Banking Activity Report

June 2023

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Executive Summary

As of the end of the first half of 2023, the International Banking Center (CBI, for its acronym in Spanish) has maintained a positive performance in its operations. The profitability of credit institutions and the performance of the credit portfolio have shown continuous improvement in recent months. Additionally, liquidity and solvency levels, in the aggregate, are above their regulatory limits.

The total assets of the CBI amounted to USD 142.95 billion, representing an increase of USD 5.65 billion compared to June 2022, indicating a year-on-year rise of 4.1%. The expansion rate of bank assets has accelerated due to growth in the net credit portfolio (6.7%) and the securities component (4.2%). However, liquid assets experienced a year-on-year decrease of 8.4%, attributed to strategic decisions aimed at optimizing returns.

As of the end of the first half of 2023, the corporate banking credit portfolio grew by 5.3% compared to 2022, totaling USD 59.62 billion. This performance resulted from an annual 4.0% growth by legal persons and entrepreneurs, an annual 2.6% increase in consumer credit, an annual 5.4% rise in mortgage credit, and an 18.4% growth in financial services. notably, the construction sector stands out, as it achieved a positive year-on-year growth of 1.2%. This is the first positive performance recorded by this credit portfolio component since May 2018. With this performance, all credit portfolio components have positive year-on-year appraisal.

The portfolio quality of CBI as of May 2023 shows a default ratio of 4.3%, with 1.6% representing loans with arrears of 30+ days and loans with arrears of 90+ days recording 2.5%. While the latter has been increasing, most banks have maintained provisioning levels that provide buffers against the moderate deterioration in asset quality. Provisions for delinquent or past due loans were strengthened during the pandemic, enhancing banks’ ability to absorb losses from future loan impairments. Provisioning for impaired loans is above 100%. However, given the context of rising interest rates and other external risks, some deterioration in the portfolio quality indicator is expected in 2023 due to a less favorable operating environment and the maturity of consumer loans, so it would be recommended that banks increase their provisioning levels.

By June, the cumulative profits for the first half of the year of CBI banks totaled USD 1.44 billion. The figure represents a 51.2% increase in earnings compared to the same period 12 months ago. This growth is attributed to the development of the financial margin and commissions, stemming from the continuous expansion of the credit portfolio, effective asset management, expense control, and a reduction in provisions in response to a preventive assessment of credit risk. Additionally, profitability was enhanced by profits generated by other entities within the banking group. It is anticipated that profitability will continue to benefit from credit portfolio growth in a potentially higher risk scenario, consistent commission income, and the digitalization processes implemented by banks.

The balance of CBI bank deposits, as of June 2023, amounted to a total of USD 100.93 billion, indicating a USD 2.11 billion increase (2.1%). Domestic deposits experienced a decrease during the surveyed period, amounting to USD 1.035 billion, representing a 1.6% decline compared to June 2022. On the other hand, domestic deposits exhibited an 8.8% year-on-year increase (USD 3.14 billion), reaching a total of USD 38.73 billion. Domestic deposits account for 38% of the International Banking Center. These deposits have continued to infuse dynamism into CBI deposits, a trend that has been amplified since late 2021. Most external deposits originate from Colombia and the United States of America, followed by Costa Rica, Venezuela, and Peru. Colombia leads this segment, contributing to 21.8% of the external deposit portfolio, trailed by the United States, 5.9%; while Costa Rica and Venezuela each account for 5.7%; and Peru for 5.2%. Notably, as of the conclusion of the first half, term deposits have accelerated their expansion, propelled by higher interest rates, which in turn has heightened the appeal of this type of savings instrument. Within customer deposits, the performance of term deposits has been pivotal in driving deposit expansion, culminating in a year-on-year increase of 2.6% for domestic deposits and 19.3% for external deposits.

