforms necessary to change the country's export-based expansion model.

The slowdown in economic activity moderated in Latin America in 2012. The region's growth is still supported by the strength of domestic demand, as confirmed by corporate confidence indicators. In spite of this, growth in Latin America may slow some more in 2013 following the trend line, with risks of a slow-down derived from the foreign environment, among which a possible deterioration in the European situation should be highlighted. According to the IMF, 3.4% growth is forecast for 2012 and 3.9% for 2014.

Table II.1
Economic Growth
(annual percentage variation)

Region	Forecasts			
Area	**Country**	**2012**	**2013**	**2014**
Global product		**3.2**	**3.3**	**4.0**
Developed economies		**1.2**	**1.2**	**2.2**
	United States	2.2	1.9	3.0
	Euro Zone	–0.6	–0.4	1.1
	Japan	2.0	1.6	1.4
	United Kingdom	0.2	0.7	1.5
	Canada	1.8	1.5	2.4
Other emerging and developing market countries		**5.1**	**5.3**	**5.7**
Latin America		**3.0**	**3.4**	**3.9**
	Brazil	0.9	3.0	4.0
	Colombia	4.0	4.1	4.5
	Mexico	3.9	3.4	3.4
	Panama	10.7	8.5	6.8
	Venezuela	5.5	0.1	2.3
Developing countries in Asia		**6,6**	**7,1**	**7,3**
	China	7,8	8,0	8,2
	India	4,0	5,7	6,2

Source: IMF (WEO, April 2013) and MEF.

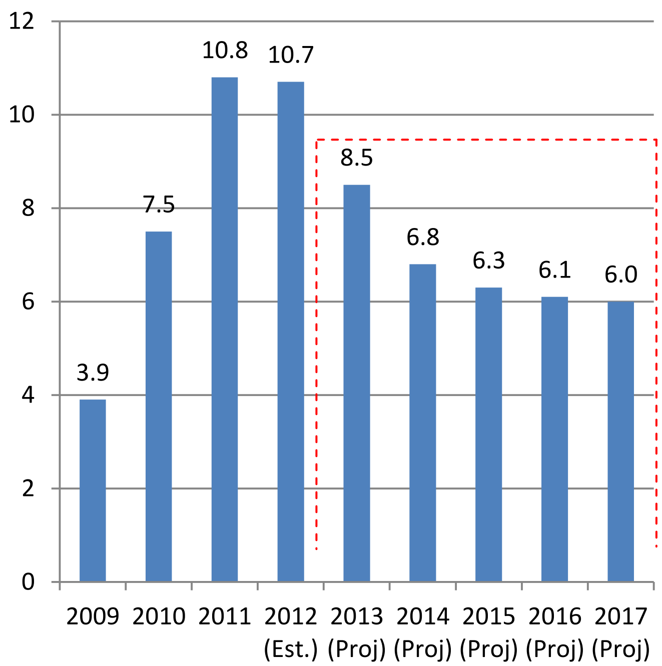
III. Domestic Economic Environment

A. Production

In spite of a complex international environment, the Panamanian economy continued showing sound indicators during 2012, in line with those of 2011. Gross Domestic Product, the value of goods and services generated by domestic producers at constant prices, increased 10.7% over the previous year and reaching US$25.76 billion (a year over year increase of US$2.49 billion).

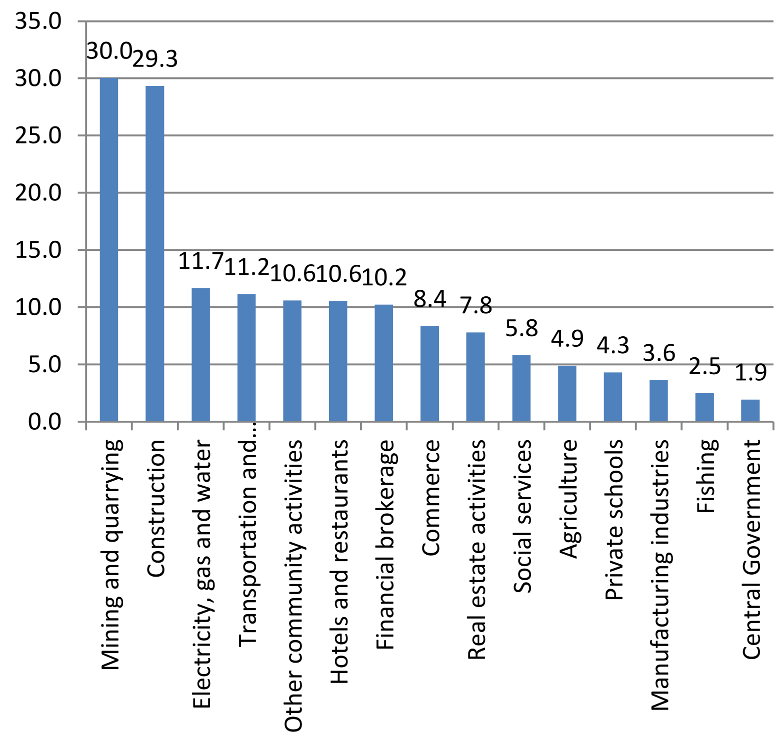
The performance of the Panamanian economy in 2012 was reflected in increases in all categories of economic activity. The following activities in the domestic economy stood out in 2012: mining and quarrying, construction, hydroelectric energy generation, electricity transmission and distribution, non-scheduled passenger land transportation, telecommunications, banking, domestic wholesale and retail operations, restaurants, real estate, housing, health services, other communal, social and personal service activities, government services and agriculture, among others..

Chart III.1: Percentage variation of Annual Gross Domestic Product, at 1996 prices: Years: 2009 - 2017



Source: Comptroller General of the Republic and IMF

Chart III.2: Percentage Variation of the Components of the Quarterly Gross Domestic Products at 1996 prices: Years: 2012 vs. 2011



Source: Comptroller General of the Republic

Construction, a partial indicator of changes in investment, performed well. The most recent data on the sector's growth are sound and the most reliable future indicators suggest that this situation could continue in the following months. In 2012, the construction market rose 29.3% and personal use construction grew 21.9%. In addition, the available indicators linked to the activity all grew: construction permits rose 32.1%, cement production increased 28.8% and pre-mixed concrete increased 2.0%. It is worth noting that sector growth is explained by the execution of public and private investment in civil engineering works and non-residential projects. At the same time, we expect an upturn in 2013 due to positive foreign direct investment income, increased execution of scheduled civil works, and strong building construction, although at a slower pace than in 2012.

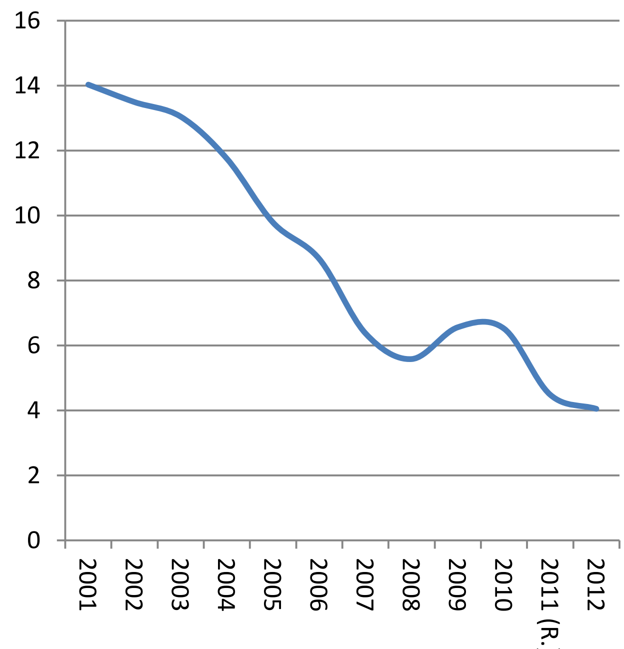
Of the activities dependent on the rest of the world, trade through the Colon Free Zone, hotels, air transportation, port services and fishing registered increases.

The Panamanian economy is forecast to increase 8.5% in 2013, with domestic demand being the main source of growth. In this sense, and after a slight moderation in 2012, private consumption is still expected to remain strong, driven by positive conditions in the labor market, favorable reliability levels and good credit access.

B. Inflation and Employment

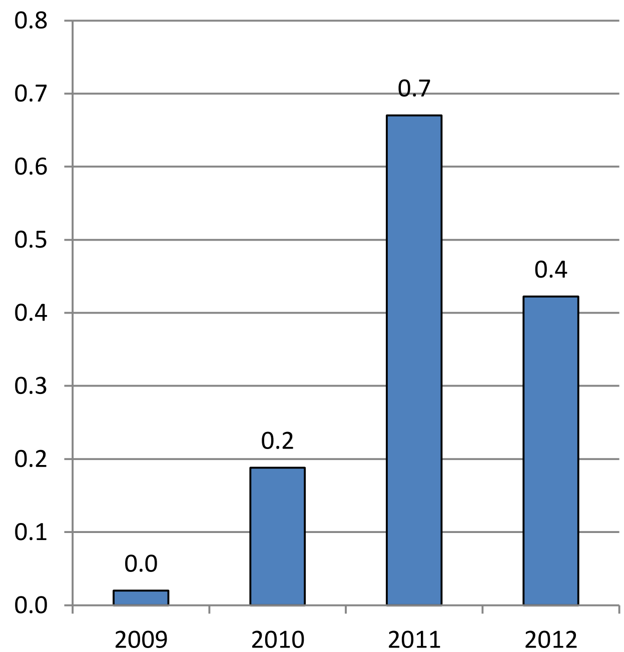
Important advances were noted in employment. According to the latest data from the Institute of Statistics and Census of the Office of the Comptroller General of the Republic, the unemployment rate for 2012 was 4.0%. This is complemented by data from the Economic Commission for Latin America and the Caribbean (ECLAC), which indicates that Panama has the lowest urban unemployment rate in Latin America and the Caribbean.

Chart III.3: Unemployment Rate
Years: 2001 - 2012



Source: Comptroller General of the Republic

Chart III.4: Employment/Product Elasticity
Years: 2009 - 2012



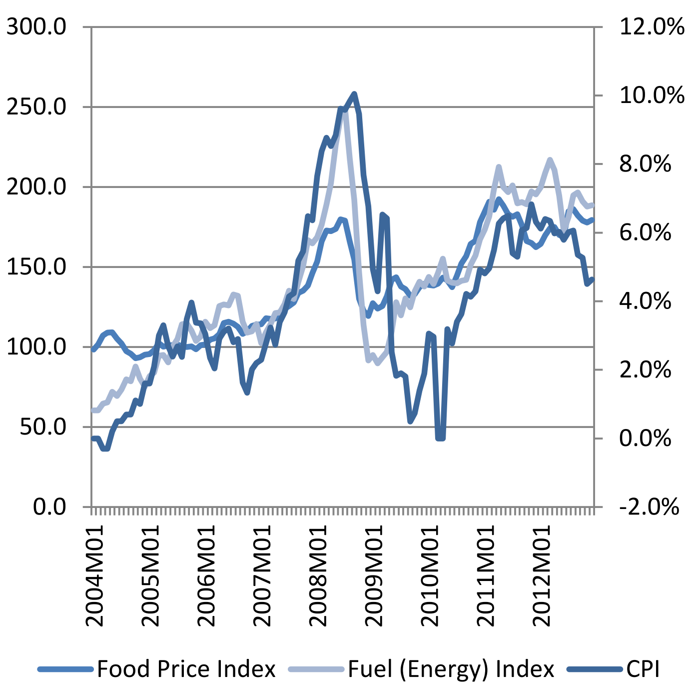
Source: Comptroller General of the Republic

In fact, in a high-growth environment, the low employment/product elasticity (0.4) figure would imply full employment in the marketplace.

The sectors with the highest propensity for creating jobs were commerce, industry, construction, and services. The behavior of the labor market confirms the sound economic growth, driven especially by robust domestic demand.

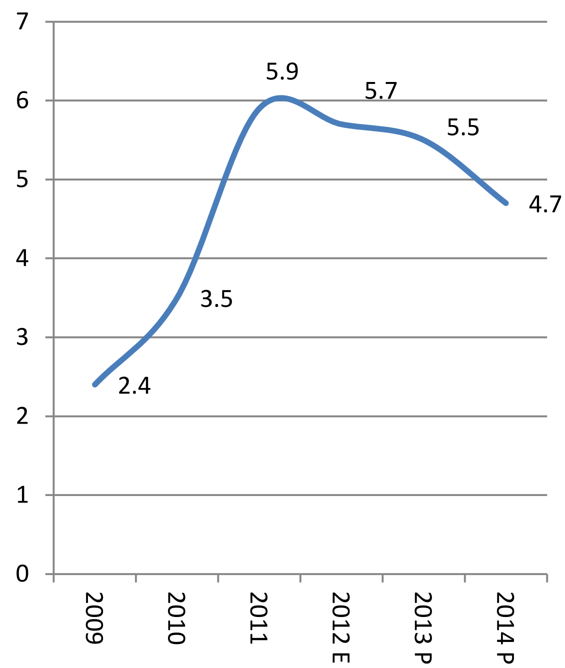
In a framework of high economic growth, expansion of domestic demand and high supply prices internationally, inflation trended upwards. In 2012, the Consumer Price Index (CPI) accelerated to 5.75%. In 2011, it had reached 5.9%.

