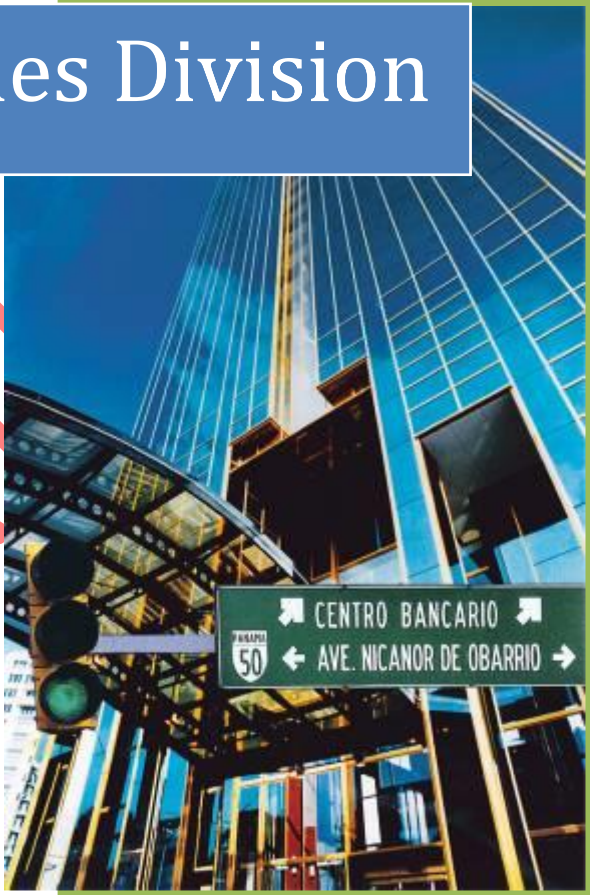
SBP 1998
Superintendencia
de Bancos de Panamá

Financial Studies Division



Banking Activity Report

March 2017

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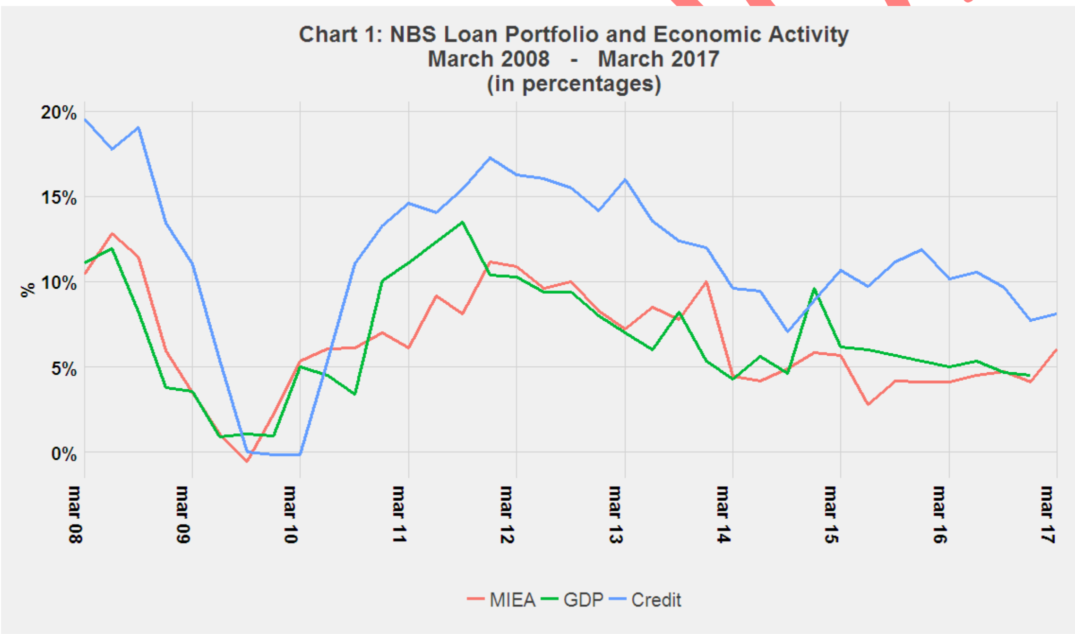
I. **Economic Environment**

A. **Monthly Indicator of Economic Activity (MIEA)**

The recently updated Monthly Indicator of Economic Activity (MIEA), estimated by the Comptroller General, showed a range of activities that grew by 6.03% during the first quarter of 2017 compared to the same period in 2016. The annual difference as of March 2017, compared to March 2016, was 7.5%. This showed a favorable performance for the economy and, given the high correlation with the added activity, it should be reflected in the GDP data for the first quarter (**Chart 1**).

As we will see below, the domestic loan portfolio has continued to grow this year along the lines expected by economic agents. As of March 2017, the domestic loan portfolio recorded an 8.1% increase on an annual basis.



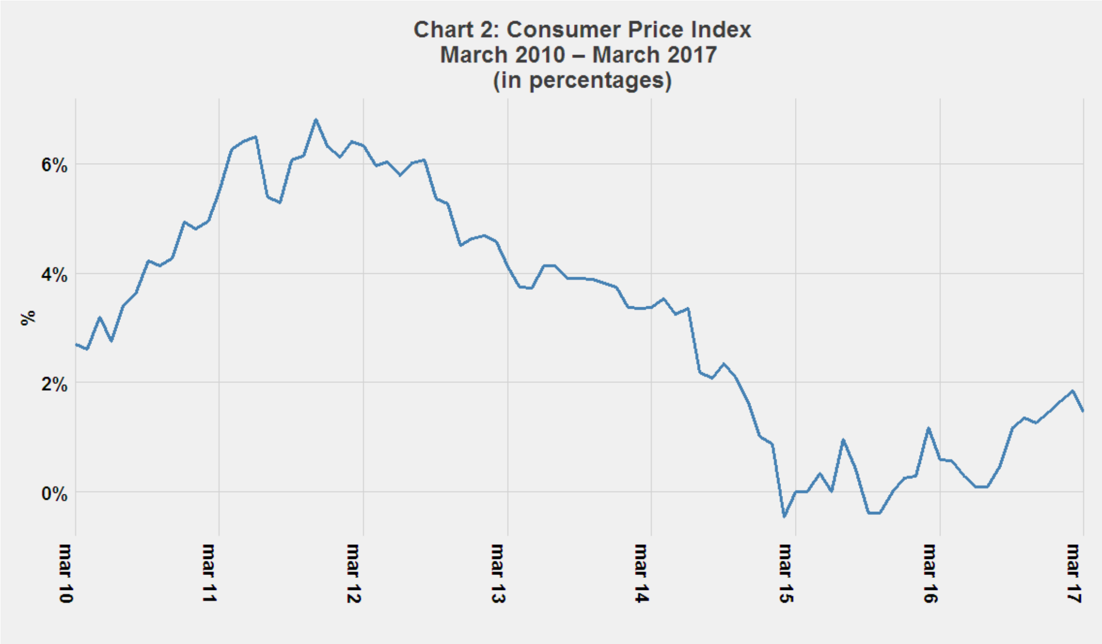
Source: SBP with NISC data.