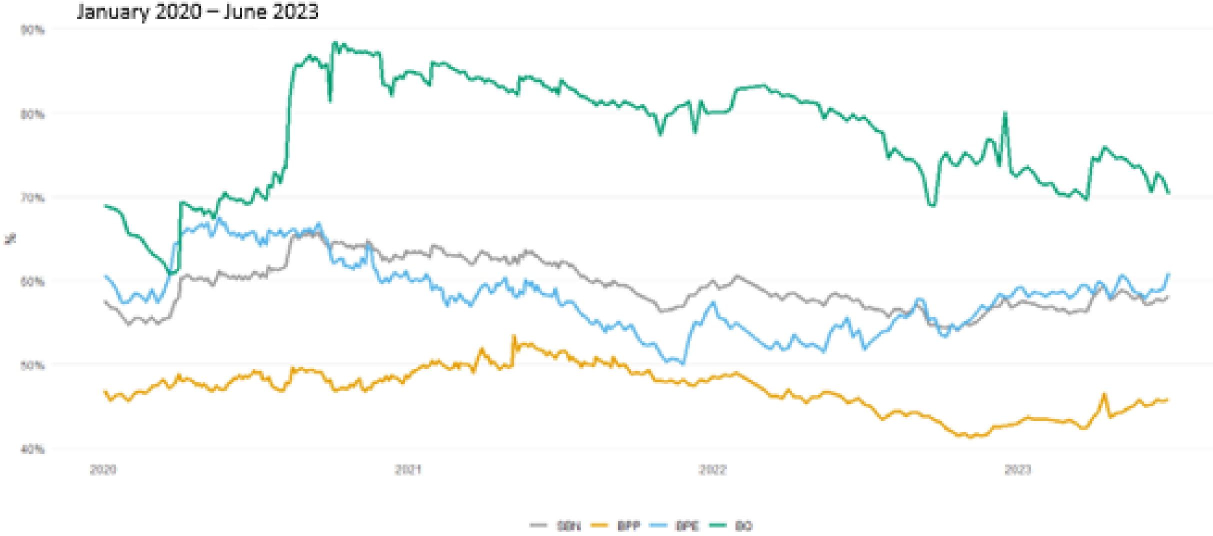
At the domestic level, since 2022, it has been observed that deposit rates, especially term deposits, have begun to rise, indicating an increase in banks' funding cost. Consequently, interest rates on term deposits have recorded an average increase of 166 basis points, with the most significant rise seen in the three-month rate, which increased by approximately 217 basis points. Concerning lending rates, data as of June 2023 indicate an upward trend, primarily in the corporate segment and, to a lesser extent, in consumer credit. The unweighted average rate of loan increases has been 62.7 basis points. During the surveyed period, the interest rates on loans for the wholesale commerce and industry sectors increased by 1.37% and 1.09%, respectively. Other rates for the productive sector have, on average, increased by 0.70%. Household loan rates, on the other hand, have remained at levels like those recorded in 2022, with changes below 20 basis points. In the case of credit cards, there was an increase of 58 basis points. While regulatory provisions stipulate that it is the responsibility of each bank to adjust the rates paid for deposits or charged for credit, it is crucial to emphasize that compliance with regulations dictating transparency of information and timely notifications rests with each bank. This enables customers to prepare for or negotiate with their bank to establish pertinent agreements and thus safeguard their credit conditions.

In conclusion, the Panamanian financial system has consistently demonstrated resilience and a solid overall position. Nonetheless, considering the external macro-financial environment and the stringent financial conditions resulting from tightening of monetary policy frameworks, the SBP will continue to closely monitor the impact of these events on market liquidity and solvency. This ongoing vigilance aims to ensure the stability of the financial system considering the present circumstances.

A. Liquidity

At the end of June 2023, the liquidity of the Banking System reached 57.6%, with the increase in deposits contributing to its improved quality position. Presently, local banks are in a robust regulatory position, which empowers them to navigate market volatility. Banks within the National Banking System (SBN for its acronym in Spanish) have consistently maintained strong liquidity buffers and dependable access to structural and wholesale deposits, constituting a critical part of their funding. It is important to note that all banks operating within the Panamanian CBI are required to adhere to Basel III requirements as stipulated by regulatory provisions. The Liquidity Coverage Ratio (LCR) gauges the ability to secure emergency or survival funding over a 30-day period. The latest figures indicate that the ratio of deposits and expectations compared to high-quality liquid assets comfortably surpasses the regulatory minimum, and its term structure is appropriate.

Graph 1: Weekly average liquidity ratio
January 2020 – June 2023

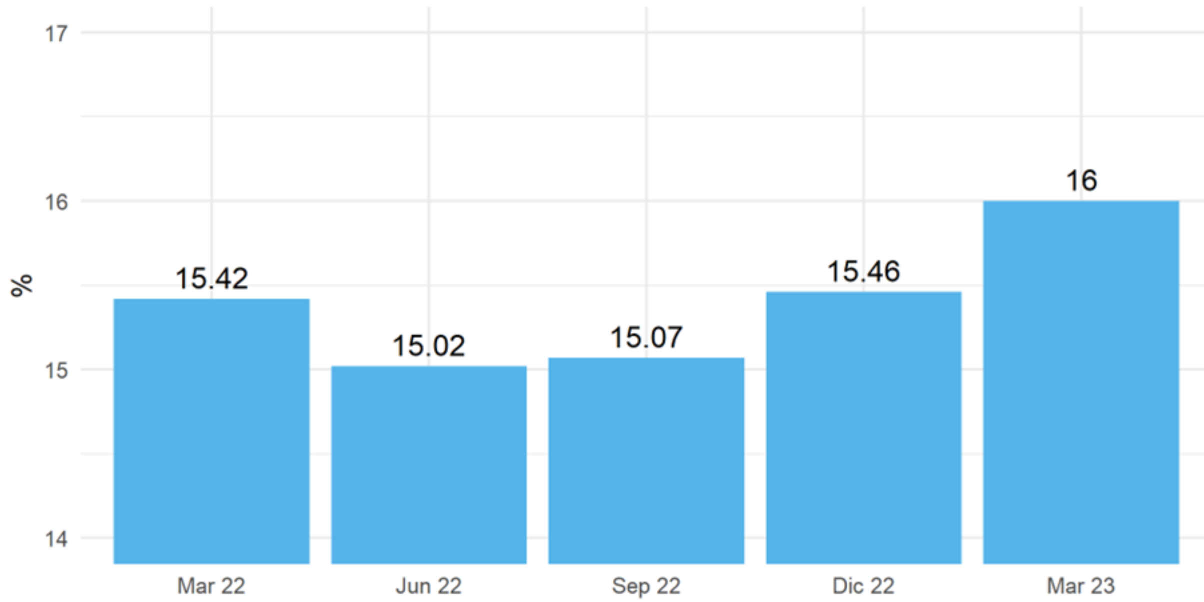


B. Solvency

The latest Capital Adequacy Ratio (CAR) indicates that the combined solvency ratios of CBI have remained in a robust position. The CAR on risk-weighted assets (RWA) stood at 16% (see **Graph 2**), surpassing the regulatory minimum of 8%. There were no significant changes in the capital of the group of banks compared to the previous quarter.

