Policy Response to the Current Phase of the Financial and Business Cycle: Session 4

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Buenos Aires, November 2016

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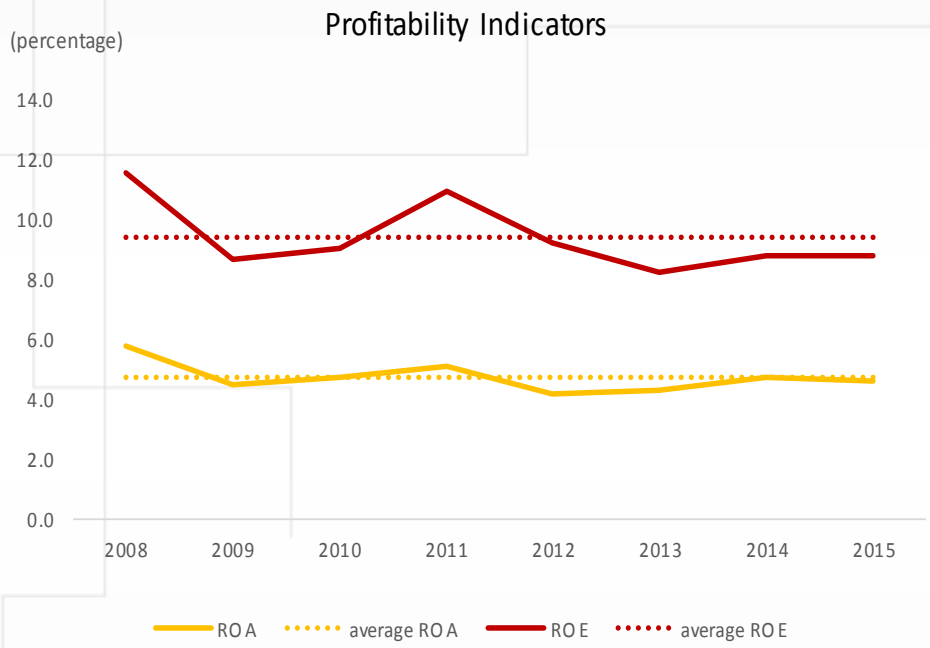
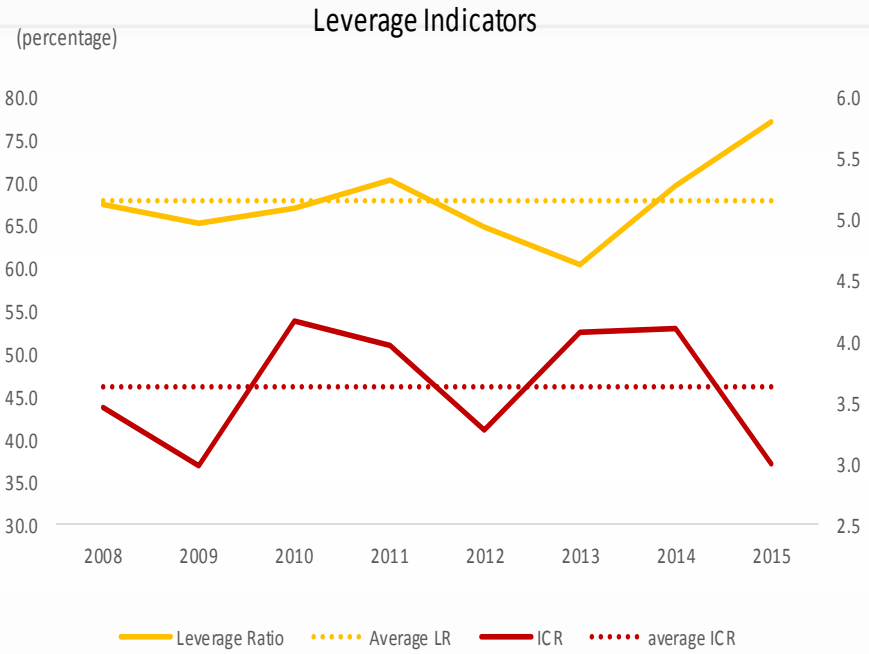
How would you characterize the current state of the financial cycle for the business sector?

