Executive Summary

The predominant macroeconomic conditions this year and those anticipated for the next favor solid growth in financial intermediation activities. On the domestic front, economic growth should continue to be propelled largely by household consumption and investment. Generating a credit expensive.

By October 2005, credit institutions had seen a positive degree of real growth in their major assets, loans (9.3%) and investments (13.7%). However, there has been a slowdown in commercial credit (6%), that has been offset by a substantial increase in consumer loans (28.6%). It is important to mention that asset growth (10.5%) has been backed by a rise in deposits (17.8%), especially in savings deposits (31.5%). Other sources of financing such as fixed end deposit certificates (CDT) and repo operations on the interbank market have declined as a share of liabilities. As a consequence, financing has become less costly.

Private debtors of the financial system (i.e. corporations and households) continued to show signs of better financial *health*. The private corporate sector has experienced good earnings, coupled with low indebtedness. Nevertheless, the tradables sector is not as profitable as it was, but profitability in the non-tradables sector has improved. As a result, the profitability in both of these sectors has converged, closing the gap observed in past months.

As to borrowing, the decline in corporate indebtedness is explained by fewer domestic obligations rather than by the reduction in external liabilities, as indicated in earlier reports. This is consistent with the slowdown in the commercial loans. With respect to households, there has been a major increase in consumer loans, as opposed to a slowdown in mortgage loans. Moreover, the job market indicators reflect a positive situation for household borrowing.

Good conditions in the private sector, coupled with more loan coverage, less post due loans, good profitability and intermediaries suggest that credit risk is not a problem for the financial system, at least in the short term. Yet, the performance of the consumer loan should be monitored carefully in view of its recent growth.

Finally, as indicated in the last edition of the *Financial Stability Report*, market risk is the greatest to financial system, due to the growing share of government bonds on the balance sheet of financial institutions. In this respect, Banco de la República and the Superintendency of Financial Institutions are pursuing a joint agenda to improve the way this risk is measured, regulated and monitored, by the analysis of different methodologies consistent with the spirit of Basel II.

Board of Governors
Banco de la República