Profitability is anticipated to remain steady. This, combined with a more cautious growth in RWAs, will bolster capital adequacy metrics across most CBI banks. Presently, all banks operating within the CBI are in satisfactory compliance with the new bank capital regulatory standards.

Graph 2: Capital Adequacy Ratio
March 2022 – March 2023



Source: General and International License Banks

C. Income Statement

As of June 2023, the cumulative profit for the first half of the year for CBI banks totaled USD 1.44 billion. This figure represents a 51.2% increase in profit compared to the same period 12 months ago. This growth is attributed to the development of the financial margin and commissions, stemming from the continuous expansion of the credit portfolio, effective asset management, expense control, and a reduction in provisions in response to a preventive assessment of credit risk. Additionally, profitability was enhanced by profits generated by other entities within the banking group.

The profitability of assets responded notably to the rise in net interest income (31.4%), propelled by the growth in portfolio interest income and securities components, as well as other income (6.1%). General expenses management amounted to USD 1.53 billion, marking a 4.5% year-on-year increase.

Provisioning expenses decreased from USD 310.3 million in 2022 to USD 250.8 million in 2023, marking a 19.2% decrease. This performance is rooted in the coverage levels of provisions established during the pandemic, which, combined with specific regulatory requirements, served as an effective buffer during challenging periods at that time. As of early 2023, identified and monitored risks continue to persist both domestically and externally. Therefore, from a prudential perspective, it would be prudent to take actions to bolster potential provisions and mitigate potential events arising from an anticipated slower growth environment and a more complex international landscape.

In summary, the Income Statement reflects a robust performance for the CBI based on the data as of June 2023. It is anticipated that profitability will further benefit from the expansion of the credit portfolio in an environment of elevated interest rates, consistent commission income, and the operational efficiency achieved through the digitalization processes implemented by banks.

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

International Banking Center	Jan.-June 2022	Jan.-June 2023	Difference %	Difference USD
Net interest income	1,293.4	1,700.0	31.4%	406.6
Other income	1,427.9	1,514.4	6.1%	86.5
Operating income	*2,721.4*	*3,214.4*	18.1%	*493.0*
General expenses	*1,460.7*	*1,526.6*	4.5%	*65.9*
Profit before provisions	1,260.7	1,687.8	33.9%	427.1
Provisioning expenses	310.3	250.8	-19.2%	(59.6)
Profit for the period	**950.3**	**1,437.0**	**51.2%**	**486.7**

Source: General and International License banks.

The National Banking System recorded accumulated net profits of USD 1.12 billion as of June 2023, signifying a 50.5% increase compared to June 2022. Like the CBI, increased credit activity and reduced provisioning positively influenced the sector's profits. It is anticipated that SBN banks will continue to implement strategies for cost control and operational efficiency. Presently, the efficiency level of the CBI is approximately 47%.

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

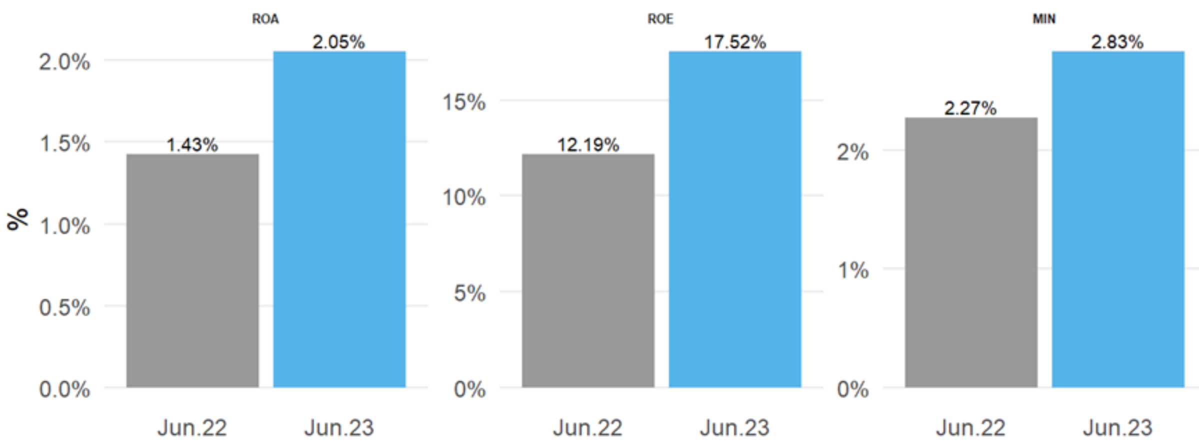
National Banking System	Jan.-June 2022	Jan.-June 2023	Difference %	Difference USD
Net interest income	1,203.8	1,505.9	25.1%	302.1
Other income	1,179.7	1,254.0	6.3%	74.3
Operating income	*2,383.5*	*2,759.9*	*15.8%*	*376.4*
General expenses	*1,342.5*	*1,399.6*	*4.2%*	*57.0*
Profit before provisions	1,041.0	1,360.3	30.7%	319.3
Provisioning expenses	301.2	247.0	-18.0%	-54.2
Profit for the period	**739.7**	**1,113.3**	**50.5%**	**373.5**

Source: General License banks.

