Superintendencia
de Bancos de Panamá

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Primer Semestre

Superintendencia
de Bancos de Panamá

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I. Executive Summary and Risk Heat Map

Since the last installment of the Financial Stability Report (FSR), the economic and financial recovery process has continued to consolidate in Panama. The data as of the end of the first half of 2021 continue to show a system with stable financial fundamentals. Capital funds and liquidity indicators accumulated by financial system entities in recent years, because of regulatory prudential requirements, have contributed to the resilience of the financial system in a pandemic era and have become important macroprudential policy tools. However, the risks associated with the evolution of the pandemic continue to be the most relevant for the financial system. Particularly, there is still uncertainty regarding its effects on the loan portfolio of the most vulnerable sectors whose income has suffered the most, as well as the risk that concentration in funding sources represents for some institutions.

It is important that the soundness of the financial system lays the foundations for greater performance in financial intermediation and contributes to economic recovery. As announced in a timely manner, and according to both previous guidelines and international best practices, some of the financial and prudential measures implemented during 2020 will begin a phase-down or phase-out process in the second half of 2020.

Along these lines, in terms of risks there are some policy measures that, although they could seek to extend or introduce new actions to help debtors at this juncture, they could put the stability of the financial system at risk.

Therefore, although the financial system has been showing a significant degree of resilience, the Superintendency of Banks of Panama (SBP) will continue to monitor and evaluate this scenario along with the Financial Coordination Council and, if necessary, will use the tools available to promote local conditions of financial stability.

The most important components to the potential vulnerabilities of the financial system included in our risk heat map will be examined.

Performance

In terms of performance, lower credit activity, provisioning, and less intermediation margins have reduced the banking system's profitability. Thus, the National Banking System's (NBS) profitability indicators have shown decreases in line with this underperformance. Therefore, banking profitability, measured through the twelve-month accumulated net profit to stockholders' equity ratio (ROE), went from 8.7% to 7.8%, while the Return on Assets (ROA) remained almost unchanged. However, a slight improvement was observed in June. **This can be seen in the 2020 Heat Map changes from red to orange shades, showing improvements towards the most recent months of the first half of 2021. (See Risk Heat Map Annex).**

Nevertheless, an improvement in the strength of banks could be observed, measured through their adequacy ratio, which is the result of greater capital growth vs. regulatory requirements (**this can be seen in green shades on the heat map**). This represents twice the regulatory minimum of 8%. This increase can be explained by the recapitalization of some entities, the reduction in the payment of dividends, and the

lower balance of assets subject to risk. Currently, all banks in operations satisfactorily comply with the new banking capital regulatory standards.

These improvements are also shown in the leverage components, showing an effective contribution in terms of capital; it appears in green shades on our heat map.

Liquidity Risk

Since the last publication of the FSR, the financial system continued to preserve high liquidity margins. As of the end of 1Q2021, the sector's legal liquidity stood at 62%, which was the result of higher deposits taken by banks. This level exceeds the average observed in the last 10 years and the values of other countries in the region. **In our heat map, liquidity risk has remained in green shades,** which is manifested in the different measurements included.

Market Risk

Although an improvement has begun to be seen in the stock markets **(green shades on the heat map**), their performance is still low. In fact, the Panamanian stock market continues to show low activity compared to the increase in external issuances by local agents. This would indicate better financing conditions for placements abroad. However, different vulnerability factors have been accentuating in international financial markets, linked to the persistence of interest rates at historically low levels. On the other hand, it is not possible to rule out the possibility of a more volatile context in the local financial markets, particularly those related to public debt securities and a significant leverage of external positions conducted in a context of low profitability.

Credit Risk

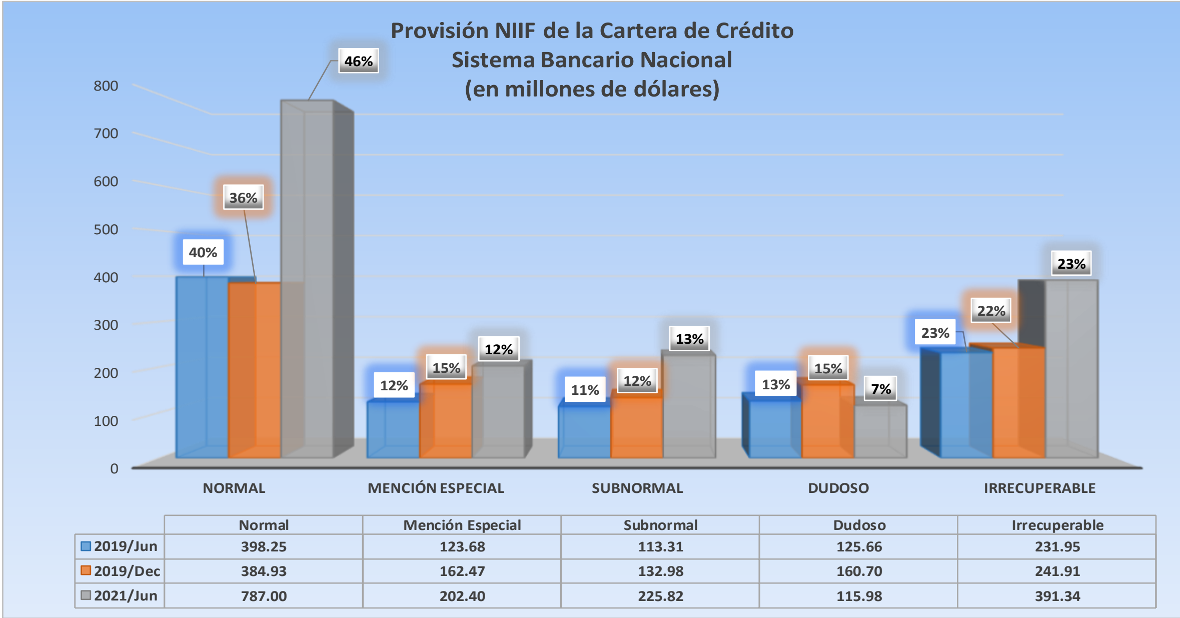
As of the end of the first half of 2021, the financial system continued to show an exposure that, although limited, remains high in a historical context (**red shades of the risk and nonperforming loan (NPL) portfolio indexes of the heat map**).

The total delinquency rate of the International Banking Center (+30 days) stood at 3.3% in June 2021, its past due balance was 1.39% (30 – 90 days), while nonperforming loans were 1.92% (over 90 days). However, as mentioned in the last FSR, it should be noted that the level and difference of these indicators, commonly used to measure the materiality of credit risk, must be interpreted within the framework of the aforementioned provisions on relief measures matters. Although they have not been improving (**yellow and green shades**), their behavior obeys to these temporary provisions.

On the risky portfolio side, a shift in the credit risk level has been observed in the last six months. As of the end of June 2021, there is an increase in the higher-risk categories (Doubtful – Loss) above USD 600 million, mainly an important transition from category (4) Doubtful to (5) Loss. To a large extent, this decline is the result of the weakening of macroeconomic variables.

On the other hand, the coverage of provisions (IFRS) in loans increases proportionally with the probability of debtors' default. The category with the highest share within the

total provisioned in the domestic portfolio is the pass category or the lower-risk category and the higher-risk category or loss category. It should be clarified that the classification shown in the graphs, both in balances and provisions, are of the aggregate portfolio, including the modified portfolio as well as the traditional portfolio (or portfolio under Rule 4-2013).



	Normal	Mención Especial	Subnormal	Dudoso	Irrecuperable
2019/Jun	398.25	123.68	113.31	125.66	231.95
2019/Dec	384.93	162.47	132.98	160.70	241.91
2021/Jun	787.00	202.40	225.82	115.98	391.34

In summary, the performance of the economic variables at the end of the year will largely determine the potential performance of debtors and the possible payment of their obligations. Greater openness will drive the hiring of a greater amount of manpower, as well as a greater flow of business. This performance will be crucial since both companies and households will have greater payment capacity, which could positively affect the reduction of the delinquent portfolio.

Credit Cycle

As of the end of the first half of 2021, the balance of the loan portfolio granted by banks decreased by 1.8% in the year-on-year comparison. Thus, total financing to the nonfinancial private sector in Panama remained at levels like those of the 1Q2021, but with an upward trend. With this, although improvements in new loans are shown, there are no signs of a credit boom or an accelerated intensity in their granting (**red shades on the heat map**). However, it is important to highlight that the sixth month of the year could represent an improvement turning point in total loan performance for several reasons: (1) an aggregate contraction less than that experienced in previous months; (2) a better performance of the portfolios that comprise it, either due to a lower contraction or growth that remains in positive numbers; and (3) because of the positive performance of new loans that, although they do not reach pre-pandemic levels, they show a consistent improvement.

Macroeconomic context

Since the last installment of the FSR, the economic recovery process continued to consolidate in Panama. The double-digit growth during the first half of 2021 and the significant reduction in the current account deficit (**both in green shades**) stand out. This improvement in external accounts reduces the risks associated with the lower flow of Foreign Direct Investment (FDI), which has been significantly reduced (**red shades on the map**). However, although domestic growth perspectives for 2021 have been improving (currently they stand at 12%), as internationally, sources of uncertainty persist, largely linked to the evolution of the pandemic itself and its possible variants. In addition to the foregoing is the transition implied by policies applied to address pre-pandemic macroeconomic imbalances, with progress in the fiscal and external context.

As will be seen in the next sections of this report, the financial system is expected to continue showing an adequate degree of resilience in the local context, adapted to what has been observed so far.

Figure 1: Heat Map

2008 2009 2010 2011 2012 2013 2014 2015 2016 2017 2018 2019 2020 2021

Desempeño
1 Roa
2 Roe
4 Adecuación
5 Apalancamiento
6 Z-score

Liquidez
1 Gap de fondeo sobre Activo
2 Fondeo no estable

Mercado
1 Volatilidad de los títulos dedeuda pública
2 Volatilidad del índice bursátil
3 Crecimiento anual del índice bursátil

Riesgo de crédito
1 ICR
2 ICM
3 Crecimiento de la cartera riesgosa
4 Crecimiento de la cartera vencida

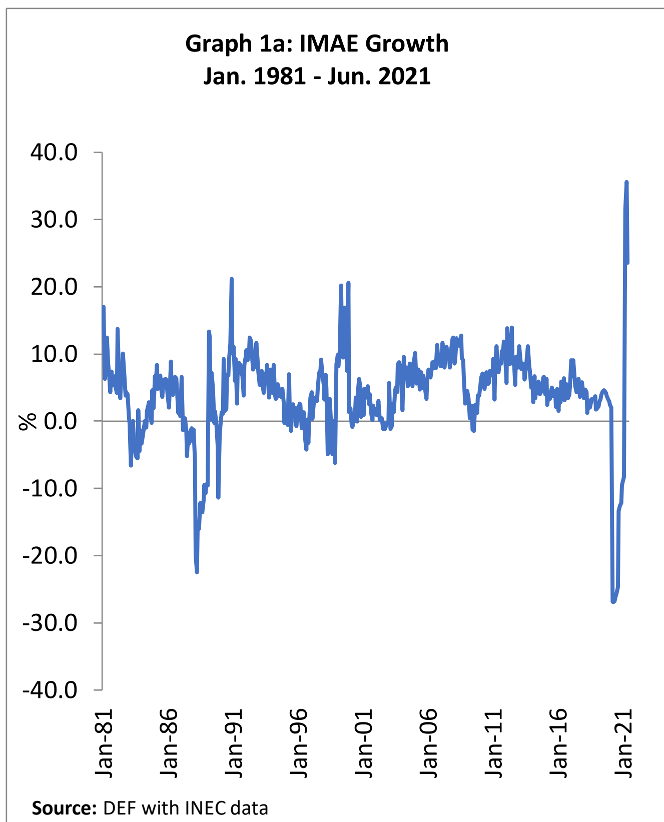
Ciclo de crédito
1 Crecimiento real de la Cartera de Crédito.
2 Intensidad del crédito
3 Auge de crédito.

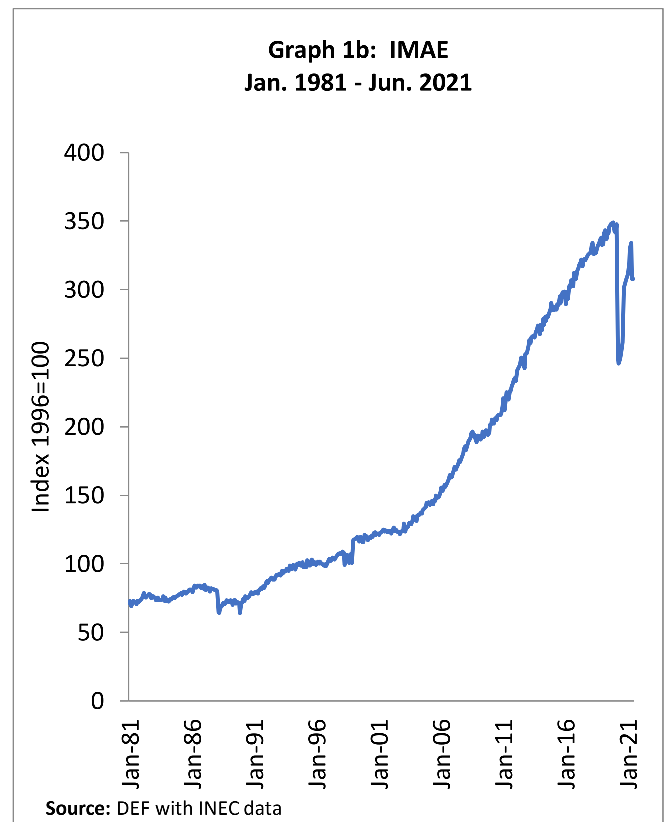
Entorno macro
4 PIB
2 Déficit de la cuenta corriente
1 IED
3 Inflación
5 EMBI
4 socios

II. Economic & Financial Context

A. Domestic Context

As of the 2Q2021, the recovery process of economic activity continued, although with some disparity between sectors. The service sector started a reactivation process, in a context in which progress in the inoculation process made it possible to loosen the restrictions associated with the health emergency, particularly in sectors with greater face-to-face interaction. During this period, the monthly economic activity index (IMAE, for its acronym in Spanish) presented a noticeable acceleration, overall showing record highs (even higher than that observed after the economic crisis of the late 80's), but analysis of the tiered data shows that the economy remains below pre-pandemic records (**see Graphs 1a and 1b**).