Chart III.5: CPI, International Prices of Electricity and Food
Period: Jan 2004 – Dec 2012



Source: Prepared by the SBP with data from CG and IMF

Chart III.6: Panama: Consumer Price Index
Years: 2009 to 2014



Source: Prepared by the SBP with data from CG and IMF

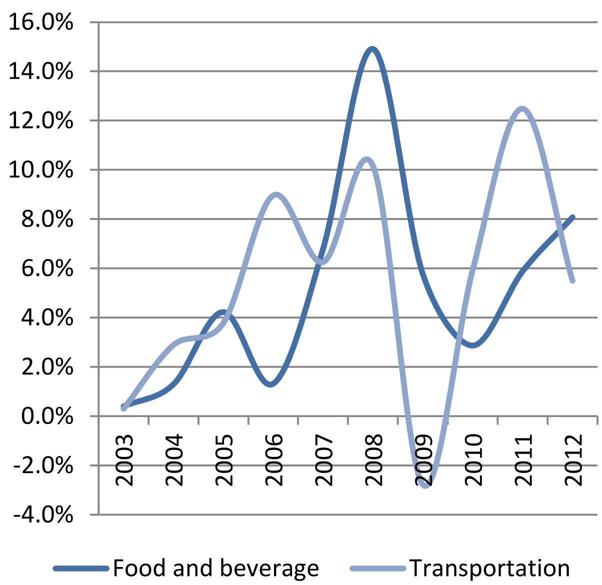
It is worth mentioning that the foreign environment has affected the behavior of domestic prices significantly, due to increases in raw materials such as oil (whose prices affect fuel, energy, transportation, and other goods) and food (principally grains). According to the OECD and ECLAC, the increase in the Consumer Price Index in Latin America was caused by increases in international oil and food prices[2], from which we can conclude that Panamanian inflation is responding primarily to foreign shocks. Inflation is expected to stabilize in 2012 and maintain an average of 5.5% in 2013 and 4.7% in 2014.

It should be noted that during the past 12 months, food prices increased 8.1% and transportation prices 5.5%. During the same period, prices for services such as school and health services increased 3.9% and 3.6%,

[2] OECD/ECLAC (2011) Latin American Economic Outlook 2012: Transforming the State for Development, OECD Publishing.

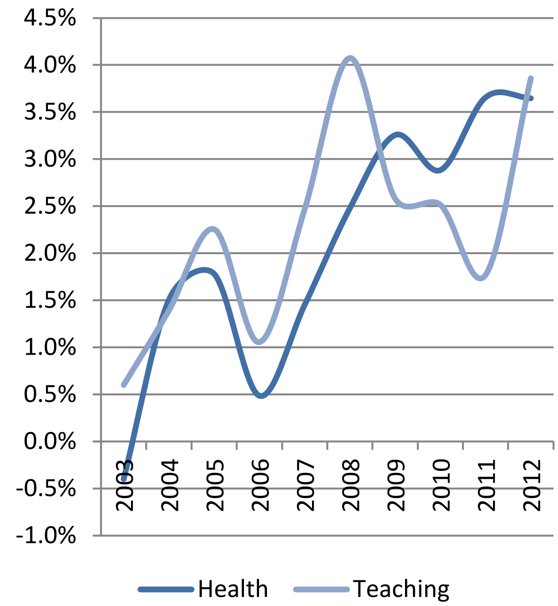
respectively. Due to the dissimilar behavior of various components of the CPI, the data appears to indicate that we are in a period of relative price readjustment.

Chart III.7: Some Consumer Price Sub-indexes
(% Annual Variation as of December)



Source: Comptroller General of the Republic

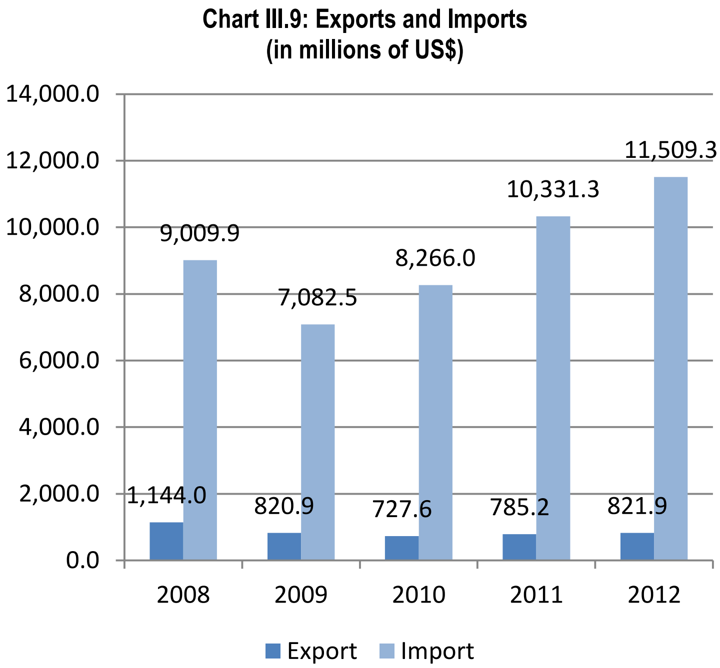
Chart III.8: Some Consumer Price Service Sub-indexes
(% Annual Variation as of December)



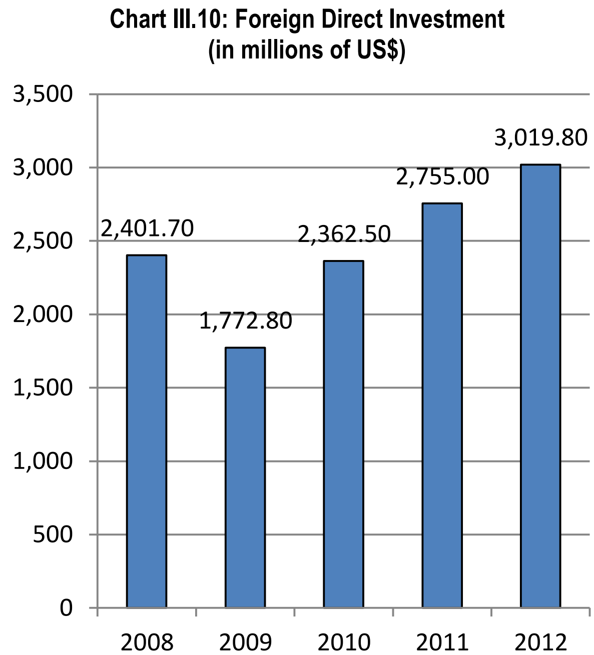
Source: Comptroller General of the Republic

C. Foreign Sector

During 2012, the Current Account registered a deficit of US$3.27 billion as a result of the negative value of the Goods portfolio (US$5.76 billion, 4.4% or US$266.6 million lower than 2011) and the Income account (US$2.66 billion, an increase of US$802.0 million, 43.3% higher than 2011). For 2012, national FOB exports totaled US$821.9 million (a 4.7% increase) and CIF imports amounted to US$11.51 billion (an 11.4% increase). Conversely, the Balance of Services continued its growth pattern, reaching US$50.06 billion. This is a US$1.18 billion increase, 30.4% over the previous year. The Current Account is expected to continue in the red for 2013 due to the slowdown in the global economy continuing to affect the export of goods.



Source: Comptroller General of the Republic



Source: Comptroller General of the Republic

As of December 2012, capital investment in Panama registered in the Capital and Financial Account stood at US$3.70 billion, US$554.5 million less than that registered in 2011. This 13.0% decrease, was affected by the 59.9% decrease in other investments due to a reduction in foreign liabilities.

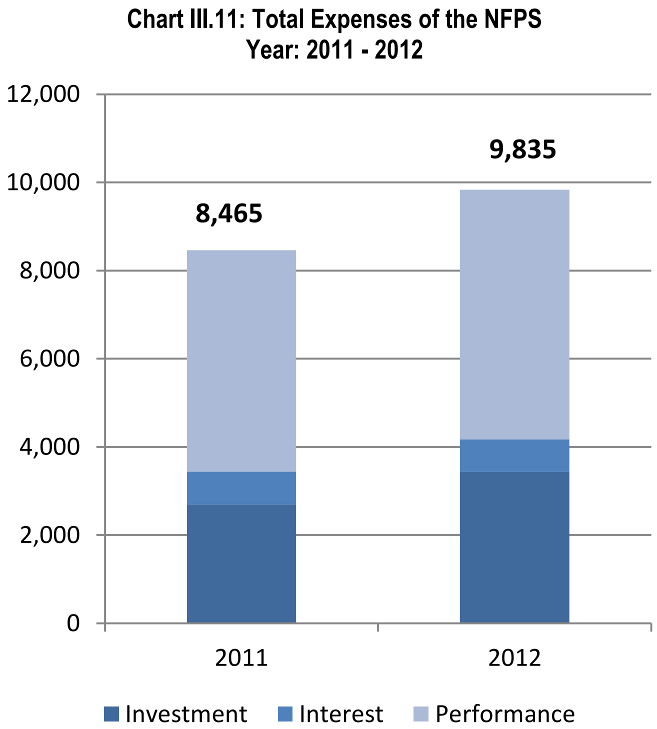
Foreign Direct Investment (FDI) was US$3.020 billion, 28.0% of which came from the purchase of stock in national companies by non-residents, especially in hotels and real estate; 49.0% from the reinvestment of profits, which was driven by allocations of foreign investors' capital in works such as the Panama Canal expansion, Metro construction and other great projects carried out within the country; and the remaining 23% in other equity. Thus, direct foreign investment increased US$264.8 million or 9.6% over 2011.

It is worth noting that Foreign Direct Investment (FDI) covers almost all of the Current Account deficit. The fact that the Current Account deficit is covered by long-term investment flows, leads us to believe that the vulnerability of the foreign accounts would be reduced in the event of a global market shock in 2013.

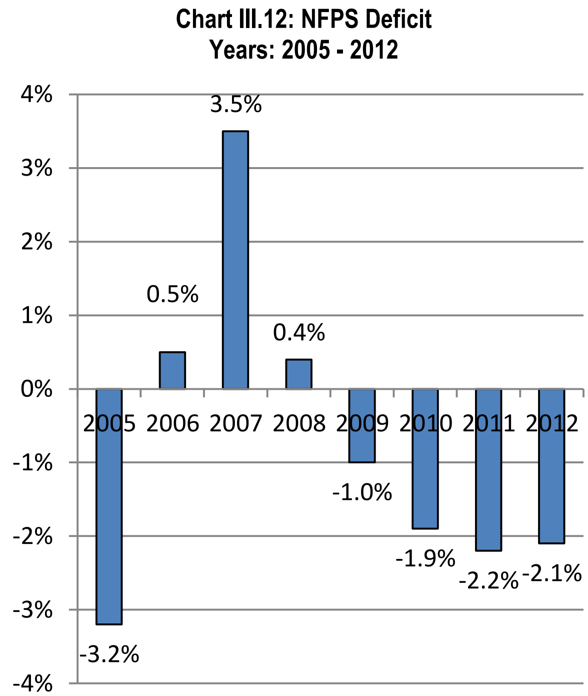
D. Public Sector

a) *Fiscal Performance*

High growth in 2012 and an improvement in collection were positively reflected in the National Government balance sheet for this year. Total Central Government income grew 16.5% over 2011. This increase in total income is explained by an increase of US$978.1 million of tax payments, 26.4% higher than in 2011. Non-tax income grew 2.9% over the previous year. The 28.9% increase in capital expenses over 2011 reflects the execution of the main megaprojects, including the first line of the Metro, road realignment, bay sanitation and the Madden – Colon Highway.



Source: MEF



Source: MEF

The deficit of the Nonfinancial Public Sector (NFPS) reached US$765.3 million in December 2012. This represents 2.1% of GDP, lower than 2.2% registered in 2012. It is worth noting that Law 38 of 2012[3] provided new maximums for the NFPS deficit: 2.9% for 2012; 2.8% for 2013; 2.7% for 2014; 2% for fiscal year 2015; 1.5% for 2016, and 1.0% for 2017.

The 2013 General Budget of the Nation was approved for a total amount of US$16.29 billion, a 12.7% increase (US$1.84 billion) over the 2012 National budget. The budget for 2013 is divided as follows: US$6.95 billion for investments; US$1.75 billion for debt servicing, and US$7.59 billion for operating expenses.

3 Article 34 of Law 38 dated 5 June 2012 creating Panama's Savings Fund and other provisions are prescribed (Official Gazette No. 27050-A)

TABLE III.1: PANAMA'S MAIN ECONOMIC INDICATORS

	2009	2010	2011	2012
GROSS DOMESTIC PRODUCT (GDP)				
GDP (annual real var., in %) *	3.9	7.5	10.8	10.7
GDP (in millions of 1996 US$)*	19,538.40	20,994.40	23,272.10	25,755.50
GDP (in millions of US$) *	24,162.90	26,589.60	31,316.40	36,252.80
INFLATION AND EMPLOYMENT (variation and rates in %)				
CPI (% variation) *	2.4	3.5	5.9	5.7
MPI (% variation) *	-6.7	0.9	11.9	4.7
Unemployment rate *	6.6	6.5	4.5	4
FOREIGN SECTOR				
Goods export FOB (in millions of US$) *	820.9	727.6	785.2	821.9
Goods import CIF (in millions of US$) *	7,082.50	8,266.00	10,331.30	11,509.30
Colon Free Zone re-exports (in millions of US$) *	10,922.70	11,395.90	15,113.10	16,141.70
Colon Free Zone CIF imports (in millions of US$) *	8,258.50	10,220.50	14,041.30	14,650.70
Foreign Direct Investment (in millions of US$) *	1,772.80	2,362.50	2,755.00	3,019.80
PUBLIC FINANCES				
Central Government Income (in millions of US$) *	6,474.10	6,323.60	7,305.20	8,666.20
Foreign Debt (in millions of US$)**	10,150.20	10,438.50	10,910.40	10,782.40
Domestic Debt (in millions of US$)**	822.2	1,191.00	1,903.80	3,482.80
Total Debt (in millions of US$)**	10,972.40	11,629.50	12,814.20	14,265.20
NFPS Deficit (in %)***	-1	-1.9	-2.2	-2.1

* Data from the Comptroller General of the Republic

** Data from the Debt Report issued by the MEF's Public Credit Directorate.

*** Ministry of Economy and Finance

IV. Structure of the National Financial System (Banking data, Securities, Cooperatives, Finance, and Other Institutions).