D. Profitability indicators

The indicators suggest that banks in the market are experiencing a positive cycle, attributed to the expansion of post-pandemic investments and the availability of relatively low-cost financing through readily accessible deposits. As a result, interest margins and profitability metrics have strengthened. The Return on Equity (ROE) stood at 17.12%, signifying an increase of 472 basis points compared to the performance in the first half of 2022, which reached 12.4%. The Return on Assets (ROA) reached 2.02% by the end of the fourth month of the year, reflecting a 56 basis points increase from the previous year. These increases occurred in a context of improvements in credit placements and a reduction in provisions for asset impairment. It is important to note that, while these results are positive, they vary among different credit entities.

Graph 3: Profitability Indicators - CBI
June 2022 – June 2023



Source: General and International License banks

E. Balance Sheet

CBI assets totaled USD 142.95 billion, reflecting a year-on-year increase of USD 5.65 billion or a 4.1% rise compared to June 2022. Banks' assets accelerated their expansion rate due to growth in the net credit portfolio (6.7%) and the securities portfolio (4.2%). Liquid assets decreased by 8.4% year-on-year.

It is important to note that most CBI assets consist of the credit portfolio, which reported a balance of USD 85.26 billion according to the financial statements submitted by banks to the SBP. Regarding the performance of the net credit portfolio's external component, it increased by 8.4%. This suggests that corporate banking lending to the private sector continues to experience positive expansion, despite recent interest rate hikes primarily targeting the commercial segment.

On the deposits side, they constitute a substantial portion of the CBI's funding and support its credit operations, resulting in a reduced dependence on wholesale funding through market debt issuances, which can typically be more volatile. CBI deposits as of June 2023 totaled USD 100.93 billion. These data demonstrate the banks' ability to maintain depositors' confidence. Notably, a significant portion of these new deposits arises from the growth of term deposits, primarily held by individuals (which exhibit high renewal rates), thereby enhancing the banks' funding and liquidity profiles. In terms of customer liabilities by maturity, term deposits continue to be the most prominent savings instrument and were the primary driver for traditional bank deposits in June 2023. This positive performance is directly linked to the ongoing interest rate hike cycle, which has heightened the relative attractiveness of this type of savings instrument.

Obligations increased by 7.5% and other liabilities rose by 9.8% compared to June 2022. Concerning bonds, these instruments also encompass the financing component through issuances. Despite the increase in borrowing costs, current market conditions could stimulate an interest in such strategies to mitigate future liquidity risks and reduce uncertainty regarding potentially higher rates that might affect new investment decisions. This situation represents an opportunity to capitalize on the flattening yield curve between short- and medium-term rates.

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

Breakdown	2022	2023	Jun. 23/Jun. 22 Difference	
	June	June	Total	%
Liquid assets	21,128.8	19,351.2	-1,777.6	-8.4%
Net credit portfolio	79,904.8	85,251.9	5,347.1	6.7%
Domestic	*54,300.6*	*57,493.4*	*3,192.7*	*5.9%*
External	*25,604.1*	*27,758.5*	*2,154.4*	*8.4%*
Securities	29,378.3	30,616.4	1,238.1	4.2%
Other assets	6,886.5	7,723.6	837.1	12.2%
Total Assets	**137,298.3**	**142,943.0**	**5,644.7**	**4.1%**
Deposits	98,824.4	100,926.2	2,101.8	2.1%
Domestic	*63,235.7*	*62,200.7*	*-1,034.9*	*-1.6%*
External	*35,588.7*	*38,725.4*	*3,136.7*	*8.8%*
Obligations	19,034.3	20,471.2	1,436.9	7.5%
Other liabilities	3,896.9	4,278.9	381.9	9.8%
Capital	15,542.7	17,266.8	1,724.1	11.1%

Source: General and International License banks

The assets of the National Banking System totaled USD 126.07 billion, indicating an increase of USD 5.53 billion or 4.6% compared to June 2022. The SBN's net credit portfolio showed a USD 5.77 billion (8.0%) increase, reaching a total of USD 78.14 billion. Net external credits grew by 14.3%, while the net domestic portfolio had a growth of 5.9%. On the other hand, the total deposits held within the SBN amounted to USD 88.17 billion, representing a 2.6% rise.