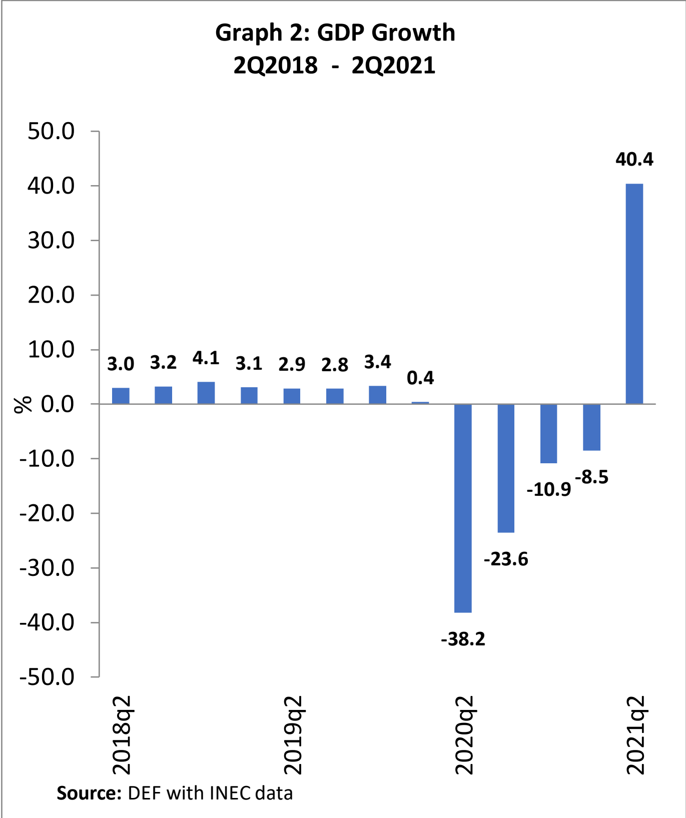


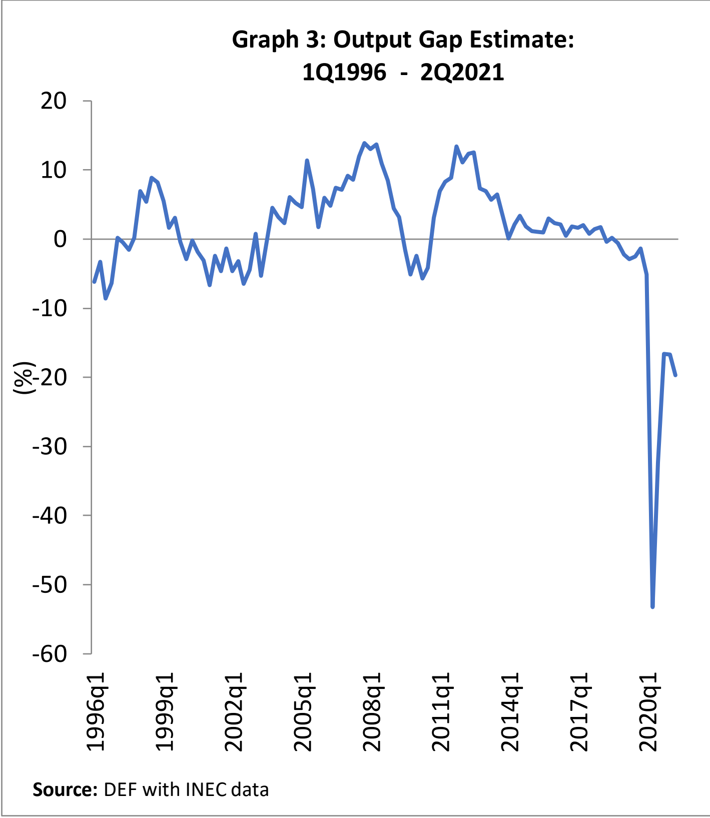
Industrial production and international trade have continued to expand steadily, although the services sector has undergone a slower recovery process, even though it has recently strengthened itself within the framework of new sectoral openings.

In fact, Panama's monthly economic activity index grew by 4.85% between January and June 2021, versus the same period of 2020, which shows that the economy is in a recovery process after the impact of the pandemic, but this increase will not be enough to cover the drop recorded in 2020 and 1Q2021.

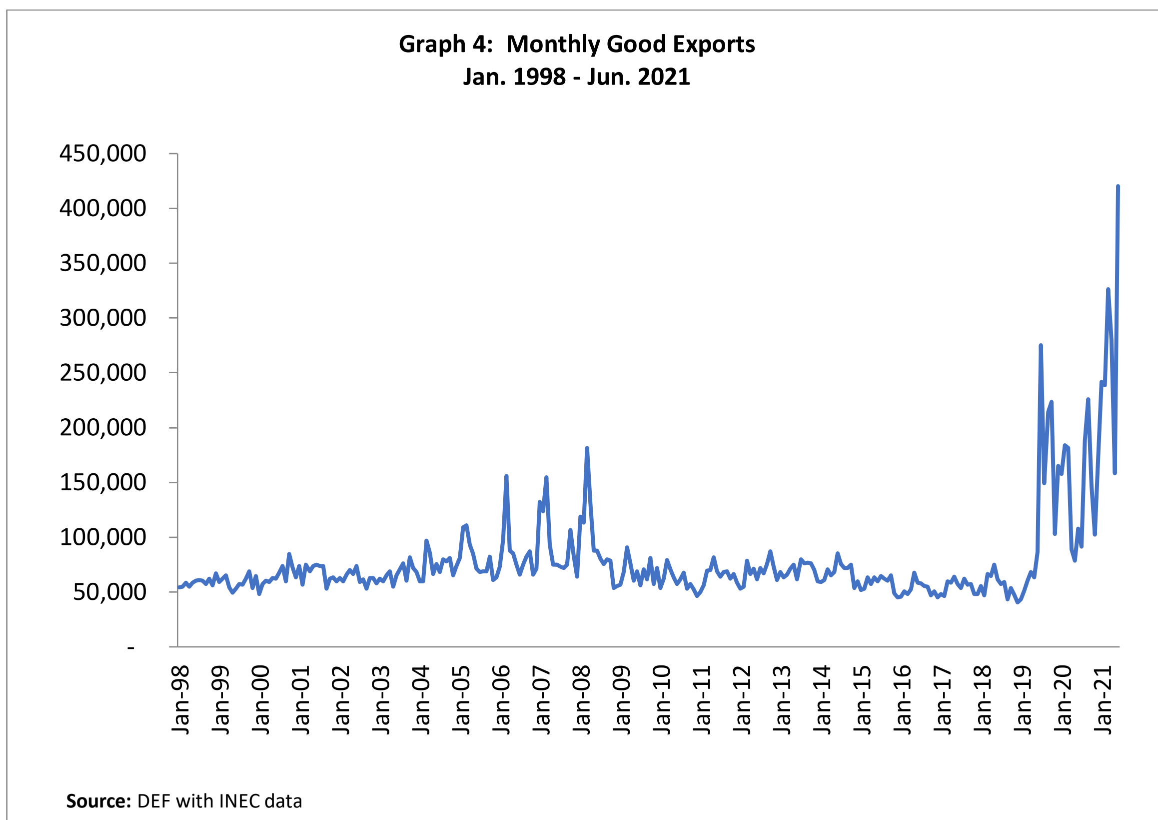
On the other hand, the GDP presented a quarterly growth of 40.4%, which is compared to previous performances of -8.5%, -10.9%, -23.9%, and -38.2% recorded at the onset of the pandemic, this being the first positive result in almost one year (**see Graph 2**).

As for the cyclical position of the economy, in the 2Q2021 the slack conditions for the economy increased. The estimate of the output gap for the 2Q2021 (still in negative numbers) showed a decrease compared to the level of the previous quarter. In this way, the economy could be 20% below the potential output (**see Graph 3**). Note that these data could be framed in a context of COVID-19 case increases in May and June, so this specific estimate must be viewed with caution.



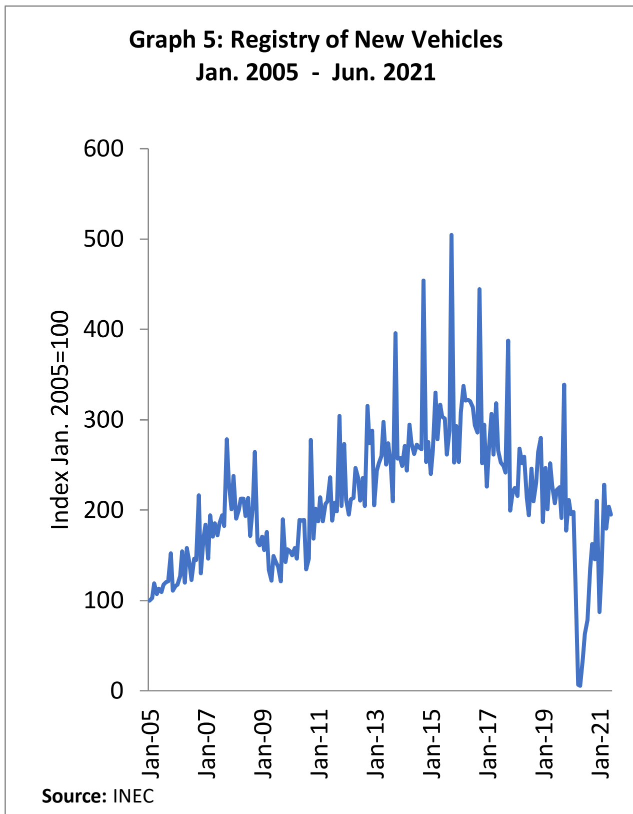


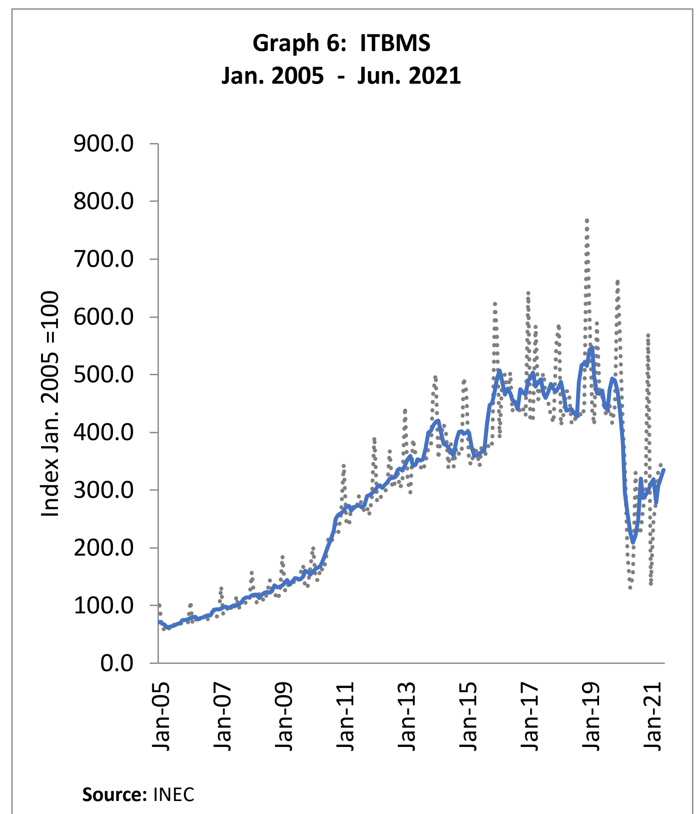
In the 2Q2021, the value of exports showed robust growth compared to the previous quarter, particularly those of copper. The increase in the value of these exports occurred at a time of higher prices in the Panamanian exportable portfolio since disruptions in the supply of various products have continued to affect commodities prices. As for the rest of primary and manufacturing exports, the increase in the quarter would seem to be associated with higher prices. By destination, manufacturing exports to China continued to expand, while shipments to the rest of the world rebounded. (**See Graph 4**).



Indicators related to overall private consumption continued to gradually recover from the new effects they faced between the end of 2020 and the beginning of 2021. Thus, in the 2Q2021, private consumption maintained its recovery. Within private consumption, the consumption of goods showed a favorable performance and remained, in some cases, at levels like those prior to the health emergency. Thus, for example, the recovery that the automotive sector has had since September 2020 has allowed sales volumes to return to pre-pandemic levels (**see Graph 5**). Although this strong boost in sales is because many families have chosen to have their own vehicle, instead of commuting, which occurs along with an upturn in economic activity. Additionally, various firms have decided to buy new car models to enhance their businesses and strengthen their supply chain.

However, the indicators associated with consumption-related taxes are still below 2019 levels (**see Graph 6**). The foregoing would indicate that consumption recovery is still partial and asymmetrical, but it is moving forward.



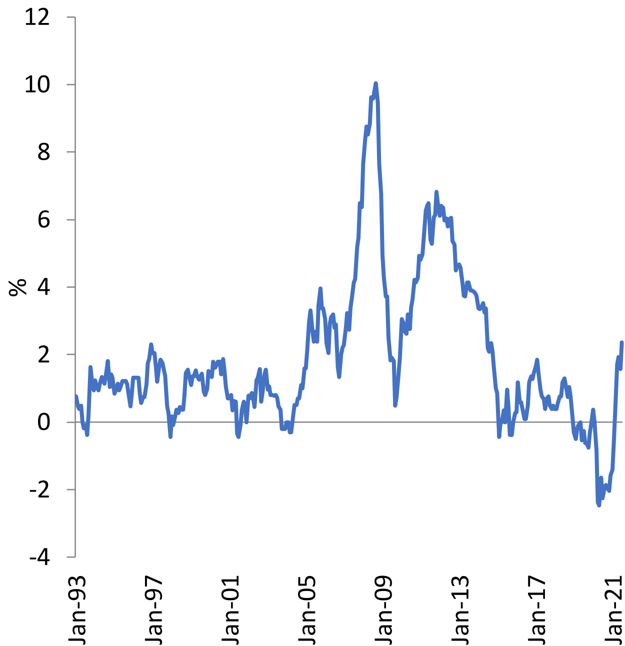


It is necessary to mention that it is possible that consumption shows a greater performance than other private spending components, which is the result of external accounts performance where a strong increase in imported goods has been noticed. This could put pressure on the checking account balance. Sustaining growth with these characteristics would be very complex.

Recent Evolution of Inflation

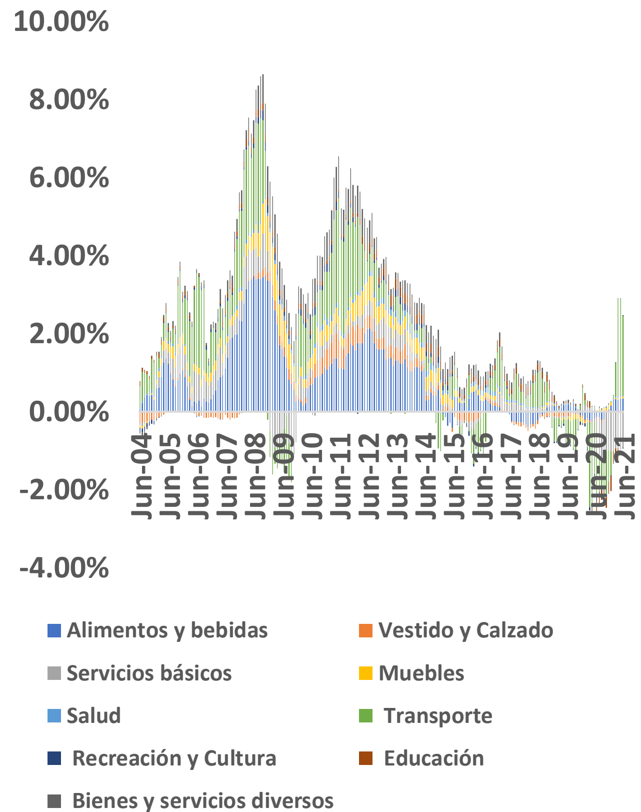
Between 1Q2021 and 2Q2021, annual headline inflation went from -1.4% in January to almost 2% at the end of the first half of 2021 (**see Graph 7**). Inflation has continued to be pushed on an upward trend by pandemic-related shocks. Thus, strong consumption performance, in a context where supply has not yet managed to fully recover itself, has pushed up inflation. Data from recent months have shown a significant increase in the price of various products, especially in items related to food and beverages and fuel. This has occurred in a scenario in which restrictions on global supply chains imposed by the pandemic remain. In fact, stock availability, shipping times, and transportation costs are factors that continue to affect the performance of various industries globally.