Similarly, we observe that bank deposits continue to grow, which generally reflects adequate economic performance. This is important because deposits still represent the main source of financial intermediation and its growth shows user trust in the stability and soundness of the Financial System.

As for economic performance, financial intermediation maintained a favorable position both in banking and insurance, with the latter capturing a higher volume of underwritten premiums.

B. Consumer Price Index (CPI)

As of March 2017, Panama's consumer price index (CPI) registered 1.46%, 4 tenths lower than the previous month (**Chart 2**). The monthly difference in the CPI was -0.1%; therefore, the accumulated inflation for the quarter is 1.7%.



Source: SBP with NISC data.

Compared to March 2016, the National Urban CPI for March 2017 recorded the following increases: Transportation, 5.0%; Education, 3.5%; Housing and utilities (water, electricity and gas), 2.9%; Healthcare, 2.0%; Miscellaneous goods and services, 1.7%; Restaurants and hotels, 1.5%; Clothing and footwear, 0.6%; Entertainment and culture, 0.5%; Alcoholic beverages and tobacco, 0.4%; Furniture, household appliances and maintenance, 0.3%; and Food and non-alcoholic beverages, 0.1%. Telecommunications decreased by 3.0%.

II. Performance of the International Banking Center

Banking operations still show positive activity, characterized by the sustained growth of the domestic portfolio and domestic collections. As for the financial soundness indicators, the IBC maintains liquidity and solvency ratios far above the minimum required by law. It is worth noting that the profit for banking is the highest ever for any quarter, which is remarkable. Additionally, we found that due to the recently enacted regulatory requirements, banks are in a better solvency position. Along with the control of expenses, this has allowed them to maintain efficiency, which has translated into better profitability levels.

A. Balance Sheet and Income Statement

The IBC ended March 2017 with assets totaling US$120.14 billion, a 2.1% increase over March 2016. For this period, the asset with the highest growth was Other Assets with 10.7%. For liabilities, deposits ended at US$85.46 billion, a 1.5% increase over the same period in 2016.

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

Banking Center	2016	2017	Difference Mar. 17 / Mar. 16	
	March	March	Total	%
Liquid assets	21,092	20,959	-133	-0.6%
Loan portfolio	72,556	74,505	1,949	2.7%
Securities investment	20,327	20,557	230	1.1%
Other assets	3,720	4,119	399	10.7%
Total Assets	**117,695**	**120,140**	**2,445**	**2.1%**
Deposits	84,217	85,451	1,234	1.5%
Obligations	17,737	17,409	-328	-1.8%
Other liabilities	3,067	3,312	245	8.0%
Equity	12,673	13,967	1,294	10.2%

Source: General and international license banks.

Analyzing the balance sheet of the National Banking System (general license banks only), total assets for March 2017 reached US$100.29 billion, a 2.3% increase over March 2016. Asset growth was mainly the result of the Loan Portfolio (4.2%). The overall loan portfolio increased by US$2.60 billion, driven by an **8.1% growth in domestic loans**. On the liabilities side, total deposits ended at US$73.25 billion, a 1.7% increase. As of March 2017, obligations decreased 0.6% over March 2016.

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

Banking System	2016	2017	Difference Mar. 17 / Mar. 16	
	March	March	Total	%
Liquid assets	16,279	15,405	-874	-5.4%
Loan portfolio	61,764	64,363	2,599	4.2%
Securities investment	16,732	16,819	87	0.5%
Other assets	3,292	3,697	405	12.3%
Total Assets	**98,067**	**100,284**	**2,217**	**2.3%**
Deposits	72,019	73,241	1,222	1.7%
Obligations	13,102	13,018	-84	-0.6%
Other liabilities	2,741	3,006	265	9.7%
Equity	10,205	11,020	815	8.0%

Source: General license banks.

IBC profits increased 12.0% during the first quarter thanks to fewer expenses and increasing financial operating income. As a result, the IBC had a net profit of US$486 million between January and March 2017. The inter-annual increase is explained by an increase in net interest income and a drop in general expenses and a slower growth of loan-related provisions. We noted that most of the banks are engaged in processes for gaining profits by improving efficiency and rationalizing resources, which should lead to increased profitability during the year.

Table 3: International Banking Center
Income Statement
(in millions of US$)

Banking Center	2016	2017	Difference 17/16
	Jan. – Mar.	Jan. – Mar.	
Net interest income	607	648	6.8%
Other income	581	580	-0.2%
Operating income	1,188	1,228	3.4%
General expenses	668	627	-6.1%
Profit before provisions	520	601	15.6%
Provisions for bad debt	86	115	33.7%
Profit for the period	434	486	12.0%

Source: General and international license banks.

Analyzing the results of the National Banking System (general license banks only), accrued profits for March 2017 reached US$354 million, 18.4% higher than last year. We should emphasize that the results generation has made it possible for banks to keep reinforcing their solvency positions, which allows them to comfortably meet the regulatory requirements by ratios reaching almost double the required minimum, as will be shown below.