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

Breakdown	2022	2023	Jun. 23/Jun. 22 Difference	
	June	June	Total	June
Liquid assets	17,247.6	14,859.0	-2,388.6	-13.8%
Net credit portfolio	72,367.2	78,134.9	5,767.7	8.0%
Domestic	*54,303.2*	*57,493.4*	*3,190.2*	*5.9%*
External	*18,063.9*	*20,641.5*	*2,577.5*	*14.3%*
Securities	24,368.1	25,678.6	1,310.5	5.4%

Breakdown	2022	2023	Jun. 23/Jun. 22 Difference	
	June	June	Total	June
Other assets	6,555.9	7,388.8	833.0	12.7%
Total Assets	**120,538.7**	**126,061.3**	**5,522.6**	**4.6%**
Deposits	85,901.0	88,163.3	2,262.2	2.6%
Domestic	*63,054.5*	*61,980.8*	*-1,073.7*	*-1.7%*
External	*22,846.5*	*26,182.5*	*3,335.9*	*14.6%*
Obligations	18,936.2	20,378.4	1,442.2	7.6%
Other liabilities	3,725.9	4,090.8	364.9	9.8%
Capital	11,975.5	13,428.8	1,453.3	12.1%

Source: General License banks

F. Credit

As of the end of the first half of the year, the corporate banking credit portfolio recorded a 5.3% growth in its year-on-year comparison, amounting to USD 59.62 billion (see **Table 5**). This performance is attributed to a 4.0% annual growth in credit to companies and entrepreneurs; a 2.6% annual growth in consumer credit; a 5.4% annual growth in mortgage credit; and an 18.4% increase in financial service activities.

Loans to the construction sector stand out, which reported a year-on-year increase of 1.2%, marking the first positive performance this segment has seen since May 2018. With this result, all credit portfolio segments have achieved year-on-year positive performances.

Table 5: National Banking System
Balance of domestic credit portfolio by economic sectors
(In millions of USD)

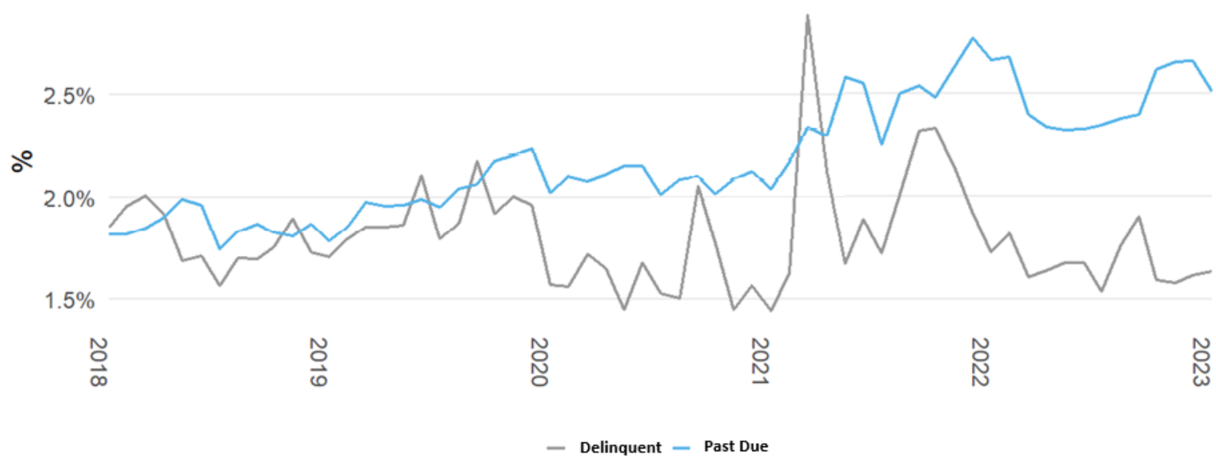
Sector	June 2022	June 2023	Jun. 23/Jun. 22 Difference	
			Total	%
TOTAL	56,590	59,614	3,024	5.3%
Public sector	1,470	2,012	542	36.9%
Private sector	55,120	57,602	2,482	4.5%
Financial & insurance activities	1,383	1,637	254	18.4%
Agriculture	467	493	26	5.6%
Livestock	1,310	1,328	18	1.4%
Fishing	87	119	32	37.1%
Mining & Quarrying	52	59	7	13.7%
Commerce	11,362	11,829	467	4.1%
Industry	3,245	3,498	252	7.8%
Mortgages	19,204	20,236	1,032	5.4%
Construction	5,035	5,093	58	1.2%
Personal consumption	12,975	13,309	334	2.6%

Source: General License banks

The portfolio quality of CBI as of June 2023 shows a default ratio of 4.1%, with 1.6% representing loans in arrears of 30+ days, and loans in arrears of 90+ days recording 2.5%. This performance demonstrates a higher arrears percentage when compared to pre-pandemic periods.

Regarding provisions for delinquent or past-due loans, they were strengthened during the pandemic, enhancing banks' ability to absorb losses from future loan impairments. It is expected that in 2023, asset quality will remain under control, even if economic conditions are less favorable. However, it has been observed that the coverage level has been decreasing due to credit analysis conducted by the entities.

Graph 4: Portfolio Quality: Delinquent and Past Due
June 2018 – June 2023



Source: General and International License Banks

G. Deposits

CBI bank deposits, as of June 2023, amounted to a total of USD 100.93 billion, indicating a USD 2.11 billion increase (2.1%). Domestic deposits experienced a decrease during the surveyed period, amounting to USD 1.035 billion, representing a 1.6% decline compared to June 2022.