Graph 7: Consumer Price Index: Jan. 1993 - Jun. 2021



Source: DEF wiith INEC data

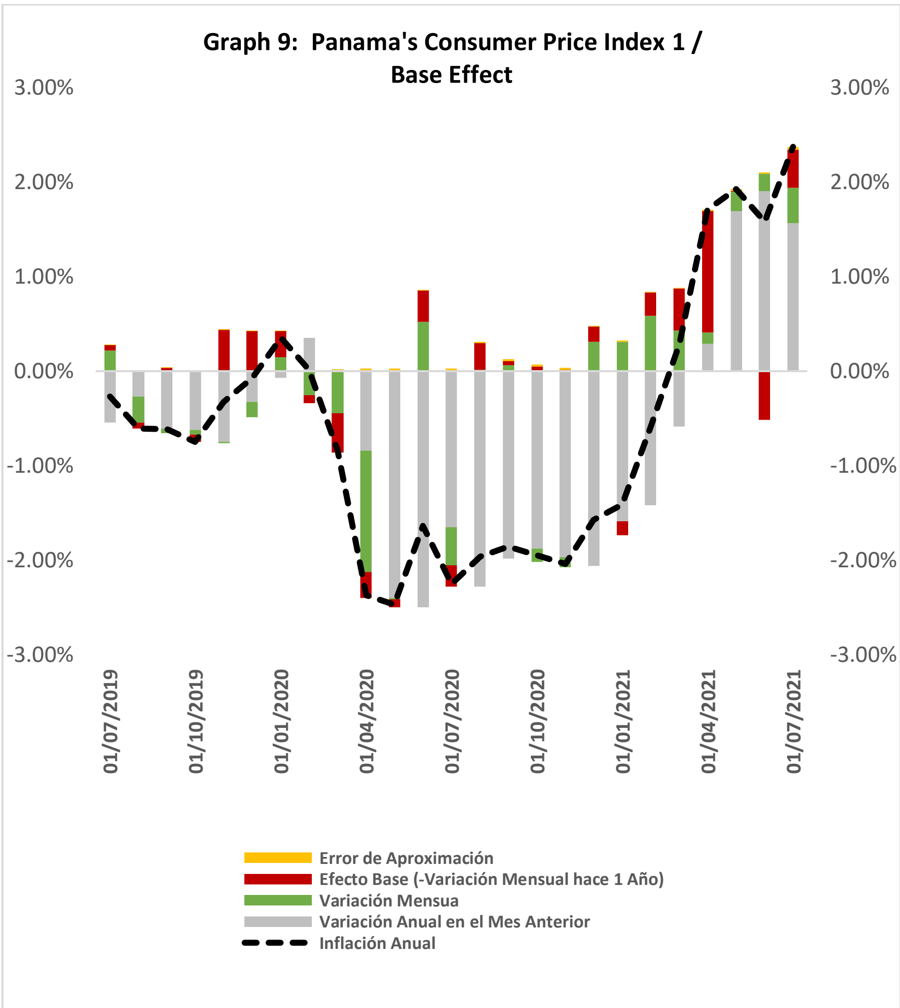
Graph 8: Contributions of Determinants to Inflation: Jun. 2004 - Jun. 2021



For its part, the remarkable increase in annual inflation in April was the result, to a large extent, of the arithmetic effect associated with low fuel prices that took place a year earlier. However, new shocks have been experienced throughout this year on prices because of production processes for all kinds of goods and services. There are cost increases derived from higher commodities or goods prices, in addition to other supply shocks such as supply chain problems, while the reopening of activities has boosted the inflation of services. Regarding the volatile component, fuels have continued to drive annual inflation, combining effective price increases in recent months. Gasoline spending is an important part of the average household consumption. But unlike other goods, whose spending can be relatively stable, in the case of fuel, significant price increases trigger an increase in the proportion of household spending that must be devoted to gas when gas prices skyrocketed, since it is difficult to adjust the amount consumed, especially in the short-term. Gas demand has a substitution price elasticity and a short-term inelasticity. Furthermore, sudden changes in oil prices are associated with the acceleration of the price of other goods and services. In fact, as can be seen in **Graph 8**, past high inflation episodes have been associated with significant increases in fuel prices.

Some of these shocks are not directly identifiable on the annual inflation measures, as these are also influenced by the base comparison effects of the price adjustments that

occurred a year earlier due to the pandemic. Using an annual inflation logarithmic decomposition methodology, it is possible to approximate the contribution of new shocks and distinguish them from the base comparison effects. Thus, in **Graph 9** of annual headline inflation, the green bars correspond to new shocks (estimated as deviations from the monthly difference of each month with respect to the historical average variation for a given month), while the red bars represent the comparison base effects (estimated as the monthly difference twelve months before relative to the historical average of the monthly difference). In March and April 2021, headline inflation showed important upward base effects, although also new shocks in the same direction, which caused headline inflation to rise from -0.59% in February to 1.71% in April 2021. By June 2021, although the base effects were negative, inflation remained high, as the new shocks that occurred in those months offset the base effects.



B. Financial System Stability

Data as of the end of the first half of 2021 showed a system with stable financial fundamentals. Banks have given a top priority to maintaining a sound liquidity position, despite a small reduction in liquid assets. The funds raised from the national economy do not show outflow trends, on the contrary, they continue to grow, which is largely explained by the caution of economic agents in maintaining their liquid balances in the banking system. Similarly, banks of the banking system continue to show an overall sound position, with capital levels above the regulatory minimum. Thus, provision and capital buffers, as well as higher profit capitalization by banks were the main factors to maintain solvency at the face of the crisis the country is going through.

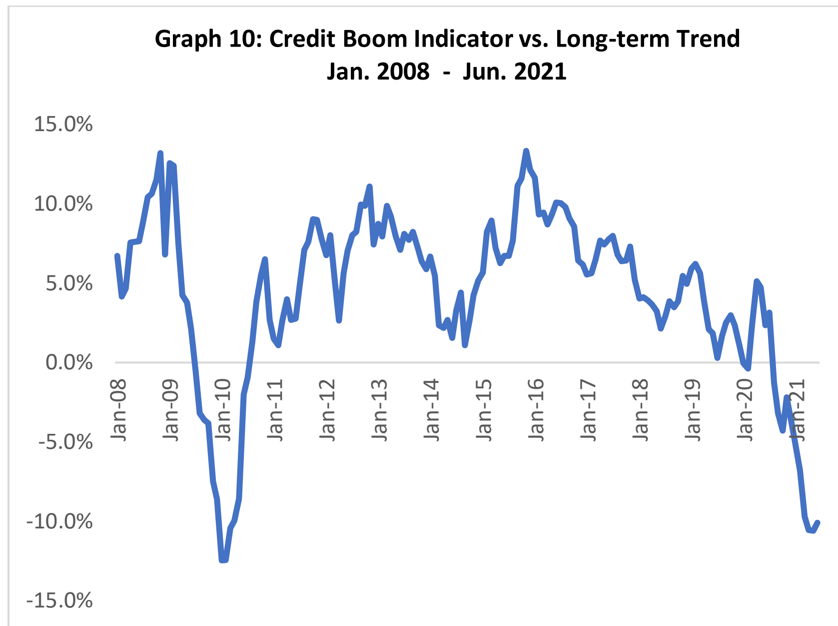
It should be noted that capital quality and quantity along with liquidity requirements are three of the most important regulatory elements developed by the Basel Committee on Banking Supervision (BCBS) to maintain financial stability. Capital and liquidity buffers accumulated by the financial system entities in recent years, as a result of prudential and regulatory requirements, have contributed to the financial system's endurance during the pandemic and have constituted important macroprudential policy tools for the SBP in the context of the health crisis.

Nevertheless, certain risks and vulnerabilities that were increased because of the contingency remain above the levels observed in the past, although they have been decreasing. The Superintendency of Banks will keep an eye on the evolution of national financial markets and will evaluate their operating conditions and the potential risks that could affect financial stability.

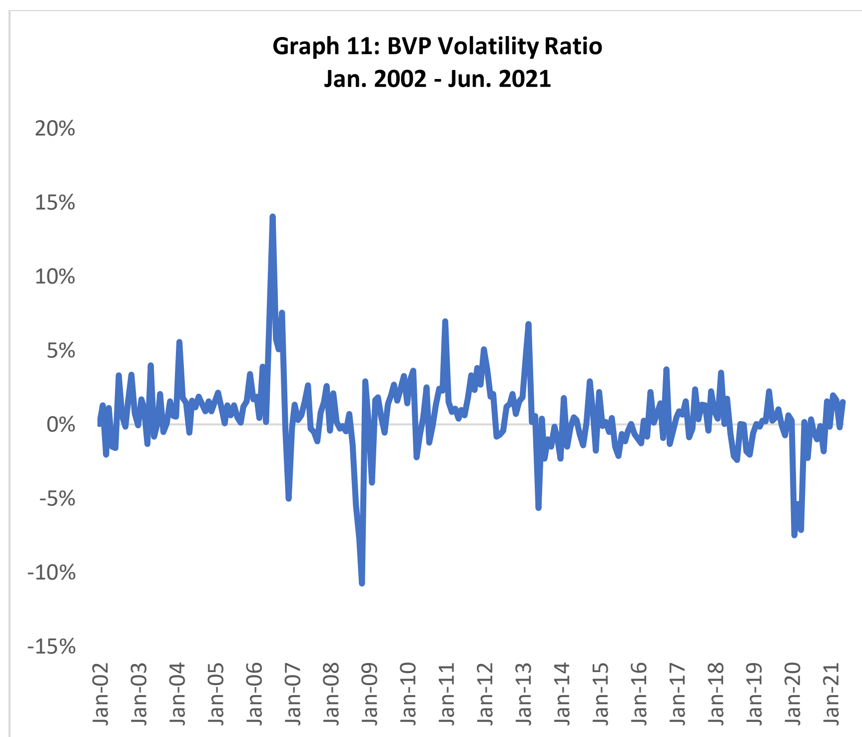
It is important that the soundness of the financial stability lays the foundations for greater performance in financial intermediation and contributes to economic recovery. As announced, and according to both previous guidelines and best international practices, some of the financial and prudential measures implemented in 2020 will begin a phase-down or phase-out process in the second half of 2021.

In Panama, the authorities of the Financial Coordination Council, which brings together the different financial authorities and the Ministry of Economy and Finance (MEF), continue to closely monitor the evolution of financial market conditions in the face of these changes.

In terms of financing during 2Q2021, the total financing to the nonfinancial private sector in Panama remained at levels like those of 1Q2021, but with an upward trend. With this, the indicator despite it grew, which could be an improvement sign of the lending process, does not show signs of a credit boom.



The Panamanian securities market continues to show low activity, compared to the growth of foreign issuances by domestic agents. This would explain better financing conditions for placements abroad. Spreads show an upward trend on the domestic side in recent months, especially on corporate nonfinancial sector.



C. Foreign Conditions

After the last installment of the Financial Stability Report (FSR) at the end of 2020, the focus shifted to the second wave of contagions, the appearance of new variants, and the pace observed in global inoculation campaigns. Although there is a global recovery (along with an improvement in commodities prices), its pace is asymmetrical and uncertain.

In connection with the foregoing, the 2021 upward trend outlook was adjusted due to global inoculation, the full reopening of many economies, greater aggregate demand, and stimuli from the fiscal and monetary policies of each country, especially the US. As for the Panamanian case, it is estimated that the domestic economic will grow 12% in 2021, which would be insufficient to reach 2019 levels.

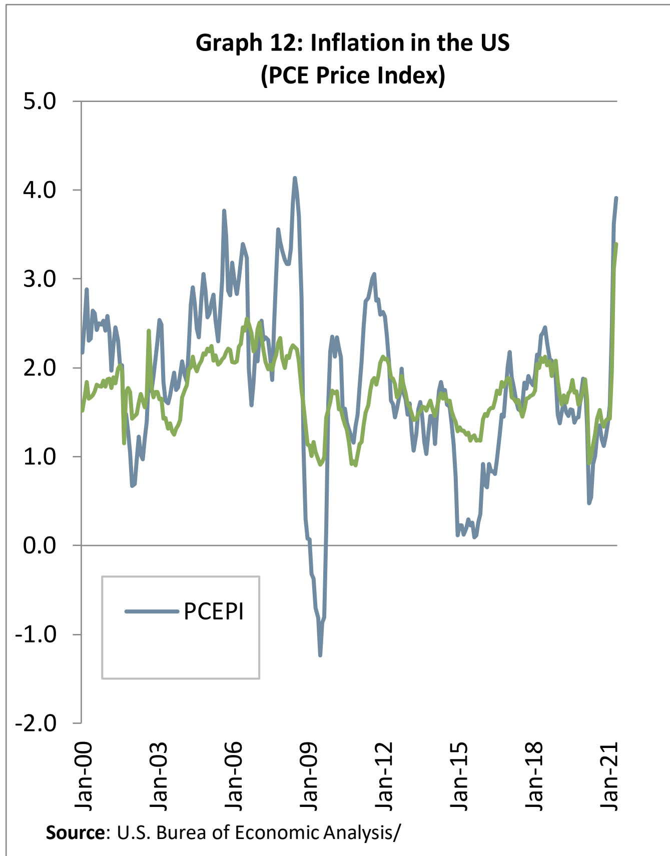
Table 1: Growth Outlooks: Some countries

	IMF (WEO April 2021)		World Bank (GEP June 2021)	
	2021p	2022p	2021p	2022p
World economy	**6**	**4.4**	**5.6**	**4.3**
Major advanced economies	**5.1**	**3.6**	**5.4**	**4**
United States	6.4	3.5	6.8	4.2
Euro Zone	4.4	3.8	4.2	4.4
Germany	3.6	3.4	n. d.	n. d.
Italy	4.2	3.6	n. d.	n. d.
Spain	6.4	4.7	n. d.	n. d.
Emerging and developing countries	**6.7**	**5**	**6**	**4.7**
China	8.4	6	8.5	5.4
India	12.5	6.9	8.3	7.5
Latin America and the Caribbean	4.6	3.1	5.2	2.9
Colombia	5.1	3.6	5.9	4.1
Brazil	3.7	2.6	4.5	2.5
Chile	6.2	3.8	6.1	3
Mexico	5	3	5	3
Peru	8.5	5.2	10.3	3.9
Panama	9	12	9.9	9.9

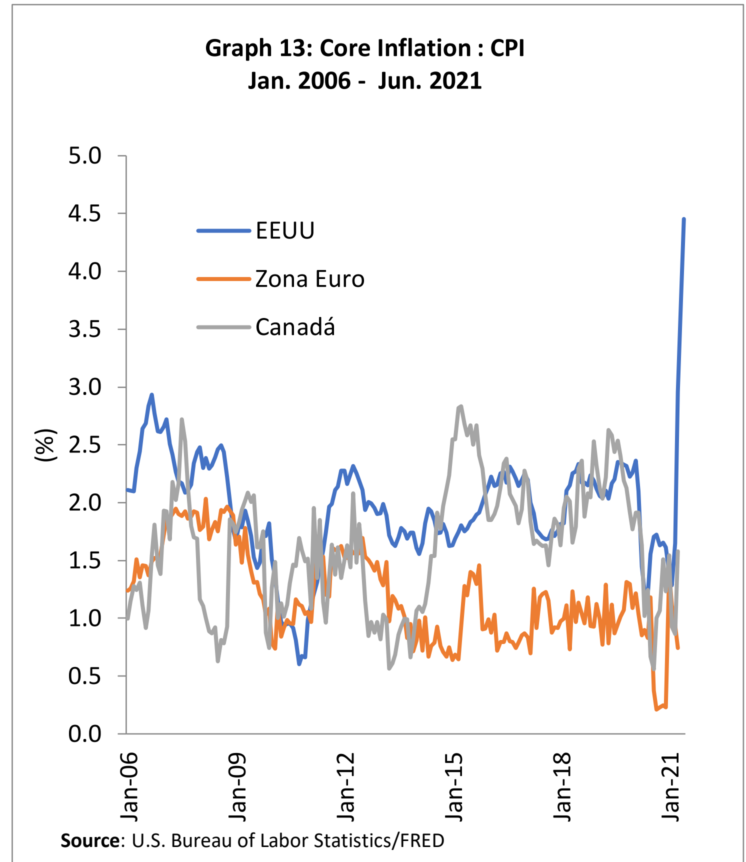
However, and despite this positive performance, it is observed that the challenges for the rest of the year in the foreign context would be focused on: the standardization of monetary policy by the Federal Reserve in the United States (particularly in tapering), the performance of international financial markets, and the economic slowdown in China.

Inflation in the US has been increasing significantly since February, reaching 5.4% in June (**see Graph 12**). The FED considers that this growth is the result of a transitory shock, caused particularly by production bottlenecks, which represents a risk for increasing interest rates. It should be noted that when inflation is said to be "transitory," it really means that supply chain interruptions drive inflation. But these interruptions

continue intensifying and spreading globally, so it is almost for certain that they will not be that transitory. Given that all countries are facing the same supply chain constraint, it could be assumed that the high US inflation is not just about global supply constraints but they respond to massive US fiscal stimulus and a big boost in demand (**see Graph 13**).