Nowadays it is common to speak of the good development of the Panamanian banking system. However, in this section we wish to present an estimate of all of the institutions that perform financial intermediation activities in one way or another.

Based on this criteria, we used the IMF's *Monetary and Financial Statistics: Compilation Guide*.

The Panamanian financial sector is comprised of:

- Deposit unions including banks, savings and credit cooperatives, savings and credit unions, and development banks.
- Insurance and pension funds associations.
- Other financial intermediaries.
- (In most countries there is a Central Bank. However, this does not apply to Panama)

Deposit unions: Include banks, savings and credit cooperatives, savings and credit unions, and development banks. Their main activity is financial intermediation, although they also acquire liabilities.

Insurance and pension fund associations: insurance associations are incorporated enterprises, mutuals and other entities whose main function is to provide life, accident, health and other types of insurance. Pension funds are those providing retirement benefits to specific groups of employees. They have their own assets and liabilities and engage in financial transactions on their own account.

Other financial intermediaries include all finance companies except deposits unions, insurance and pension fund associations. This includes finance companies, brokerage houses, leasing companies, etc.

There are around 688 entities in the financial sector. Each has its own supervisory body, with the exception of the Agriculture Development Bank and the National Mortgage Bank.

Supervisory bodies: Superintendency of Banks, Superintendency of the Securities Market, Superintendency of Insurance and Reinsurance, IPACOOP and the Ministry of Commerce and Industry.

It is worth noting that the Comptroller General of the Republic is making significant efforts to compile statistics on other financial intermediaries (Savings and Loans Unions, Leasing Companies, Remittance Companies, etc.)

Banking is the most important activity in the financial sector portfolio, representing 76.6% of the sector. The Banking Center, created in the seventies, is a nationally and internationally competitive industry meeting the demands of recent times. With US$89.78 billion in assets as of December 2012, the strength of the industry is clear, working hand in hand with regulations based on best practices and compliance with international standards.

The stock market is the second largest activity in financial sector operations, representing 18.2% of the financial system and accumulating total assets of US$21.33 billion. This sector is regulated by the recently-created Superintendency of the Securities Market (formerly known as the National Securities Commission).

The insurance sector is in third place in size of operations, representing 1.6% of the total financial system and having total assets of US$1.89 billion. This sector is regulated by the Superintendency of Insurance and Reinsurance.

Chart VI.1
Financial System Structure
As of December 2012

Financial Entity	Period	Entities	In millions of US dollars	%	Supervisor
Banks		**92**	**89,772**	**76.6**	**Superintendency of Banks**
General License	12-Dec	49	72,937		Superintendency of Banks
International License	12-Dec	29	16,835		Superintendency of Banks
Representation License	12-Dec	14	-		Superintendencia de Bancos
Cooperatives (a)			**1,823**	**1.6**	**IPACOOP**
Cooperatives	12-Dec	595	1,823		IPACOOP
Savings and Credit Unions (a)	12-Jun	4	ND		National Mortgage Bank
Mortgage Savings and		4	ND		National Mortgage Bank
Credit Unions					
Insurance Companies (b)		**31**	**1,881**	**1.6**	**Superintendency of Insurance**
Insurance Companies	12-Dec	31	1,881		Superintendency of Insurance
Pension Fund (b)			**644**	**0.6**	**Superintendency of the Securities Market**
Pension Funds	12-Dec	2	644		Superintendency of the Securities Market
Development Banks (a)		**2**	**593**	**0.5**	**Agriculture Development Bank and National Mortgage Bank**
National Mortgage Bank	12-Dec	1	234		
Agriculture Development Banks	12-Dec	1	359		Agriculture Development Bank and National Mortgage Bank
Finance Companies (a)		**161**	**830**	**0.7**	**Ministry of Commerce and Industry**
Finance Companies	12-Jun	161	830		Ministry of Commerce and Industry
Leasing Companies		**118**	**322**	**0.3**	**Ministry of Commerce and Industry**
Leasing Companies (*)	12-Jun	118	322		Ministry of Commerce and Industry
Securities Companies			**21,329**	**18.2**	**Superintendency of the Securities Market**

Securities Companies	12-Dec	81	21,329		Superintendency of the Securities Market
Money Remittance Companies (a)			ND		Ministry of Commerce and Industry
Money Remittance Companies	12-Mar	15	ND		Ministry of Commerce and Industry
Pawn Shops (a)		280	ND		Ministry of Commerce and Industry
Pawn Shops	12-Mar	280	ND		Ministry of Commerce and Industry
Total		**688**	**117,194**	**100.0**	

(*) Leasing companies belonging to banking groups.

(a) Information as of March 2012

(b) Information as of December 2011

V. Financial Performance of Panama's International Banking Center (Financial Soundness)

Development of Banking in Panama: General Outlines

The Panamanian banking marketplace shows in its organizational structure a diversity of banks operating under general and international banking licenses. The general license allows banks to engage in the banking business in Panama and to carry out transactions to be concluded or effective abroad, while the international license only permits banks to carry out transactions from Panama to be effective abroad.

Banking is one of the cornerstones of our service economy, thanks to its contribution to funding the economic development of the country. Thus the banking sector generates about 8% of GDP and almost all of the contribution of the financial sector.

The Banking Center is a highly international marketplace with first-class foreign banks, coming mainly from Latin America, which, at the same time, is its main target market.

As of the end of December 2012, the International Banking Center was comprised of 92 banks:

- 2 State-owned banks,
- 29 foreign private banks holding General License,
- 18 Panamanian private banks holding General License,
- 29 banks with International licenses, and
- 14 banks with Representation Licenses.

The presence of banks from various regions is based on the interest of different banking groups of operating in a marketplace that promotes favorable performance and reflects high liquidity, equity strength, and asset quality.

Among the remarkable strengths of the center, we can mention: efficient, reliable regulation and supervision, application of international standards, security and reliability of the system, level playing field, banking confidentiality and secrecy, historical background/record, free flow of capital, over 100 years as a dollarized economy and reasonable operating costs.

The continuous banking supervision and a regulatory framework in compliance with international standards are the key to maintaining the reliability, stability, soundness, and competitiveness of the Panamanian banking system.

Balance Sheet

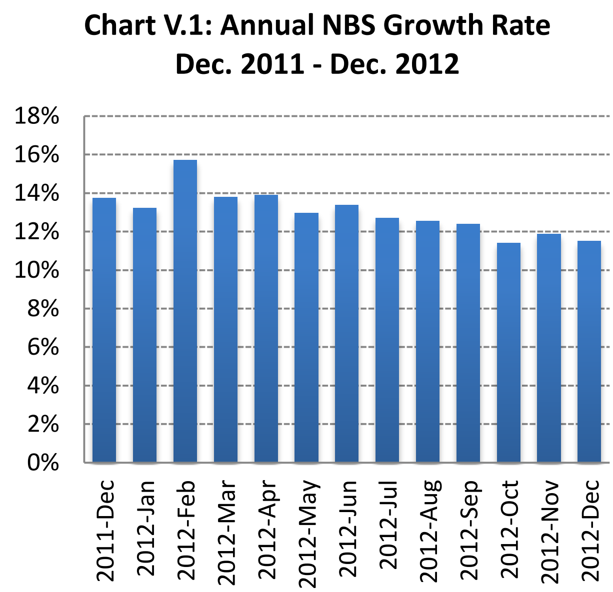
Table V.1: International Banking Center
Balance Sheet
December 2011 vs. December 2012
(in millions of US dollars)

Accounts	2011	2012	December 12 / 11 Var.	
	December	December	Total	%
Net liquid assets	13,633.0	15,785.6	2,152.6	15.8%
Net credit portfolio	**50,186.2**	**56,009.0**	**5,822.9**	**11.6%**
Net securities investment	14,093.0	14,764.1	671.1	4.8%
Other assets	3,063.1	3,172.0	108.8	3.6%
Total assets	**80,975.3**	**89,730.7**	**8,755.4**	**10.8%**
Deposits	**57,437.8**	**64,070.7**	**6,632.9**	**11.5%**
Liabilities	11,912.3	13,407.7	1,495.4	12.6%
Other liabilities	2,557.4	2,693.3	136.0	5.3%
Equity	9,067.9	9,559.0	491.1	5.4%
Total Liabilities and Equity	**80,975.3**	**89,730.7**	**8,755.4**	**10.8%**

Source: General and International license banks.

Panama has distinguished itself as an International Banking Center (IBC) where the banking business supports, among other things, funding to international trade to the Latin American market, cash flow management for important international banking groups, and the development of private banking. Its macroeconomic stability, with growth and low inflation compared to other countries of the region, as well as the absence of exchange risk and interest rates close to international rates have guaranteed and distinguished Panama as an attractive center for Latin America. As of the end of December 2012, the IBC closed with assets of US$89.74 billion, 10.8% more than at the end of 2011.

Regarding the financial development of the National Banking System (NBS), as of the end of 2012 it showed continued asset growth, reaching US$72.90 billion. Annual growth has also been steady, with growth rates in consonance with the local and external environmental conditions in which the activity occurs.



Source: General and International license banks.

In terms of structure, the balance sheet of the NBS is characterized by a focus, in terms of uses, on the loan portfolio (63.6% of total assets) and funding through deposits (74.9% of total liabilities + equity). Nevertheless, liquid assets, investments and equity accounts represent a very important part of the balance sheet. Therefore, even though loans are still the main component of the balance sheet, the Banking System is diverse enough to permit it to weather situations that might possibly be adverse for any particular activity.

Below are some relevant aspects of the main accounts in the balance sheet of the Banking System.

ASSETS

Liquid Assets

Liquid assets represent 16.9% of the balance sheet of the Banking System as of December 2012. They consist of cash and cash flow, as well as the balance of demand and time deposits in banks and financial institutions. Eighty-two point four percent of allocated deposits are in institutions abroad, while according to their expiration dates, 32.2% and 67.8% are demand and time deposits, respectively.

Loans

The net loan portfolio of the IBC equates to US$56.1 billion, with 59.1% being of domestic origin. As of December 2012, it grew 11.6% over December 2011.

Domestic credit (US$33.10 billion) includes a greater participation of commerce (30.2%), mortgages (26.7%), and personal consumption (18.9%). Domestic credit to State institutions is relatively low, totaling US$1.19 billion--3.6% of the total.

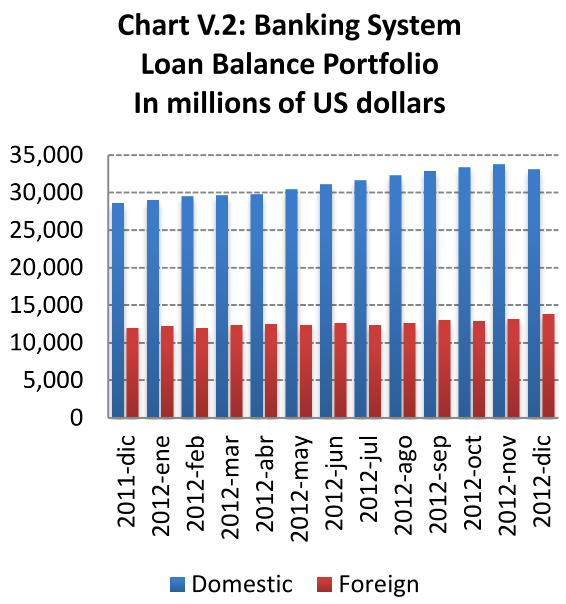
Table V.2: National Banking System
Loan Balance by Sectors
(in millions of US dollars)

Sectors and Activities	Dec. 11	Dec. 12	Dec. 11 – Dec. 12 Var.	
			Total	%
TOTAL	**28,610.8**	**33,093.9**	**4,102.6**	**14.2%**
Public Sector	942.7	1,182.5	238.9	25.3%
Private Sector	**27,668.1**	**31,911.4**	**3,863.7**	**13.8%**
Finance and Insurance Cos.	861.0	786.3	-110.3	-12.3%
Agriculture	289.8	376.4	86.5	29.8%
Stockbreeding	684.6	756.3	71.3	10.4%
Fishing	39.0	56.0	11.4	25.5%
Mining and quarrying	33.1	52.7	18.9	55.9%
Commerce	7,979.4	10,000.0	1,851.7	22.7%
Industry	1,683.9	1,794.4	71.6	4.2%
Mortgage	7,642.1	8,839.5	1,127.8	14.6%
Construction	2,771.1	2,982.7	164.4	5.8%
Personal consumption	5,684.0	6,267.2	570.4	10.0%

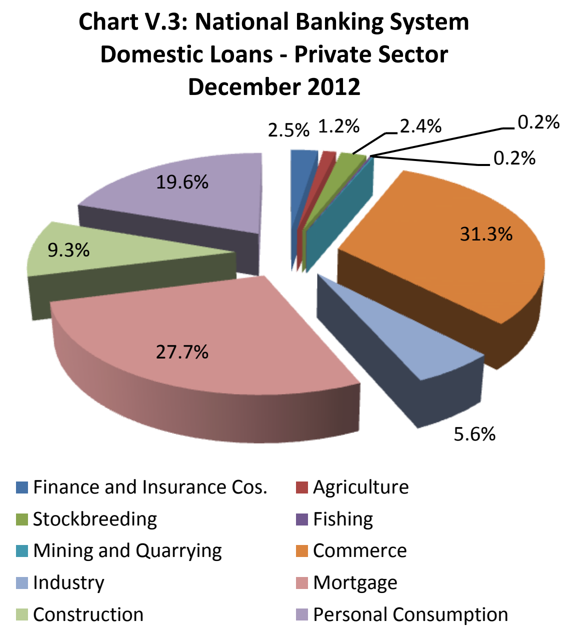
Source: General license banks.