These figures have relied on obtaining net interest income reaching US$585 million (a 6.4% increase) and other income of US$455 million (a 2.0% increase), aided by a policy of diversification of income-generating products and services. The 6.8% decrease of general expenses is also remarkable. We highlight the fact that appropriate control of financial costs and loans is key to maintaining the operating profitability that supports asset growth.

Table 4: National Banking System
Income Statement
(in millions of US$)

Banking System	2016 Jan. – Mar.	2017 Jan. – Mar.	Difference 17/16
Net interest income	550	585	6.4%
Other income	446	455	2.0%
Operating income	996	1,040	4.4%
General expenses	618	576	-6.8%
Profit before provisions	378	464	22.8%
Provisions for bad debt	79	110	39.2%
Profit for the period	299	354	18.4%

Source: General license banks.

B. Loans

The National Banking System loan portfolio increased 4.5%, but the **increase was 8.1% if the domestic portfolio alone is considered**. As of March 2017, loans to the private sector grew by 8.7 compared to March 2016. On the other hand, foreign loans in the banking system retreated – a sign of prudence of banks, considering the complex, uncertain external environment.

Table 5: National Banking System
Domestic loan portfolio by sector and activity
(in millions of US$)

Description	2016 March	2017 March	Total Difference 17/16	% Difference
TOTAL	45,874	49,602	3,727	8.1%
Public sector	1,123	937	-186	-16.6%
Private sector	44,751	48,665	3,914	8.7%
Finance and insurance companies	1,238	1,308	70	5.7%
Agriculture	415	422	7	1.7%
Livestock	1,102	1,226	123	11.2%
Fishing	88	88	-1	-1.0%
Mining and quarrying	40	38	-2	-4.6%
Commerce	11,209	11,155	-54	-0.5%
Industry	2,209	2,462	253	11.5%
Mortgage	13,722	15,126	1,403	10.2%
Construction	5,500	6,437	937	17.0%
Personal consumption	9,228	10,403	1,175	12.7%

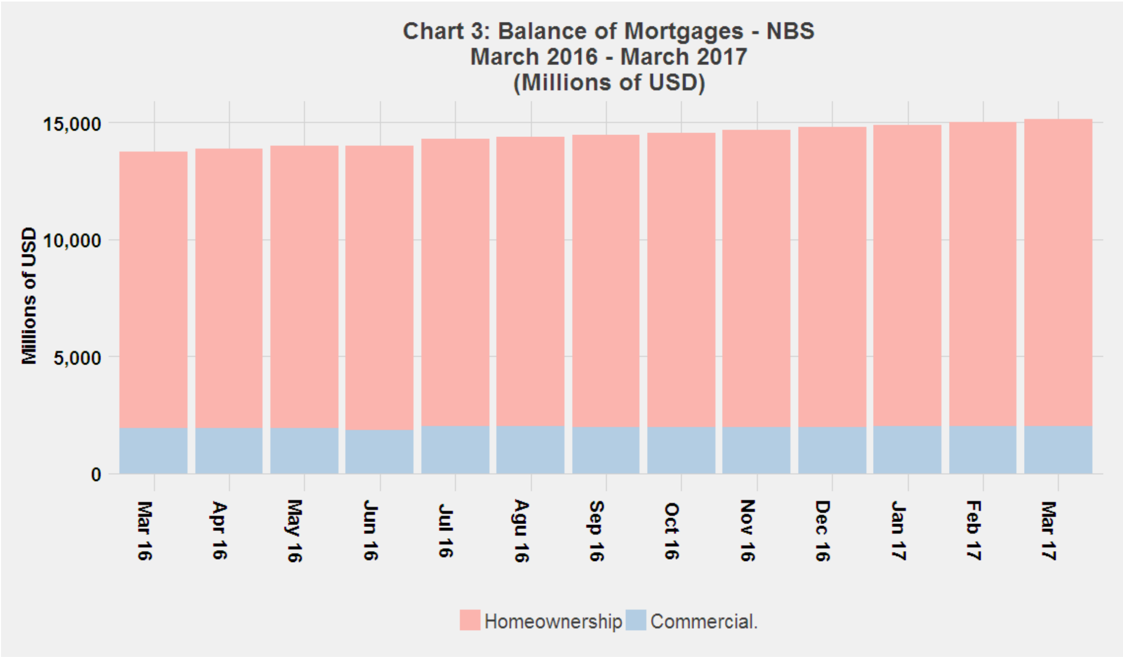
Source: General license banks.

By allocation, the sector with the highest growth was real sector companies and individuals with commercial activities. The loan business maintains a positive behavior in economic sectors showing dynamism, such as construction (17.0%), mortgages (10.2%), industries (11.5%) and livestock (11.2%), among others.

Compared to March 2016, the activity with the highest growth in absolute terms during March 2017 was mortgages at US$1.41 billion, followed by consumption at US$1.18 billion and construction with US$937 million. These are the most important activities.

1. Mortgage Portfolio

For banking, mortgages are still one of the loans with rising demand. This is shown by their 10.2% increase in March 2017. For the analyzed period, mortgages granted totaled US$15.13 billion, a US$1.41 billion increase compared to the same period in 2016 (**Chart 3**).