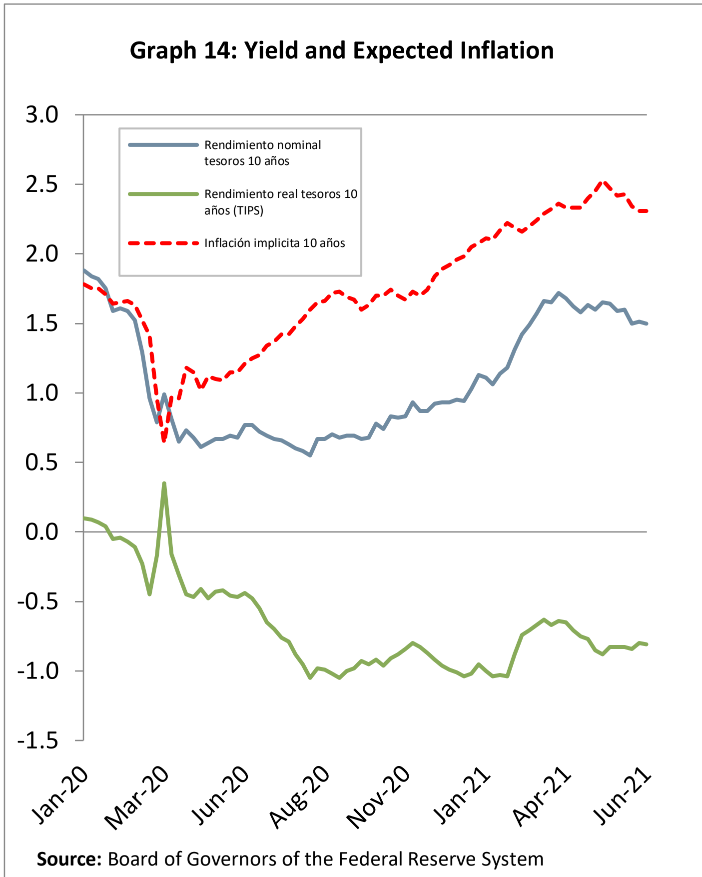
Source: U.S. Burea of Economic Analysis/



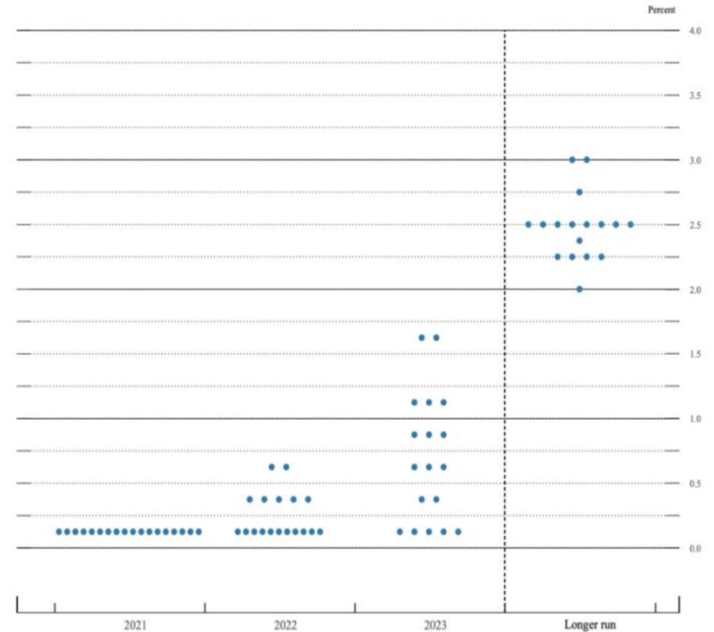
Source: U.S. Bureau of Labor Statistics/FRED

The main concern is the persistence of core inflation, which has problems that go beyond the arithmetical effect on the comparison base. It should be remembered that core inflation is a medium-term trend indicator of headline inflation and that it has already started to affect perspectives (**Graph 14**).

Recently, at the June meeting of the Federal Reserve, the perspectives of the FOMC participants showed, for the first time, a start of policy rate increases (for the median) in 2023. Although the Federal Reserve does not want to formally link the timing of ending asset purchase to the first rise in interest rate. The median of the most recent FOMC outlook is that the first of the two rate hikes will occur sometime in 2023, but as early as June, seven FOMC participants anticipated at least one rate hike in 2022. These would presumably seek for ending the purchase program by mid-2022.



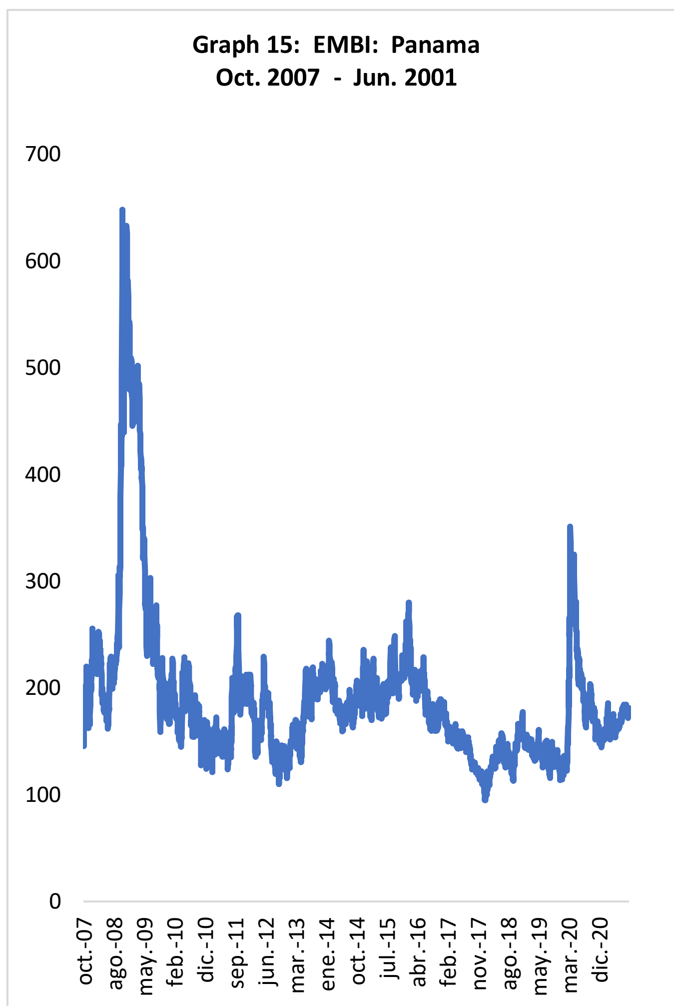
Source: Board of Governors of the Federal Reserve System

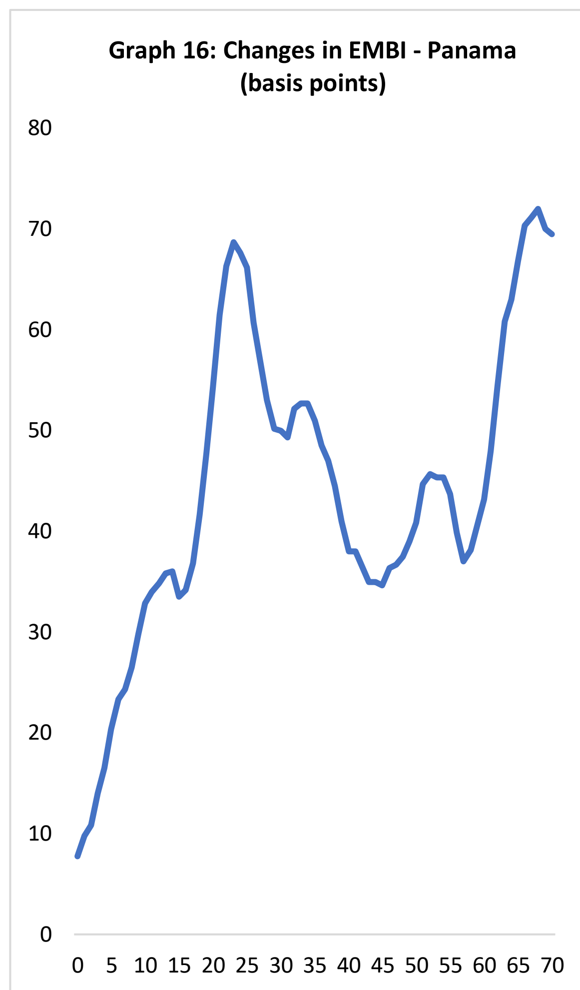


This is relevant, since a change in interest rate hikes expectations faster than expected in developed economies could have negative effects worldwide. The main risk associated with the withdrawal of asset purchases by the Fed (the so-called tapering) is that it occurs in a disorderly manner, which would generate volatility and uncertainty and an event like that of 2013.

Although domestic financial conditions remain favorable, with a low perception of risks on the local economy (in comparative terms with the region), it has been growing (**Graph 15**). The risk level perceived by international investors on the local economy remains low, but has been increasing since the beginning of the year, so events of this type could put pressure on long-term rate hikes, as seen in the Panamanian EMBI during 2013 (**Graph 16**), which could put pressure on public debt management[1].

[1] For the purposes of seeing the accumulated change, May 22, 2013 is used as a reference. Cumulative changes are evaluated in days.



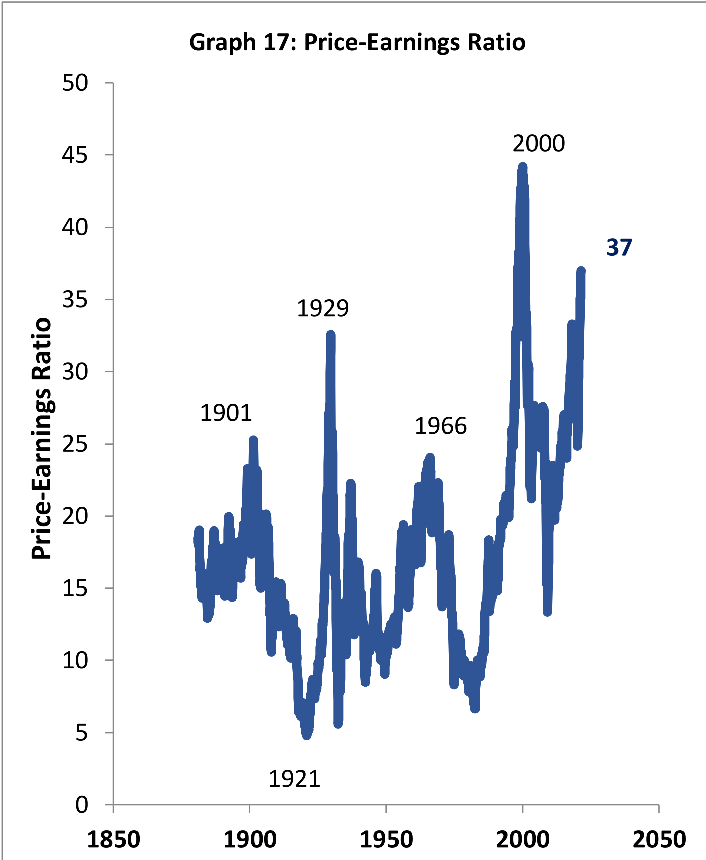


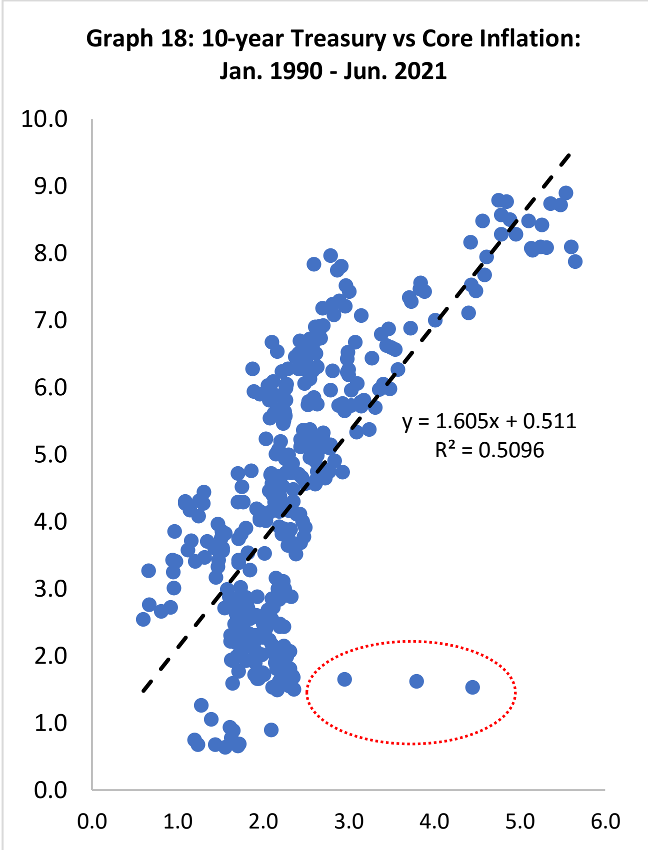
Towards the next FED's FOMC meetings, we should pay special attention to: (1) signs of when asset purchase could be adjusted (tapering); (2) update of the rate adjustment chart (dot plot); and (3) update of economic outlook, because of the impact of the *Delta* variant on the US economy.

The financial market remains optimistic by the inoculation process and the expectation of more fiscal stimulus in the US. Indexes such as the *Dow Jones*, *Nasdaq*, and *S&P500* reached new all-time highs in 2021. So far this year, the *S&P500* has reached 57 record closes and the *Nasdaq*, 34. In particular, important changes have been observed in technology stock prices because of the expectations that long-term consumption will change and will not necessarily be for all types of companies (even if they are from the technology sector or discretional online sales). The foregoing could have lower interest rates as its central axis, which reduces the opportunity cost of investing in fixed-income assets. The discount rate in the valuation of listed companies is also reduced and their valuation increases. That said, it is possible that the rise in the stock market and the recent record highs are the result of a denominator effect and not necessarily of a good economic expectation in the future.

Although it can be considered a statistical element, the price-earnings ratio far exceeds its average value (**Graph 17**). In previous episodes these have matched with financial crises episodes.

Similarly, since April atypical changes were observed in the core inflation and 10-year Treasury rate relations (the nominal anchor of other rates). Although the outliers could show that inflation could be very transitory (due to lags in various global value chains), they could also show future changes in fixed income markets (**Graph 18**).





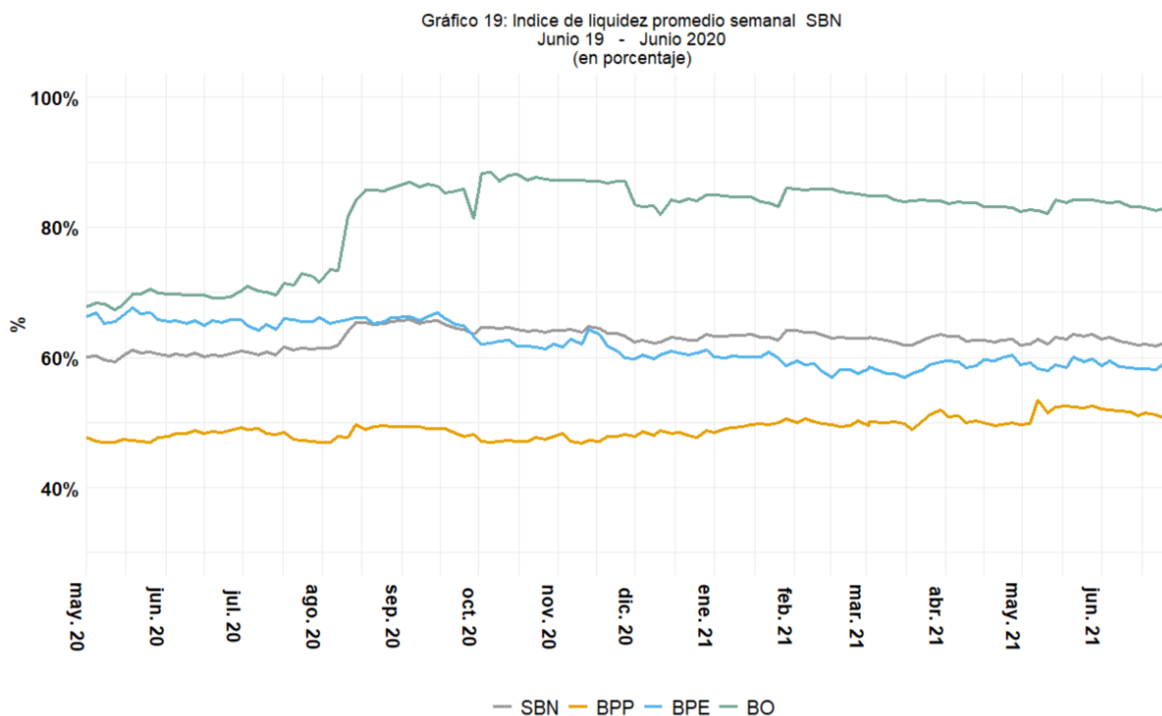
Anomalous stock market performances have also occurred in other jurisdictions. Hong Kong's Hang Seng stock index has dropped more than 20% since its peak in February 2021, making it a bear market. This could shed on a Chinese economy that could be slower for the coming quarters.