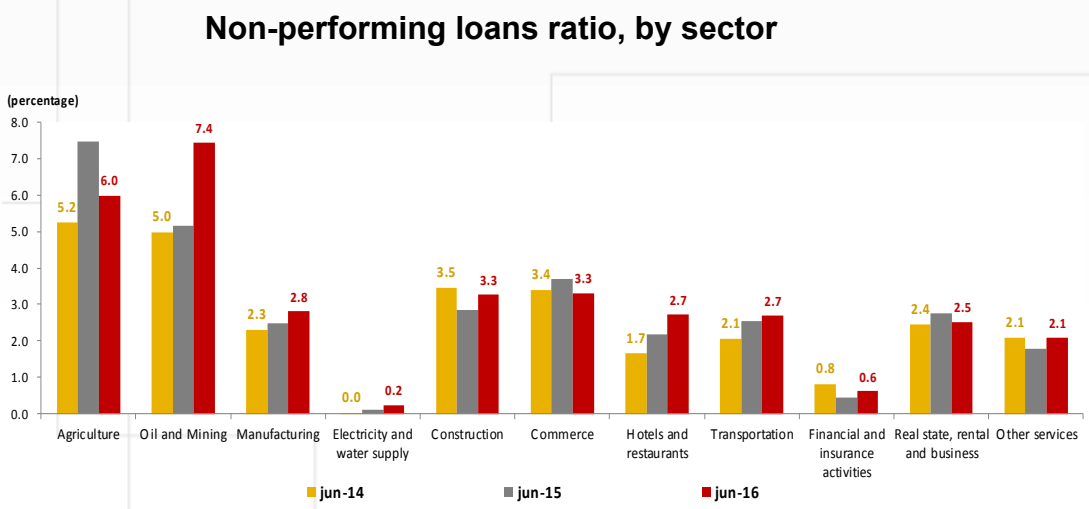


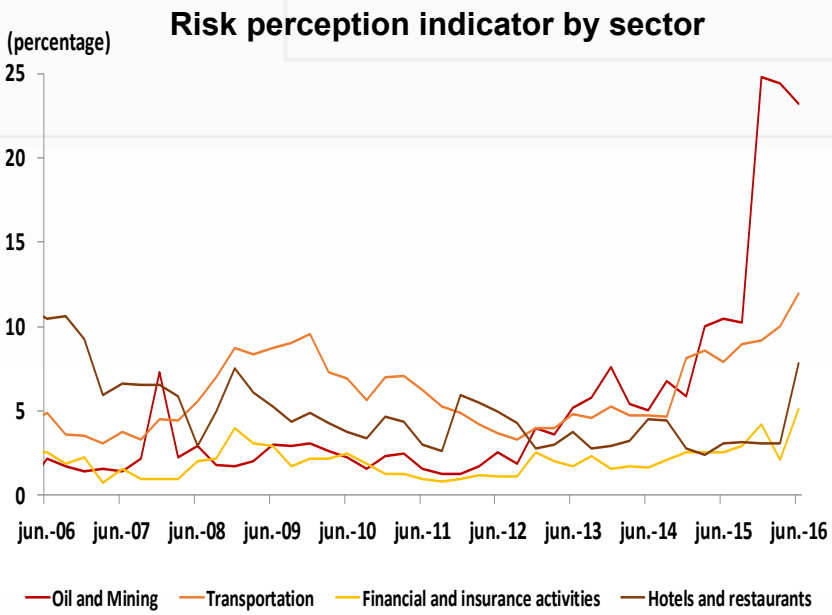


- As of December of 2015, the financial indicators of the corporate sector show a stable behavior of profitability (**Moderate**), but a deterioration in leverage (**High**).