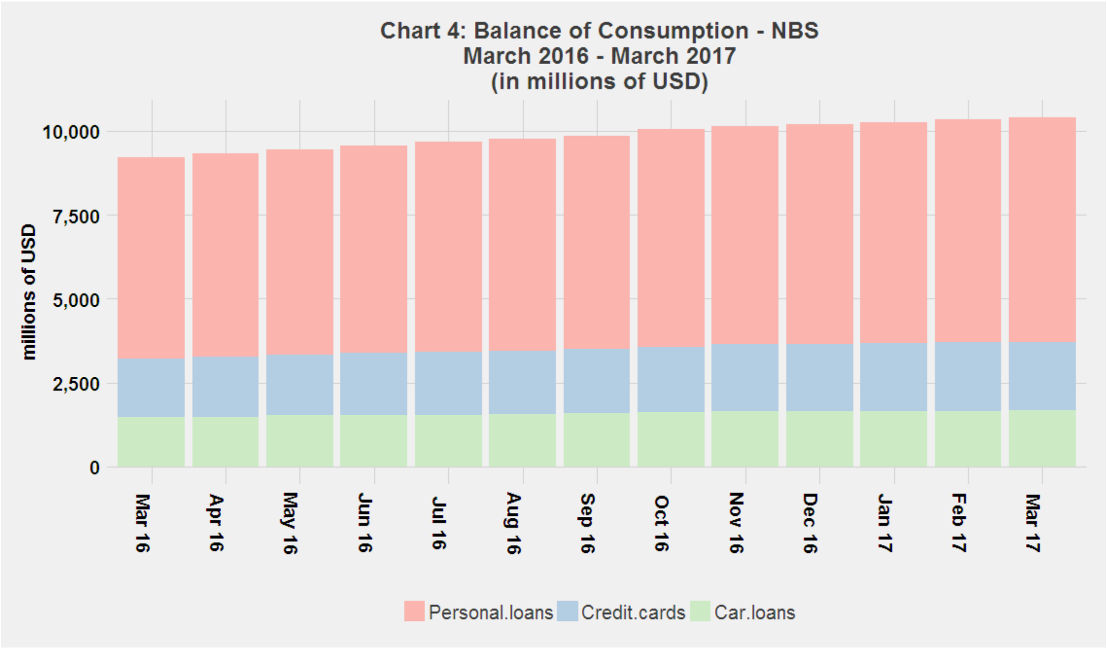


Source: General license banks.

The improvement in conditions for residential mortgages in recent years has been the principal promoter for housing. For commercial banking, lower interest rates and higher average terms have increased the purchasing power of families. It is estimated that the demand for mortgages could remain strong due to increasing housing demand and greater loan access in a framework of sustained growth.

2. Personal Consumption Portfolio

By type of loans, consumption loans continued growing at a sustained pace of 12.7%. One of the most dynamic sectors was car loans which grew 14.2% in March 2017 compared to the same period in the previous year. Similarly, credit cards were also significant, growing 16.8%.

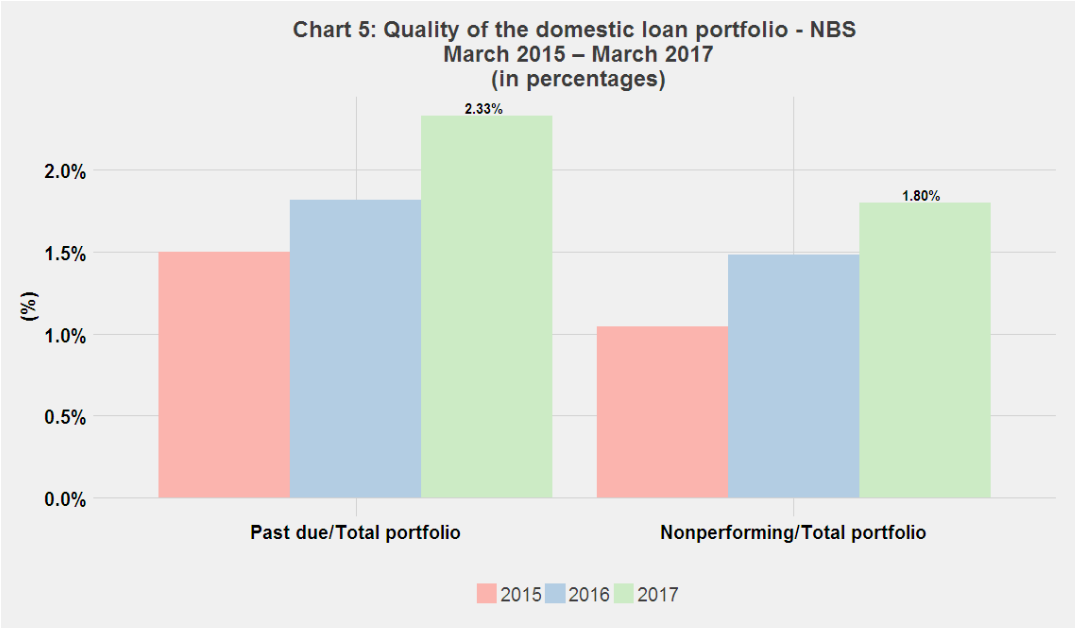


Source: General license banks.

C. Portfolio Quality

The quality of IBC the portfolio remains stable. As of March 2017, the nonperforming balance (greater than 90 days) stood at 1.4% and the past due balance at 1.7%.

As for the quality of the domestic portfolio the past due balance was 2.3% of the total domestic portfolio, while nonperforming loans represented 1.8% of the total domestic portfolio. The sum of past due and nonperforming loans represented 4.1% of the domestic portfolio as of March 2017.



