



Financial Studies Division

Banking Activity Report

December 2018

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I. Economic Environment

A. Gross Domestic Product

The Panamanian economy grew by 3.7% in real terms compared to the same period in the previous year. The GDP valued at constant prices with a reference year of 2007, according to INEC calculations, amounted to USD 41.69 billion, reflecting an increase of USD 1.47 billion.

**Table 1. Components of GDP by the supply side
2017 – 2018**

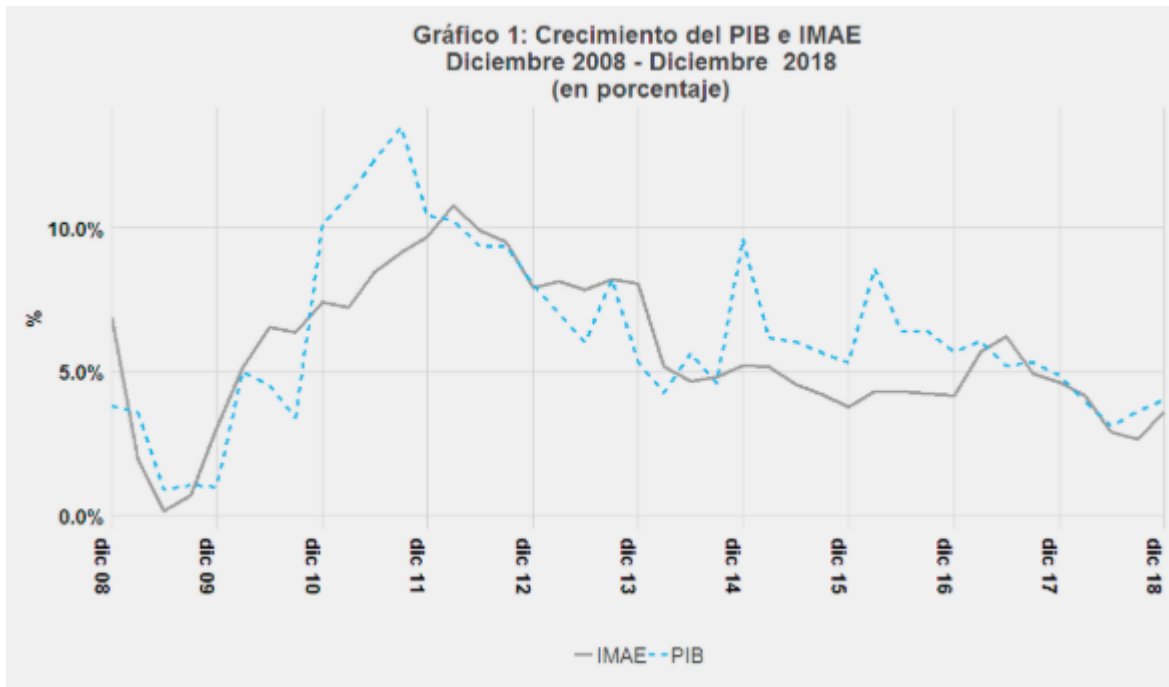
Sector	Annual Difference (%)		Contributions (pp)	
	2017	2018	2017	2018
GDP	5.3%	3.7%	5.3	3.7
Central Government	8.6%	8.4%	0.6	0.6
Transportation and communications	9.5%	7.3%	1.2	1.0
Financial intermediation	5.1%	4.2%	0.4	0.3
Commerce	3.3%	3.6%	0.6	0.6
Construction	8.3%	3.2%	1.3	0.5
Real estate activities	2.7%	2.8%	0.4	0.4
Utilities (Energy, gas, and water)	4.4%	2.6%	0.2	0.1
Other activities	4.4%	2.1%	0.5	0.2
Primary sector	0.4%	1.8%	0.0	0.0
Manufacturing industry	2.3%	0.7%	0.1	0.0
Fishing	1.5%	-3.2%	0.0	0.0
Hotels and restaurants	2.5%	-3.8%	0.1	0.1

Source: SBP with CGR data.

On the other hand, nominal GDP reached USD 65.05 billion, reflecting a growth rate of 4.4% compared to the previous year. This corresponds to an annual increase of USD 2.77 billion."

The Panamanian economy accelerated its growth in the last quarter of 2018, driven by a better dynamic of private spending (see Graph 1). In effect, GDP for the last quarter exhibited a positive performance of 4.0% compared to the same period of the previous year, surpassing the results of the third quarter (3.6%) and the second quarter (3.1%).

In a context where inflation has remained stable and inflation expectations are also well-anchored (see next section), the conditions will be positive for the economy to continue growing in the coming quarters, as projected by various organizations (**see reference at the end of this section**).



Source: SBP with CGR data.

From a sectoral perspective, the activities grouped in the transport, storage, and communication category recorded a growth of 7.3%, making it the most dynamic economic division in 2018, and consequently, the one that contributed the most to GDP growth with 1.0 percentage point (explaining a 26% growth in 2018). Among the activities that showed positive performance are the operations of the Panama Canal, which grew by 7.5%, driven by an 8.5% increase in tolls and a 1.3% increase in ship services, attributed to the behavior of transit numbers and non-traditional market segments due to the expanded canal. The port system experienced a rise of 3.5%, attributed to a 1.7% increase in the container movement (TEUs) and a 6.1% increase in general cargo, while bulk cargo decreased by 7.9%. Additionally, the telecommunications sector saw a growth of 4.1%, attributed to increased demand for mobile telephony, internet, cable TV, and messaging services. In the fourth quarter, the transport and telecommunications category exhibited an upward trend of 5.7%.