Source: Superintendencia de Sociedades; calculations by Banco de la República.

Are there any economic sectors that face more difficult conditions?





- Sectors with the highest increment in their non-performing loans ratio are: oil and mining, hotels and restaurants and transportation.
- These are also among the sectors which are being perceived as riskier by financial institutions.

Source: Superintendencia Financiera de Colombia; calculations by Banco de la República.

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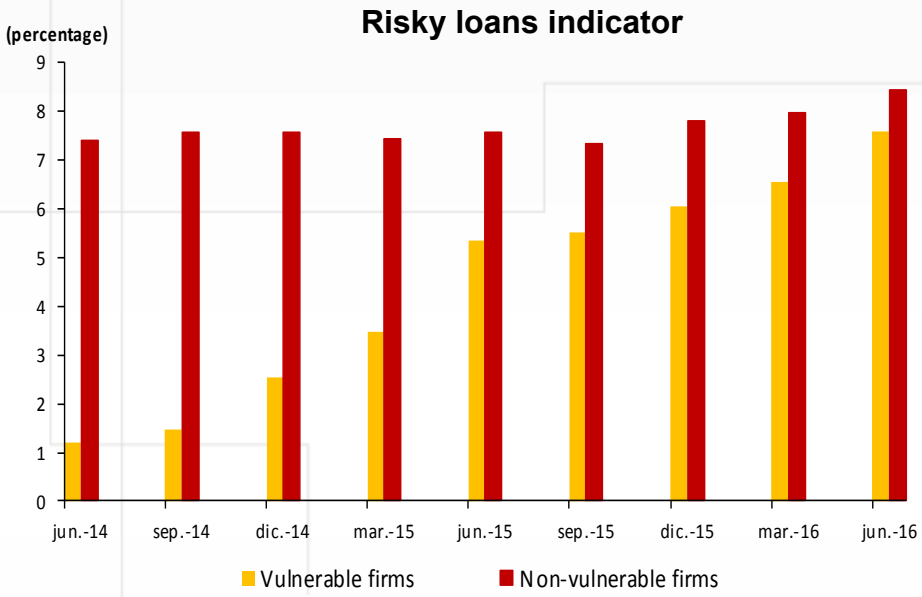

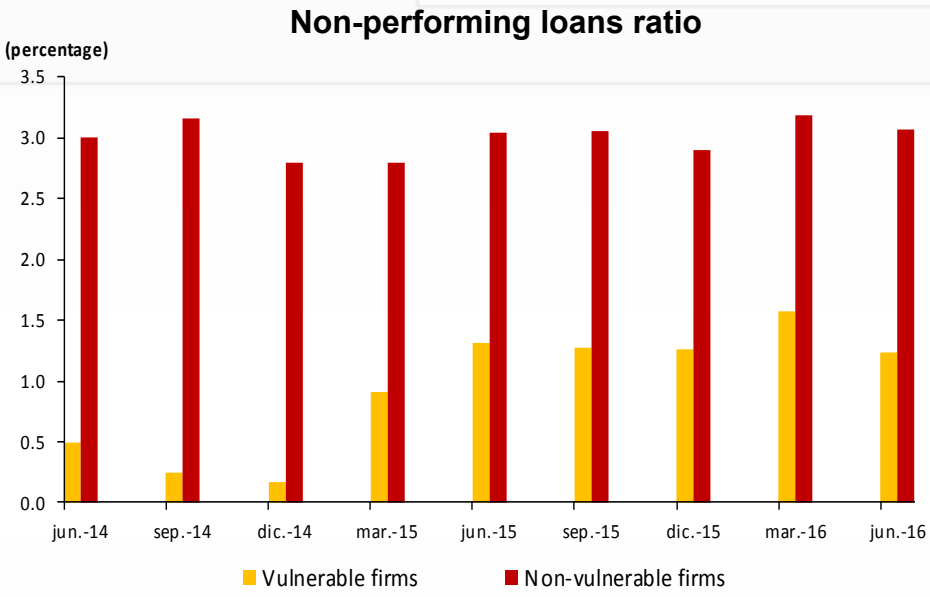

- In a depreciation scenario, one of the main channels of risk for credit establishments is the default by firms in the real sector exposed to high currency mismatches → as of June 2014, a total of 731 companies were identified as vulnerable (4.3% of commercial loans).