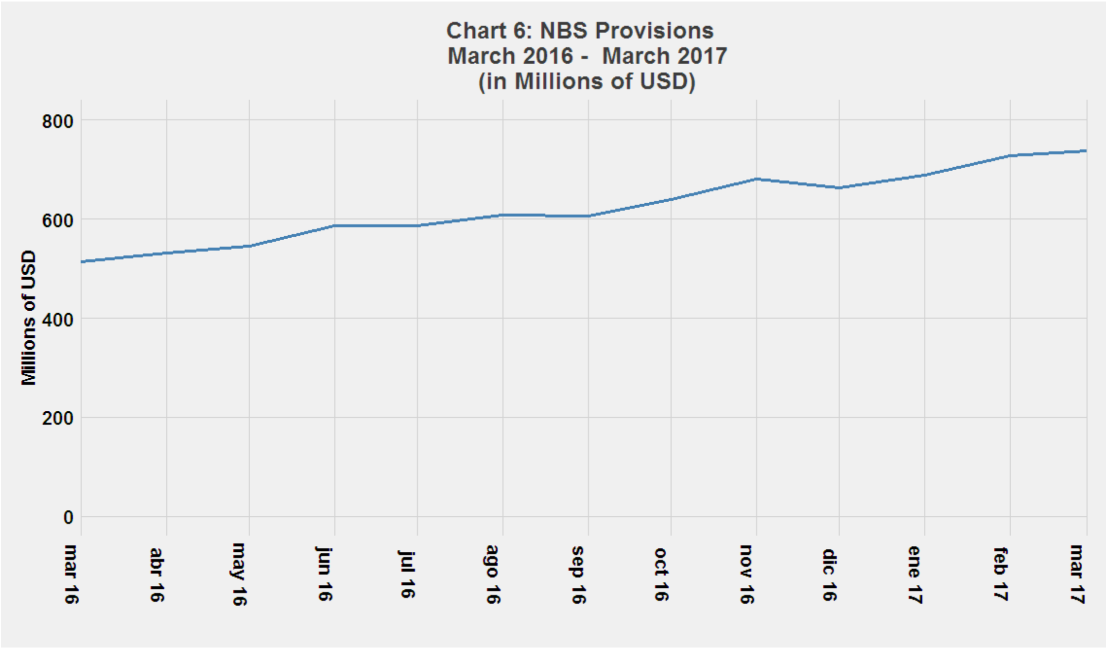
Source: General license banks.

As for portfolio quality, despite registering an increase in nonperforming loans, all portfolios (with the exception of consumption loans) are backed by provisions and collateral covering over 100% of the portfolio.

Although the past due portfolio has shown a slight upward trend in recent years, it maintains relatively low levels.

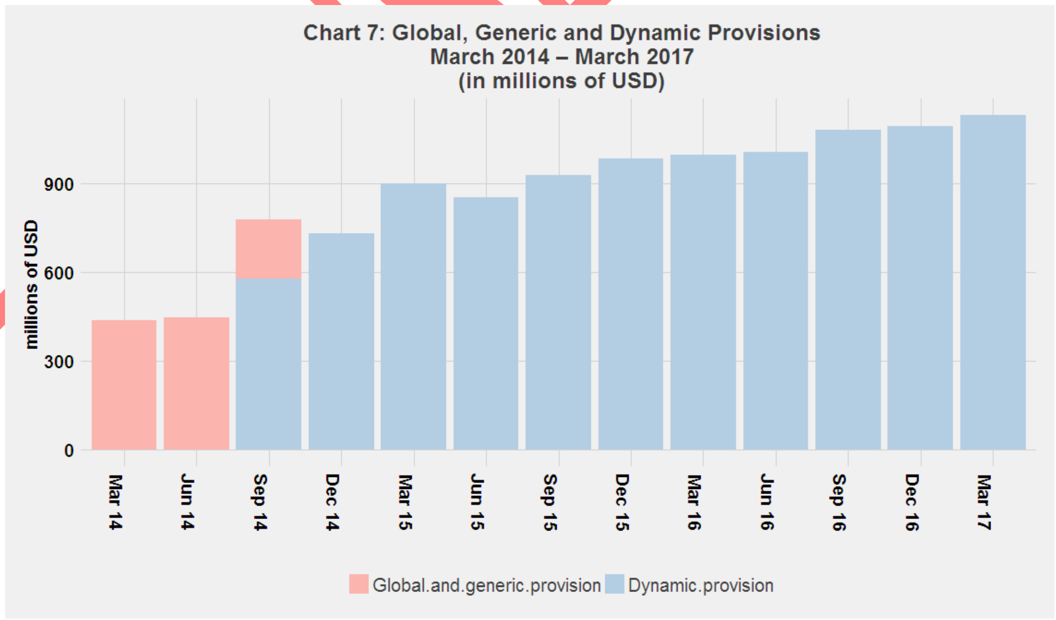
It is worth noting that the regulatory framework for prudential measures for mitigating credit risk has been strengthened recently. In that sense, data through March showed an increase of specific provisions for the different risk categories (**Rule 4-2013**).

This Rule requires creating provisions to cover the possibility of the bank incurring losses decreasing its asset value if debtors were to fail to comply on time or fully with the terms of the loan agreements. As of March 2017 and under this rule, the provisions were at US$738 million (**Chart 6**), which is more than that required under the parameters of the previous rule (**Rule 6-2000**).



Source: General license banks.

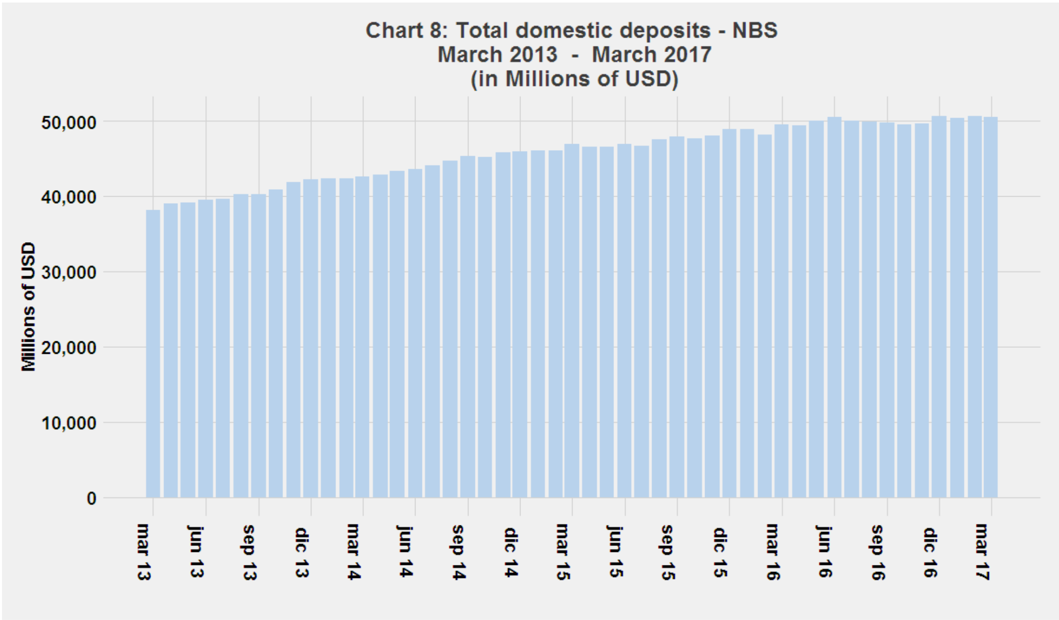
At the same time, dynamic provisions were created this year for all loans lacking an assigned specific provision under the prudential criteria provided by the Basel Committee on Banking Supervision, i.e. loans classified as Normal. As of its implementation, this bank reserve has increased by 95%, registering US$1.11 billion as of March 2017.