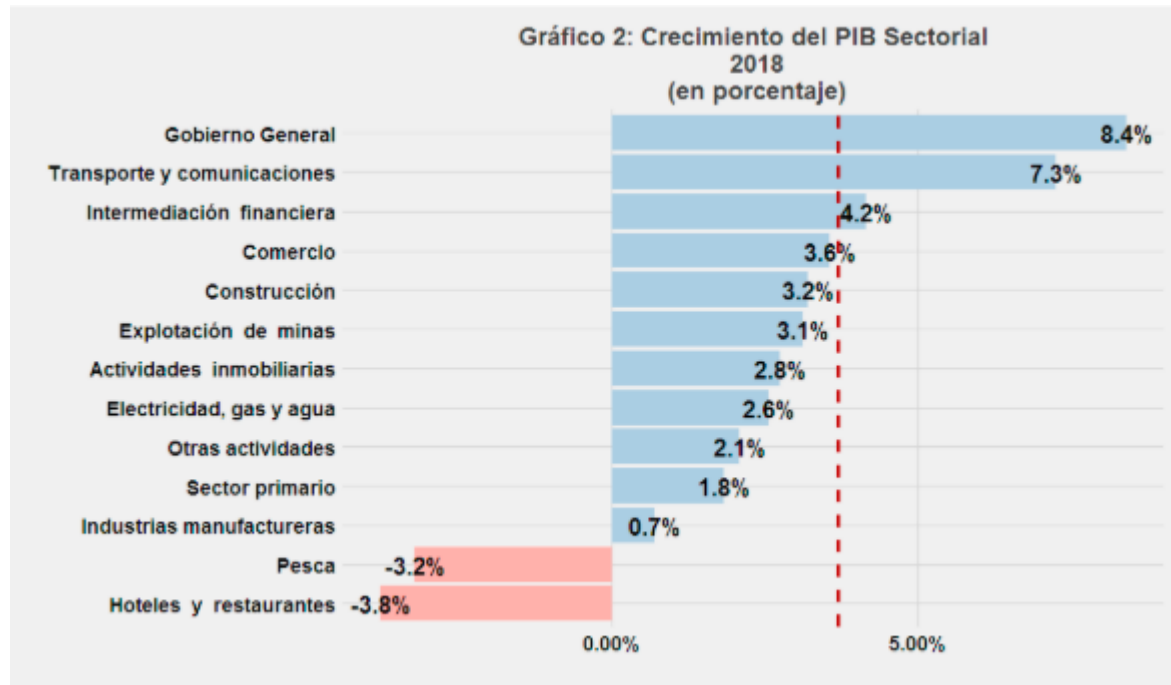
Financial intermediation in the national accounts reflected a growth of 4.2%, attributed to the performance recorded in the International Banking Center, which exhibited a 3.7% increase in financial services¹ during the period. **This result positions financial**

¹ Note that the data presented in this section do not coincide with the data reported by the SBP, as the Indirectly Measured Financial Intermediation Services (SIFMI) are constituted by the indirect remuneration obtained by financial institutions in deposit and loan operations with their clients, due to their methodological

intermediation activity as one of the most dynamic sectors in the economy in 2018.

Insurance companies experienced growth due to an increase in net premiums, while financial intermediation ancillaries had a lesser increase. The financial sector saw a 5.6% increase in the fourth quarter of 2018.

With respect to the construction sector, it ended 2018 with a growth rate of 3.2%. From a compositional point of view, this sector, along with real estate activities, could represent 29.9% of GDP, which is why these sectors should be observed with special attention.



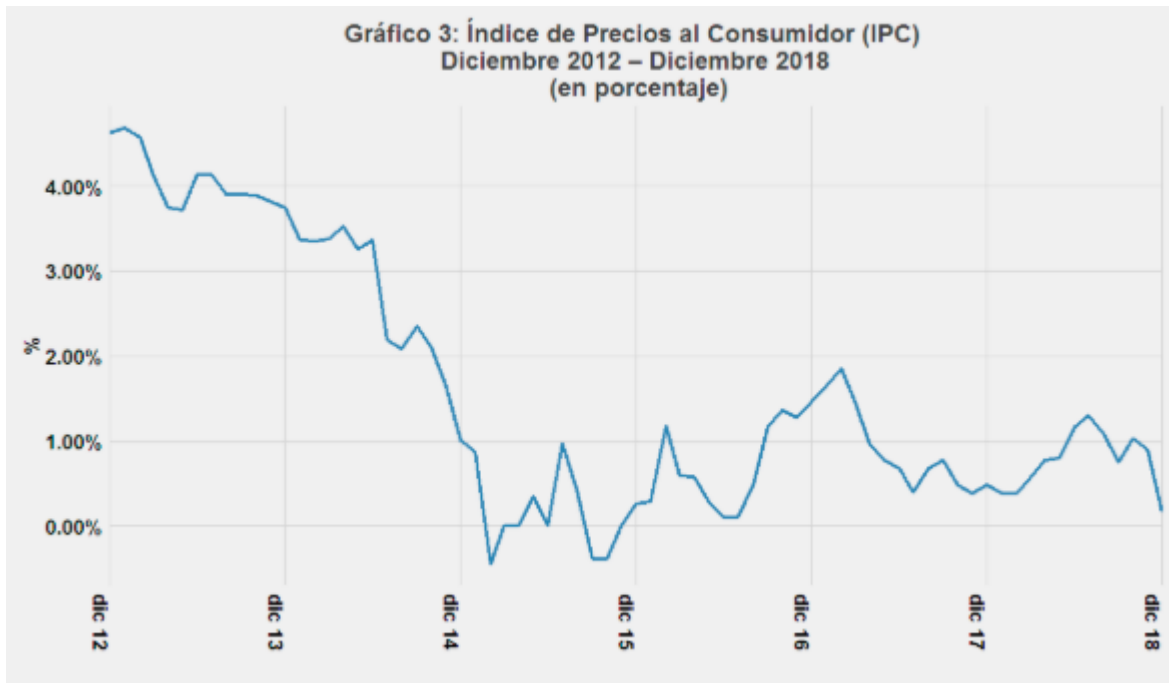
Source: SBP with CGR data.

According to the International Monetary Fund and the World Bank, Panama is projected to grow by 6% in 2019, which aligns with the projections of the Ministry of Economy and Finance (MEF). Additionally, the Economic Commission for Latin America and the Caribbean (ECLAC) projects a growth rate of 5.6%.

B. Consumer Price Index (CPI)

Panama accumulated an inflation rate of 0.8% in 2018, according to data from the National Institute of Statistics and Census (INEC).

construction. Additionally, these data differ because they are deflated based on the methodological process established by the INEC for this purpose.