- Despite the deterioration of these debtors, their indicators have always been below those of firms not considered vulnerable.

Source: Superintendencia Financiera de Colombia; calculations by Banco de la República.

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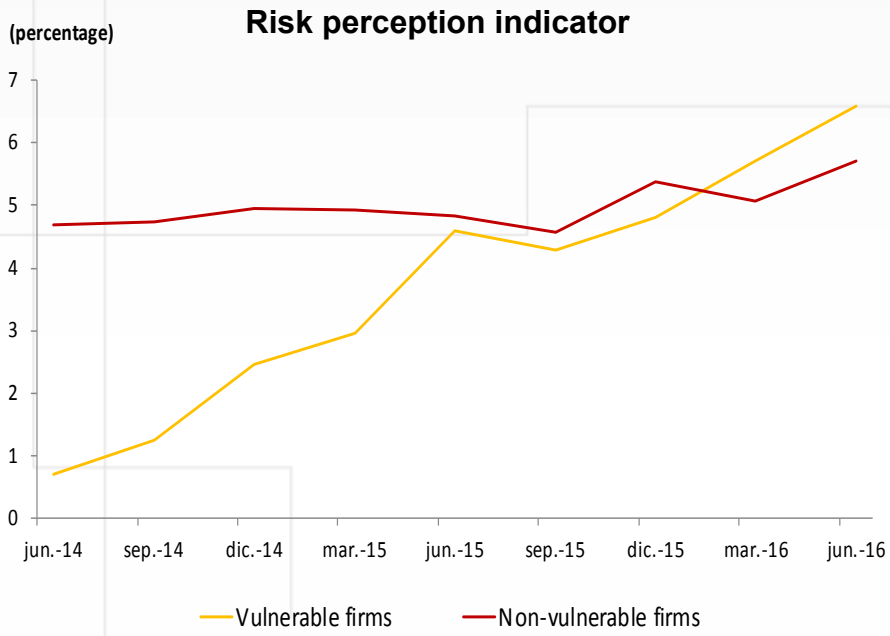