In loans to commerce we can highlight the increase in loans to the Colon Free Zone (22.4%), as well as loans to the rest of the country (28%). In the mortgage sector, private home loans reached US$7.28 billion, while loans for commercial establishments totaled US$1.14 billion, representing a 15.7% and 19.8% increase over 2011, respectively. As for personal consumption, personal loans grew by 9.4% (US$5.48 billion), while car loans grew by 16.8% (US$793.1 million) during the same period.

However, it is clear that loan expansion, particularly personal consumption loans, requires constant vigilance by the economic agents, because any deterioration in its quality would have both decisive repercussions for the results obtained and cascading implications for the commerce sector, which bases its performance in large measure on domestic personal consumption.



Source: General license banks.



Source: General license banks.

As for foreign loans, the main countries to which those were allocated are: Chile, Costa Rica, Brazil, Colombia, Peru, and Guatemala. The activities receiving the most foreign loans are the industrial, commerce, and finance sectors.

Once again, the regional influence of the Panamanian banking sector, which redistributes financial resources in the area, is obvious. It is also clear that the conditions that have supported Panama's ability to sustain its credit operations have been strengthened by the steady stream of regional bank deposits.

Investments

The Investment balance sheet has reached US$11.51 billion, representing 15.8% of the Banking System balance.

The Banking Center portfolio extends to US$14.77 billion, with an increased relative weight in privately issued securities. On this point, it is necessary to point out that banking has always been preponderantly conservative, with little appetite for financially complex investments.

The largest components of the investment portfolio are corporate bonds and stock in companies, whether or not the banks are majority shareholders. Global bonds and sovereign debt of various countries are also important elements. The review of the portfolio showed that it does not include securities from countries currently experiencing financial problems.

LIABILITIES AND EQUITY

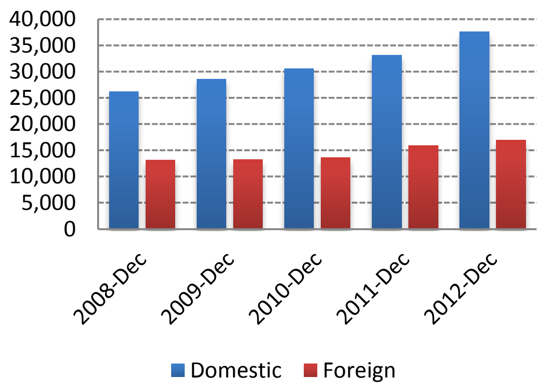
As for NBS bank funding, 74.9% consists of deposits, while 10.6% belongs to equity or equity funds.

Deposits

As of December 2012, NBS total deposits were US$54.59 billion, of which 68.9% are domestic deposits.

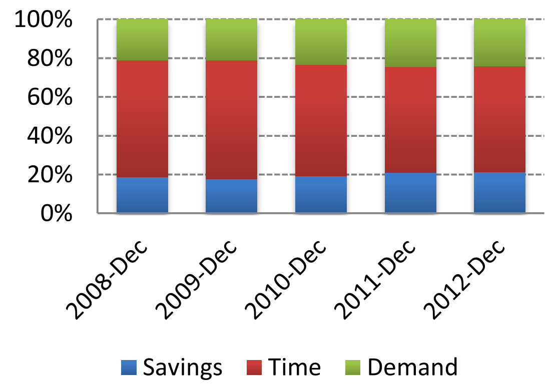
Private deposits were US$41.08 billion as of December 2012, with 54.5% being time deposits.

Chart V.4: National Banking System Total Deposits by Region Dec. 2008 - Dec. 2012 In millions of US$



Source: General and International license banks.

Chart V.5: National Banking System Private Deposits Portfolio Dec. 2008 - Dec. 2012 In percentages



Source: General and International license banks.

Liabilities

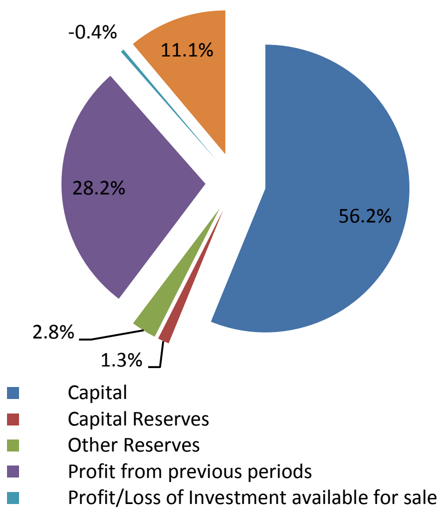
The liabilities of the Banking System were US$8.09 billion (11.1% of liabilities + equity), of which 84.5% were foreign and the remainder was from domestic sources.

Equity

Total equity of the Banking System was US$7.75 billion, a 1.1% increase over the same period of 2011. The equity represents 10.6% of total liabilities and equity.

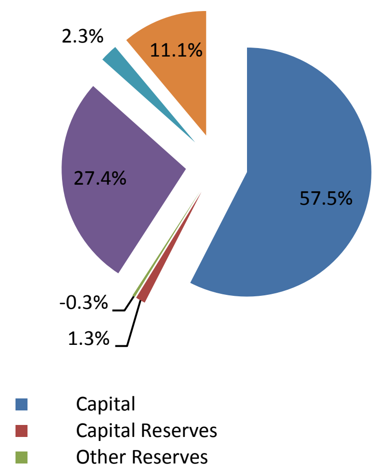
The main categories of equity as of December 2012 are capital (56.9%) and retained profits from previous periods (27.1%). This indicates that for now, banks do not feel any pressure to increase their equity, given that the minimum required capitalization is only 8%.

Chart V.6: National Banking System Equity Funds Portfolio. Year: 2011



Source: General and International license banks.

Chart V.7: National Banking System Equity Funds Portfolio. Year: 2012



Source: General and International license banks.

Profits

As of the end of December 2012, profits registered US$1.47 billion, US$154 million more (11.7%) than the profits accumulated through December 2012.

Interest income stood at US$3.79 billion, a 9.5% increase compared to the same period of the previous year. This increase happened primarily because of increases in loan interest income that totaled US$346.9 million more than what had been accumulated in December 2011.

In the end, 2012 performance was determined by Net Interest Income (US$142.3 million), a direct result of a combination of low rates paid on deposits and interest received on fixed rate loans made in previous periods.

Table V.3: International Banking Center
Cumulative Income Statement
Jan. – Dec. 2011 and 2012

Description	Jan. – Dec. 2011	Jan. – Dec. 2012	Total Var.	% Var.
Interest Income	3,453.7	3,782.5	328.8	9.5%
Operating Expenses	1,759.2	1,945.7	186.5	10.6%
Net Interest Income	1,694.5	1,836.8	142.3	8.4%
Other Income	1,705.6	793.5	-912.1	-53.5%
Operating Income	3,400.1	3,695.8	295.7	8.7%
General Expenses	1,862.7	2,001.5	138.7	7.4%
Profit before Reserves	1,537.3	1,694.3	157.0	10.2%
Bad debt reserves	223.0	226.0	3.0	1.3%
Profit for the period	1,314.4	1,468.3	154.0	11.7%

Source: General and International license banks.

With regard to expenses for the January to December 2012 period, operating expenses increased by 10.6% relative to the same period of 2011. At the same time, general expenses rose 7.4%

INDICATORS

Profitability

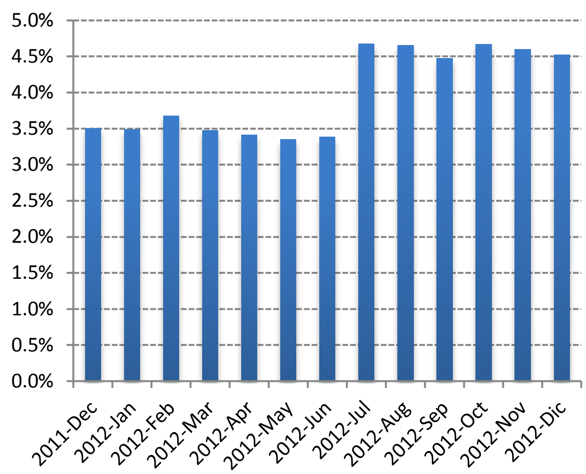
ROA, ROAA and ROE remained stable during the period between December 2011 and 2012, with the first quarters of 2011 and 2012 notable for levels above those in previous periods.

Portfolio Quality

Portfolio quality has improved due to an increase in assets and a decrease in delinquency, boosting business. There has been a slight increase in debt balances marked special mention through unrecoverable (SM, SS, D and U), reaching 4.5% in December 2012; additionally, a stable level of reserves has been achieved for these portfolios.

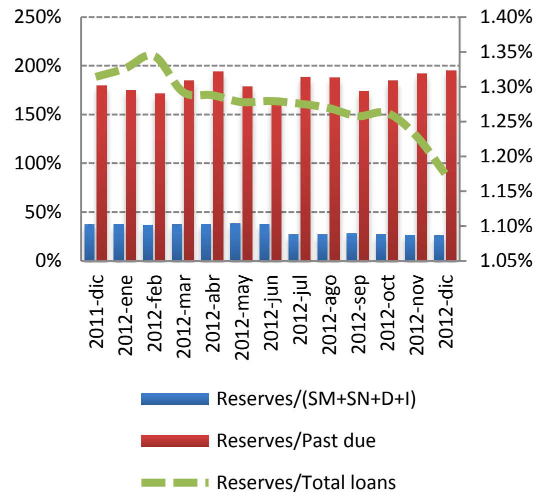
On the other hand, reserves are lower than they were in December 2011 as a percentage of the total portfolio (1.33%), reaching 1.18% as of December 2012. Reserves covered 195.1% of delinquent loans in December 2012, while reserves were 26% of loans marked special mention through unrecoverable (SM, SS, D and U) at the end of December 2012.

Chart V.8: International Banking Center (SM+SS+D+U)/Total Dec. 2011 - 2012



Source: General and International license banks.

Chart V.9: International Banking Center Portfolio Quality Dec. 2011 - 2012



Source: General and International license banks.

Liquidity

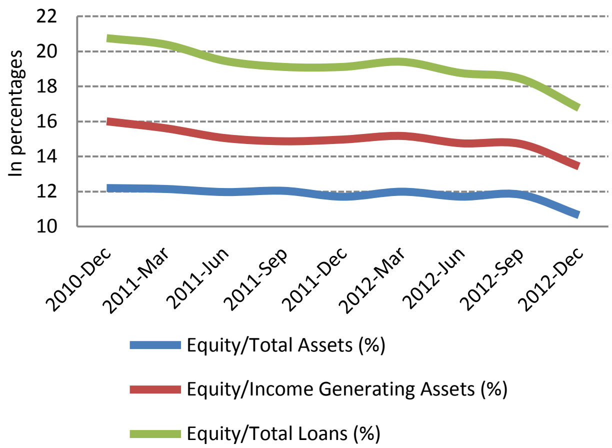
Credit expansion has withdrawn liquid resources from the system, gradually lowering financial liquidity ratios. Nevertheless, registered levels are within the satisfactory and normal ranges in terms of prudential banking standards.

The average legal liquidity index as of December 2012 was of 65.5%, over the 30% required by law.

Capitalization

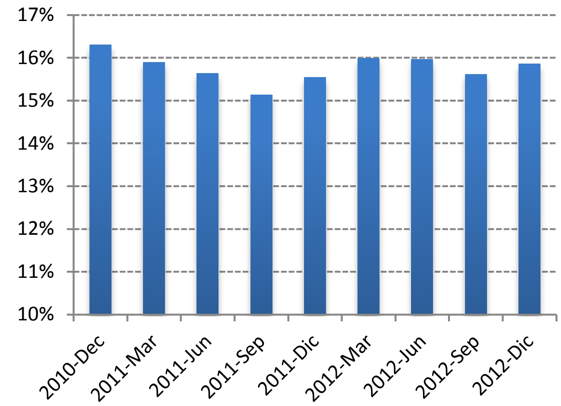
In 2010 and 2011, two characteristics that contributed to the stability of the NBS were the high liquidity and capitalization levels of banks. This conservative position has contributed to an increase in international and domestic trust in the system that has permitted the Panamanian banking system to project itself domestically and internationally and expand its operations in the marketplace. In this way, the behavior of the NBS's capitalization and liquidity ratios reflect the administrator's strategy for adapting to existing favorable conditions by maintaining a level of equity that supports credit grow thand handling reserves efficiently. Although the capitalization and liquidity ratios fell slightly in December 2012, they are within the range that is adequate for the market's operations.

Chart V.10: National Banking System Capitalization



Source: General and International license banks.