Source: INEC

On the other hand, the furniture, household goods, and ordinary household maintenance group exhibited a decrease in eight of its eleven classes. The most significant variation was observed in the "large tools and equipment" class (-1.9%), attributed to the reduction in the price of household tools, according to the institution. The decline noted in the housing, water, electricity, and gas group stemmed from the decrease recorded in two of its eight classes.

Conversely, the groups with positive variations were food and non-alcoholic beverages; health; restaurants and hotels; and miscellaneous goods and services, all with a 0.2% increase.

II. International Banking Center

At the close of December, the International Banking Center (CBI) maintained solid financial stability indicators, characterized by an adequate capacity to generate profits and appropriate levels of efficiency. Net income for the period ended at USD 1.85 billion, representing a growth of 3.9%. **These results allow banks to sustain their capacity to strengthen their capital. Income from financial assets increased by 6.5%, demonstrating adequate resource management** in an environment of slight interest rate increases, which also leads to higher funding costs. This behavior reflects that, despite the adjustment in the cost of liabilities, the Center has managed to maintain a favorable interest margin.

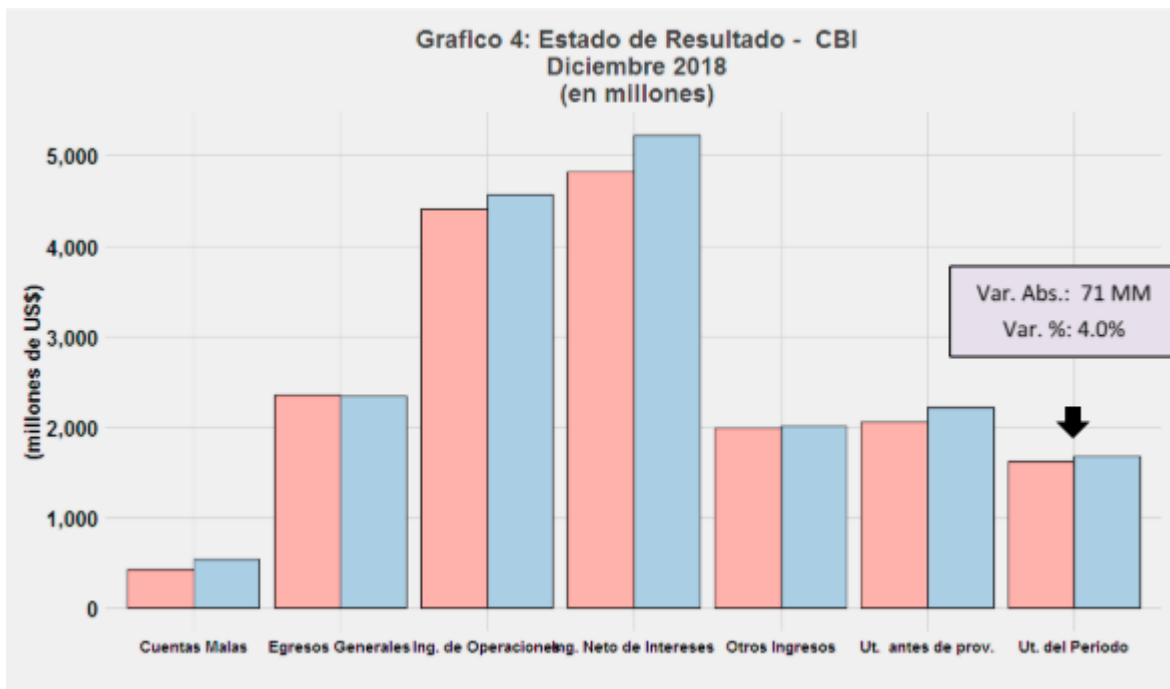
In this scenario, operating income increased moderately by 4.0%. However, there was a reduction in non-recurring financial income from foreign exchange trading, especially in international banks. Nonetheless, this operating income is almost 1.9 times the level of operating expenses, which demonstrates efficiency and a solid capacity to generate profits. Simultaneously, this factor has enabled the International Banking Center to maintain provision expenses, increasing by 19.2% without affecting the income statement, amidst slower growth of the Panamanian economy. This is indicative of a more conservative banking policy.

It is worth noting that the CBI closed 2018 with total assets of USD 121.48 billion, representing an increase of 1.5%, which amounts to USD 1.77 billion more than in 2017. In the case of the National Banking System (SBN), total assets registered USD 104.56 billion, indicating a growth of 3.1%. In both cases, the increase is attributed to the growth of the domestic loan portfolio as the primary use of bank resources, as it yields the highest return for bank operations.

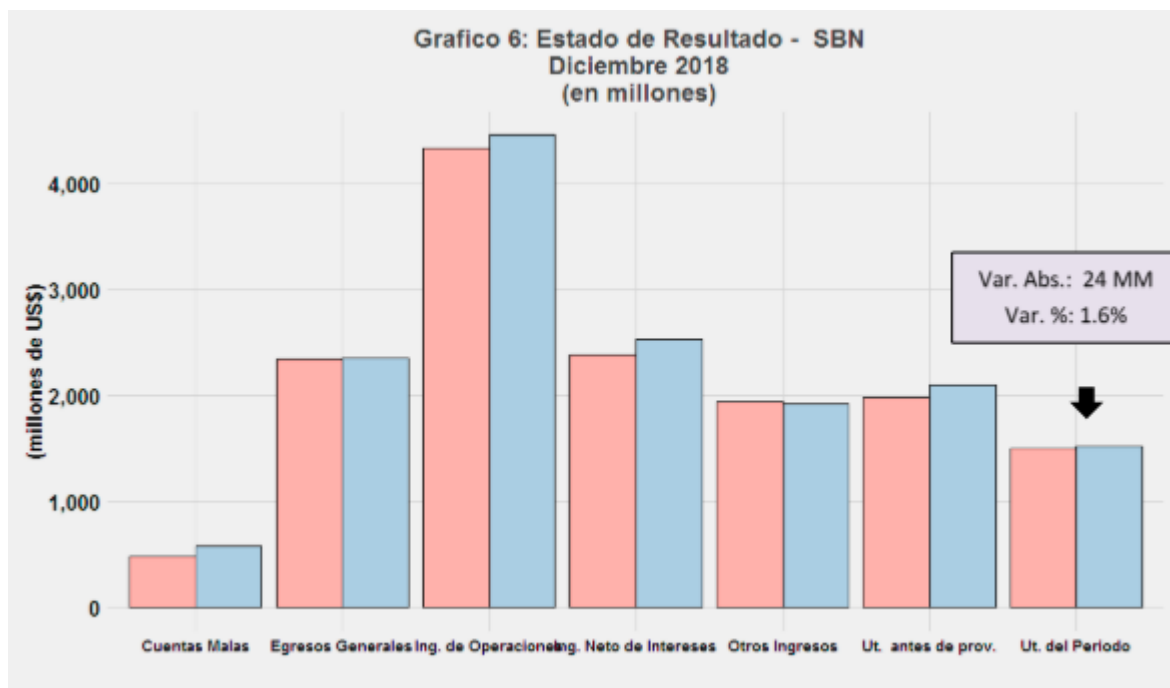
It is worth noting that the International Banking Center's (CBI) liquid assets decreased. This was due to banks redirecting some of these assets in search of better profitability and operational efficiency, given the relatively low level of interest rates in interbank placements. However, this redirection was done without compromising the fulfillment of regulatory liquidity requirements. In fact, the CBI closed 2018 with a liquidity ratio of 61.4%, nearly double the legal requirement. From an analytical standpoint, liquid assets largely represent the treasury management or money desk placements of banks."