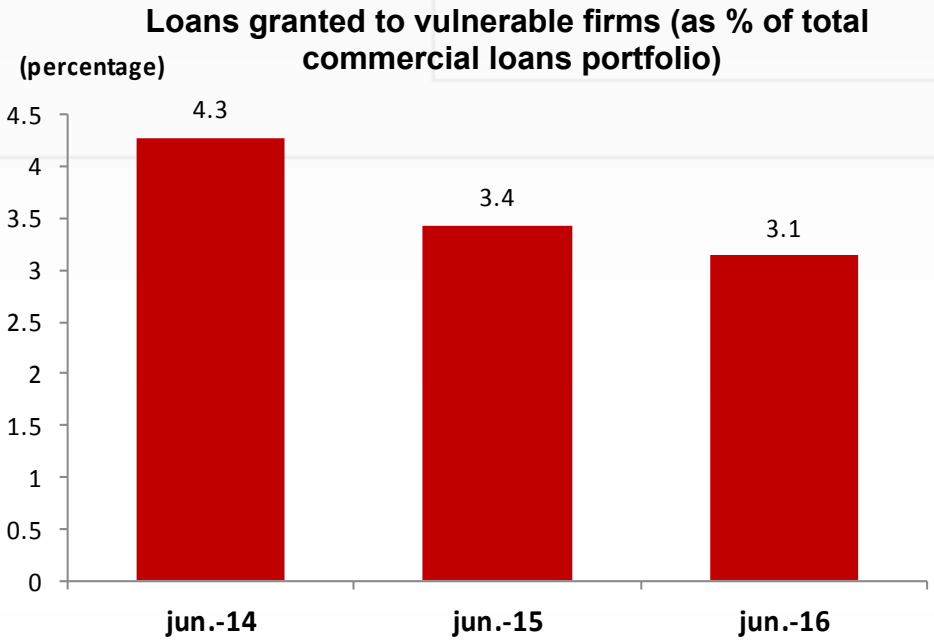

- The sample of vulnerable firms has showed a sustained increase in the risk perception indicator: the indicator rose from 0.7% in June 2014 to 6.6% in the same month of 2016.

- However, the exposure of the financial system to these firms has actually been reduced.

Fuente: Superintendencia Financiera de Colombia ; cálculos del Banco de la República.