Chart V.11 Banking System Capital Adequacy

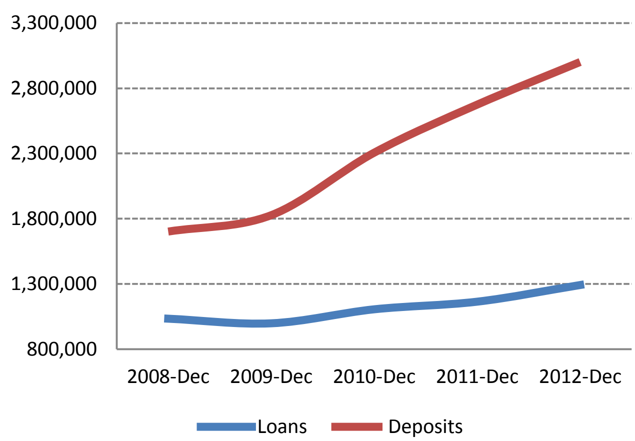


Source: General and International license banks.

FINANCIAL INCLUSION

Financial inclusion refers to the population's access to financial services. In recent years, this concept has become relevant because of its positive impact on economic development. However, there is no consensus on its definition (Capera and Gonzalez, 2011). There are many indicators that could be used to measure financial inclusion in a country. One positive indicator is the increasing number of deposits noted during the last two years, which is, to a large extent, the reason that its numbers have remained above those for the flow of credit. The fact that the public continues increasing its deposits despite the low interest rates for savings accounts is positive.

Chart V.12: Number of of Domestic Loans and Deposits in the Country

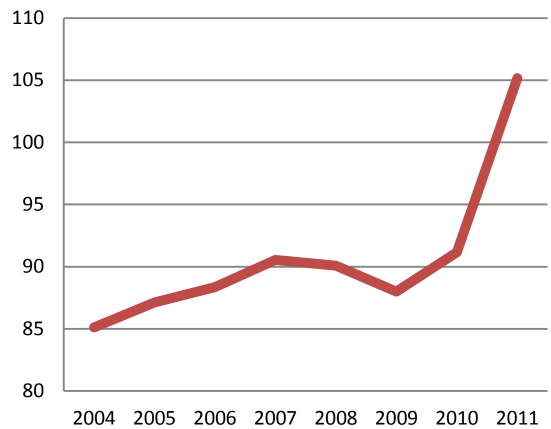


Source: General license banks.

Another indicator to measure financial inclusion is the relationship of credit to GDP. The last report issued by the World Bank in 2012, using data from 2011, shows that Panama has a Credit/GDP relation of 105.2%. This indicator has increased in recent years, with the country being the one with the greatest accessibility to credit relative to GDP in Latin America (excluding the Caribbean).

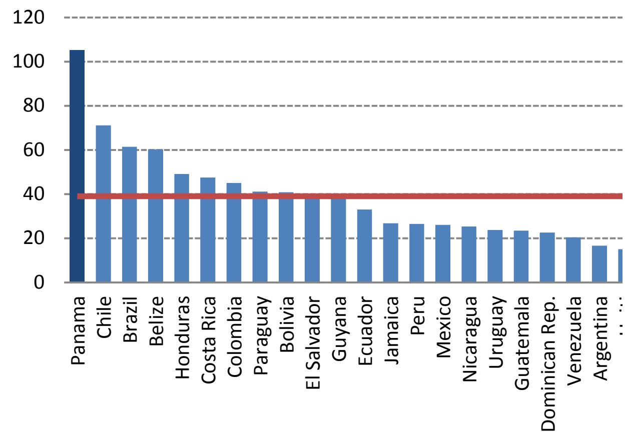
Panama has a high Credit/GDP ratio, almost at the same level as developed countries. All other Latin American countries behave differently from Panama, with Chile being second at 71.2%. Half of Latin American countries are below the average of the region.

Chart V.13: Panama's Credit/GDP Ratio
Years: 2004 - 2011
In percentages



Source: World Bank

Chart V.14: Credit/GDP Ratio
Year: 2011
In percentages

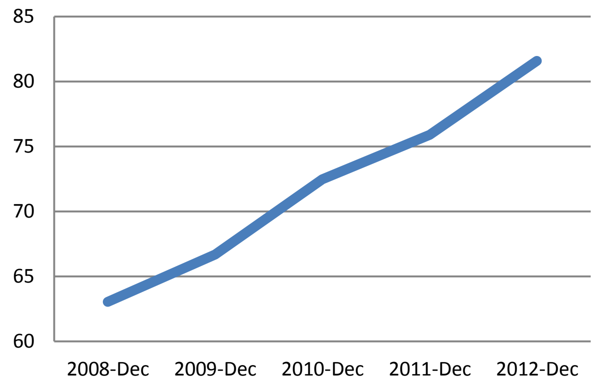


Source: World Bank

Another indicator used internationally is one that highlights the geographic coverage, taking into consideration the number of branches, agencies, ATMs and others per 100,000 adults. To obtain an access index, all branches, ATMs and drive-through banks were added up; the result was divided by the adult population 18 to 74 years old. Through December 2012, a banking access index of 81.6 per 100,000 adults was obtained.

This indicator reflected the fact that the banking system has increased its banking network 7.5% since last year and 29.4% in the past five years in terms of brokerage points. It is worth noting that the indicator would increase if we added the 595 cooperatives in the country to this calculation.

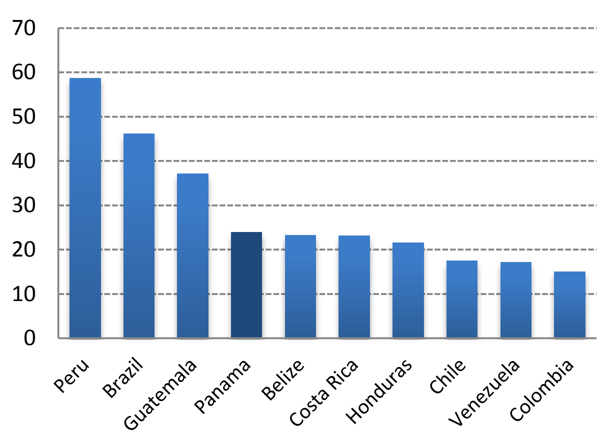
Chart V.15: Access to Banks (Branch Offices, ATMs, other establishments per each 100,000 adults)



Source: SBP and Comptroller General of the Republic

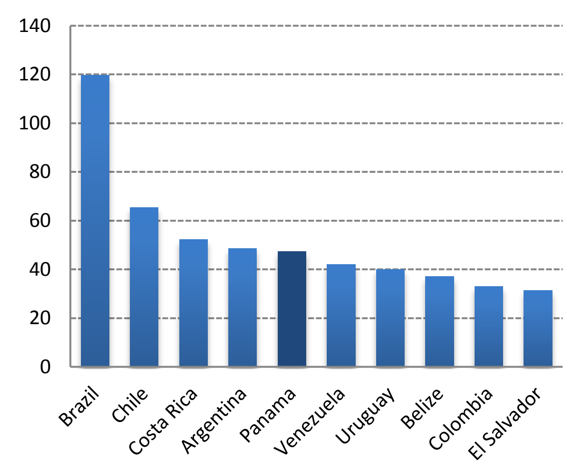
To compare the level of financial inclusion in Panama to the other Latin American countries (excluding The Caribbean), we have selected some indicators from the Financial Access Survey prepared by the International Monetary Fund in 2012 using data from 2011. The index of commercial bank branches per 100,000 inhabitants places Peru in the lead with 58.7 banks and branches per 100,000 adults; Panama ranked fourth with 23.9, after Guatemala (37.1) and in front of Belize (23.2). Regarding ATMs, Brazil is in first placew ith 119.6 ATMs per 100,000 adults; Panama is in fifth place with 47.4 ATMs per 100,000 adults, behind Argentina (48.5) and in front of Venezuela (41.9).

Chart V.16: Commercial Banks and Bank Branches per 100,000 adults in Latin American Countries. Year: 2011



Source: International Monetary Fund.

Chart V.17: : ATMs per 100,000 adults in Latin American Countries. Year: 2011

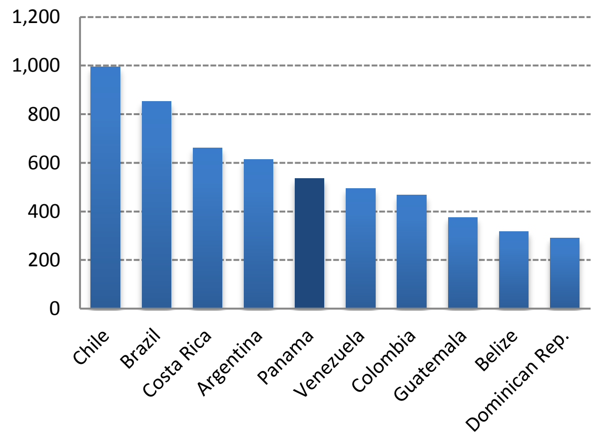


Source: International Monetary Fund.

Another indicator used by the IMF in the Financial Access Survey was commercial bank loans per 1,000 adults, withChile in the lead with 995.8 loans per 1,000 adults. Panama ranked fifth with 536.1 loans per 1,000 adults, behind Argentina (614.8) and in front of Venezuela (494.2). Another indicator is related to deposits per

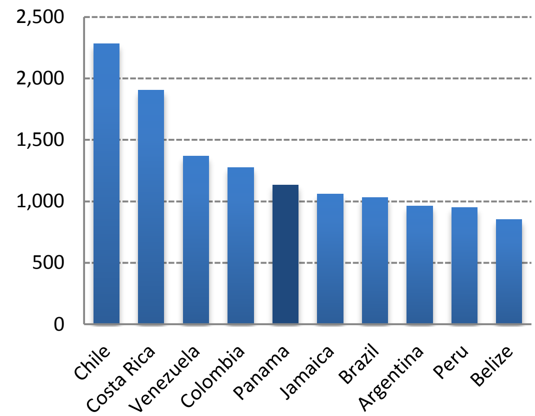
1,000 adults. Latin America is being led by Chile with 2,281.6 deposits per 1,000 adults, and Panama ranked fifth with 1,135.1 deposits per thousand adults, behind Colombia (1,277.3) and in front of Brazil (1,032.7).

Chart V.18: Loan Accounts in Commercial Banks per 1,000 adults in Latin American Countries. Year: 2011



Source: International Monetary Fund.

Chart V.19: Deposit Accounts for each 1,000 adults in Latin American Countries. Year: 2011



Source: International Monetary Fund.

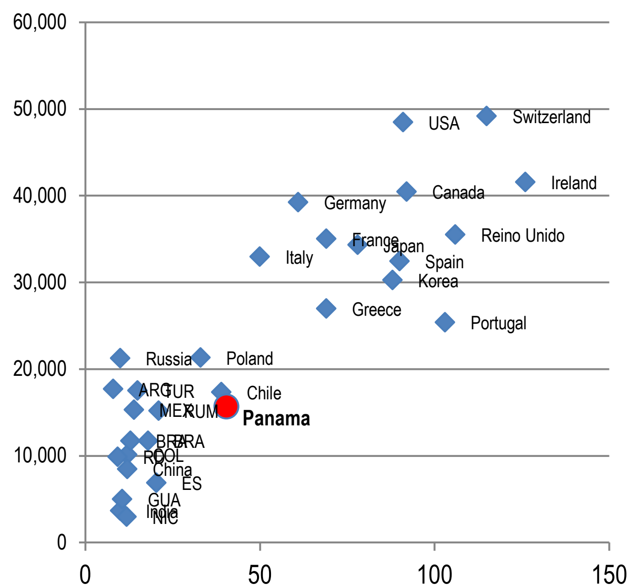
The indicators show that Panama is very well positioned in terms of financial inclusion in Latin American, being in the top five positions in the indicators shown. This shows that Panama has high accessibility to its financial services, a fact that is related to the growth of the marketplace in recent years.

VI. Sector Vulnerability

A. Household Debt

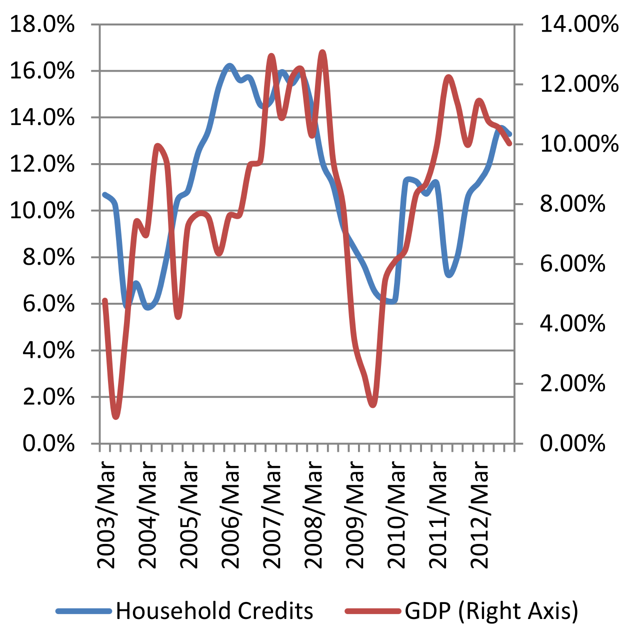
In 2012 the debt of Panamanian households represented 39.8% of GDP. While this figure seems high compared to other countries of the region, it is below the average indebtedness in developed countries. Household debt vs. GDP tends to increase as income increases. In the case of Panama, its indebtedness level is normal for its income level, if we consider a linear relationship between income level and debt. Banking development, lower interest rates, longer payment terms and larger loans are factors that have helped maintain the high level of activity.

Chart VI.1: Household Indebtedness: Total Loans, Consumption and Mortgages/GDP (%)
Year: last year available



Source: Chart prepared by the Financial Studies Division of the SBP based on data from the IMF and Financial Stability Reports.

