

EXECUTIVE SUMMARY

In 2011, the international economic environment was characterized by a high degree of uncertainty brought about by the problems of public or private debt in many of the industrialized countries. The financial conditions in the euro zone deteriorated significantly in the last quarter of the year and their outlook for growth got worse. Thus, in spite of the recent improvement in the economic strength of the United States, moderate worldwide growth is anticipated for the first six months of 2012. The economic activity indicators in Colombia, in turn, showed a favorable performance in the second half of 2011 and expectations continue to be optimistic.

Intermediation activities showed a strong performance which manifested itself in a growth rate for the credit institutions' gross loan portfolio that was close to a real annual 18% as of December 2011. The consumer and micro-loan portfolios, in particular, were the ones with the highest growth rates while the commercial one presented a slowdown. The expansion of credit generated an upswing in the interest income of the credit institutions which made the profitability and capital adequacy levels favorable.

The non-banking financial institutions (NBFI), in turn, registered less strength in the changes of the loan portfolio in comparison to what had been seen in the first half of 2011. This was reflected in lower levels of profitability. The devaluation in the national variable income securities generated a shift which favored the share of public debt securities and of investments in the financial sector.

When the indebtedness of the main borrowers is analyzed, one sees that the growth in the loans companies have was accompanied by improvements in their economic situation. At the same time, the household financial burden rose as a consequence of the performance of the consumer loan portfolio.

In the second half of 2011, the default and loan portfolio quality indicators improved. These are defined as the value of the non-performing and risky loan portfolios expressed as a share of the gross loan portfolio respectively.

This is mainly caused by the greater strength in all of the different types of loan portfolios. The risky and non-performing loan portfolios, in particular, that are part of the consumer loan portfolio showed positive growth although the rise in credit risk in this loan portfolio has been backed by an increase in the loan-loss provisioning.

The exposure to market risk, in turn, climbed as a result of the higher amount exposed and the upswing in the duration of the financial entities' portfolios. This has not translated into increases in the potential losses due to the low volatility of the TES price.

Furthermore, the entities in the financial system showed levels of liquidity during this period that made it possible for them to face an adverse funding scenario though these levels are lower than they were in the first half of 2011. Likewise, when market liquidity risk is analyzed, a situation that is favorable in terms of exposure to this risk is seen.

In conclusion, in 2011, the financial system continued to demonstrate an expansion process which was reflected in rises in the gross loan portfolio and stable levels of profitability for credit establishments. Although this trend was accompanied by improvements in the traditional indicators of credit risk, the growth of the risky and non-performing loan portfolios that was seen in the second half of the year for some areas of credit highlights the importance of continuing to monitor the quality of financial assets strictly.

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FINANCIAL STABILITY REPORT

Prepared By:
The financial Stability Department of the
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One of the duties of Banco de la República, as stipulated in the Colombian Constitution and in Law 31/1992, is to ensure price stability. Doing so depends largely on maintaining financial stability, which is understood as a situation in which the financial system is able to broker financial flows effectively. Financial stability contributes to better resource allocation, which is important to preserving macroeconomic stability. For that reason, financial instability has a direct impact on macroeconomic stability and on Banco de la República's capacity to fulfill its constitutional mandate. In short, monitoring and maintaining financial stability are crucial to that activity.

Banco de la República provides for financial stability in a variety of ways. To begin with, it makes sure the payment system in the Colombian economy operates properly. Secondly, it extends liquidity to the financial system through its monetary transactions and by exercising its constitutional faculty as the lender of last resort. Thirdly, being the country's credit authority, it designs financial regulatory mechanisms to reduce episodes of instability. It does so in conjunction with the Superintendencia Financiera de Colombia. (Financial Superintendence) Moreover, Banco de la República carefully monitors economic trends that could threaten the country's financial stability.

The Financial Stability Report is part of this last task and accomplishes two objectives. First, it describes the recent performance of the financial system and its principal borrowers. This is done so future trends in that performance can be visualized. Secondly, it identifies the major risks to credit institutions. The reason for both these objectives is to inform the public of the trends and risks that can affect the financial system as a whole.