A. Balance Sheet and Profit Statement

Profits of the International Banking Center (CBI) reached USD 1.85 billion, reflecting a growth of USD 71 million, equivalent to 4.0%. Meanwhile, profits of general license banks, which engage in both domestic and foreign operations, reached USD 1.52 billion, indicating a growth of USD 24 million, equivalent to 1.6%.



Source: General and international license banks.



Source: General license banks.

At the close of 2018, the International Banking Center (CBI) ended with total assets of USD 121.48 billion, reflecting an increase of 1.5%. This growth was supported by a net increase of USD 1.74 billion in the net loan portfolio, representing a 2.3% increase.

Table 1: International Banking Center
Balance Sheet
(in millions of USD)

International Banking Center	2017	2018	Dec. 18/Dec. 17 Difference	
	December	December	Total	%
Liquid assets	18,496	17,840	(656)	-3.5%
Loan portfolio	75,470	77,213	1,744	2.3%
Securities investment	21,579	21,690	111	0.5%
Other assets	4,165	4,741	575	13.8%
Total Assets	119,709	121,484	1,775	1.5%
Deposits	84,280	83,465	(815)	-1.0%
Obligations	17,719	19,970	2,251	12.7%
Other liabilities	3,411	3,303	(108)	-3.2%
Equity	14,300	14,745	445	3.1%

Source: General and international license banks.

The balance sheet of the National Banking System (excluding international license banks) ended 2018 with total assets of USD 104.56 billion, reflecting an increase of 3.1%. The total net loan portfolio, on the other hand, shows an increase of 4.4% at the close of December 2018, indicating signs of improvement. Domestic credit activities were the most dynamic, registering a 5.0% increase.

Total deposits amounted to USD 73.33 billion, reflecting an increase of 0.4% compared to the previous year. Customer deposits grew by 2.6% during that period. Liabilities, on the other hand, totaled USD 16.29 billion, marking a 19.6% increase over the same period in 2017. Within this category, external financing operations stood out, constituting 85% of the total balance of these commitments.

Table 2: National Banking System
Balance Sheet
(in millions of USD)

International Banking Center	2017	2018	Dec. 18/Dec. 17 Difference	
	December	December	Total	%
Liquid assets	13,864	13,528	-336	-2.4%
Loan portfolio	65,341	67,722	2,612	3.7%
Securities investment	18,349	18,813	576	2.5%
Other assets	3,847	4,450	435	15.7%
Total Assets	101,401	104,563	3,101	3.1%
Deposits	73,049	73,339	319	0.4%
Obligations	13,619	16,294	2,855	19.6%
Other liabilities	3,131	3,066	-223	-2.1%
Equity	11,603	11,864	150	2.2%

Source: General license banks.

B. Loans

Total domestic credit increased by 5.0% compared to the same period in 2017. The sectors driving the greatest growth in absolute terms are associated with personal banking products, especially in the mortgage (5.3%) and personal loan (8.7%) sectors. Regarding the commercial sector, which shows a decrease of 0.1%, it can be noted that this decline is primarily attributable to a specific sector, such as the Colón Free Trade Zone. If we exclude data from this free zone, the growth in the commercial sector would be 0.9% compared to 2017.

Table 3: National Banking System
Domestic loan portfolio by sectors and activities
(in millions of USD)