Chart VI.2 Quarterly GDP and household indebtedness Annual variation (%)
Years: 2003 – 2012

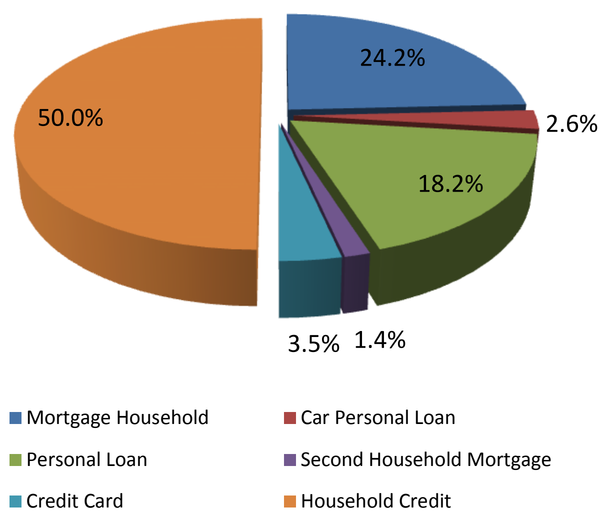


Source: Chart prepared by the Financial Studies Division of the SBP.

Household loans are highly sensitive to the economic cycle. After 2009, which was marked by a less expansionist scenario in the economic activity of Panama and the world, household loans recovered their performance, growing at significant rates. However, the growth of this credit segment has not surpassed its pre-crisis performance, due in part to regulatory changes that tended to increase reserves in some segments and to prudential policies applied by the banks themselves.

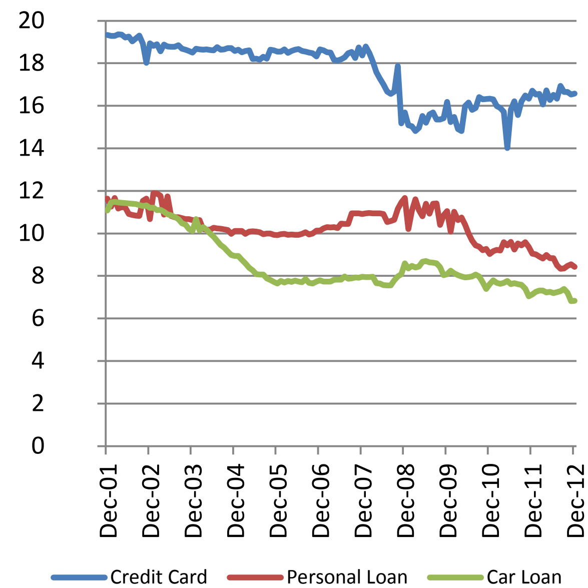
In the household debt portfolio, housing loans comprise the largest portion, with 48.4% (US$7.28 billion) in principal living quarters mortgages and 2.9% (US$432.4 million) in second home mortgages. Consumer credit was led by personal consumption with US$5.48 billion, credit cards with US$1.05 billion, and car loans with US$793.1 million.

Chart VI.3: Consumer Loan and Mortgage Portfolio December 2012



Source: Chart prepared by the Financial Studies Division of the SBP.

Chart VI.4: Interest Rates on Consumer Loans December 2001-2012



Source: Chart prepared by the Financial Studies Division of the SBP.

It is worth noting that the better credit conditions created by low interest rates have permitted an increase in financing to families without impairing portfolio quality. A sharp increase in household income, an unemployment level which stands at record lows and direct discount policies, among others, have contributed to this improvement.

B. Corporate Debt

Corporations desiring to increase their assets make investments. That is why they need to look for external funding to complete their investment resources. In this survey, we analyze corporate recourse to indebtedness through bank credit applications. Basic corporate indicators are shown below:

Table VI.1 Basic Commercial Credit Indicators

	PANAMA			
BASIC COMMERCIAL CREDIT INDICATORS	**2009**	**2010**	**2011**	**2012**
TOTAL BANK COMMERCIAL LOANS /GDP (%)	44,5%	48,8%	48,5%	48,4%

Source: SBP with data from the CGR

The chart above shows that corporate debt represents around 48.4% of GDP, which indicates its high funding requirement and the trust existing between the corporate and banking sectors.

The economic boom driven by dynamic urban development and financial penetration has greatly improved business performance in the region. It is worth noting that financial competition is fierce. This can be seen in interest rates, which on average have declined in recent years.

Below is an interest rate summary for the last five (5) years:

Table VI.2 Corporate Loan Rates

CORPORATE LOAN RATES			
	WHOLESALE		RETAIL
DATE	COLON FREE ZONE	REST OF THE COUNTRY	
2007 Average	7 9/16	8 5/16	8 13/16
2008 Average	6 5/16	7 4/16	7 7/8
2009 Average	6 3/4	7 2/16	7 5/8
2010 Average	5 13/16	6 15/16	7 5/16
2011 Average	4 3/4	6 4/16	6 13/16
2012 Average	4 10/16	6 4/16	6 9/16

Source: SBP with data from CGR

The most representative customers from the different sectors can be found in the table below:

Table VI.3 Commercial Portfolio

Activities	Total Credit to 50 of the Largest Companies (millions of US dollars)	Participation
Commerce	2,191.32	29.23%
Financial Sector	1,615.19	21.55%
Industry	1,314.83	17.54%
Services	942.10	12.57%
Central Government	800.47	10.68%
Construction	330.23	4.40%
Agriculture	275.32	3.67%
Mortgage	19.67	0.26%
Stockbreeding	5.53	0.07%
Others	2.14	0.03%

Source: SBP

With the above, we can say that the most important activities are concentrated in:

- Commerce
- Industry
- The Financial sector

As of December 2012, the 50 biggest clients of the IBC held 13.15% of the loans representing US$56.01 billion. The commercial sector has excelled in the isthmus historically, as the geographic position has benefited re-export trade development as well as high domestic consumption.

It is worth noting that activities carried out by the Central Government have taken more relevance in recent years with the development of big infrastructure megaprojects such as the Panama Canal expansion and the Metro (mass transportation by commuter rail).

With the significant development of roads and means of communication, transportation (logistics) and tourism, among others, are joining the services sectors, which occupy a dominant position complementing the sectors mentioned previously.

C. Public Debt

The balance of public debt as of December 31, 2012, reached US$14.27 billion. Foreign Public Debt rose to US$10.79 billion, 75.6% of the total, and was composed principally of foreign bonds. Domestic Public Debt totaled US$3.49 billion and was mainly composed of Treasury Bonds and loans from the Banco Nacional de Panamá.

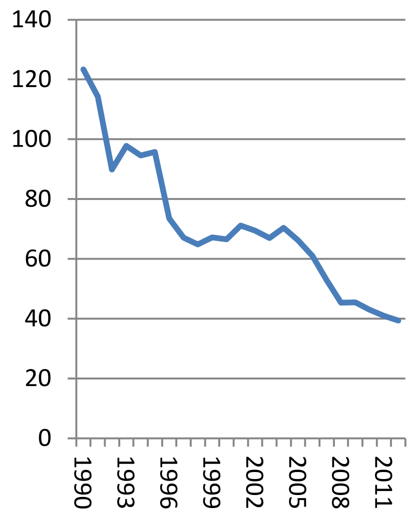
While debt has grown in absolute terms, the sustainability indicators have improved as a result of a significant reduction in total debt as a percentage of Gross Domestic Product (GDP). This reflects improved government revenue and economic growth. In 2012, public debt/GDP was below 40%, reaching 39.4%. It is worth mentioning that the Law on Fiscal Responsibility states that once the forty percent (40%) goal is reached, the Ministry of Economy and Finance will apply public debt policies ensuring this percentage ratio is not exceeded[4].

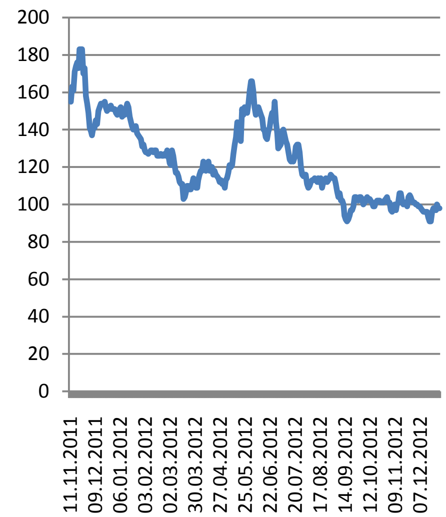
It is worth noting that the interest rates on Panamanian CDS and foreign bonds indicate that their credit risk is perceived to be equal to that of countries with better investment credit ratings. This trend was noticed throughout 2012, and led not only to Panama's investment grade being confirmed with a stable outlook (Standard & Poor's), but also to several rating agencies raising the sovereign evaluation from "BBB-" to "BBB" (Fitch Ratings) and Baa3 to Baa2 (Moody's) due to the prospect of strong growth in the mediumterm and the sustained, continuous improvement in public finances.

Chart VI.5: Public Debt to GDP Ratio
Years: 1990 - 2012

Chart VI.5: Panama Sovereign Risk Premiums
(Measured by 5-year CDS in basis points)

[4] Article 12 of Law 34 dated 5 June 2008 on Fiscal Responsibility (Official Gazette 26,056)





Source: Directorate of Public Credit of the MEF

Source: Bloomberg, December 31, 2012.

On the other hand, in spite of the trust in the health of public finance associated with good fiscal management, the application of fiscal reforms leading to fiscal consolidation, and good economic performance favoring Government income, a further improvement in Panama's sovereign rating is not expected in 2013 because this will be a pre-election year, a period not usually used by agencies to make such adjustments. However, a confirmation of the sovereign risk assessment is expected during the year. Likewise, it is important to note that Credit Default Swaps and EMBI+ show that international markets recognize Panama's achievements and are listing Global Bonds at levels equal to or higher than those of Latin American countries with similar investment grades.

Total Public Debt Status
By Public Sector
As of December 31, 2012
(in millions of US dollars)

Creditor	Balance 12/31/2012	Payments	Capital	Price Premium	Interest	Fees	Total
TOTAL	**14,265.20**	**4,048.20**	**2,513.98**	**49.75**	**749.26**	**26.72**	**3,339.70**
CENTRAL GOVERNMENT	**14,058.90**	**4,028.21**	**2,501.24**	**49.75**	**739.02**	**26.7**	**3,316.72**
DECENTRALIZED INSTITUTIONS	**206.3**	**19.99**	**12.73**	**0**	**10.24**	**0.02**	**22.99**
EXTERNAL PUBLIC DEBT	**10,729.45**	**868.7**	**913.53**	**41.77**	**639.24**	**25.74**	**1,620.28**
CENTRAL GOVERNMENT	**10,729.45**	**868.7**	**913.53**	**41.77**	**639.24**	**25.74**	**1,620.28**
Public Creditors	**2,701.59**	**533.95**	**172.42**	**0**	**71.56**	**4.48**	**248.46**
Multilateral	2,351.48	517.38	154.85	0	65.34	4.4	224.59
Bilateral	350.1	16.57	17.57	0	6.23	0.07	23.87
Private Creditors	**8,027.86**	**334.75**	**741.11**	**41.77**	**567.68**	**21.27**	**1,371.82**
Corporate Banking	302.16	86.16	0	0	4.24	20.47	24.72
Global Bonds	7,725.70	248.6	741.11	41.77	563.43	0.79	1,347.11

DOMESTIC PUBLIC DEBT	**3,329.45**	**3,159.50**	**1,587.71**	**7.98**	**99.79**	**0.96**	**1,696.44**
CENTRAL GOVERNMENT	**3,329.45**	**3,159.50**	**1,587.71**	**7.98**	**99.79**	**0.96**	**1,696.44**
Public Creditors	**397.75**	**806.9**	**745.8**	**0**	**20.48**	**0**	**766.28**
Funding by State-owned Banks	397.75	806.9	745.8	0	20.48	0	766.28
Private Creditors	**2,931.70**	**2,352.61**	**841.91**	**7.98**	**79.31**	**0.96**	**930.16**
Private Funding	19.53	0	4.34	0	0.47	0	4.81
Treasury Notes and Bills (2)	1,548.13	988.57	837.57	7.98	57.65	0.47	903.67
Treasury Bonds (1)	1,364.04	1,364.04	0	0	21.19	0.49	21.68
EXTERNAL PUBLIC DEBT	**52.95**	**4.67**	**4.57**	**0**	**1.42**	**0.02**	**6**
DECENTRALIZED INSTITUTIONS	**52.95**	**4.67**	**4.57**	**0**	**1.42**	**0.02**	**6**
Public Creditors	**52.95**	**4.67**	**4.57**	**0**	**1.42**	**0.02**	**6**
Multilateral	51.5	4.67	3.87	0	1.36	0.02	5.25
Bilateral	1.45	0	0.69	0	0.06	0	0.75
DOMESTIC PUBLIC DEBT	**153.35**	**15.33**	**8.17**	**0**	**8.82**	**0**	**16.98**
DECENTRALIZED INSTITUTIONS	**153.35**	**15.33**	**8.17**	**0**	**8.82**	**0**	**16.98**
Public Creditors	**152.43**	**15.33**	**8.17**	**0**	**8.82**	**0**	**16.98**
Funding by State-owned Banks	152.43	15.33	8.17	0	8.82	0	16.98
Private Creditors	**0.91**	**0**	**0**	**0**	**0**	**0**	**0**
Private Funding	0.91	0	0	0	0	0	0
Central Government Accounts Payable:							
Awards and claims liabilities	28.7	0	0	0	0	0	0
Total Public Debt	**14,293.90**	**4,048.20**	**2,513.98**	**49.75**	**749.26**	**26.72**	**3,339.70**

Total Public Debt	**14,293.90**	**4,048.20**	**2,513.98**	**49.75**	**749.26**	**26.72**	**3,339.70**

Remarks:

(1) Treasury Bond auctions 5.625% - 2022 have generated Cumulative Premiums of USD$156,119,492.80. Of that premium, USD$38,735,185.00 was used to repurchase the 2015 Global Bond. The net effect of this transaction generated an equity income of USD$2,578,317.51.

