Box 2
BORROWING IN FOREIGN CURRENCY BY COLOMBIAN COMPANIES AND ITS IMPORTANCE TO THE DOMESTIC FINANCIAL SYSTEM

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1. Introduction

The last fifteen years have seen a considerable increase in the outstanding external debt in the private sector. On the one hand, corporate external borrowing doubled,[1] going from USD $11,334 million (m) in December 2000 to USD $25,005 m in June 2015. On the other, the external debt in the Colombian bank system rose by more than 800%, from USD $1,461 m USD $12,925 m. The Peso appreciation over a number of years, as well as low foreign interest rates (compared to those for loans in pesos), provided an incentive for this to happen.

Generally speaking, the real sector demands loans in foreign currency (F/C), either from foreign lenders or the domestic financial system, to finance working capital, foreign trade or to purchase assets. The financial sector, for its part, operates primarily as an intermediary. In other words, it uses its lines of credit abroad to grant loans in F/C to its customers and, in recent years, to acquire financial institutions in other countries.

The floating exchange rate regime adopted by Colombia in 1999 contributes to the country's financial stability by helping to avoid excessive foreign exchange risk-taking in the real sector. Likewise, many of the regulations governing the financial system are intended to limit its currency exposure. However, after more than 50% depreciation of the Colombian peso against the US dollar since July 2014, companies with debts in F/C and no hedging could be exposed to a substantial increase in their financial costs and detriment to their equity.

This section offers a characterization of companies in the real private sector that have F/C debt and shows the importance of these loans on the balance sheets of lending institutions. Also included are the main results of the exercises outlined, in detail, in the September 2015 edition of the Financial Stability Report with respect to the possible impact of default on the financial obligations of companies that are indebted in F/C to domestic banks.

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2. Real Private Sector Debt in Foreign Currency

The outstanding F/C debt in the real corporate sector has grown considerably during the course of this century. Particularly since 2006, there has been a steady increase in borrowing from lending institutions in Colombia, and from foreign agents as well (except during the global financial crisis). Average growth in the F/C debt has exceeded that of nominal GDP in dollars since 2008. By June 2015, the F/C debt in the real private sector was estimated to be nearly 10.5% of GDP[2] (Graph B2.1).

a. Debt Contracted with Foreign Agents

According to the F/C borrowing reports companies submit to *Banco de la República*, the external debt in the private sector was USD $25,005 m by June 2015. It is concentrated in the transport and communications sector (USD $8,652 m, 35%), trade(USD $6,124 m, 24%),

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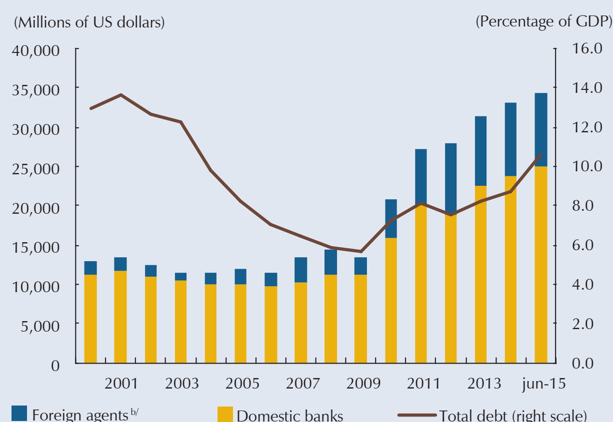
1 This includes loans, financial leasing, bonds and commercial credit with agents. It does not include third-party portfolios managed by trusts companies, financial vehicles, financial institutions or pension funds, nor does it contemplate any agency in the public sector.

2 Pertains to the sum of the real private sector debt to foreign agents, as reported to *Banco de la República* (pursuant to External Circular DCIN-83) and the F/C portfolio of lending institutions (about 98% of the portfolio by December 2014 was comprised of commercial loans and 95% went to the private sector).

Graph B2.1
Real Private Sector Debt in foreign currency a/



a/ Pertains to the foreign-currency denominated portfolio granted by lenders in Colombia. At December 2014, approximately 98% of that portfolio was in commercial loans and 95% of them were granted to the private sector.
b/ Includes loans, leasing, bonds issued abroad and commercial loans of the real private sector that are denominated in foreign currency.
Source: *Banco de la República*

industrial manufacturing (USD $3,448 m, 14%) and mining (USD $2,891 m , 12%) (Table B1.1). Based on the number of firms, the branches with the most loan recipients are retail and manufacturing (52% of the total). However, transportation and telecommunications[3] and electricity, gas and water are the sectors with the largest average balance.