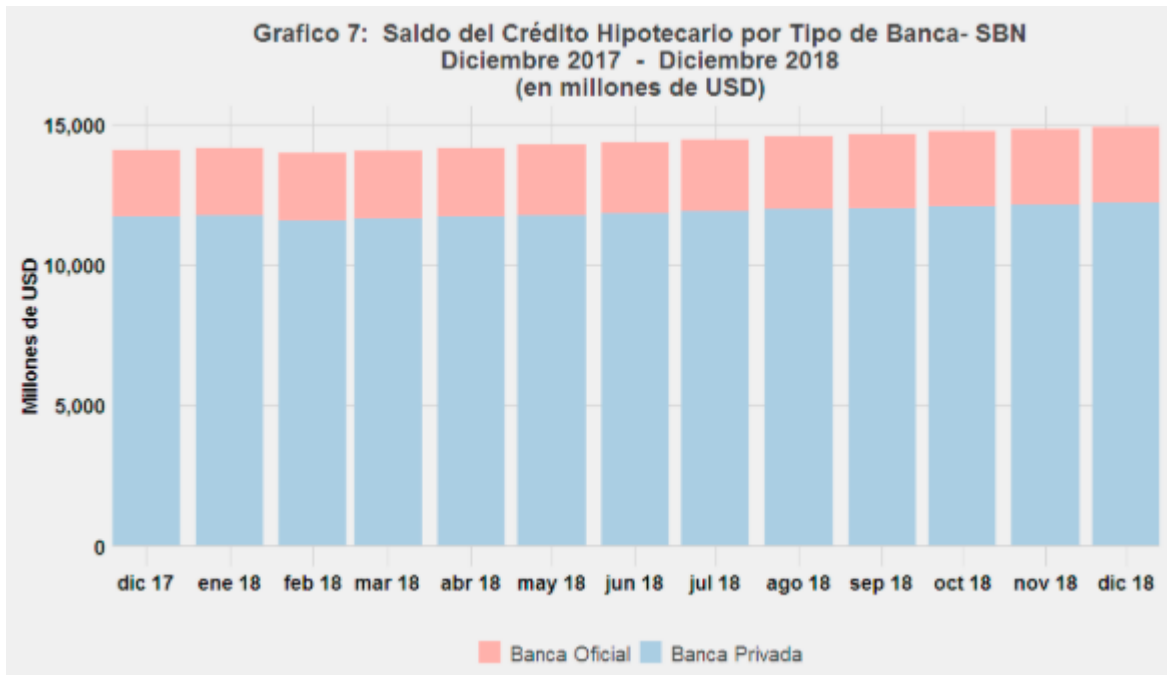
Sector	2017	2018	Dec. 18 / Dec. 17 Difference	
	December	December	Total	%
TOTAL	51,557	54,116	2,559	5.0%
Public sector	539	575	36	6.7%
Private sector	51,018	53,541	2,523	4.9%
Finance & insurance activities	1,206	1,484	278	23.0%
Agriculture	440	476	36	8.1%
Livestock	1,257	1,305	48	3.9%
Fishing	87	89	2	1.7%
Mining & quarrying	35	33	-2	-5.6%
Commerce	11,292	11,283	-9	-0.1%
Industry	2,780	3,361	581	20.9%
Mortgages	16,122	16,984	862	5.3%
Construction	6,744	6,506	-239	-3.5%
Personal consumption	11,055	12,020	965	8.7%

Source: General license banks.

1. Residential Mortgage Loan Portfolio

Mortgage credit continues to show positive signs in the last month of the year, with a growth of 5.3% compared to December 2017. This represents an increase of USD 862 million, maintaining its position as one of the most significant contributors within the domestic credit sector. The residential sector accounted for USD 14.96 billion, comprising 87.6% of the total loans to this sector, while the commercial premises sector accounted for 12.4%. This distribution underscores the importance of homeownership among Panamanians.

Additionally, 34.9% of the loans in the mortgage sector are governed by preferential interest laws, while the remaining 65.1% are not subject to such laws.



Source: General license banks.

2. Personal Consumption Portfolio

The domestic consumer loan portfolio maintains a continuous growth rate, showing an increase of 8.7%. As of December 2018, personal loans increased by 9.9%, while car loans grew by 2.3%. The portfolio maintains low delinquency levels, allowing these products to continue to be offered and providing attractive returns for the banks.

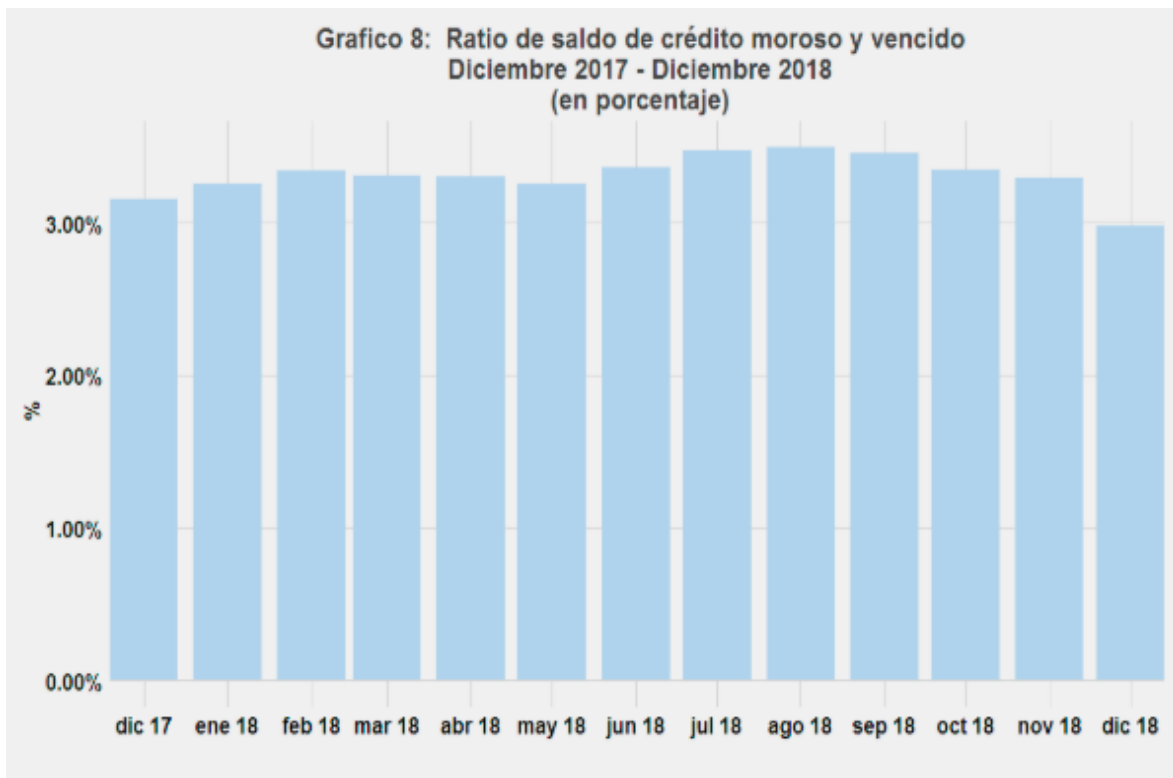
3. Commercial Sector Portfolio

Loans to the commercial sector show a slight year-on-year decline of 0.1%, as mentioned earlier. This slowdown in the sector is the result of specific commercial activities, as well as sectors of the service industry such as communications and tourism. It is worth noting that banks have conservative positions in some sectors. The other commercial sectors, such as wholesale trade in the rest of the country and retail trade, show more stable figures.