III. Performance of the Banking Sector

A. Liquidity

After more than a year since the onset of the pandemic, the banks of the International Banking Center (IBC) continue to show a strong aggregate liquidity position. The resistance to liquidity shocks by most entities is based on the appropriate asset and liability distribution by maturity terms, on the diversified funding structure, and on the high-quality liquid assets (HQLA) they have been building. In fact, during June 2021, the liquidity of the National Banking System (NBS) reached to 62.2%. As stated in previous reports, in terms of legal liquidity, most banks maintain levels higher than those registered prior to the outbreak of the pandemic (**see Graph 19**), which responds to a comprehensive strategy of caring for the quality of assets, generating reserves, and expanding liquidity. This growth was implemented through an increase in funding mainly from deposits, and from financing, both from the domestic interbank market and from resources that come from lines of credit from correspondent banks.

It should be noted that banking in Panama maintains great liquidity levels since before the pandemic, which has been an important factor in coping with the effects of the complex situation we have had since March 2020. The foregoing is explained, in part, because banks increased their liquidity reserves, due to the adoption of Rule 2-2018 on the implementation of the Liquidity Coverage Ratio (LCR). The LCR and HQLA requirements are particularly relevant given the absence of a central bank and a deposit insurance, which is why this provision has remained in force in the context of the COVID-19 contingency.

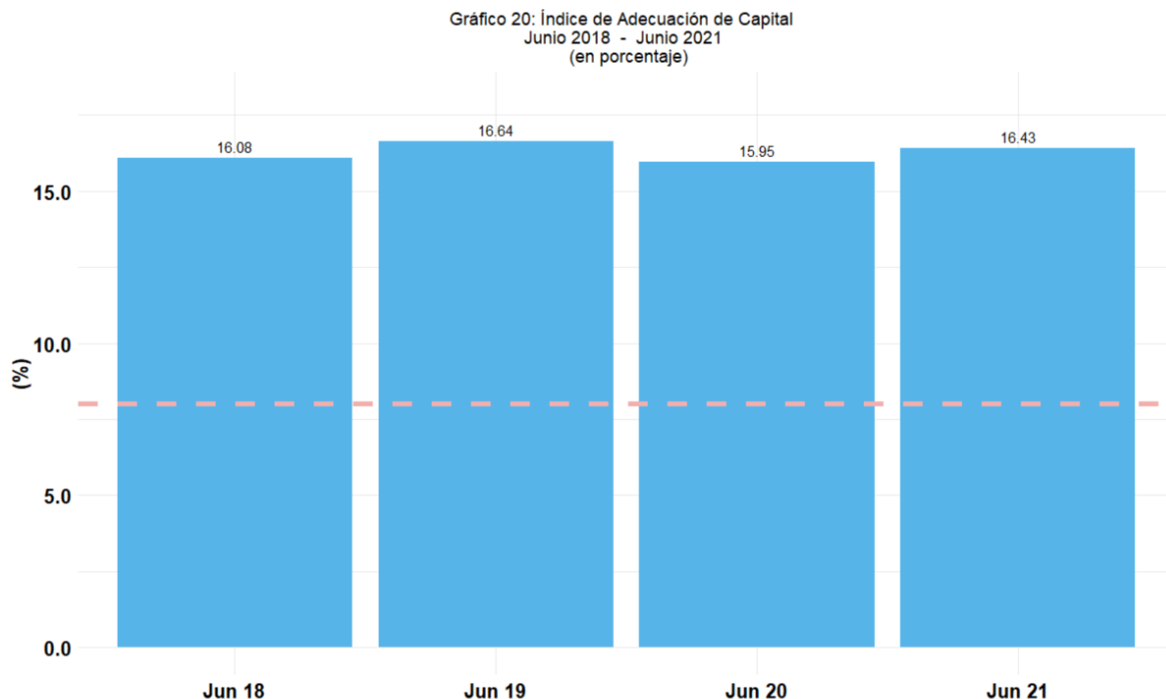


Source: General License Banks.

B. Solvency

The capital adequacy ratio (CAR) on risk-weighted assets was 16.36% for 1Q2021, even showing an improvement at the cut-off date of the survey (that reached 15.48% during the same period of 2020), due to higher growth in capital in regard to regulatory requirements. This represents twice the regulatory minimum of 8%. This increase can be explained by the recapitalization of some entities, the reduction in the payment of dividends, and the lower balance of risk-weighted assets. Currently, all banks running operations satisfactorily comply with the new regulatory standards on bank capital.

It is worth noting that solvency is measured under Basel III standards for capital composition and under a standardized methodology for credit, market, and operation risk assets. These results show that both general and international license banks (to which the regulation applies) have demonstrated their commitment to ensuring the well-being of savers, by maintaining such robust capital levels. However, in the future, the ability of banks to maintain or strengthen their solvency levels in the current juncture through different methods (capitalization of profits, capital contributions, issuing or taking subordinated debt, optimization of risk-weighted assets, among others) will be important.



Source: General and International License Banks.

C. Income Statement

The International Banking Center recorded accumulated net profits, as of June 2021, of USD 617.9 million, 5.7% less than that of June 2020, which is mainly the result of lower portfolio interest income (associated to a slowdown in credit), in addition to expenditures corresponding to provisioning expenses. However, although net interest income (-12.3%) has not yet recovered the levels observed prior to the onset of the pandemic, the decrease in both general expenses (-1.7%) and a slowed generation of preventive reserves for credit risks (-16.1%) have contributed to an improvement in the accumulated net results of baking until the first half of 2021. It should be noted that, unlike what happened in the NBS, the results of the IBC are significantly influenced by a substantial contraction in the income obtained by a foreign international license bank as the payment of dividends by its subsidiaries was deferred, an element that will continue for the rest of the year.

It is important to state that, in response to the modified loans facility produced by the pandemic, interests in this modality are recorded under the accrual method, that is, accrued interest is recorded but not necessarily collected. This must be considered at the face of the potential occurrence of default events.

Table 1: International Banking Center
Accumulated Income Statement - (in millions of USD)

International Banking Center	Jan. – June 2020	Jan. – June 2021	% Diff.	Total Diff.
Net interest income	1,283.5	1,125.3	-12.3%	-158.2
Other income	1,024.0	1,046.3	2.2%	22.3
Operating income	2,307.5	2,171.7	-5.9%	-135.8
General expenses	1,166.5	1,146.4	-1.7%	-20.1
Profit before provisions	1,141.0	1,025.2	-10.1%	-115.7
Bad debt provision	485.4	407.4	-16.1%	-78.0
Profit for the period	655.5	617.9	-5.7%	-37.7

Source: General and International License banks.

As indicated in previous reports, the COVID-19 pandemic has had a negative effect on the income-generating capacity of banks. This is because the current situation adversely affects the volume of economic activity and, therefore, credit.

For its part, the National Banking System recorded accumulated net profits, as of June 2021, of USD 534.3 million, 10.7% more than that of June 2020.

Table 2: National Banking System
Accumulated Income Statement - (in millions of USD)

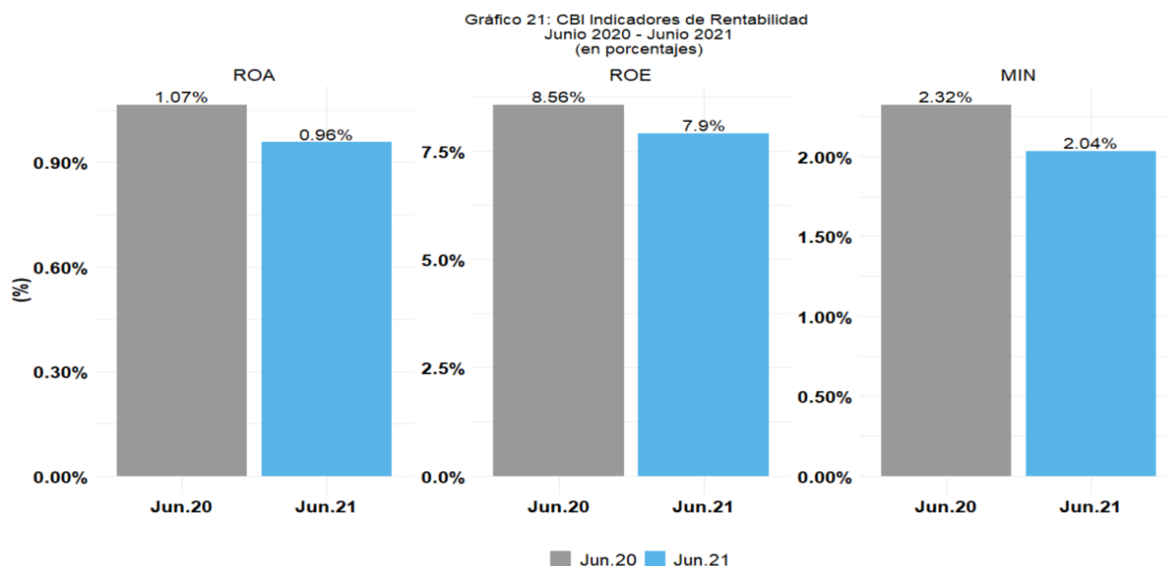
National Banking System	Jan. – June 2020	Jan. – June 2021	% Diff.	Total Diff.
Net interest income	1,197.7	1,070.6	-10.6%	-127.1
Other income	838.0	915.8	9.3%	77.8
Operating income	2,035.8	1,986.4	-2.4%	-49.4
General expenses	1,078.2	1,046.3	-3.0%	-31.9
Profit before provisions	957.6	940.1	-1.8%	-17.4
Bad debt provision	474.7	405.8	-14.5%	-68.9
Profit for the period	482.9	534.3	10.7%	51.4

Source: General license banks.

Given the current juncture, we foresee that bank profitability will remain low, at levels similar or lower than those of 2020, because loan provisioning will continue to be an important item, which will not yet be offset by the gradual recovery of operating income. The banks of the system will continue with expense control and operational efficiency strategies.

D. Profitability Indicators

As could be seen in the previous section, the lower credit activity, the constitution of provisions, and the reduction in intermediation margins have reduced the profitability of the banking system. Thus, the profitability indicators of the National Banking System have decreased in line with this underperformance. However, a slight improvement is observed in June 2021. Banking profitability, measured through the twelve-month accumulated net profit to stockholder's equity ratio (ROE), went from 7.8% to 8.7%, while ROA remained almost unchanged. It is worth noting that these lower levels of bank profitability, which have increased during the last period, were also observed for a significant sample of countries, i.e. it has not been an exclusive situation of banks in the country.



Summarizing, although banks have increased the spending on provisions, in accordance with the materialization of credit risks in a reduced banking business environment, which has translated into lower profitability for the system, this has not affected the solvency or the liquidity of these entities. We reiterate that solvency levels are high and provide a robust cushion to face the losses derived from the current situation.

E. Balance Sheet

As of the end of the first half of 2021, the assets of the International Banking Center totaled USD 128.99 billion, which represents a decrease of USD 167.7 million, when compared to June 2020, that is, a year-on-year decrease of 0.13%.

Liquid assets registered a year-on-year increase of 0.3% to reach to USD 25.07 billion. It is worth noting that, although these continue to grow, they do so at a lower rate, which responds to a rearrangement of cash towards investments in high-quality liquid assets. It should be noted that since last year most of the entities have strengthened their liquid assets positions, which allowed their sensitivity to the negative shocks triggered by the health crisis to be limited during most of 2020.

Regarding bank financing sources, deposits registered an increase of USD 3.94 billion (4.3%), which resulted from the performance of domestic deposits (+9.0%), particularly from customer and government deposits. The deposits of the International Banking Center, as of June 2021, amounted to USD 95.31 billion. It is emphasized that the performance of customer deposits, both by the domestic and foreign depositor, can be understood as they have remained confident on the stability of the banking system, which his shown in a growth in the funding of establishments. As indicated in previous reports, bank liabilities showed a rearrangement towards more liquid instruments. In fact, it has been found that this growth has been underpinned by demand and savings deposits.

As a result of greater availability of public resources, the need for banks to finance themselves through other sources was reduced, therefore the share of financing through obligations and other liabilities decreased between June 2020-21 by 21.4% and 5.4%, respectively. This change in the composition of the sources of funds, coupled with the reduction in interest rates, decreased the cost of bank funding.

Regarding the net loan portfolio, as of June 2021, the International Banking Center showed a decrease of 4.9% to reach to USD 71.15 billion.

As for securities, there was an increase of USD 2.59 billion. So far this year, this item registered a positive performance (showing a year-on-year growth of 11.1%) and it would reflect the search for profitability by banks within a context of a positive performance of financial markets that made it possible to maintain higher-risk assets.

Table 3: International Banking Center
Balance Sheet
(in millions of USD)

Breakdown	2020	2021	Jun. 21/Jun. 20 Difference	
	June	June	Total	%
Liquid assets	24,994.3	25,063.1	68.8	0.3%
Net loan portfolio	74,800.0	71,142.8	-3,657.2	-4.9%
Domestic	53,837.1	52,157.4	-1,679.7	-3.1%
Foreign	20,962.9	18,985.4	-1,977.5	-9.4%
Securities	23,283.5	25,864.5	2,581.0	11.1%
Other assets	6,074.1	6,913.8	839.7	13.8%
Total Assets	**129,151.9**	**128,984.2**	**-167.7**	**-0.1%**
Deposits	91,369.8	95,300.5	3,930.7	4.3%
Domestic	57,977.2	63,185.6	5,208.4	9.0%
Foreign	33,392.6	32,114.9	-1,277.7	-3.8%
Obligations	18,235.9	14,337.0	-3,898.9	-21.4%
Other liabilities	3,907.7	3,696.8	-210.9	-5.4%
Capital	15,638.4	15,649.9	11.5	0.1%

Source: General and International License banks

The assets of the National Banking System (general license banks only) totaled USD 114.98 billion, an increase of USD 3.13 billion or 2.8% more than that of June 2020. The net loan portfolio of the National Banking System decreased by USD 1.16 billion, to amount to USD 65.82 billion.

The total deposits taken by the NBS reached to USD 85.04 billion, a 6.7% growth, which is mainly the result of customer and government deposits. Meanwhile, obligations and other liabilities fell by USD 2.16 billion compared to June 2020.

Table 4: National Banking System
Balance Sheet
(in millions of USD)

Breakdown	2020	2021	Jun. 21/Jun. 20 Difference	
	June	June	Total	%
Liquid assets	19,246.7	20,308.5	1,061.8	5.5%
Net loan portfolio	66,969.6	65,810.8	-1,158.8	-1.7%
Domestic	53,837.1	52,157.4	-1,679.7	-3.1%
Foreign	13,132.5	13,653.4	520.9	4.0%
Securities	19,862.6	22,199.8	2,337.2	11.8%
Other assets	5,776.7	6,658.7	882.0	15.3%
Total Assets	**111,855.6**	**114,977.8**	**3,122.2**	**2.8%**
Deposits	79,715.9	85,030.6	5,314.6	6.7%
Domestic	57,877.6	63,100.6	5,223.0	9.0%
Foreign	21,838.4	21,930.0	91.6	0.4%
Obligations	16,131.4	14,200.7	-1,930.8	-12.0%
Other liabilities	3,751.3	3,528.5	-222.8	-5.9%
Capital	12,257.0	12,218.1	-38.9	-0.3%

Source: General License banks

F. Loans

As of the end of the first half of 2021, the balance of the domestic loan portfolio, granted by banks, decreased 1.8% in the year-on-year comparison (i.e. versus June 2020) to totalize USD 54.23 billion. The reduction in nominal balances was less than in May and April (-2.3% and 3.0%, respectively), months in which a significant base effect was recorded in the annual comparison due to the growth observed in the same months of 2020.

By loan aggregates that make up the NBS portfolio, the negative annual nominal variations were financial and insurance activities, -35.1%; industry, -18.2%; construction, -9.4%; and commerce, -6.5%.