3 An important part of the corporate debit in this sector pertains to air transport.

In most sectors (except mining and agriculture), companies with foreign debt have a foreign-trade-operations deficit. The agricultural sector is known for having a large natural hedge, with exports worth nearly three times the balance of its debt; other sectors, such as retail, have considerable debt and their non-tradable vocation means they export very little. However, some companies in these sectors receive a significant portion of their income in F/C (e.g. air transport companies). Furthermore, a considerable percentage of debtor firms in all the sectors have foreign direct investment, particularly in the case of electricity, gas and water, and mining.

b. Debt in F/C with Lending Institutions

As illustrated in Graph B2.1, approximately 27% of the debt in F/C is contracted directly with lending institutions in Colombia. This share increased significantly between 2002 and 2012, with several interruptions in 2006 and 2009. In June 2015, the F/C loan portfolio of lending institutions came to USD $9,263 m.

Most of this loan portfolio is in the form of commercial loans to the private sector, which are characterized as being used mainly to finance foreign trade operations and working capital. On a sector basis, the debt is concentrated in manufacturing, trade, and electricity, gas and water.

3. Importance of the F/C Loan Portfolio on the Balance Sheet of Lending Institutions

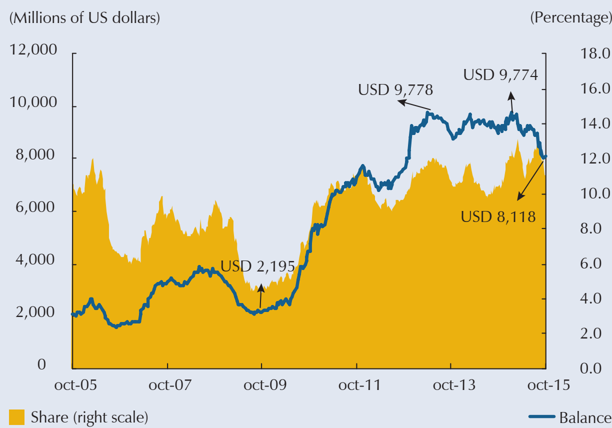
Graph B2.2 shows the evolution of the total F/C portfolio held by lending institutions and its share of the overall

Table B2.1
Characterization of Real Private Sector Companies with Foreign Debt at June 2015

Sector	Sector Balance in Millions of US Dollars	FOB value of Exports (Millions of US Dollars)a/	CIF Value of Imports (Millions of US Dollars)a/	Percentage of Companies with FDI b/
Agriculture	304	838.0	54.9	45.5
Retail	6,124	185.9	3,028.6	49.1
Construction	749	2.6	29.8	49.1
Electricity, gas and water	1,030	3.6	20.5	79.3
Manufacturing industry	3,488	1,968.9	3,942.5	54.7
Mining	2,891	1,227.9	97.4	76.1
Transport and Communications	8,652	7.0	995.3	56.6
Unclassified	1,766	16.0	262.5	27.4
Total	25,005	4,249.8	8,431.5	

a/ The January-June 2015 accumulated figure for operations of companies with foreign debt.
b/ Firms with more than 10% of their proprietary capital held by foreign shareholders.
Source: *Banco de la República*

Graph B2.2
Commercial loan Portfolio in foreign currency: Balance and Share of the Total Commercial loan Portfolio



Source: Superintendencia Financiera de Colombia; Calculations by *Banco de la República*

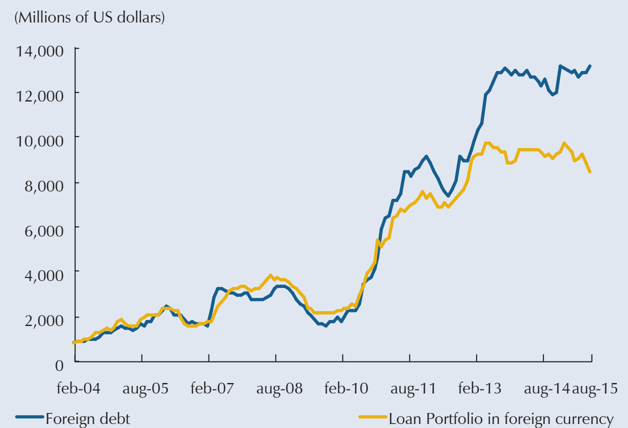
commercial loan portfolio. The balance of loans in F/C went from nearly USD $2,200 m to a record high of USD $9,778 m between October 2009 and April 2013, and their share of the commercial loan portfolio increased from 4.4% to about 11. 8%.

The loan portfolio in F/C has declined steadily since late January 2015 and even more so in recent months. By October 23 (the latest data available when this section was written), it came to USD $8,118 m, with an annual contraction of 12.1% and an 11.1% share of the total commercial loan portfolio (6. 5% of the total portfolio). Generally speaking, this reduction has occurred with no changes in the financial conditions (in terms of the interest rate and credit limits) foreign banks place on domestic banks.