C. Portfolio quality

In terms of the asset quality of the International Banking Center, non-performing loans represent 1.4% (30-90 days), and past due loans represent 1.5% (over 90 days). With respect to the Banking System component, non-performing loans represent 1.6%, and past due loans represent 1.7%. The regulatory framework requires banks to conduct an exhaustive analysis of debtors' cash flow capacity and to take prudential measures to create specific

reserves that reflect the realizable value of the loan. It should be noted that we have observed a consistent improvement in this indicator in the last quarter.



Source: General license banks.

In addition, banks, in their credit administration process, require real collaterals to mitigate potential deteriorations in credit exposure. The dynamics and trend observed in the balance of overdue portfolios show that the expansion of the level of bank loans has not led to a significant deterioration in the quality of the credit portfolio. This suggests that financial intermediation entities have conducted adequate credit granting management.

The data as of December 2018 show an increase in accounting provisions to a level of USD 1.28 billion, demonstrating the conservative management of banks in terms of coverage in operations with credit exposure (IFRS 9).

As of 2012, banks in the Banking Center are required to report financial statements using IFRS criteria (see **Rule 6-2012**). Therefore, in addition to calculating regulatory provisions under Rule 4-2013, they must also calculate provisions under IFRS. Any difference in favor of regulatory provisions must be shown as Equity Reserve.

IFRS 9, effective since January 2018, introduced a significant change in the calculation of provisions. Unlike IAS 39, which was based on incurred losses (objective evidence of

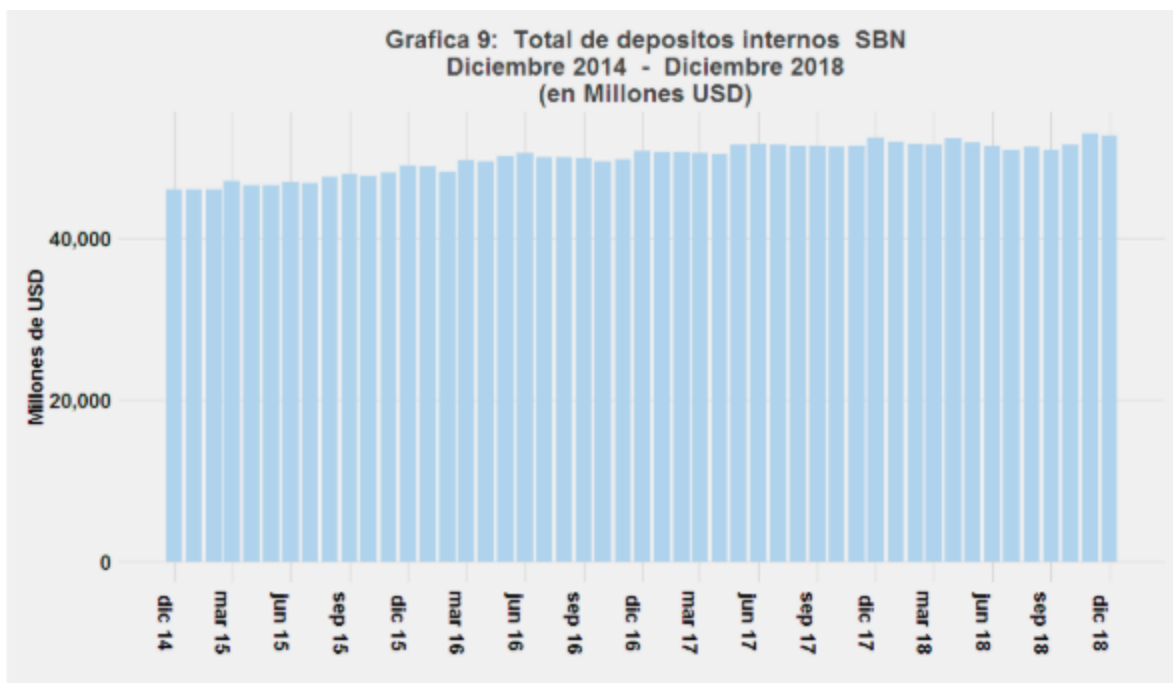
deterioration), IFRS 9 mandates that provisions must be calculated based on expected losses that operations may present.

Additionally, dynamic provisions were created to cover the increase in all loans lacking assigned specific provisions, i.e., loans classified as normal.

D. Deposits

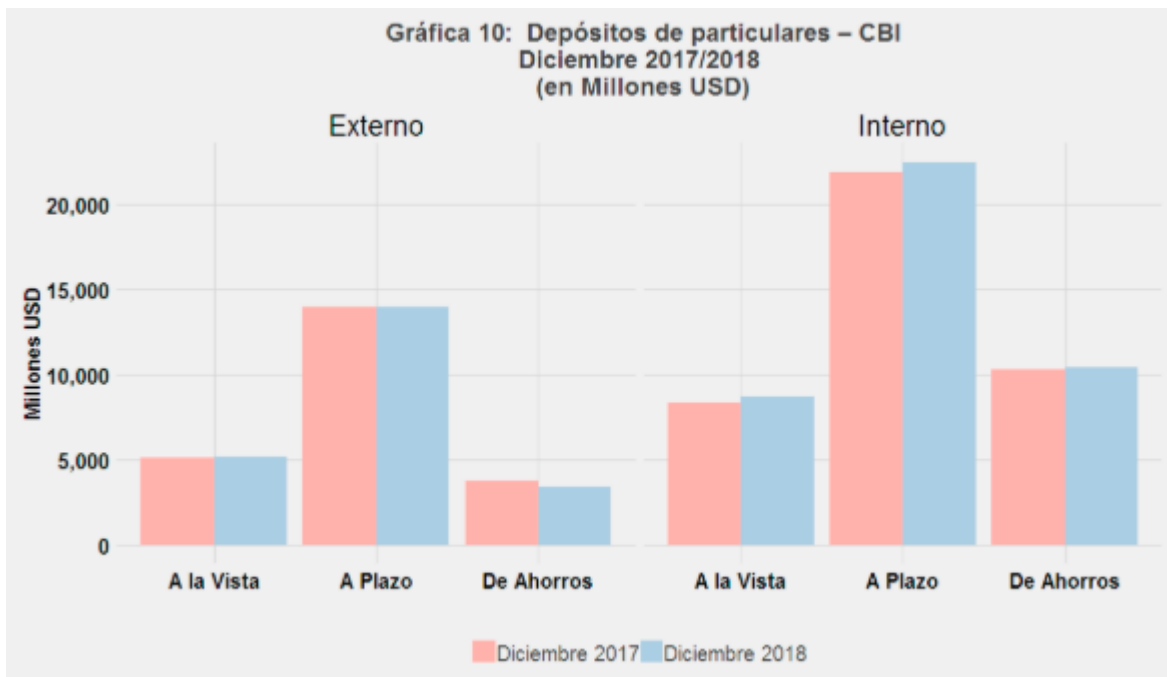
The behavior of deposits as of December 2018 continues to be influenced by the movements of international banks with their parent companies, where a small number of banks represent more than 100% of the total decrease in foreign deposits registered in the CBI and the SBN.