Table 5: National Banking System
Balance of Domestic Loans by Economic Sectors
(in millions of USD)

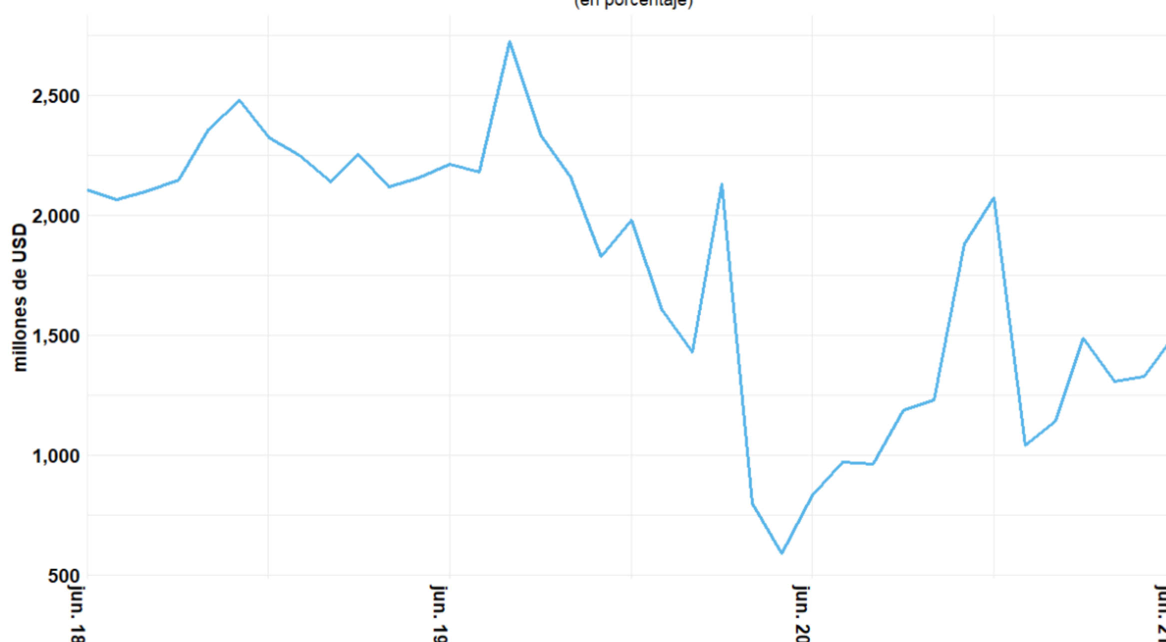
Breakdown	June 2020	June 2021	June 21/June 20 Difference	
			Total	%
TOTAL	**55,213**	**54,226**	**-987**	**-1.8%**
Public sector	**446**	**1,436**	**990**	**222.2%**
Private sector	**54,767**	**52,790**	**-1977**	**-3.6%**
Financial & insurance activities	1,931	1,254	-677	-35.1%
Agriculture	394	415	21	5.4%
Livestock	1,323	1,359	36	2.7%
Fishing	82	86	4	5.0%
Mining & quarrying	56	57	1	2.0%
Commerce	11,202	10,477	-725	-6.5%
Industry	3,321	2,717	-603	-18.2%
Mortgage	17,923	18,396	473	2.6%
Construction	6,131	5,555	-576	-9.4%
Personal consumption	12,404	12,474	70	0.6%

Source: General License banks

In the case of the evolution of the commercial and financial and insurance activities portfolios, it is noteworthy to mention that, during the period between March and May 2020, companies contracted commercial credit lines, at the onset of the health crisis and the social distancing period to face the total or partial lockdowns. This constituted a high comparison base, which goes some way to explaining the larger declines in these segments. As of June, practically in all segments of the corporate portfolio, the drop in loan placement was already slightly less than that shown in previous months in its year-on-year comparison.

The rest of the activities classified in the different sectors had positive results, where mortgages (+2.6%) stood out and where the housing portfolio continues to be the only one that maintained positive nominal and real growth rates.

It should be highlighted that the sixth month of the year could represent a turning point for the performance of total loans for several reasons: (1) a smaller aggregate contraction than that experienced in previous months; (2) a better performance of portfolios that make it up, either due to a smaller contraction or growth; and (3) due to the positive performance of new loans that, although they do not reach pre-pandemic levels, show a consistent improvement (**see Graph 4**) [sic]. A sustained improvement in activity and employment indicators in the medium-term would consolidate a better performance in the credit market. As mentioned in previous reports, the main vulnerability for the stability of the financial system in the short-term is the uncertainty surrounding the evolution of the pandemic.



Source: General License Banks.

The flows of new loans accumulated from January to June 2021 by banks stood at USD 7.98 billion, which represents an increase of 5.7% compared to the same period of 2020, showing growth in almost all segments, except those subject to a high base of comparison.

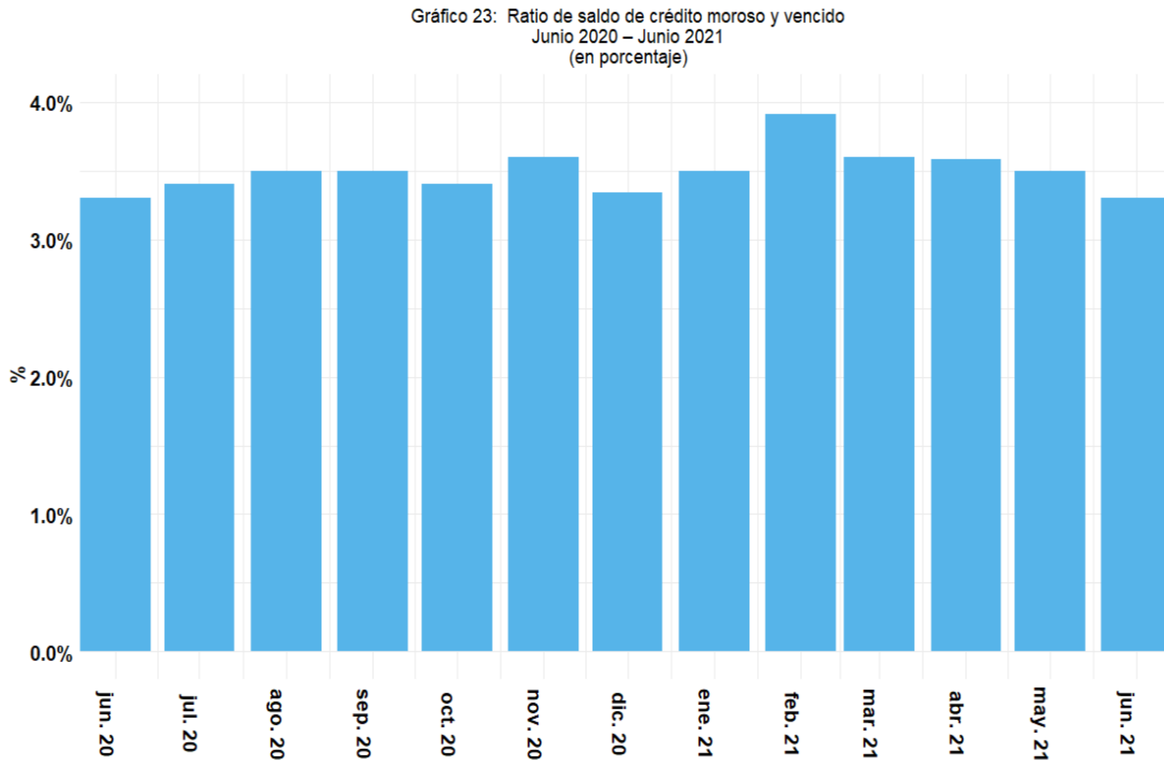
Table 6: National Banking System
New Domestic Loans by Sectors and Activities
(in thousands of USD)

Sectors	Jun. 21/20 Difference				Jan.-Jun. 21/20 Difference			
	Jun. 20 (R)	Jun. 21	Total	%	Jan.-Jun. 20 (R)	Jan.-Jun. 21 (P)	Total	%
Public entities	12,410	19,818	7,408	59.7%	51,392	99,443	48,051	93.5%
Finance companies	24,615	63,929	39,313	159.7%	634,560	329,888	-304,673	-48.0%
Agriculture (incl. Forestry)	7,460	23,568	16,108	215.9%	56,561	91,339	34,777	61.5%
Livestock	27,813	44,528	16,716	60.1%	189,287	261,265	71,978	38.0%
Fishing	6,178	6,281	104	1.7%	10,640	18,000	7,360	69.2%
Mining & Quarrying	744	607	-137	-18.4%	15,233	5,735	-9,498	-62.4%
Commerce (incl. Services)	393,740	649,091	255,351	64.9%	3,297,514	3,405,699	108,184	3.3%
Industry	152,295	193,898	41,603	27.3%	1,115,953	1,115,377	-576	-0.1%
Mortgages	50,747	177,933	127,186	250.6%	587,145	819,960	232,814	39.7%
Construction	83,358	139,224	55,866	67.0%	567,978	606,348	38,370	6.8%
Personal consumption	69,331	181,181	111,850	161.3%	849,297	1,044,593	195,296	23.0%
Total	**828,691**	**1,500,059**	**671,368**	**81.0%**	**7,375,562**	**7,797,646**	**422,084**	**5.7%**

Source: General License banks

G. Portfolio Quality

The total delinquency rate of the International Banking Center (+30 days) stood at 3.3% in June 2021, its past due balance was 1.39% (30 – 90 days), while nonperforming loans (NPL) were 1.92% (over 90 days). The decrease in the delinquency ratio occurred at the same time there was an increase in total loans granted.



Source: General and International License Banks

It should be noted that, given the current juncture, the modified loans category was established (**see Section H**), with which if loans are in default, the rolling instructions will not be applicable to the impaired categories. With this, banks do not deteriorate the debtor's ratings, and therefore, banks are not required to make provisions immediately. Therefore, it is vitally important to continue with the evaluation and implementation of measures that seek an orderly performance of financial markets. All the foregoing helps mitigate the pressure on credit markets and facilitates the channeling of financial resources to the private sector. Notwithstanding the above, it is important to mention that, within the modified portfolio, there could be a significant number of loans that are in the current portfolio and, at the name the normal regulatory regime protected by Rule 4-2013 is restored, there will be debtors who will still be unemployed or companies that could not resume operations, which could cause an increase in the default rate.

On the other hand, through Rule 9-2020, the constitution of a generic provision equivalent to 3% of the gross balance of the modified loan portfolio was established, which includes accrued uncollected interest and capitalized expenses, applied pursuant to the International Financial Reporting Standards (IFRS) and in a complementary manner with the prudential standards established by Rule 9-2020.

As of June 2021, the accounting provisions of the International Banking Center reached to USD 2.33 billion.

H. Modified loans

During June 2021, the Superintendency of Banks of Panama issued two regulations related to the process by which modified loans are managed. Both regulations are related to credit risk management. The first one refers to the situation of the so-called modified loans and the second to the restructuring of debtors' loans who are willing to meet their obligations despite being in a temporary liquidity restriction. These regulations will have significant effects, both in the risk rating of bank's loan portfolios and in provisioning. Additionally, Rule 2-2021 and Board of Directors' General Resolutions 3-2021 and 4-2021 define the conditions, special measures, and terms to restructure debts under the modified loans modality.

The amendment to the banking regulation comprises several measures, including the following:

- The loans on which banks made modifications, in accordance with the parameters of Rule 2-2020, and whose debtors, as of the entry into force of this rule, are in compliance with the terms and conditions originally agreed on (prior to the financial relief measures due to COVID-19), the provisions established in Rule 4-2013 on Credit risk will apply, classifying the loans in the pass category. Likewise, the bank must exclude them from the modified loans category and any future changes to the terms and conditions will be governed by Rule 4-2013.

- The loans that as of 30 June 2021 are classified in the modified special mention category may be returned to the application of Rule 4-2013, after complying with their new terms and conditions and provided that they demonstrate compliance with their payments consecutively during the six-month period, in accordance with the payment plan agreed on with the client. In these cases, these loans may be classified in the pass category.

- The loans that as of 30 June 2021 are classified in the modified special mention category, whose their new terms and conditions included grace periods for principal and/or interests or others – that are still under this modality – cannot not be returned to the application of Rule 4-2013 and will remain in the modified special mention category until the agreed grace period is completed. These loans may be restored to the application of Rule 4-2013 after complying with their terms and conditions, if they demonstrate compliance with their payments consecutively during the six-month period, in accordance with the payment plan agreed on with the client. In these cases, these loans may be classified in the pass category.

- The restructured loans, in accordance with Rule 4-2013, on which the bank has modified their terms and conditions and that were up to date in their payments, will maintain the classification they had at the time of modification. Likewise, they

will maintain the provision equivalent to the higher value between the provision originally established under Rule 4-2013 and the provision established in accordance with Rule 2-2020. Article 19 of Rule 4-2013 will apply to these loans and, consequently, they will no longer be considered modified loans.

- The restructured loans, in accordance with Rule 4-2013, on which the bank has modified their terms and conditions and which have breached the new terms, will be returned to the provisions of Rule 4-2013 and will be classified based on the category they were before their modification, adding the corresponding days of arrears. Likewise, they will maintain the provision equivalent to the higher value between the provision originally established under Rule 4-2013 and the provision established in accordance with Rule 2-2020.

- The loans classified as substandard, doubtful, and loss that were modified in accordance with Rule 2-2020 and complied with their payments during the first half of 2021, will remain in the classification in which they were at the time of modification. Likewise, they will maintain the provision equivalent to the higher value between the provision originally established under Rule 4-2013 and the provision established in accordance with Rule 2-2020. The stipulations of Rule 4-2013 will be applicable to these loans and, consequently, they will no longer be considered modified loans.

- The loans classified as substandard, doubtful, and loss that as of 1 January 2021 were modified in accordance with Rule 2-2020 and partially or totally defaulted on their payments during the first half of 2021 will be returned to Rule 4-2013 and will be classified based on the category they were before their modification, adding the corresponding days of arrears. Likewise, they will maintain the provision equivalent to the higher value between the provision originally established under Rule 4-2013 and the provision established in accordance with Rule 2-2020.

All modified loans that were returned to the provisions of Rule 4-2013 and any other loan classified in accordance with Rule 4-2013 may not be transferred, as of 1 July 2021, to the modified special mention category.

As of 1 July and until 30 September 2021, banks may restructure modified loans, if these loans meet the following characteristics:

- The new terms and conditions must meet the financial viability criteria, taking into consideration the debtor's payment capacity and the bank's loan policies.

- The debtor proves, through reasonable financial data and/or documents, that he/she has the precise, present and/or prospective payment capacity.

- The viability assessment must be based on the debtor's financial characteristics and the restructuring measure must be in accordance with his/her economic situation.

- The debtor has agreed to catch up on the amounts in arrears and a significant reduction in the outstanding balance is expected within the agreed period.

Restructured modified loans may not be subject to the successive application of several restructuring measures. Periods without debt payment, i.e. payments to principal and/or interests, may not exceed, for the same loan facility, a period of up to six (6) months for consumer loans and up to twelve (12) months for corporate loans, subject to the debtor's payment capacity.

Corporate loans are reviewed on a case-by-case basis according to the conditions and particularities of each business. As a result of this rule, the banks of the Panamanian market, with the latest data obtained in June 2021, have registered 490,412 clients with modified loan operations, whose balances reached to USD 15.97 billion.

Table 7: National Banking System
Modified Loans – 25 June 2021

Loans	Balance in millions (USD)	Quantity of Operations
Corporate		
Agriculture	219.90	2,021
Commerce	1,508.47	4,194
Construction	2,303.34	2,751
Others	1,193.82	2,215
Services	1,162.14	7,029
Hotels & restaurants	407.09	286
Total Corporate	**6,794.76**	**18,496**
Consumer		
Mortgages	6,397.50	95,110
Car loans	547.30	61,153
Personal loans	1,090.90	135,352
Credit cards	1,138,29	180,301
Total consumer	**9,173.99**	**471,916**
Total modified loans	**15,968.76**	**490,412**

Source: SBP

I. Deposits

As of June 2021, the deposits of the International Banking Center increased by 4.3% compared to June 2020. This difference is the result of an increase in domestic deposits, by both demand and savings deposits, on the one hand, and on the other, of government deposits, by 13.7%. Thus, deposits raised by the market, as of the first half of 2021, registered a total of USD 95.31 billion, a USD 3.94 billion growth compared to June 2020 (**see Table 8**). A thorough analysis of this segment shows that domestic deposits recorded a rise of 9% in June 2021, to reach USD 63.19 billion. Foreign deposits recorded a decrease of USD 1.28 billion, to amount to USD 32.12 billion.