According to the June 2015 edition of the Survey of Foreign Borrowing and Credit Limits, Colombian banks perceive the demand for F/C loans in the real sector as being low, due to uncertainty about how the exchange rate will evolve. They also have the impression that loans in F/C are being replaced by those in pesos. In fact, commercial lending in domestic currency has accelerated in recent months (from 12.9% annual growth earlier this year to 16.3% in October)[4] and is oriented towards preferred loans (to debtors with bargaining power). In turn, this type of credit was disbursed at longer maturities. Therefore, despite the increase in loans, it is possible to conclude the F/C loan portfolio in the last few years has accounted for a relatively small share of the loan portfolio held by domestic banks. And, even that share has declined recently as well.

In most cases, when granting loans in F/C, lending institutions in Colombia act only as intermediaries, borrowing from international banks to lend in F/C. So, the ratio of their portfolio to their debt denominated in F/C is very narrow (Graph B2.3). However, the series diverge as of 2011, mainly because some of the acquisitions and expansions made by Colombian banks in Latin American countries and in Central America were done with funding from foreign lenders.

Graph B2.3
Loan Portfolio and Debt in foreign currency of Credit Institutions



Source: *Banco de la República*

The narrow ratio between the F/C debt series and the F/C loan portfolio is due largely to foreign exchange regulations. As part of these regulations, FX market intermediaries were authorized to raise capital in F/C so as to provide loans in F/C, or in pesos, through hedging with a financial derivative and, in both cases, at equal or less maturity than the financing obtained.[5]

Currency exposure also is limited by the regulations on FX net open position.[6] FX market intermediaries must maintain a FX net open position or total net position (rights minus obligations in F/C, including derivatives

4 Series adjusted to eliminate the statistical effects of the IFRS.

5 Resolution 8/ 2000 (Article 59) also authorized operations such as export leasing and operations to supply liquidity in F/C in clearing systems in the event of default by a participant. In general, active operations in F/C and in pesos have been allowed since October 30, 2015 (with respective hedging), but on the condition that maturity is less than or equal to that of the financing obtained.

6 See External Resolution 9/ 2013 and External Circular DODM-139 for specific definitions and greater detail. The provisions in External Resolution 15/ 2015 on indicators of short-term exposure on the part of foreign exchange market intermediaries were not yet in force at the time this report was written.

and on- and off-balance sheet contingencies) between 5% and 20% of their regulatory capital, and a cash position (considering F/C assets and liabilities, excluding derivatives) that is positive[7] and less than 50% of their regulatory capital. The amount of financial derivatives is also limited by the regulations on gross leveraged position (the sum of future and term rights and obligations and the sum of contingencies) to 550% of regulatory capital.

Accordingly, the financial system does not take, in principle, foreign exchange risk in its activity as an intermediary (except in cases where it has used resources obtained abroad for purposes other than lending).

However, a possible default on obligations (including those denominated in pesos) by companies with F/C debt is one way lending institutions can be affected. The September 2015 edition of the Financial Stability Report contains estimates of the financial system's exposure to companies with F/C liabilities[8] (to domestic or foreign lenders) and to firms which are net importers.

While the financial system's exposure to borrowers of this type rose slightly compared to June 2014,[9] the quality indicators for these groups in terms of risk and arrears remained lower than those of all the others (there is evidence of some increase in the quality indicator for arrears compared to December 2014). Also, with additional deprecation,[10] as occurred between August and September, a small percentage of commercial loans (3.2%) would pertain to companies that would see their equity deteriorate significantly (over 30%).[11] Furthermore, the stress tests presented in that report consider, among other things, a deterioration in loan quality for companies in the private sector with F/C debt that are not engaged in foreign trade or are net importers (such as those involved in trade).

4. Conclusions

The balance of the private debt in F/C increased considerably during the last decade in both the real sector and the financial sector. A look at the data by June 2015 shows that much of the real private sector debt in F/C is owed by companies in the non-tradable sectors. Debtor companies in mining and agricultural, on the whole, are the ones with a trade balance surplus. On the other hand, a number of the companies with foreign debt have foreign direct investment.

The financial sector does not appear to be especially exposed to possible deterioration in the equity capital of those institutions with F/C debt. The foreign exchange regulation and controls of FX net open position that have been in effect for the last few years have helped to prevent the financial system from taking on excessive exchange risk. F/C denominated loans did not account for a major share of its balance sheet and, at June, the risk indicators for debtors who could have been affected by the depreciation of the peso were better than those for other borrowers.

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7 The lower limit was changed to -20% of regulatory capital in September 2015, effective as of October 2015.

8 This group considers only companies that are not engaged in foreign trade. Since export companies receive operating income in foreign currency, they have a natural hedge against depreciation. Importers are considered in a separate group.

9 The debts these companies have with lending institutions increased from 28.6% of the balance of commercial loans granted to the private corporate sector to 30.7%, and from 4.4% to 4.8% of private corporate debtors.

10 The impact on corporate equity that 40% depreciation would have, given the representative market rate of exchange on 30 June 2015, is simulated.

11 This last exercise is partial, since it pertains to a simulation on equity at December 2014 for a smaller group of companies (those that report their financial statements to the Superintendency of Corporations).