Domestic deposits in the National Banking System represent 71.7% of total deposits in the system. The graph below shows the evolution of the balance of domestic deposits (**Graph 9**).



Source: General license banks.

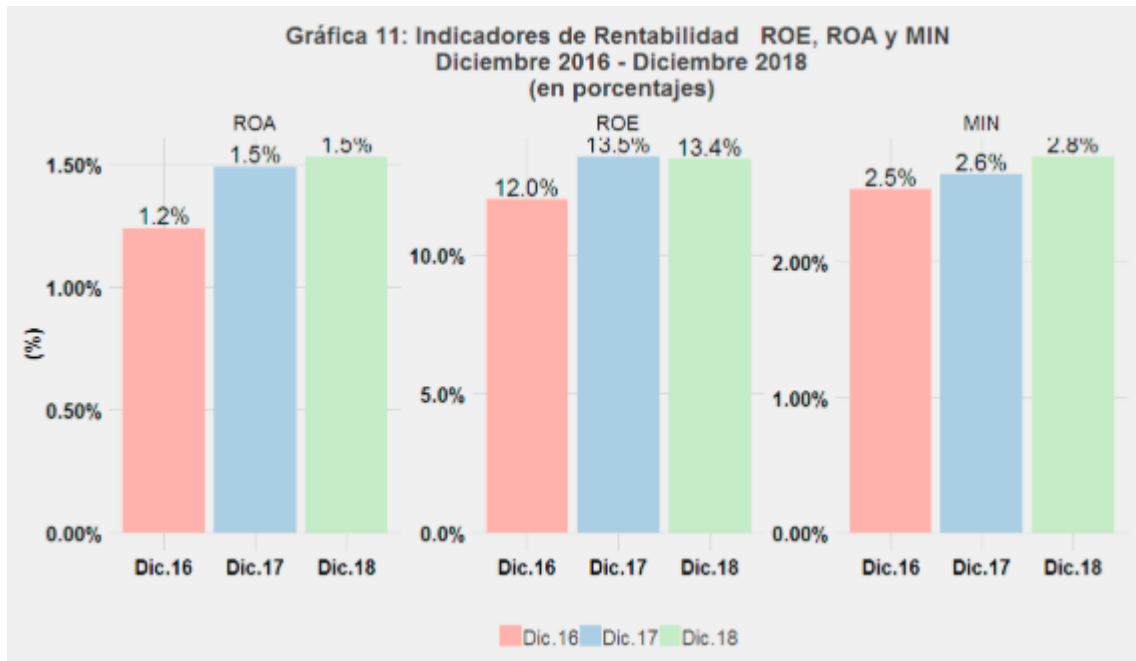
In December 2018, customer domestic deposits maintained a growth of 2.7% compared to the same period of the previous year, especially in time deposits (2.6%). Likewise, current accounts (4.5%) and savings products (1.2%) also show favorable growth trends."



Source: General and international license banks.

E. Profitability indicators

The return on assets (ROA) for the International Banking Center was 1.6% for December 2018. Meanwhile, the same indicator for the National Banking System (only general license banks) was 1.5%. These indicators denote adequate treasury management. Even without asset growth, yields are generated that drive profits.



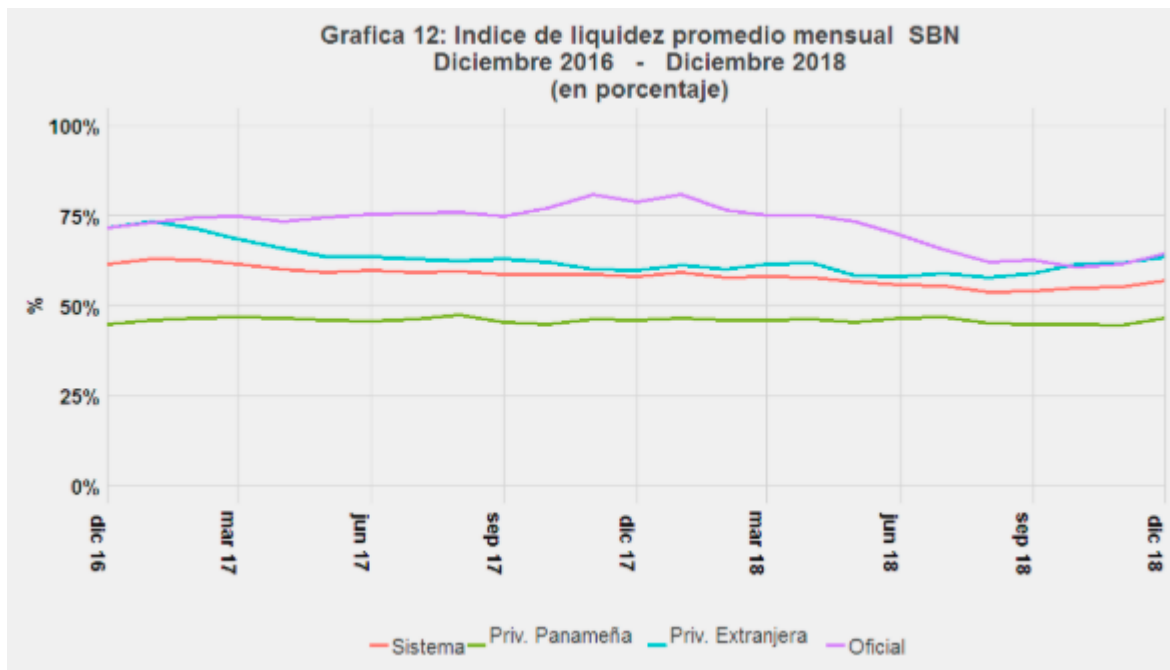
Source: General and international license banks.