On the other hand, domestic deposits exhibited an 8.8% year-on-year increase (USD 3.14 billion), reaching a total of USD 38.73 billion. Domestic deposits account for 38% of the International Banking Center. These deposits have continued to infuse dynamism into CBI deposits, a trend that has been amplified since late 2021. Most external deposits originate from Colombia and the United States of America, followed by Costa Rica, Venezuela, and Peru. Colombia leads this segment, contributing to 21.8% of the external deposit portfolio, trailed by the United States, 5.9%; while Costa Rica and Venezuela each account for 5.7%; and Peru for 5.2%.

Table 6: International Banking Center
Total Deposits
(In millions of USD)

Accounts	2022 June	2023 June	Jun. 23/Jun. 22 Difference	
			Total	%
Deposits	98,824	100,926	2,102	2.1%
Domestic	63,236	62,201	-1,035	-1.6%
Government	11,884	11,696	-188	-1.6%
Customer	47,994	47,105	-890	-1.9%
Banks	3,357	3,400	43	1.3%
External	35,589	38,725	3,137	8.8%
Government	428	281	-147	-34.3%
Customer	28,054	30,081	2,027	7.2%
Banks	7,107	8,364	1,257	17.7%

Source: General and International License banks.

In the case of the SBN banks, there is a trend like that of the CBI, with a total balance of USD 88.17 billion, representing a 2.6% decrease compared to June 2022, even though external deposits have shown stronger performance (see **Table 7**).

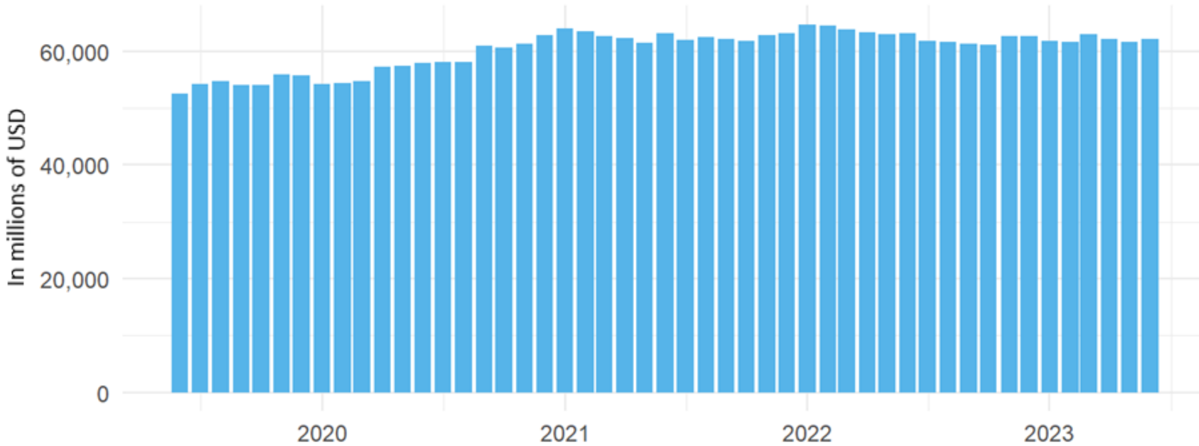
Table 7: National Banking System
Total Deposits
(In millions of USD)

Accounts	2022 June	2023 June	Jun. 23/Jun. 22 Difference	
			Total	%
Deposits	85,901	88,163	2,262	2.6%
Domestic	63,055	61,981	-1,074	-1.7%
Government	11,884	11,696	-188	-1.6%
Customer	47,994	47,105	-890	-1.9%
Banks	3,176	3,180	4	0.1%
External	22,847	26,182	3,336	14.6%
Government	426	224	-201	-47.3%
Customer	15,803	18,167	2,363	15.0%
Banks	6,617	7,792	1,174	17.7%

Source: General License banks.

It is important to note that domestic deposits account for 70.3% of the total SBN deposits, with 76% of these being customer deposits. While domestic deposits decreased, they are still higher than pre-pandemic levels. **Graph 5** illustrates the evolution of the domestic deposit balance.

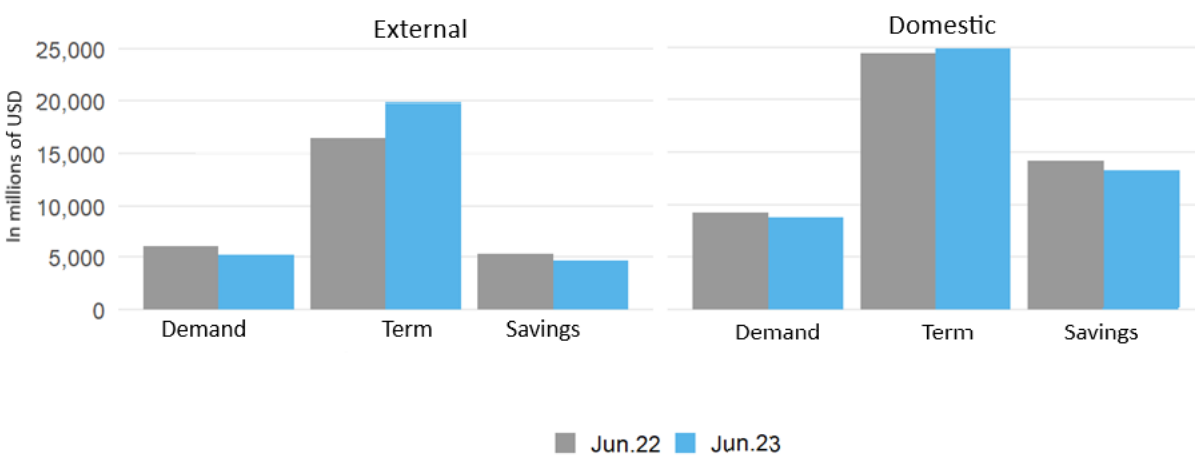
Graph 5: Total Domestic Deposits
June 2019 – June 2023