Source: General license banks.

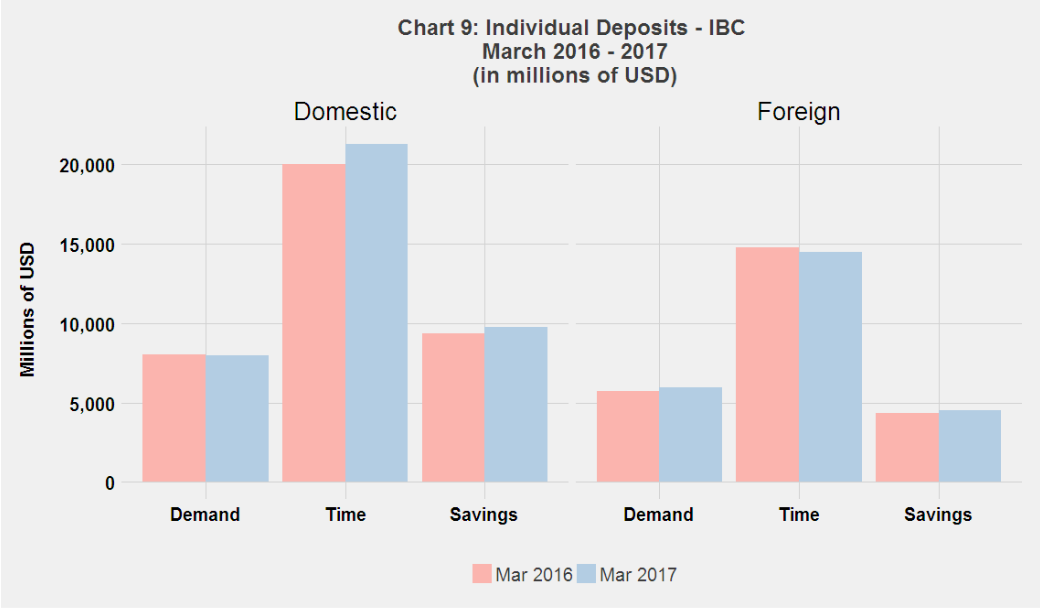
D. Deposits

Domestic deposits represent 68.9% of total deposits in the National Banking System. The chart below shows the movement in domestic deposits (**Chart 8**). It is worth noting that domestic deposits maintain a positive trend of 1.9% over March 2016.



Source: General license banks.

As of March 2017, the trend in domestic individual deposits has resulted in demand deposits totaling US$8.0 billion; time deposits of US$21.31 billion and savings accounts totaling US$9.74 billion (**Chart 9**).

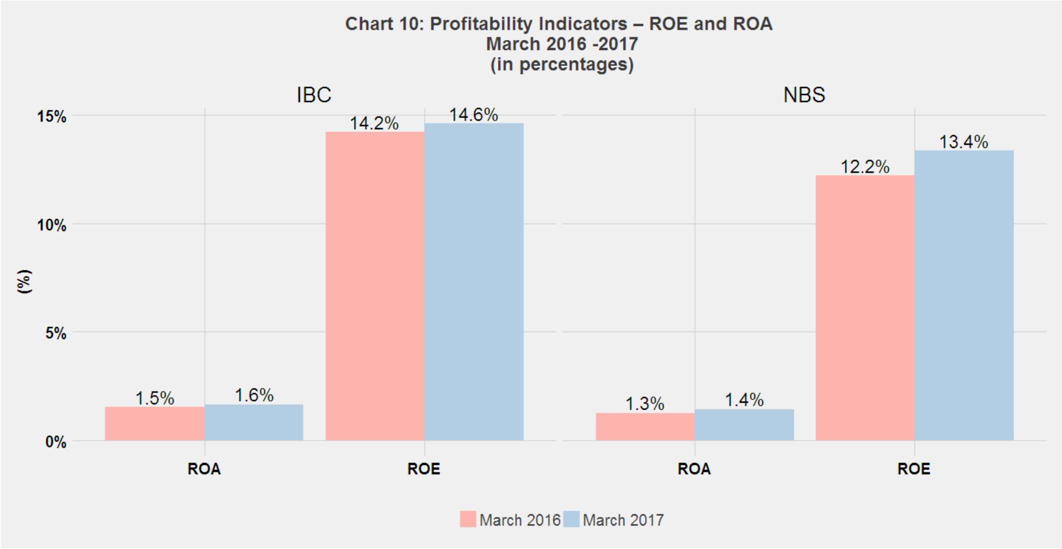


Source: General and international license banks.

The growth of domestic allocations showed an upward trend of 1.9%. Deposits reached increases in an environment of a growing domestic economy, which translates into greater income and an increase in monetary surpluses (especially in the short term) for economic agents, who appear to prefer banks due to the financial and legal stability of the Panamanian banking system. The increase observed in deposits can also be explained by the campaigns launched by banks to bring in those individual and company surpluses to cover the bank's loans.

E. Indicators

The comfortable increase in results allows the clear improvement of management indicators (**Chart 10**). The return on assets (ROA) for the International Banking Center registered 1.6% for March 2017, while the same indicator for the National Banking System (general license banks only) registered 1.40%. These indicators are consistent with the growth of profits and assets.