Along with the improvement in profits, the return on equity (ROE) has also improved in the International Banking Center. The ROE, which measures the return to shareholders for each dollar invested, was 12.8% for the CBI.

The generation of positive results has ensured that the banks have maintained their solvency position, enabling them to meet regulatory requirements at levels almost double the minimum required.

F. Liquidity

The average monthly liquidity for December 2018 was 57.1% for the National Banking System (General License) and 61.4% for the International Banking Center. By type of bank, it was 64.5% for state-owned banking, 63.6% for foreign private banking, and 46.5% for Panamanian private banking. This strong liquidity position would allow banks to comfortably meet short- and medium-term maturities. Sensitivity analyses through stress tests on liquidity items suggest that the Panamanian banking system currently has assets that can be quickly converted to cash.



Source: General license banks.

G. Solvency:

The latest solvency ratio demonstrates the strength of equity, reflected at 16.0%, well above what is required by regulation, which has become more conservative since Rules 1-2015 and 3-2016. The individual solvency ratio of the banking sector reflects the entities' ability to cope with unexpected losses (the country's regulatory minimum is defined at 8%, as established by Basel III)."

The Panamanian banking system has made significant progress, including elements such as the definitions of basic capital and additional capital (aligned with the definitions of Tier 1 and Tier 2) and the treatment of hybrid bonds. It has also established the minimum basic capital at 4.5%.

Currently, all banks in operation satisfactorily comply with the new regulatory standards on bank capital.

III. New Banking Regulations

Below, we have included the most recent regulatory changes to date for the stability of the system, particularly in accounting, risk management, and AML/CFT/WMD. These changes comprise a set of measures that form part of the agenda adopted by the Superintendencia de Bancos to enhance the quality of capital, assess the risks to which banks are exposed, align with International Financial Reporting Standards, and remove the Republic of Panama from discriminatory and non-cooperative jurisdiction lists. Currently, the SBP has approved

regulations on market risk, operational risk, the short-term liquidity coverage ratio (LCR), and derivative instruments, among others, with some already undergoing implementation according to the schedule developed by the SBP.

Similarly, all information regarding current banking regulations in Panama is available on the SBP's website. The Superintendency of Banks' URL address is <http://www.superbancos.gob.pa>.

Table 1: Recent Regulations

Document	Topic
2017 -2018	
Rule 13-2018	Rule 10-2015 is amended. New assumptions were established to which simplified due diligence is applicable. Additionally, articles 14, 15, and 38 are amended.
Rule 12-2018	Article 8 of Rule 9-2009 is amended. The definitions of Christmas Club and School or Education savings deposits are amended.
Rule 11-2018	New Operational Risk provisions are established. The principles, general criteria, and minimum parameters that banks must observe in the design, development, and application of their operational risk management are established and must include the identification, measurement, mitigation, monitoring, control, and information.
Rule 10-2018	Rule 4-2015 is amended. It is established that banks, trust companies, and financial intermediaries, as applicable, authorized as domestic or foreign custodians of bearer shares, must identify the owner of the bearer shares and/or final beneficiary by requesting and consulting reliable documents, data, or information from independent sources. Additionally, they must prepare a customer profile that will include minimum information about the owner of the shares and/or final beneficiary.
Rule 9-2018	Article 2 of Rule 4-2008 is amended and Article 3 of Rule 4-2008 is rescinded.
Rule 8-2018	Repeals Rule 10-2002 since the currently applicable claims management procedure is the one established in Rule 3-2008.
Rule 7-2018	Provisions on country risk management are hereby established. The obligation of all reporting entities to conduct efficient management of

	their resources abroad is established. This includes implementing effective policies and procedures to identify, evaluate, quantify, control, and mitigate the risks taken. These policies must be documented through a manual that includes the country classification methodology, internal exposure limits, stress tests, contingency plans, among other aspects. This should be done in accordance with the degree of complexity and the volume of exposure to country risk.
Rule 6-2018	Special service fees are hereby updated and established for banks, and special service fees are also established for trust companies.
Rule 5-2018	Article 1 of Rule 9-2009 on Time Deposits and Domestic Savings Deposits is amended to establish that in the event of the death of the holder of domestic time deposits, the designated beneficiaries will be subject to the clauses established in the time deposit agreement signed by the holder and to the rules stipulated in the Rule. This means that they will not be able to withdraw, decrease, or increase the amount before the agreed term expires.
Rule 4-2018	Article 35 of Rule 2-2018 on liquidity risk management and the short-term liquidity coverage ratio is amended.
Rule 3-2018	Capital requirements for financial instruments registered in the trading portfolio are established.
Rule 2-2018	Provisions regarding liquidity risk management and the short-term liquidity coverage ratio are established.
Rule 1-2018	Provisions are issued regarding interbank deposits, and the regulation of other activities that international license banks can conduct.
Rule 8-2017	Article 1 of Rule 5-2015 is amended to make it applicable to money service businesses, exchange bureaus, Banco de Desarrollo Agropecuario (Agricultural Development Bank), Banco Hipotecario Nacional (National Mortgage Bank), and housing savings and loan associations. Law 21 of 2017 amended Law 23 of 2015, assigning these new reporting entities to the Superintendency of Banks for matters related to AML/CFT/WMD.
Rule 7-2017	Article 10 of Rule 1-2014 regarding the standardization of personal and commercial checks in Panama is amended. This article modifies the validity, allowing the circulation of checks issued before the required standards until February 1, 2018.
Rule 6-2017	Through this, new provisions on Shared Banking are issued.
Rule 5-2017	Article 6 of Rule 5-2009, which implements Article 215 of the Banking Law on Inactive Assets, is amended to clarify procedures. It is stipulated that when transferring liquid funds to Banco Nacional, it must be in the currency of the original account. If Banco Nacional cannot accept the transfer in the original currency, the bank must convert it to balboas or U.S. dollars accordingly.



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