(2) The premium in the amount of USD$41,401,894.40 belongs to equity income, of which USD$7,979,440.00 were used for paying the interest on Treasury Note 3.5% -2013; finally generating a Net Premium of USD$33,422,454.40.

Excludes the balance of government sources and inter-institutional funding.

Source: MEF, Directorate of Public Credit.

VII. Identified Macro Financial Threats to the IBC

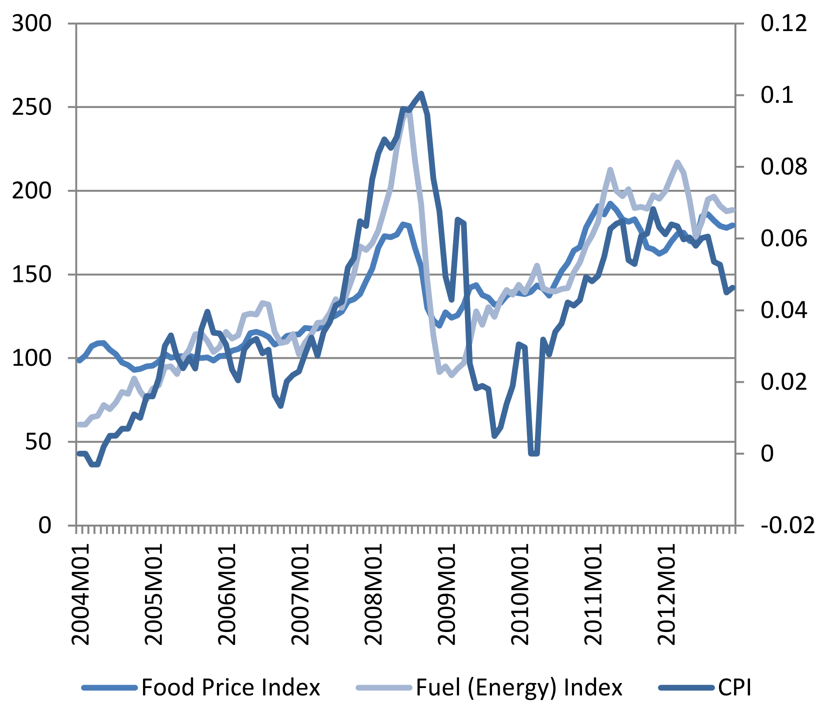
The strong fundamentals of the Panamanian economy have contributed to favorable growth during 2012 despite the deterioration in the external environment. The economy remains on a positive trajectory, reflecting the dynamic performance of services exports, work on the Panama Canal expansion, and the large-scale public investment program being implemented by the government.

The current crisis is now focused on Europe and the United States, which undoubtedly leads to the rise of certain external threats to the Panamanian financial system that need to be considered, including:

A. Inflation due to increases in fuel and other raw material prices

International oil and food prices have registered major increases in both level and volatility since the middle of the last decade. The uptrend began to manifest itself in 2004 in the case of energy and after 2006 in the case of grain. This has had a direct effect on inflation at the global and domestic levels. In the case of energy, because it is part of the consumption portfolio of the Consumer Price Index and of the grain basket, and because of the impact it has on the cost of foodstuff used as basic ingredients.

Chart VII.1: CPI, International Energy and FoodP rices
Period: Jan 2004 – Dec 2012



Source: SBP with data from CGR and IMF.

During 2012, inflation in Panama accelerated to reach 5.8% compared to 6.5% in the same period of 2011. The inflation rates for food (8.1%) and transportation services (5.5%) also increased.

In the shortterm, risks associated with the performance of agricultural products have increased, especially in light of the drought affecting grain crops in the United States, which is estimated to impact production costs in the agricultural industry. These increases in raw material prices could mean negative supply shocks that could cause a temporary increase in consumer prices but that, in the absence of secondary effects (significant increases in inflationary expectations over the medium and longterm), do not contribute to inflationary risks in the longterm. Estimates show that within six months after an increase in international food prices, the domestic CPI increases by 9% of this increase in international prices.

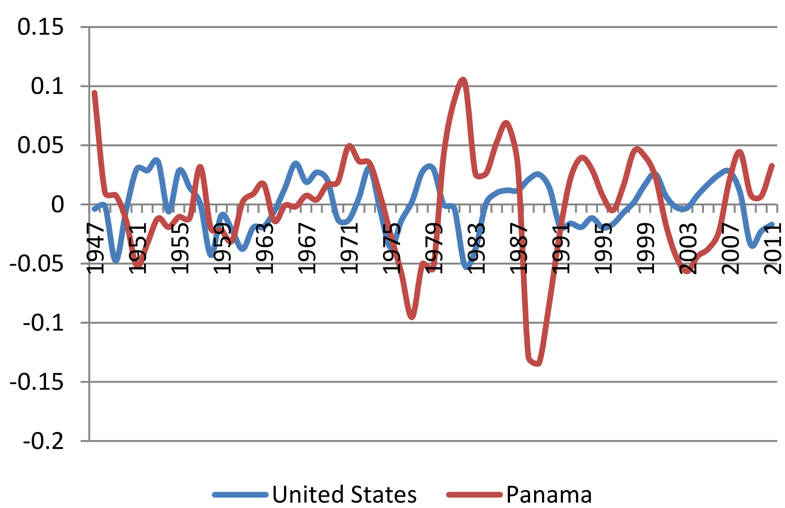
It is estimated that in the mediumterm, the inflationary risk caused by the increase in oil prices is a latent issue. Estimates of the coefficient of elasticity of the CPI to international oil prices seem to show little reaction—1%—in terms of inflation due to oil increases. This could be due to the fact that fuel prices and residential energy are regulated/subsidized. However, rising oil and commercial consumption energy prices have led to higher prices of non-food products with a coefficient of 3%. The latter factor may amplify the effect of oil on costs and, therefore, on inflationary pressures, in the mediumterm.

A new spike in oil prices could undermine the capacity for growth in household consumption, which reduces the aggregate supply of the economy, increasing inflationary dangers and causing a possible decline in GDP. In past episodes, substantive oil price hikes have been associated with significant slowdowns in Panama.

B. Deceleration in the economic activity of the main trading partners

In spite of the growth rate of the Panamanian economy, the long development of external vulnerabilities has lowered mediumterm forecasts for the growth of the Panamanian economy, as a result of the negative international environment. In particular, the slowdown in some indicators of the U.S. economy (Panama's main trading partner) and downward revisions in the outlook for economic growth in Europe and China have increased the possibility that the Panamanian economy may be affected by a negative external demand shock.

Chart VII.2: Cyclical Component of Real GDP; U.S. and Panama
Years: 1947 - 2012



Source: SBP with data from CGR and FED.

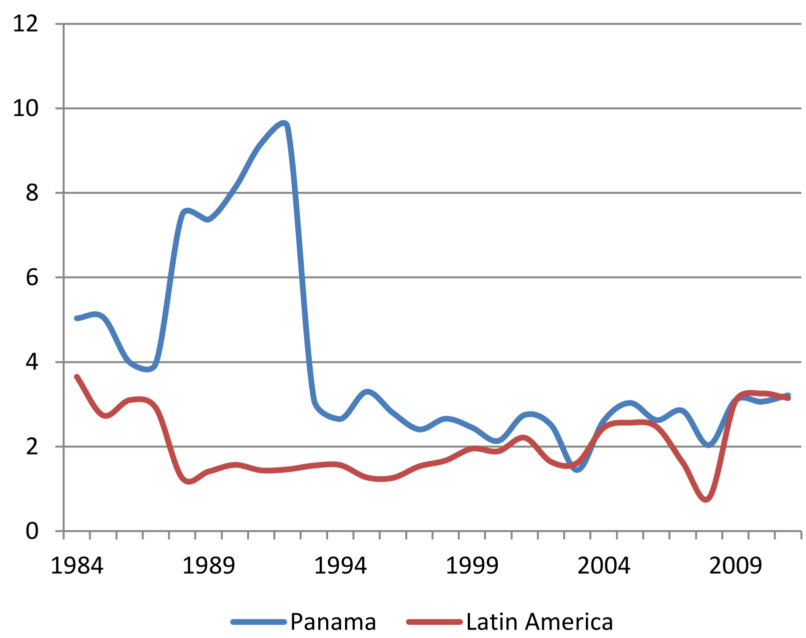
There is sufficient evidence to expect changes in the growth of the United States to induce changes in the growth of the Panamanian economy[5]. However, IMF estimates indicate that Panama will lead Latin America and the Caribbean in growth for the 2011 – 2015 period. Consequently, while US growth is a factor that may cause concern, there is no reason why this factor should increase the perception of risk as long as the present scenario surrounding the Panamanian economy is maintained.

C. *Uncertainty in the International Financial Markets*

In recent years, integration into international financial markets has been one of the pillars of economic development in the country. After the mid-1990's, the Panamanian economy showed a more stable and less volatile growth path than the rest of the Latin American economies.

In this sense, Panama is now a representative emerging economy whose financial integration is central to its situation as a service-based economy. Panama has been at the forefront of financial liberalization and ranks among the emerging market countries with the fewest barriers to financial flows. This liberalization process has led to greater financial integration with the rest of the world.

Chart VII.3: GDP Volatility



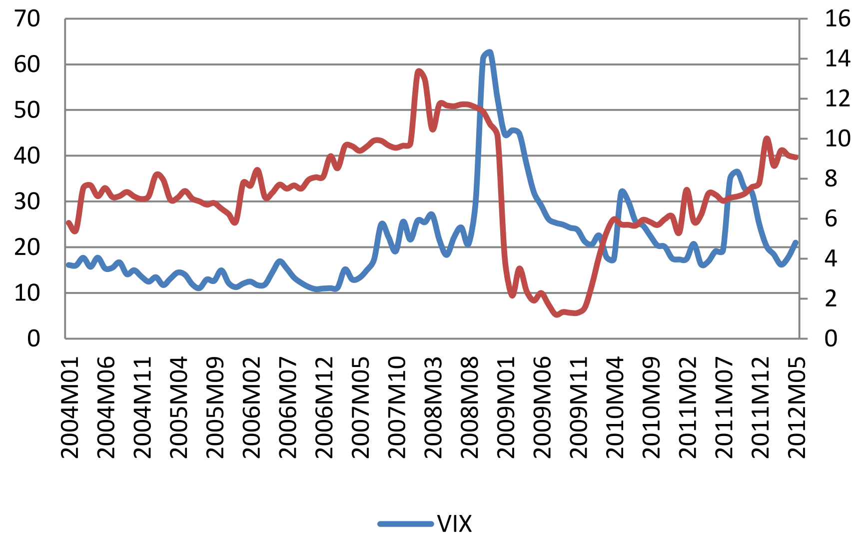
Source: SBP with data from the IMF.

Given the above, it is clear that financial risks, which continue haunting the world economy, raise questions about the potential impact they may have on the country. As show in the chart below, the significant increase in the volatility of the Panamanian economy coincides with major episodes of international financial stress, represented by the VIX index, which indicates that Panama has not been immune to the external financial

[5] The analysis shows that the United States is linked (in the Granger sense) to Panama. It is worth mentioning that there is a significant integrative relationship of the two economies, i.e. there is a long-term equilibrium towards which both economies converge after a temporary disturbance.

environment affecting the highly integrate financial economies to the world. A similar pattern has occurred in the level of economic activity in advanced and emerging economies with a high degree of financial integration.

Chart VII.4: VIX and IMAE Volatility Index
Years: 2004 - 2012



Source: SBP with data from the CBOE y CGR.

However, the data show that, even though Panama is still vulnerable, the impact that external financial shocks have on the level of economic activity seems to have been reduced in certain ways overtime. In this sense, the strengthening of macroeconomic fundamentals seems to have compensated for the effects of greater financial integration. Macroeconomic fundamentals related to foreign and fiscal sustainability seem to be particularly important in mitigating the effect of these global financial shocks, both by discouraging capital outflows and by softening the economic impact of the resultant shock in the capital account.

D. Risk Matrix

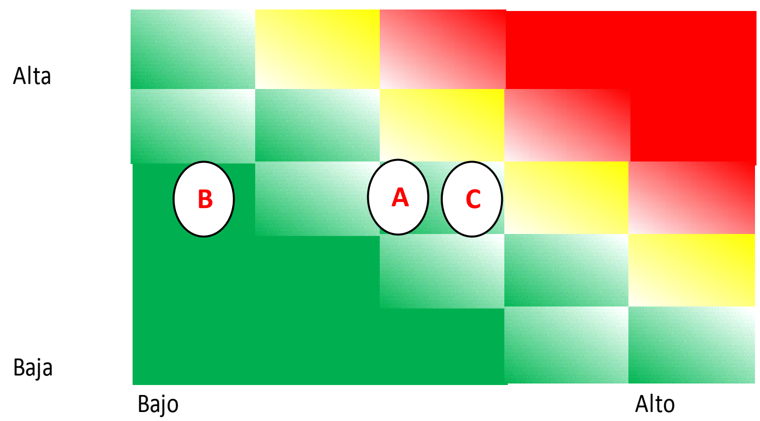
The global financial system is still in a period of significant uncertainty. Although the global economy's recovery process is expected to continue strengthening, progress toward financial stability could take some time. Although the exercise conducted shows that there may be a moderate risk of continuing the current performance of the economy, there is no doubt that such threats will have to be handled under a prudential framework.