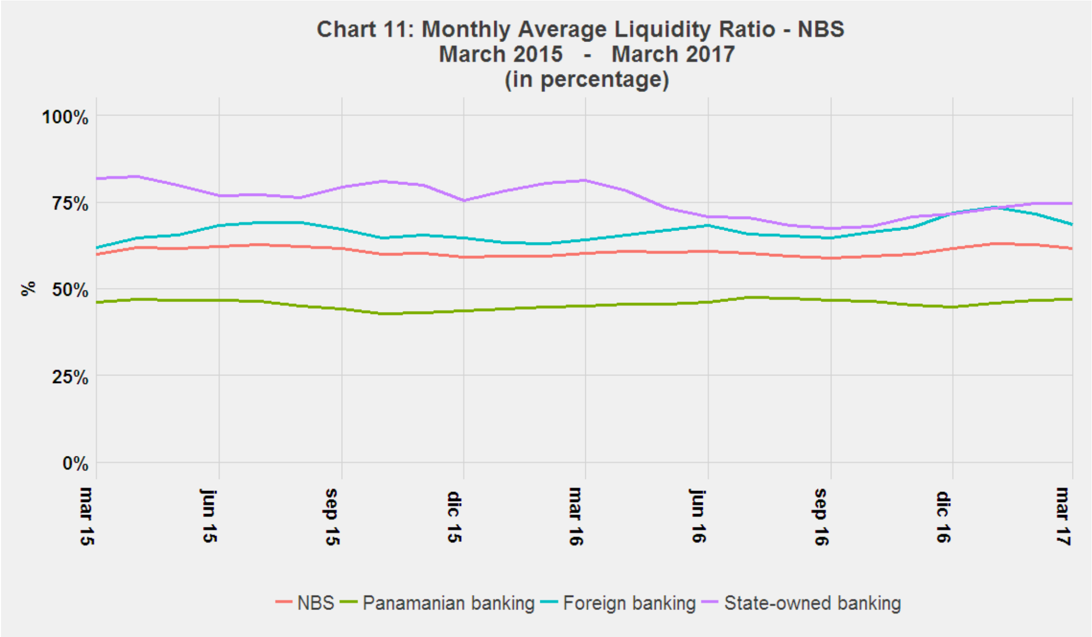


Source: General and international license banks.

With the improvement in profits, the return on equity (ROE) has also improved. The ROE — which measures the return to shareholders for each dollar invested in the International Banking Center — registered 14.6% through March 2017, while the indicator registered 13.4% for the National Banking System.

These indicators show the sound capacity of financial intermediation entities for generating profits, which permits them to expand, to maintain a competitive position in the market and to replenish and increase their equity. It should be emphasized that profit generation has made it possible for banks to keep reinforcing their solvency position, which permits them to handily meet regulatory requirements with ratios reaching almost double the minimum required.

As of March 2017, the monthly average liquidity ratio was 61.7% for the National Banking System. By the type of banking, the average was 74.7% for state-owned banking, 68.6% for foreign banking and 46.9% for Panamanian banking. The strong liquidity position should permit banks to face short- and medium-term maturities comfortably (**Chart 11**).

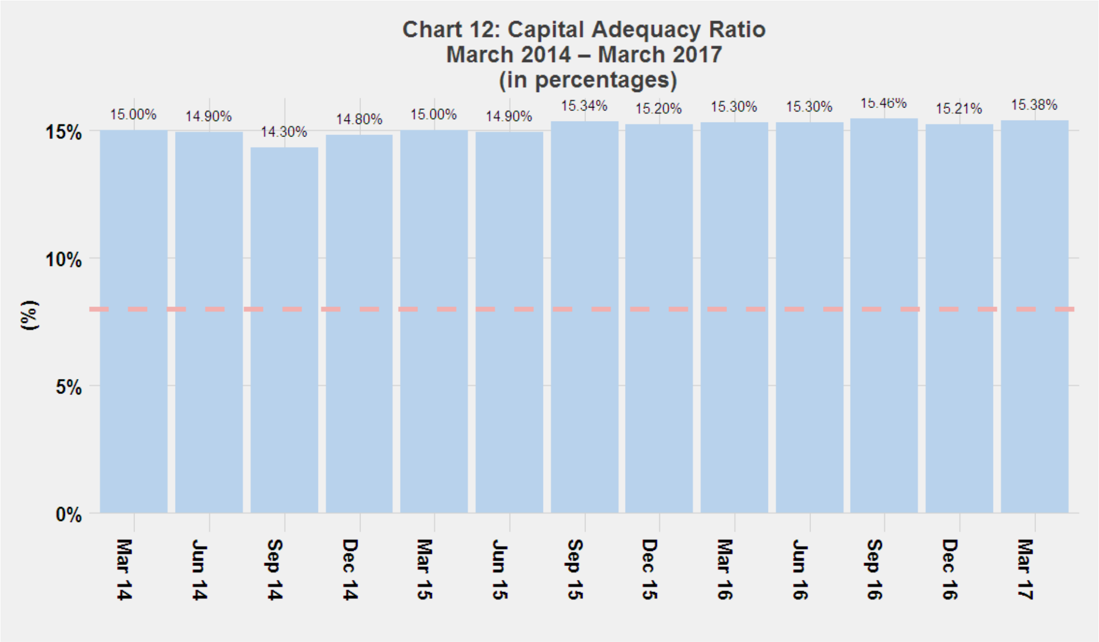


Source: General license banks.

The capital adequacy ratio of the International Banking Center for the first quarter of 2017 was an average of 15.38%, an increase compared to the same period in 2016 (**Chart 12**). It is worth mentioning that this indicator is above the legally required minimum of 8%.

We emphasize that this indicator fits the new Capital rules under Basel III recommendations that seek to have banks raise their financial capacity to face incidentals. Panama is the first country in the Central American region to implement this regulation. As a result, Panama has a robust, solid and dynamic financial system providing and meeting the most stringent capitalization guidelines that exist in the world today. These are the Basel guidelines.

These indicators show a profitable, appropriately provisioned and capitally strong Panamanian Financial System.



