



Credit Pro-cyclicality and Bank Balance Sheet in Colombia

Working Paper No. 762 Keep in mind

The series Working Papers on Economics is published by the Office for Economic Studies at the *Banco de la República* (Central Bank of *Colombia*). It contributes to the dissemination and promotion of the work by researchers from the institution. This series is indexed at Research Papers in Economics (RePEc).

On multiple occasions, these works have been the result of collaborative work with individuals from other national or international institutions. The works published are provisional, and their authors are fully responsible for the opinions expressed in them, as well as for possible mistakes. The opinions expressed herein are those of the authors and do not necessarily reflect the views of Banco de la República or its Board of Directors.

AUTHOR OR EDITOR Franz Hamann, Rafael Hernández, Luisa Fernanda Silva, Fernando Tenjo
AUTHORS AND/OR EDITORS Rafael Hernández

The recent financial crisis has renewed the interest of economists, both at the theoretical and empirical level, in developing a better understanding of credit and its mechanisms. A rapidly growing strand of the literature views banks as facing funding restrictions that condition their borrowing to a risk-based capital constraint which, in turn, affects bank lending. This work explores the way banks in Colombia manage their balance sheet and sheds light into the dynamics of credit and leverage during the business cycle. Using a sample of monthly bank balance sheets for the period 1994-2012, we find not only that the Colombian banking sector is predominantly pro-cyclical, but also that the composition of bank liabilities provides important information to policy makers regarding the phase of the cycle of the economy. Shifts from low non-core liability ratios to higher ones during the upward phase of the leverage cycle could play the role of an early warning indicator of financial vulnerability. In addition, we find that bank heterogeneity matters and thus, an aggregate measure of bank leverage can mask successfully a fragile financial sector.

The views expressed in this document are those of the authors and not necessarily those of the Banco de la República. Of course, any mistake in this paper is our responsibility

Documento actualizado: 11/04/2013 03:40 p.m.