In the future, we will need to design and implement macroprudential measures that reduce the procyclicality of the financial system and mitigate systemic risks.

Below is the risk matrix, which shows concisely the results of the analysis of macro financial threats:

- A: Inflation due to the increase of hydrocarbon and other raw material prices would have a moderate impact and medium probability.
- B: Slowdown in the economic activity of the main trading partners, low impact and medium probability.

- C: Uncertainty in the international financial markets would produce a moderate impact and medium probability.



VIII. Sensitivity Analysis

Sensitivity analyses were focused on liquidity and the credit portfolio. The information used is from December 31, 2012.

Liquidity Sensitivity Analysis

Objectives:

1. Describe the composition of the liquid assets portfolio.
2. Assess NBS capacity to absorb withdrawals.
3. Analyze the interbank deposits matrix for the purpose of determining banking concentration.

To this end, the following activities were carried out:

- Verify the composition of the liquid assets portfolio.
- Assess the impact of not fully considering the payment of 180-day liabilities (45% of 30%), 186-days deposits, non-investment grade obligations, for the calculation of liquidity.
- Determine the % of total NBS deposits that are (foreign) demand and time deposits.
- Determine the assets that will be used to cover withdrawals.
- Determine the ratio of assets to be used / deposits received.

Results:

Describe the composition of the liquid assets portfolio

Article 73 of the Banking Law states that the required minimum legal liquidity index is 30%. As of the end of December 2012, NBS liquidity stood at 67.38%, with thirty-two (32) banks having a legal liquidity index between 40% and 80%.

Table VIII.1
Number of Banks by Liquidity Range

Liquidity Range as of Dec. 28, 2012	Number of banks
37.01 % - 40 %	3
40.01 % - 60%	16
60.01% - 80%	16
80.01% - 100%	7
Over 100%	7

Source: Financial Studies Division of the SBP.

For its part, assets composing the liquid assets portfolio are diversified and of high quality. Below are the categories representing approximately 77% of that portfolio.

Table VIII.2
Categories composing the Liquid Assets Portfolio

Description	% of the total portfolio
Deposits in banks in Panama	7.6%
Deposits in banks abroad	40.5%
Investment grade liabilities	11.8%
Payments to liabilities in Panama	17.0%

Source: Financial Studies Division of the SBP.

We analyzed the sensitivity of the NBS legal liquidity index by reducing the percentage of some categories in the liquid assets portfolio (payment to obligations, non-investment grade liabilities, and deposits up to 186 days). The objective was to determine the impact that reducing some of the components of the liquid assets portfolio permitted for the calculation of the legal liquidity index would have on the statutory liquidity ratio of the NBS.

Table VIII.3
Legal Liquidity Index Sensitivity
Reducing the percentage of non-investment grade liabilities

% of non-investment grade obligations to be considered	Liquidity Index
100%	67.38%
80%	66.36%
60%	66.35%
40%	66.34%

Source: Financial Studies Division of the SBP.

Within the liquid assets portfolio, investment and non-investment grade liabilities are considered. Participation of non-investment grade liabilities is only 0.1%, so its reduction has no significant impact on the statutory liquidity index.

As can be seen, if we use total non-investment grade liabilities, the liquidity index would be 67.38% in contrast to using 40% of those, in which case the liquidity index would be 66.34%.

Table VIII.4
Legal Liquidity Index Sensitivity
Reducing the percentage of Payments on Obligations

% of Payments on Obligations to be considered	Liquidity Index
45% to 40 %	67.38%
35%	66.46%
30%	64.96%
25%	63.46%
20%	61.96%
15%	60.46%

Source: Financial Studies Division of the SBP.

Just as in the previous exercise, it can be seen that the liquidity index decreased to 60.46%, i.e. only 6.92%, when using only 15% of Payments to Liabilities.

Table VIII.5
Sensitivity of Liquidity Index
Decreasing Deposits of up to 186 days

% of Deposits of up to 186 days to be considered	Liquidity Index
100%	67.38%
80%	63.19%
60%	59.01%
40%	54.82%

Source: Financial Studies Division of the SBP.

When considering only 40% of deposits of up to 186 days, the statutory liquidity index reached 54.82%.

Assess the NBS capacity to absorb deposits withdrawals

As of December 31, 2012, demand deposits rose to US$12,723,362,751.61, representing 23% of total deposits in the NBS. For their part, domestic and foreign time deposits represented 36% and 32%, respectively.

For the following analysis, is important to clarify that Article 1 of Rule 9-2009 establishes that domestic time deposits cannot be withdrawn or reduced before the agreed period.

The sensitivity analysis to be accomplished will consist of two stages. In the first stage the percentage of demand deposits covered by a group of chosen assets is analyzed. During the second stage, the percentage of demand deposits plus foreign time deposits covered by chosen assets is analyzed.

The liquid assets that were considered are:

- Legal currency in Panama, Gold (commercial value)
- Foreign Exchange

- Checks to be paid
- Placed demand deposits
- Negotiable investments and investments available for sale [6]

The amount of assets considered for this exercise reached US$13,361,395,835.80. The ratio of assets used for the next exercise, "Demand deposits collected" is 104% for the NBS.

Table VIII.6
Number of Banks vs. Assets used and Demand Deposits Collected

Ratio of Assets Used / Demand Deposits Collected	Number of Banks
Below 25%	1
25% - 50%	2
50.01% - 80%	12
80.01% - 100%	4
Over 100%	28

Source: Financial Studies Division of the SBP.

As can be seen, 32 banks in the system have enough liquid assets to meet 80%, 100% or more of demand deposits collected. There are twelve banks that have the assets to meet the range between 50% and 80% of demand deposits; and three banks are below 25% and from 25% to 50%. It is worth noting that there are three banks that did not report Demand Deposits in liabilities as of December 2012.

With regard to Liquid Assets to be used / Demand Deposits + Foreign Time Deposits, the NBS ratio is 60%, as shown below:

Table VIII.7

Ratio of Assets used / Demand deposits collected	Number of Banks
Below 25%	1
25% - 50%	2
50.01% - 80%	12
80.01% - 100%	4
Over 100%	28

Source: Financial Studies Division of the SBP.

Looking at the results, it can be inferred that 34 banks in the system have a capacity equal to or greater than 50% to meet Demand Deposits + Foreign Time Deposits. However, there are three banks whose responsiveness is equal to or below 25%.

Analyze the Interbank deposits Matrix

[6] In the case of investments, we only considered those of investment grade.

For this survey, we prepared a domestic and foreign *Interbank Demand Deposits and Time Deposits* matrix for the IBC. The purpose of this matrix was to determine the possible concentration and exposure of some banks both in placing and collecting deposits.

According to data gathered as of December 31, 2012, interbank placing and collections reached US$14.80 billion. Placements are interbank deposits placed by IBC banks, whether in banks of the marketplace or banks belonging to other marketplaces. Similarly, deposits collected correspond to IBC bank deposits from banks of the marketplace and other marketplaces.

It is worth noting that for both placements and collections, only interbank transactions are included; this means they <u>do not include placed or collected deposits from other financial institutions.</u>

On the other hand, 88.1% of interbank deposits are the equal to or greater than US$10 million.

According to data collected as of December 2012, IBC banks placed their deposits in 183 banks inside and outside of our marketplace.

Table VIII.8
IBC Interbank Deposits
As of December 31, 2012

International Banking Center Deposits			Banks whose percentage of demand deposits is greater than 2% of Banking Center Deposits	
Total Balance	Excluding balances below US$10.0 million	Relation to the Banking Center	Balance	Percentage of the Banking Center
14,794,116,273	**13,027,899,704**	**88.1%**	**8,212,383,686**	**56.0%**

Source: Financial Studies Division of the SBP.

Table VIII.9
Distribution of the number of banks and their balances
as a percentage of total IBC demand deposits. As of December 31, 2013

% of Collected deposits	Number of Banks	Total Deposits	% of the Total
Below 0.6%	144	2,194,869,458	15%
Between 0.61% - 1.0%	11	1,242,383,083	8%
Between 1.01% - 1.5%	11	2,143,177,048	14%
Between 1.51% - 2.0%	4	1,001,302,995	7%
Between 2.01% - 5.0%	10	5,474,443,834	37%
Over 5.01%	3	2,737,939,852	19%

TOTAL	183	14,794,116,273	100%

Source: Financial Studies Division of the SBP.

Note: We used 2% to exclude those banks that were around the average or below the average (1.2% and 1.6% for banks collecting and placing, respectively.)

In all, fourteen (14) banks hold 69% of IBC interbank deposits.

Table VIII.10

International Banking Center			Banks whose demand deposits are greater than 2% of Banking Center totals	
Total Balance	Excluding balances below US$10.0 million	Percentage of the Banking Center	Placements	Percentage of the Banking Center
14,794,116,273	13,027,899,704	88.10%	10,273,369,368	69%

Source: Financial Studies Division of the SBP.

Credit Sensitivity Analysis

Objectives:

1. To analyze the percentage of the commercial, industry, consumption and mortgage portfolios covered by collateral and reserves.
2. To measure impact on reserves and capital adequacy of different scenarios of portfolio deterioration.

To this end, the following activities were carried out:

- Analyze the percentage of the selected portfolio covered by collateral and reserves.
- Verify the current portfolio (N, SM, S, D,U).
- Depreciate the portfolio (commercial, industry, consumption – for each of their components and construction).
- Determine the impact on reserves of different scenarios of portfolio deterioration.

It is worth clarifying that reserves depend on certain factors set forth in Rule 6-2000. However, we used a "litmus test."

Results:

Analyze the percentage of the commercial, industry, and consumption portfolios covered by collateral and reserves.

The commercial, industry, and consumption (personal loans, car loans and mortgages) portfolio represents 65.1% of the NBS portfolio. Following is a summary of the balances, reserves and collateral for these portfolios, as well as the percentage of the portfolio covered by collateral and reserves.

Table VIII.11 (In millions of US dollars)

	Commercial	Industry	Personal Loans	Home Mortgages	Car
Balance (MM)	10,469	5,358	5,769	7,822	798
Reserves (MM)	42	14	55	38	4
Value of the collateral (MM)	7,788	2,902	1,550	11,313	1,227
(Collateral+ Reserves)/Balance	75%	54%	28%	145%	154%

Source: Financial Studies Division of the SBP.

The collateral considered are: Property Mortgages, Pledged Deposits in the bank, Pledged Deposits in other banks, and collateralized securities. In the particular case of the Car, Personal Loan, and Industry portfolios, Personal Property Mortgage value was also considered.

Measure the impact on reserves of different scenarios of portfolio deterioration.

We depreciated the commercial, industry and consumption (personal loans, car loans and mortgages) portfolios migrating 50%, 35%, 25%, and 15% of the loans classified as normal to unrecoverable. We took as additional reference pledged deposits and retained earnings from previous periods and profits for the period.

Table VIII.12

Commercial Loans: 97.9% of portfolio is normal

% migrated from Normal to Unrecoverable	Reserve (US$)
50%	6,648,921,992
35%	4,730,229,507
25%	3,451,101,184
15%	2,171,972,861

Source: Financial Studies Division of the SBP.

Profit for this period and from previous periods: US$2.97 billion

Table VIII.13

Industry Loans: 98.1% of portfolio is normal

% migrated from Normal to Unrecoverable	Reserve (US$)
50%	3,301,021,902
35%	2,313,980,364
25%	1,655,952,672
15%	997,924,980

Source: Financial Studies Division of the SBP.

Profit for this period and from previous periods: US$2.97 billion

Table VIII.14

Personal Loans: 96.3% of the portfolio is normal

% migrated from Normal to Uncoverable	Reserve (US$)
50%	3,962,519,034
35%	2,788,010,553
25%	2,005,004,899
15%	1,221,999,244

Source: Financial Studies Division of the SBP.

Profit for this period and from previous periods: US$2.97 billion

Table VIII.15

Car Loans: 95.9% of the portfolio is normal

% migrated from Normal to Uncoverable	Reserve (US$)
50%	635,717,835
35%	446,083,503
25%	319,660,615
15%	193,237,726

Source: Financial Studies Division of the SBP.

Profit for this period and from previous periods: US$2.97 billion

Table VIII.16

Home Mortgages: 94.3% of the portfolio is normal

% migrated from Normal to Unrecoverable	Reserve (US$)
50%	5,353,442,574
35%	3,755,745,855
25%	2,690,614,710
15%	1,625,483,565

Source: Financial Studies Division of the SBP.

Profit for this period and from previous periods: US$2.97 billion

Glossary of Abbreviations

• SBP	Superintendency of Banks of Panama
• MEF	Ministry of Economy and Finance
• CGR	Comptroller General of the Republic
• IPACOOP	Panamanian Institute of Autonomous Cooperatives
• BIS	Bank of International Settlements
• FED	Federal Reserve of the United States
• IMF	International Monetary Fund
• BCE	European Central Bank
• ECLAC	Economic Commission for Latin America and the Caribbean
• IBC	International Banking Center
• NBS	National Banking System
• OECD	Organization for Economic Co-operation and Development
• GDP	Gross Domestic Product
• QGDP	Quarterly Gross Domestic Product
• CPI	Consumer Price Index
• MPI	Materials Price Index
• CDS	Credit Default Swaps
• ROA	Return on Assets
• ROAA	Return on Average Assets
• ROE	Return on Equity
• SM	Credit risk classification category: Special Mention
• SN	Credit risk classification category: Substandard
• Doubtful	Credit risk classification category: Doubtful
• Unrecoverable	Credit risk classification category: Unrecoverable
• ACODECO	Authority for Consumer Protection and Defense of Competition