Table 8: International Banking Center
Total Deposits
(in millions of USD)

	2020	2021	June 2021 /June 2020 Diff.	
	June	June	Total	%
Deposits	91,370	95,301	3,931	4.3%
Domestic	57,977	63,186	5,208	9.0%
Government	10,975	12,474	1,499	13.7%
Customer	43,612	47,117	3,505	8.0%
Banks	3,390	3,595	205	6.0%
Foreign	33,393	32,115	-1,278	-3.8%
Government	144	165	21	14.9%
Customer	25,005	24,375	-630	-2.5%
Banks	8,244	7,574	-669	-8.1%

Source: SBP

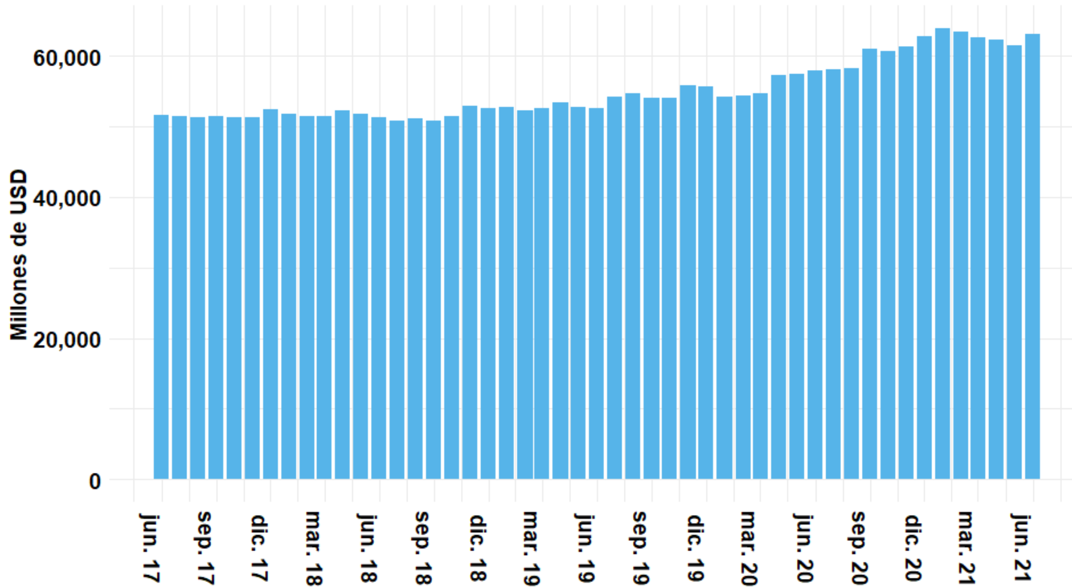
As for the banks of the National Banking System, there is a trend like that of the IBC, recording USD 85.04 billion, a 6.7% increase versus June 2020, driven by customer domestic and foreign deposits (**see Table 9**).

Table 9: National Banking System
Total Deposits
(in millions of USD)

	2020	2021	June 2021 /June 2020 Diff.	
	June	June	Total	%
Deposits	79,716	85,031	5,315	6.7%
Domestic	57,878	63,101	5,223	9.0%
Government	10,975	12,474	1,499	13.7%
Customer	43,612	47,117	3,505	8.0%
Banks	3,291	3,510	219	6.7%
Foreign	21,838	21,930	92	0.4%
Government	144	165	21	14.9%
Customer	13,990	14,709	719	5.1%
Banks	7,705	7,056	-649	-8.4%

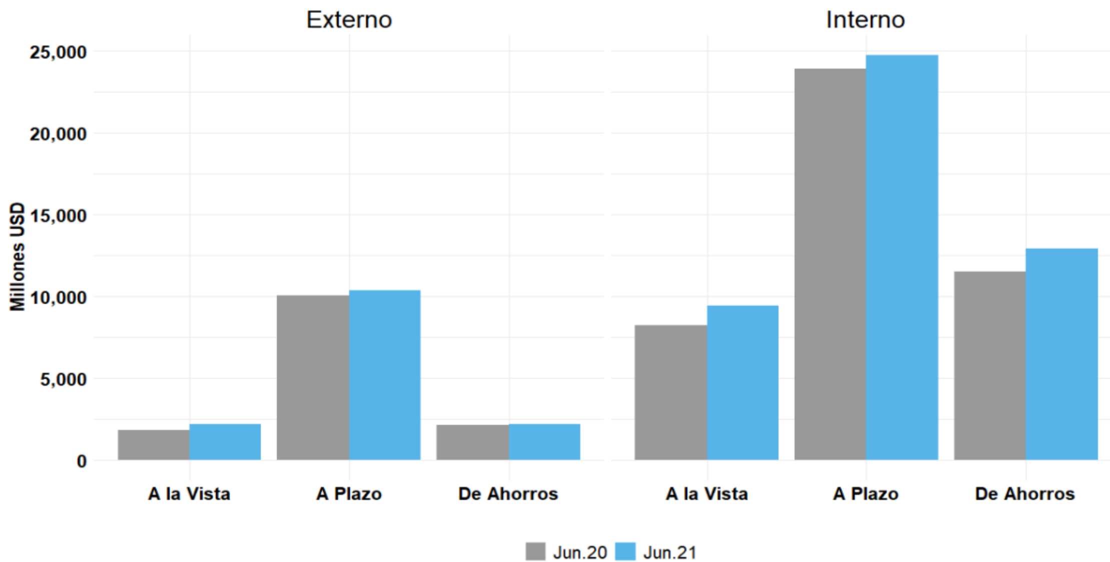
Source: SBP

The domestic deposits of the National Banking System represent 74.2% of the total deposits of the System. To date, we observe that customer deposits have shown resilience and there are no short-term reductions that could indicate that there could be a situation that exposes the group of banks. **Graph 6** (sic) shows the evolution of the balance of domestic deposits.



Source: General license banks

Regarding the structure of customer liabilities by maturity, Certificates of Deposits (CD) continue to be the most important savings instrument. As of the end of the first half, CDs represent 52.2% of customer domestic deposits adding up to USD 24.75 billion, followed by savings amounting to USD 12.94 billion, and demand deposits totaling USD 9.44 billion. Customer domestic deposits grew 8.04% in June. The greatest performance was recorded by demand deposits (14.4%) and savings deposits (12.72%).



Source: General and International license banks

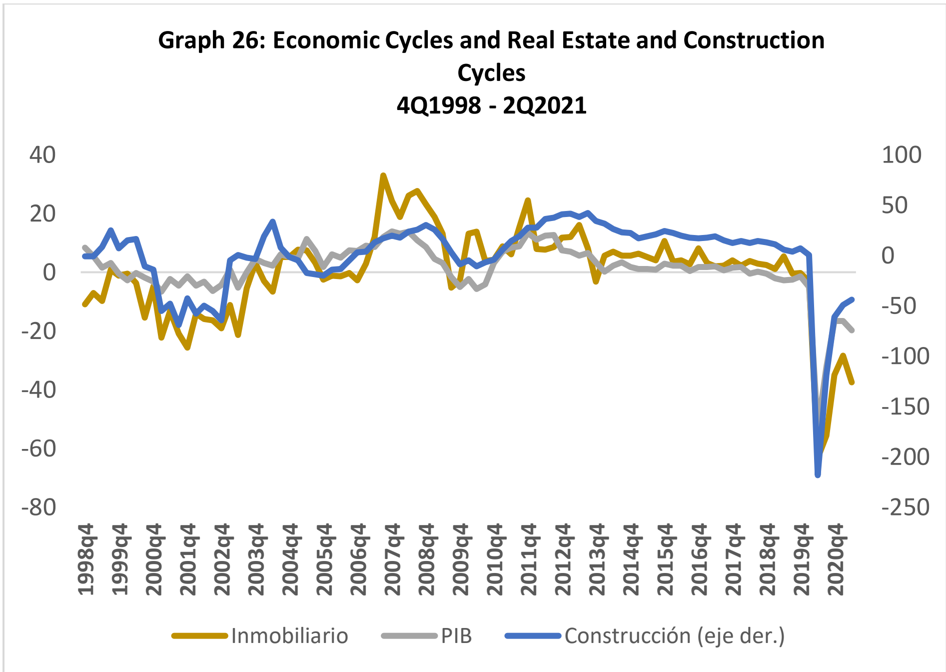
IV. Macro financial Variables

A. Performance of the Construction and Real Estate Sector

The demand for housing and the construction process, after a contraction because of the COVID-19 contingency, recorded an important recovery, but it is still below its long-term trend.

Graph 26 shows that the real estate and construction market cycles regularly follow the same direction as the aggregate cycles of the economy, indicating that the real estate and construction activity is procyclical to the economic activity. The foregoing was statistically proven through the "positive" correlations between the aggregate cycles of economic activity and the real estate sector cycles[2]. In fact, as expected based on the previous literature, these activities overreact to the cycle, that is, the pass-through ratio is greater than one, which implies that when the economy grows, the sector does so to a greater extent, but similarly, when the economy decreases, the sector also does so to a greater extent.

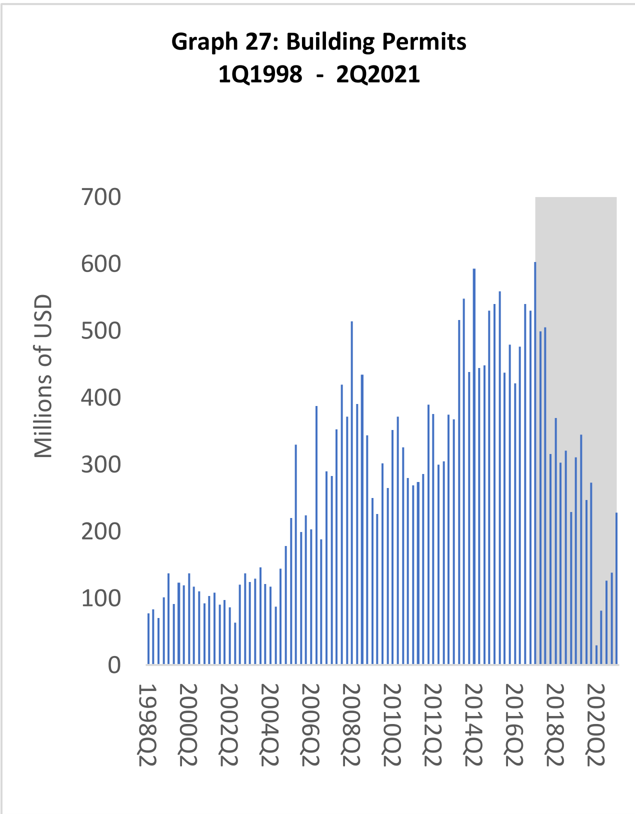
Similarly, the graph shows that building permit cycles are more volatile than real estate sales and economy cycles. The foregoing is explained, in part, because building permits accumulate in certain periods due to the extensive bureaucratic procedures they must go through. Meanwhile, real estate sales cycle shows smaller fluctuations with respect to their long-term measures, because of the aggressive competition of the credit market, which in general speeds up the processes of acquiring a home. The foregoing is undoubtedly information that provides a clear room for improvement for the sector performance.

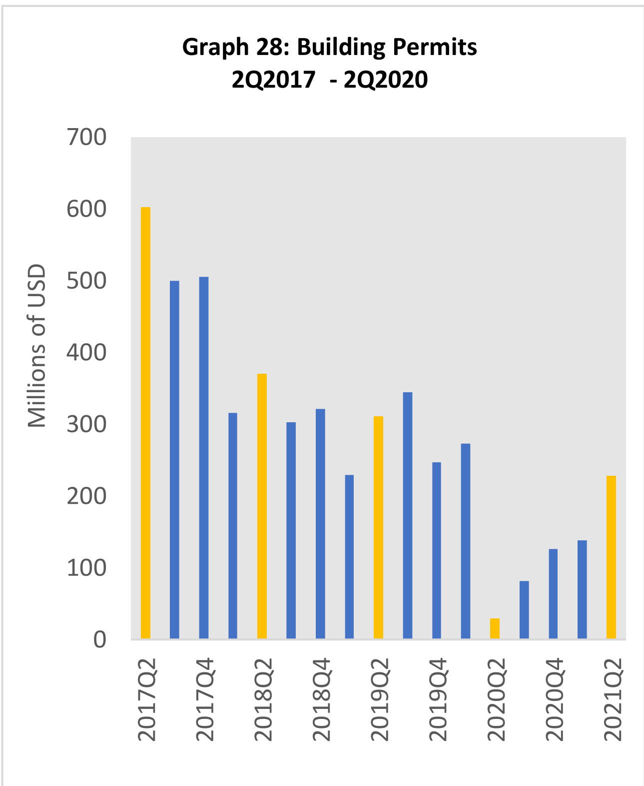


[2] Both are above 0.8.

It is noteworthy that due to the weighing of these sectors in investment (Gross Capital Formation), they will be key to the recovery of both the real estate and construction markets.

So far this year, the approval of new building works has recorded a positive accumulated difference of 20.9% versus 2020. Thus, between January and June, an estimated of 625,314 square meters were approved for construction, i.e. an increase of 23.6%. It should be noted that housing development is an important component of gross fixed capital investment, representing an average of 24%. Particularly, building permits (the data we have), which reflect an early stage of housing development, have expanded significantly, and could reach 2019 levels this year. This would be the consequence of a significant increase in housing demand, caused by a change in household preferences, in a context of low long-term interest rates[3]. It is remarkably that, despite this recovery process, it will still be necessary to assess whether the levels prior to 2018 are reached, when the sector dropped sharply.





This substantial loss of dynamism was also observed in the wholesale demand for building materials. However, for the first half of 2021, factors such as the gradual deconfinement process in 1Q2021 and the improvement in business expectations led to a recovery in the supply and demand of construction supplies.

[3] Liu, Sitian and Su, Yichen, The Impact of the COVID-19 Pandemic on the Demand for Density: Evidence from the U.S. Housing Market (April 11, 2021).

For example, cement production – a product extensively used in the early stages of construction – has been experiencing interesting growth rates, but still lower than those recorded in 2019.

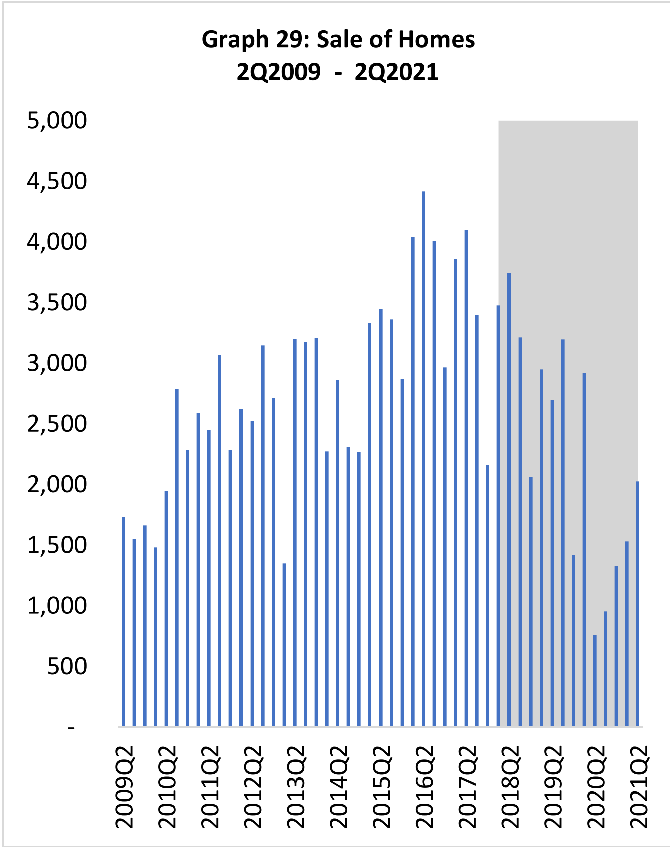
At a more micro level, the rise in the price of building materials for the construction of buildings and specialized activities is consistent with the higher prices observed in basic products (commodities). In this context, several construction companies are already being notified of material price rises by their suppliers and this could produce a transfer to the end user.