Source: General license banks.

Regarding the structure of customer liabilities by maturity, term deposits continue to be the most prominent savings instrument. As of the end of June 2023, customer domestic term deposits totaled USD 25.08 billion; followed by savings deposits at USD 13.12 billion, and demand deposits at USD 8.92 billion.

Graph 6: Customer Deposits
June 2022 – June 2023



Source: General and International license banks.

Notably, as of the conclusion of the first half, term deposits have accelerated their expansion, propelled by higher interest rates, which in turn has heightened the appeal of this type of savings instrument. Within customer deposits, the performance of term deposits has been pivotal in driving deposit expansion, culminating in a year-on-year increase of 2.6% for domestic deposits and 19.3% for external deposits.

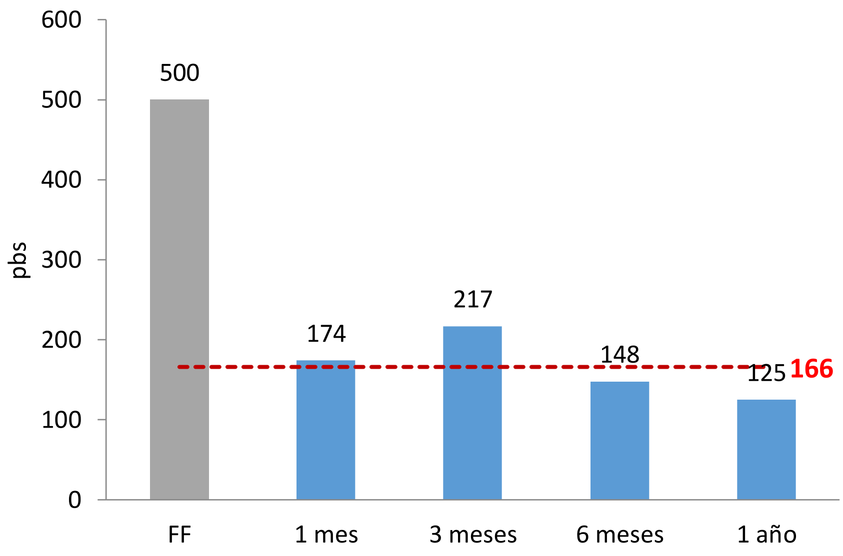
Box: Interest Rate Performance

Since the first quarter of 2023 until June, the U.S. Federal Reserve has increased its intervention rate by 500 basis points, reaching a rate of 5.00% to 5.25% in June 2023.

Although Fed rates are not directly applicable in Panama, they indirectly affect the cost of funding, which could influence changes in domestic rates. Specifically, external rate movements manifest in domestic market rates through two channels: deposit-taking costs (constituting the highest proportion of liabilities) and obligations cost (incurred in funding through issuances, lines of credit, and subordinate credit). It is important to note that Article 79 of the Banking Law stipulates that banks are free to set the interest rates for their lending and deposit operations. Therefore, other laws or standards will not apply. This means that banks have the autonomy to determine their own lending and deposit interest rates.

At the domestic level, since 2022, it has been observed that deposit rates, especially term deposits, have begun to rise, indicating an increase in banks' funding cost. Consequently, interest rates on term deposits have recorded an average increase of 166 basis points, with the most significant rise seen in the three-month rate, which increased by approximately 217 basis points.

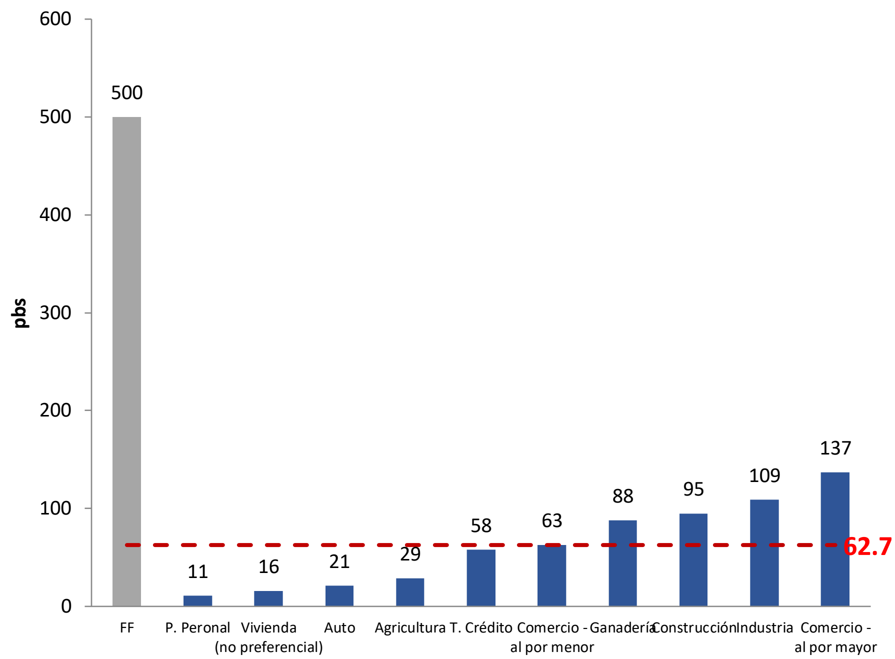
Graph R.1: Changes in Fed rates and deposits – Basis Points
Δ February 2022 – June 2023



