Monitoring of Vulnerabilities and Risks

Last modified Wednesday the 29th of November, 2023 What does it mean that the financial system faces vulnerabilities and risks?
Financial activity consists of the intermediation of resources between different individuals or sectors of the economy. In this way, the financial system directs economic resources from those individuals who have surpluses (lenders) to those individuals who need them (borrowers) with the promise of paying them back in the future. It then uses the payment it obtains from borrowers to remunerate lenders and itself.

As simple as it may seem, the financial system's activity entails multiple risks for the system and the individuals involved. Those individuals to whom resources are directed for their investment or spending projects may, for various reasons, fail to meet their obligation to pay them back, resulting in a risk of losses for the financial system (credit risk). Those who deposit their surpluses in the financial system may require them immediately regardless of the projects or the term of the projects in which they are invested. Thus, the financial system may need enough immediate resources to meet its obligations to depositors (liquidity risk).

Some projects in which the financial system invests the resources of surplus individuals may suddenly lose value as a result of the ups and downs of the economy, leading to a risk of losses for the system (market risk). The financial system could also lend resources or acquire assets in a currency other than the Colombian peso, and could therefore face variations in the exchange rate (currency risk). The financial system may fail to perform its functions with consequent losses for depositors and borrowers (operational risk). When one or a few entities of the financial system fail or experience problems, different channels may affect the system's operation as a whole (systemic risk).

The fact that financial activity entails risks, as can be assumed, does not make it intrinsically negative for the economy. On the contrary, the benefits of financial activity for the allocation of resources usually justify that participants in the system assume those risks as long as they are adequately measured and managed and the system has the capacity to absorb, dissipate and mitigate autonomously the materialization of risks that may arise as a result of adverse events. In other words, financial stability is necessary for an economy to obtain the potential benefits of financial activity. For this reason, it is of the utmost interest for Banco de la República (the Central Bank of Colombia) to promote financial stability and monitor the trends that may affect it.

In this respect, Banco de la República, through the Financial Stability Division, closely monitors the risks faced by the financial system and seeks to identify vulnerabilities to its stability. These are understood as the properties of the financial system and its environment that reflect the accumulation of financial imbalances, increase the probability of risk materialization, or cause disruptions to the system's functioning. The analysis of risks and vulnerabilities to financial stability allows the economic authorities to forestall and the participants in the financial system to keep themselves informed about its behavior, thus contributing to promote financial stability and strengthen the Colombian economy's capacity to confront adverse scenarios.

Fuente: https://www.banrep.gov.co/en/financial-stability/monitoring-vulnerabilities-risks