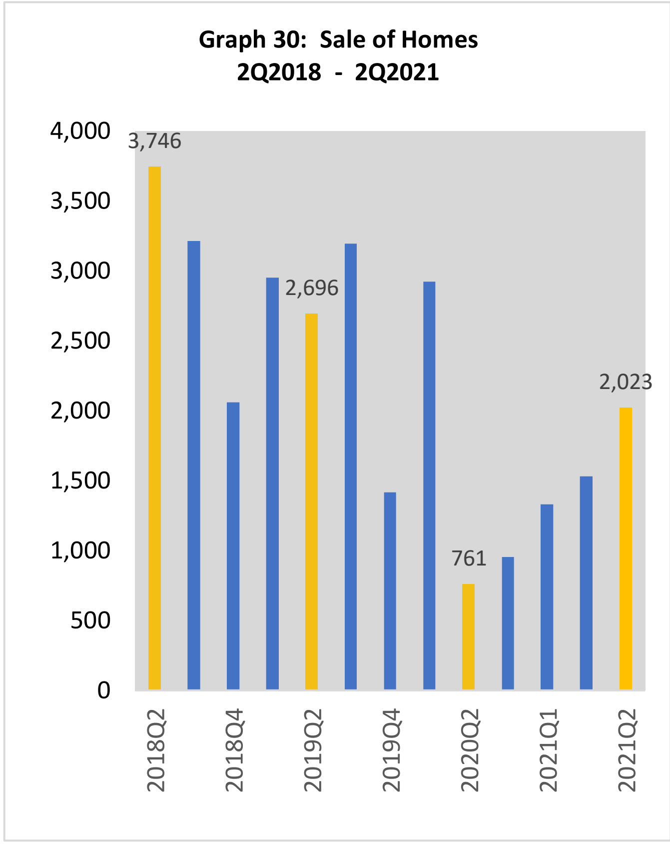
Real Estate market performance

The real estate sector, as other economic and productive activities, has shown significant improvements. The real estate sector is still one of the axes of economic recovery in the country, as it grew by nearly 165% during 2Q2021. Although salesrooms have remained closed due to regional/provincial lockdowns, which has made it difficult to sign promise of purchase and sale agreements, the real estate sector has extensively used virtual sale channels and, in this way, it has been possible to appreciate marketing levels better than expected.

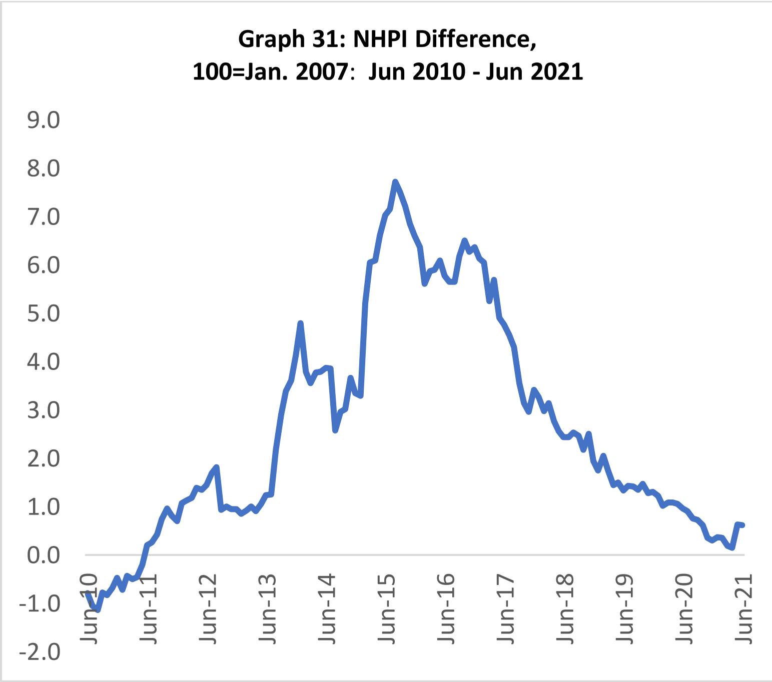
The economic recovery after the toughest months of the pandemic and the successful inoculation process are increasing the appetite for home purchases. Preliminary data show that the inactivity of the construction sector has led to the consumption of the available housing stock (that was historically high), which could put pressure on demand in the short- and medium-term and new pressure on prices.

We emphasize once again that, prior to the COVID shock, this market was in a slowdown phase, a process that seems to have been observed since 2016.

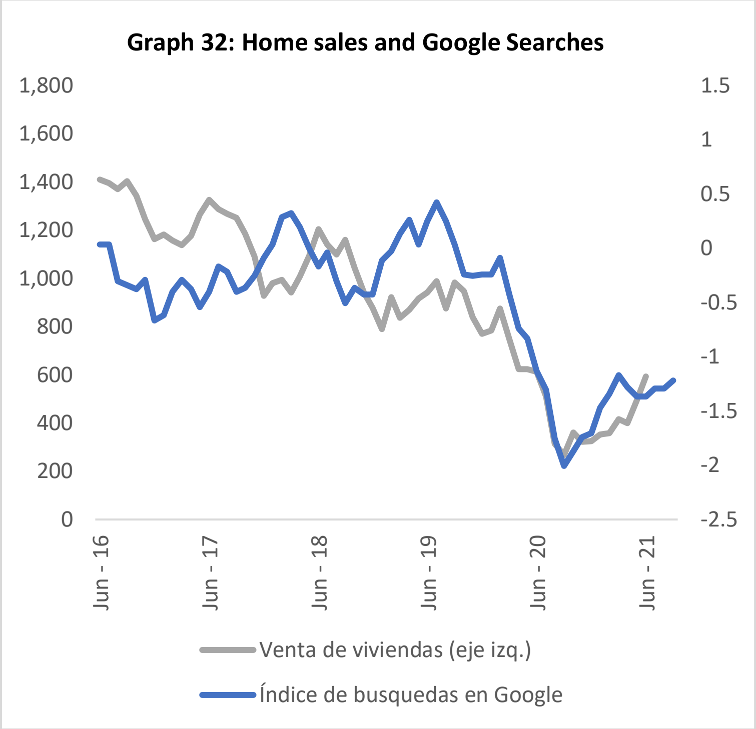




New home prices have showed an evolution consistent with the supply and demand dynamics analyzed in previous reports. Thus, a slight increase began to be observed, in accordance with the fundamentals of the sector.



It is noteworthy that the lockdown and the difficulty in completing some of the tasks related to the home buying and selling process would have had a monumental impact on demand. This can be seen, for example, from indicators based on Internet searches for terms related to the real estate sector, which show a sharp drop that has not yet fully recovered. However, the preliminary data for this indicator show that home sales could increase in the coming months, even though seasonally a lower performance is expected in the second half of the year.



Graph 32: Home sales and Google Searches

Summary

The degree of real estate and construction market activity recovery, once the health crisis comes to an end, will depend on the extent to which the economic and financial effects of this disturbance will last.

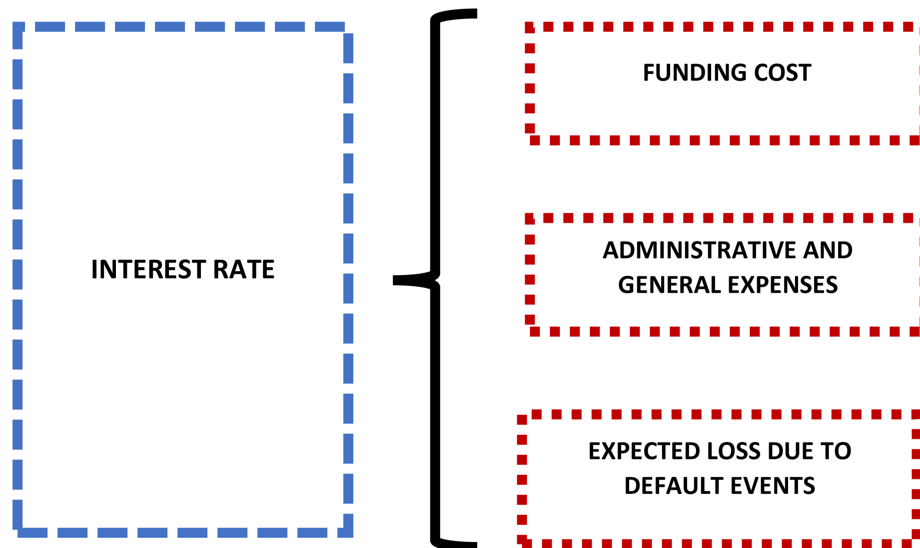
B. Interest Rate Caps

Currently, there is a bill that seeks to fix interest rate caps in Panama with a maximum of an effective [interest] rate of 15% per year. Both theory and practice indicate that the imposition of interest rates below the threshold and far from their fundamentals tends to reduce access to financial services, affects bank access and produce informal credit markets.

Interest rates charged by banks and other financial companies must allow them to cover their funding costs, their operating expense, and the risk component associated with payment default (**see Figure 1**). In particular, the latter or the probability of loss is estimated by banks and other companies within the financial system based on the client risk profile which, in turn, depends on the debtor's income, his/her degree of employment or self-employment, his/her credit record, and the collateral the debtor has

placed to guarantee his/her loans. Therefore, people with few collateral, little credit record, and a higher probability of default may face higher rates for the same product.

Figure 3: Costs related to Fixing Interest Rates



That said, although the current proposal for the Usury Law is intended to benefit the population by fixing interest rate caps, it may, on the contrary, unprotect people with lower incomes, whose particular characteristics of lower income, higher level of self-employment, and lack of information, require the customization and response of credit products that recognize this condition and, therefore, need a greater margin of operation to compensate for the operating cost and risk through the interest rate.

However, it is noteworthy that when compared to the rest of the region, both lending and deposit rates of the Panamanian market are low and show little volatility. This responds mainly to low country risk, with no devaluation risk, and with financial integration with which interest rates are low, closer to those in international markets.

If interest rates are compared to those of the region, a lower level of domestic rates versus rates offered by neighboring countries can be seen. The product with the highest prices in the Panamanian banking system is the credit card, however, it could be below those offered by other countries in the region and be very competitive when compared to countries like the United States.

Table 10: Benchmark Interest Rate by Product (Latin America and the US)

Currency	Country	Lending interest rates			Deposit interest rates	
		Mortgage	Personal loan	Credit card	30-day deposits	Annual CD
USD	Panama	5.76%	8.67%	19.80%	0.81%	2.68%
USD	United States	3.09%	9.63%	12.93% - 25.3%	0.05%	0.21%
ARS	Argentina	30.22%	50.57%	29.99%	28.68%	
BRL	Brazil	7.17%	79.60%	69.70%	2.15%	2.43%
CLP	Chile	2.79%+UF	11.52%	23.50%	0.24%	0.56%
COP	Colombia	7.35% - 14.90%	27.18%	27.40%	1.9% - 3.9%	0.12% - 3.2%
CRC	Costa Rica	6.5%-7.5%		18% - 37.69%	2.25%	3%
USD	Costa Rica			18% - 30.36%		
USD	Ecuador	10.17%			5.13%	8.28%
USD	El Salvador	7.45%	9.92%	18.57% - 36.57%	3.54%	4.45%
GTQ	Guatemala			45.2%-48.9%		3% - 3.5%
NIO	Nicaragua	10.55%-12%	16.27%-19.55%	44.76%	0.93%	5.83%
NIO	Nicaragua		10.38%-16.61%	24.69%	1.53%	5.79%
PYG	Paraguay	10.00%	17.00%	13.00%	0.10%	3.90%
PEN	Peru	7.5% - 14%	15% - 40%	24% - 60%		0.1% - 5.7%
USD	Uruguay	6.40%		6.70%	0.10%	0.20%
UYU	Uruguay			58.20%	3.20%	70.00%

Source: SBP, FELABAN and various surveys

International experience shows how interest rate caps have negatively affected financial inclusion and lending to clients, as well as the stability of companies in the financial system of different countries or regions that had or have interest rate caps. A World Bank[4] survey shows that at least 76 jurisdictions worldwide (61 of the World Bank) currently use some type of interest rate cap.

As for the effects of these interest rate caps, evidence points to negative effects: ① Exclusion of lower income segments (Nicaragua); ② increase in illegal/unregulated loans (e.g. Colombia); ③ decrease in licensing of new credit institutions (as in Bolivia); ④ increase in the total cost of loans through additional fees and commissions (as in Armenia, Nicaragua, and South Africa); and ⑤ decrease in product diversity.

An important element, so that people can benefit from more competitive interest rates, goes through a relevant expansion of financial education that allows credit takers to properly use and understand the existing information when managing a loan.

Prior to making a political decision regarding the adoption of interest cap measures, a specialized and comprehensive technical analysis is required to minimize financial exclusion to the detriment of lower income population, which, according to international evidence explained above, they could be affected by fixing a maximum interest rate.

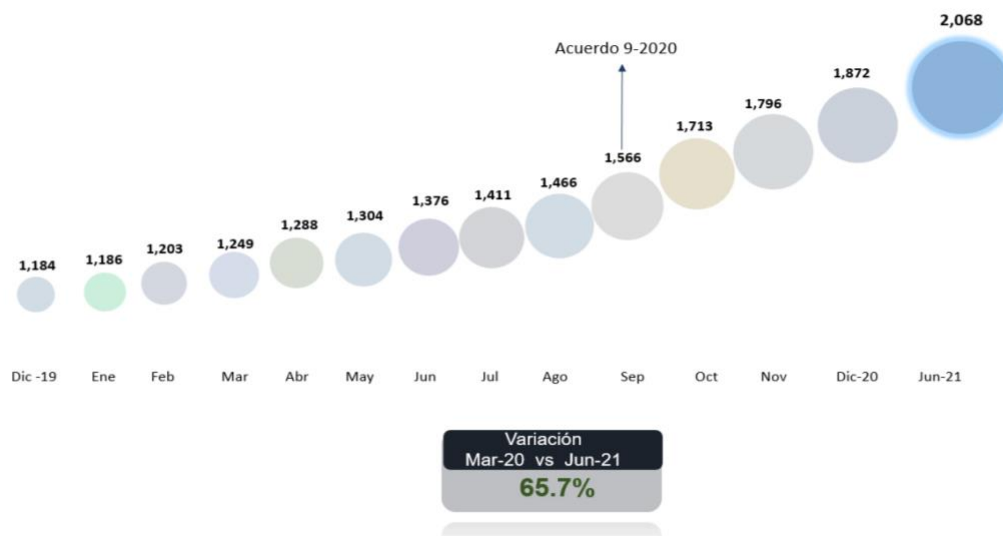
[4] Maimbo, Samuel Munzele and Henriquez Gallegos, Claudia Alejandra, **Interest Rate Caps Around the World: Still Popular, But a Blunt** Instrument (October 1, 2014). World Bank Policy Research Working Paper No. 7070

V. IFRS 9 Provisions

In the current juncture, accounting provisions have been strengthened, reflecting an increase of 65.7% since the outbreak of the pandemic, which translates into USD 820 million more provisions. This is because of the models that some banks used to predict expected losses according to the parameters established by the IFRS 9, as well as by the provisions of the SBP in Banking Rule 9-2020, which requires an increase in regulatory provisions, with a minimum of 3%, of which 1.5% is passed through results and the remaining 1.5% through capital, as of September 2020.

This increase in provisions is reflected in the different risk rating stages; mainly in the first two, which correspond to loans that may or may not present a significant increase in credit risk, but still do not present objective impairment evidence.

These models must be reviewed on an ongoing basis, especially in the current juncture, so that they collect as closely as possible the different parameters necessary for calculating the expected loss of both the modified and the unmodified portfolio.



The recorded provisions improve coverage and strengthen the NBS position against expected losses of both the modified and unmodified portfolio.

The SBP is constantly monitoring the evolution of the modified portfolio and its provisions. Similarly, exercises have been carried out to stress the modified portfolios and calculate provisions under stressed scenarios.

The portfolio has been segmented taking into consideration whether it has reflected a significant increase in its risk or whether impairment events have been evidenced. This analysis is complemented by the modified portfolio risk analysis, which assesses whether it is in the payment period, it has been restructured or it is pending restructuring. As of the end of June 2021, the IFRS Provision/Modified Portfolio ratio was of 4.7%. The results of the assessments made reflect IRFS Provision/Modified Portfolio ratios between 7 and 7.5%.

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