Source: General license banks.

Remarks Dotted line corresponds to the legally required coefficient of 8%.

III. New Banking Regulations

Below we have included the most recent regulatory changes to date for the system's stability, especially on accounting, risks and AML/CFT/WMD. These changes are a set of measures that are part of the agenda adopted by the Superintendency of Banks of Panama to improve the quality of capital, measure the risk to which the banks are exposed, update to International Financial Reporting Standards and remove the Republic of Panama from discriminatory or non-cooperative jurisdictions lists.

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

Table 7: Recent Regulations

Instrument	Topic
2015 -2017	
Rule 1 (2017)	Amends Rule 10-2015 on the prevention of the misuse of banking and trust services.
Rule 8 (2016)	Amends Rule 3-2016 on the regulations for determining credit and counterparty risk-weighted assets.

Rule 7 (2016)	Guidelines are established for the prevention of money laundering, the financing of terrorism and the financing of the proliferation of weapons of mass destruction that may arise from cross-border correspondent banking relationships provided by correspondent banks in the Panamanian market. Stipulates that banks established in Panama providing correspondent services to banks located in foreign markets must put in place and apply due diligence procedures and have knowledge of entities that banks intend to represent or with whom they have previously established correspondent banking services.
Rule 6 (2016)	Guidelines are established for managing risks related to the prevention of money laundering, the financing of terrorism and the financing of the proliferation of weapons of mass destruction that may arise due to new products and technologies. Requires regulated entities to assess the new products and services they will provide customers, as well as the geographic location where the new products and services will be provided, offered and marketed. In addition, the new technologies or developing technologies for current and new products and services must be assessed. Based on these assessments, regulated entities must identify and assess ML/FT risks.
Rule 5 (2016)	Amended Article 8 of Rule 6-2009 on risk concentration of economic groups and related parties. It provided that the Superintendency may grant temporary exceptions to state-owned banks for the application of a sole person concentration limit, when loans are granted by these banks to wholly-owned Panamanian state corporations.
Rule 4 (2016)	Amended Rule 4-2011 on the rules for the collection of certain fees and surcharges applied by banks to require banks to include the guidelines on the collection of fees and surcharges on lending and deposit operations in baking contracts or separate documents that must be provided to the bank customer.
Rule 3 (2016)	Establishes the rules for determining credit and counterparty risk-weighted assets.
Rule 2 (2016)	Adds Article 33-A to Rule 7-2014, which establishes standards for the consolidated supervision of banking groups, requesting banking groups consolidating their operations in Panama and falling under the home supervision of the Superintendency publish their consolidated financial statements.

Rule 1 (2016).	Establishes the general guidelines on ACH settlement and funds available.
Rule 12 (2015)	Establishes punitive administrative proceedings to be conducted by the Superintendency of Banks for those cases without a special administrative proceeding.
Rule 11 (2015)	Amends Article 3 of Rule 2-2012 to expand the services banks may offer through nonbanking correspondents.
Rule 10 (2015)	Establishes the measures banks and trust companies must adopt to prevent the misuse of banking and trust services. The Rule mainly covers the following aspects: • Appropriate measures for customer identification. • Measures to identify individuals and legal entities. • Enhanced due diligence measures for Politically Exposed Persons (PEPs). • Updating and safekeeping of information and documentation records. • Due diligence measures for trust funds.
Rule 9 (2015)	Establishes the punitive administrative proceedings for potential violations of the provisions for the Prevention of Money Laundering, the Financing of Terrorism and the Financing of the Proliferation of Weapons of Mass Destruction applicable to regulated entities.
Rule 7 (2015)	Updates the suspicious transactions guide for banks and trust companies based on the Red Flags catalog prepared by the Financial Analysis Unit (based on the recommendations made by several supervisory and control bodies). The Red Flags catalog contains those customer, employee or company behaviors and the characteristics of certain financial operations that could lead to detect a suspicious transaction related to Money Laundering, the Financing of Terrorism and the Financing of the Proliferation of Weapons of Mass Destruction. Regulated entities must detect and pay special attention to the behavior described in the Rule and must determine whether those behaviors constitute Suspicious Transactions taking into consideration other factors, signs and criteria.

Rule 6 (2015)	Updates Article 17 of Rule 4-2008 on compliance with the Legal Liquidity Ratio in order to provide timely information to monitor liquidity risk. It establishes that the legal liquidity ratio will now be calculated pursuant to a Schedule determined by the Superintendency, while it had previously restricted the calculation of the legal liquidity ratio to once a week.
Rule 5 (2015)	Establishes the necessary AML measures other regulated entities under the supervision of the Superintendency must take to prevent that their operations and/or transactions being conducted with funds or on funds resulting from activities related to the crimes of Money Laundering, the Financing of Terrorism and the Financing of the Proliferation of Weapons of Mass Destruction.
Rule 4 (2015)	Further develops the procedure and requirements that must be met by entities interested in obtaining an authorization to act as domestic and foreign custodians of bearer shares. Similarly, it defines the obligations they must meet and the events in which that authorization will be revoked if there are deficiencies in providing services.
Rule 3 (2015)	Modifies Articles 9 and 14 of Rule 4-2010 on External Auditing to update the special external reports auditors must submit to comply with the International Financial Reporting Standards (IRFS) and the period for the rotation of the external auditing team.
Rule 1 (2015)	Establishes rules for capital adequacy applicable to banks and banking groups in order to update the regulatory framework governing the capital requirements to international standards to keep strengthening the solvency of the banking system, limit leveraging and encourage banks to have sustainable growth strategies that will improve the financial stability of the banking center.
Resolution SBP-GJD-0003-2015	Establishes the technology guidelines and requirements for inspections of regulated financial entities supervised by the Superintendency on the prevention of money laundering, the financing of terrorism and the financing of the proliferation of weapons of mass destruction.
General Resolution SBP-RG-0001-2015	Updates the Resolution on the contents, form, frequency, accuracy and quality of information banks are required to provide and the sanctions for noncompliance.