Source: SBP with Fed and SBN banks data

Concerning lending rates, data as of June 2023 indicate an upward trend, primarily in the corporate segment and, to a lesser extent, in consumer credit. The unweighted average rate of loan increases has been 62.7 basis points. During the surveyed period, the interest rates on loans for the wholesale commerce and industry sectors increased by 1.37% and 1.09%, respectively. Other rates for the productive sector have, on average, increased by 0.70%. Household loan rates, on the other hand, have remained at levels like those recorded in 2022, with changes below 20 basis points. In the case of credit cards, there was an increase of 58 basis points.

Graph R2: Changes in Fed rates and loans - basis points
Δ February 2022 - June 2023



Fuente: SBP con datos de la Fed y Bancos del SBN

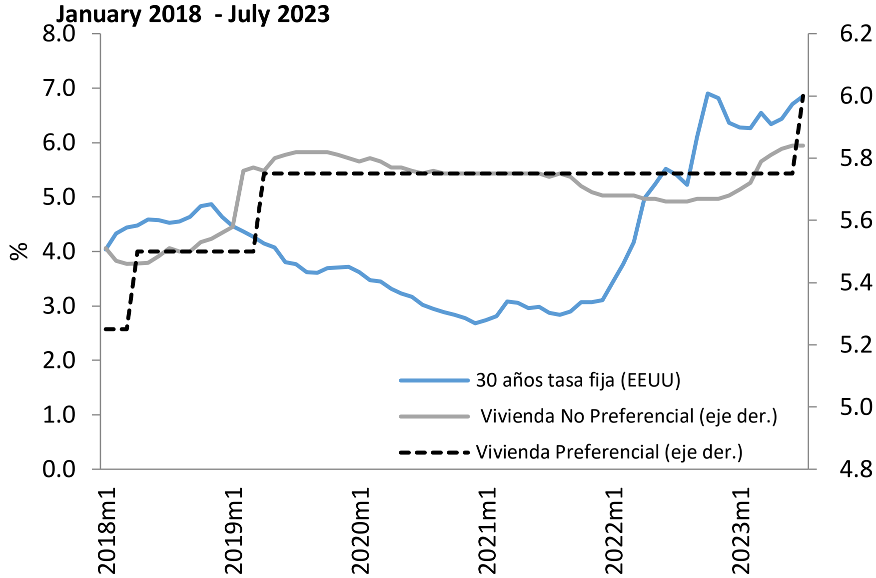
It is also worth noting that deposit rate hikes, in comparable terms, were greater than those observed in lending rates. While regulatory provisions stipulate that it is the responsibility of each bank to adjust the rates paid for deposits or charged for credit, it is crucial to emphasize that compliance with regulations dictating transparency of information and timely notifications rests with each bank. This enables customers to prepare for or negotiate with their bank to establish pertinent agreements and thus safeguard their credit conditions.

Mortgage Market Interest Rates

The domestic mortgage market reference rate (MMRR) was established for the first time in 1985, when what now we call the Preferential Interest Rate Law was formally introduced. The Residential Mortgage Preferential Interest Rate Law and its respective amendments [1] stipulate that the domestic mortgage market reference rate is determined as the weighted average of the interest rate reported by the five private banks with the highest residential mortgage loan portfolios, as well as by Caja de Ahorros.

The mortgage loans considered for the calculation are those not covered by the laws that establish tax credit benefits. These loans are granted based on an amortization table with a term of no less than 15 years, and the weighting is determined by the relative weight of the portfolio of the six banks under consideration. The average resulting from this calculation is rounded to the nearest quarter (1/4) of a percentage points. This rounded figure is subsequently communicated to the tax authorities, who will acknowledge the tax credit for credit entities participating in the subsidy scheme. Importantly, the prime interest rate had remained stable at 5.75% since the second half of 2019, making it one of the most consistent rates in the credit portfolio. Recently, the rate has been recorded at an approximately 6%.

Graph R3: Mortgage Rates in the USA and Panama
January 2018 - July 2023



Fuente: SBP y Freddie Mac

The SBP solely performs the calculation for this determination in accordance with the regulatory parameters described previously. However, it does not provide assessments on the potential changes, whether upward or downward, that the domestic mortgage market reference rate might experience.

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