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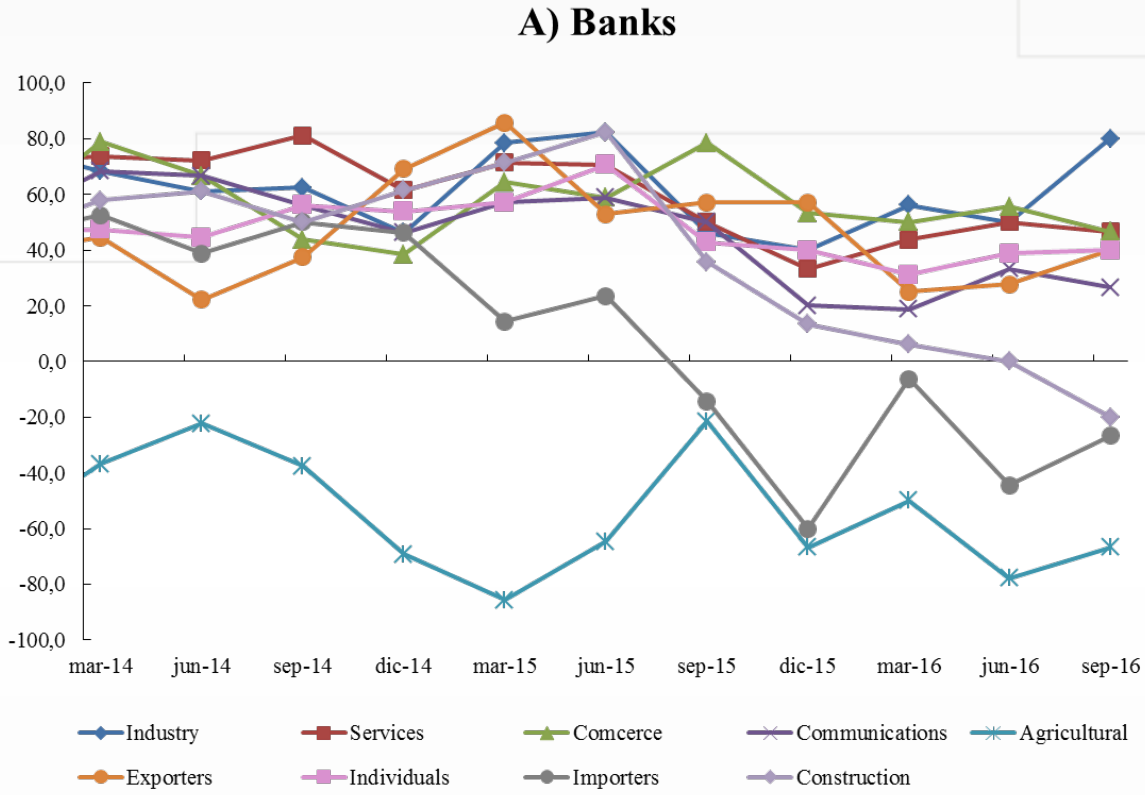
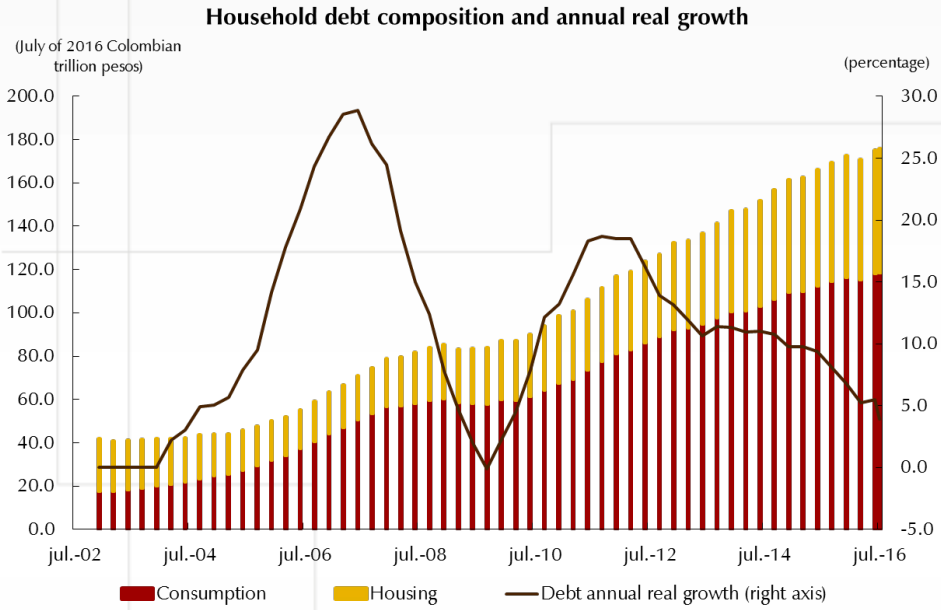
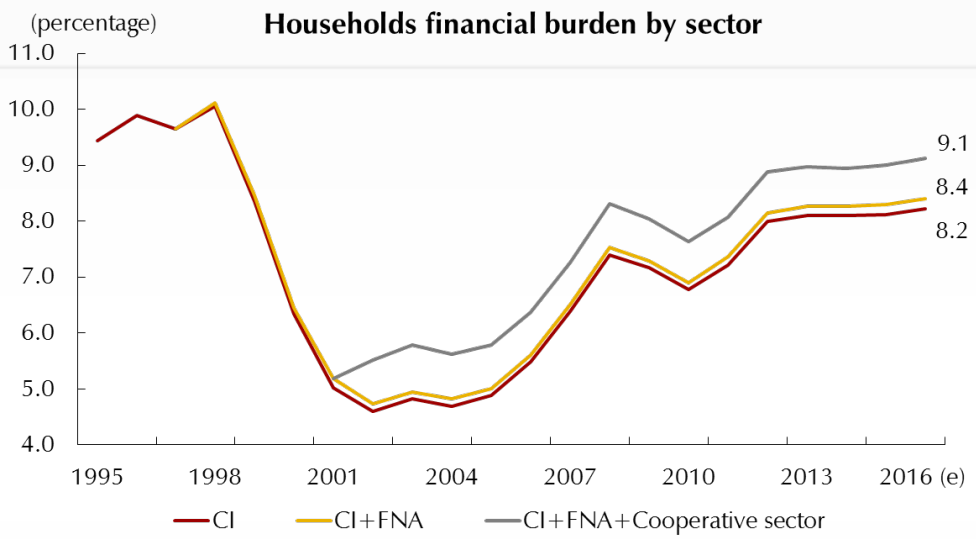


Surveys highlight that importers are having a harder time in accessing credit since the depreciation shock.

Source: Quarterly Credit Survey; Banco de la República.

Any concerns about the household sector?





- Household debt has been decelerating in the last 4 years…
- …which has resulted in a flattening of their financial burden.
  - Below mid-90s levels.

Source: Superintendencia Financiera de Colombia, FNA, Supersolidaria; calculations by Banco de la República.

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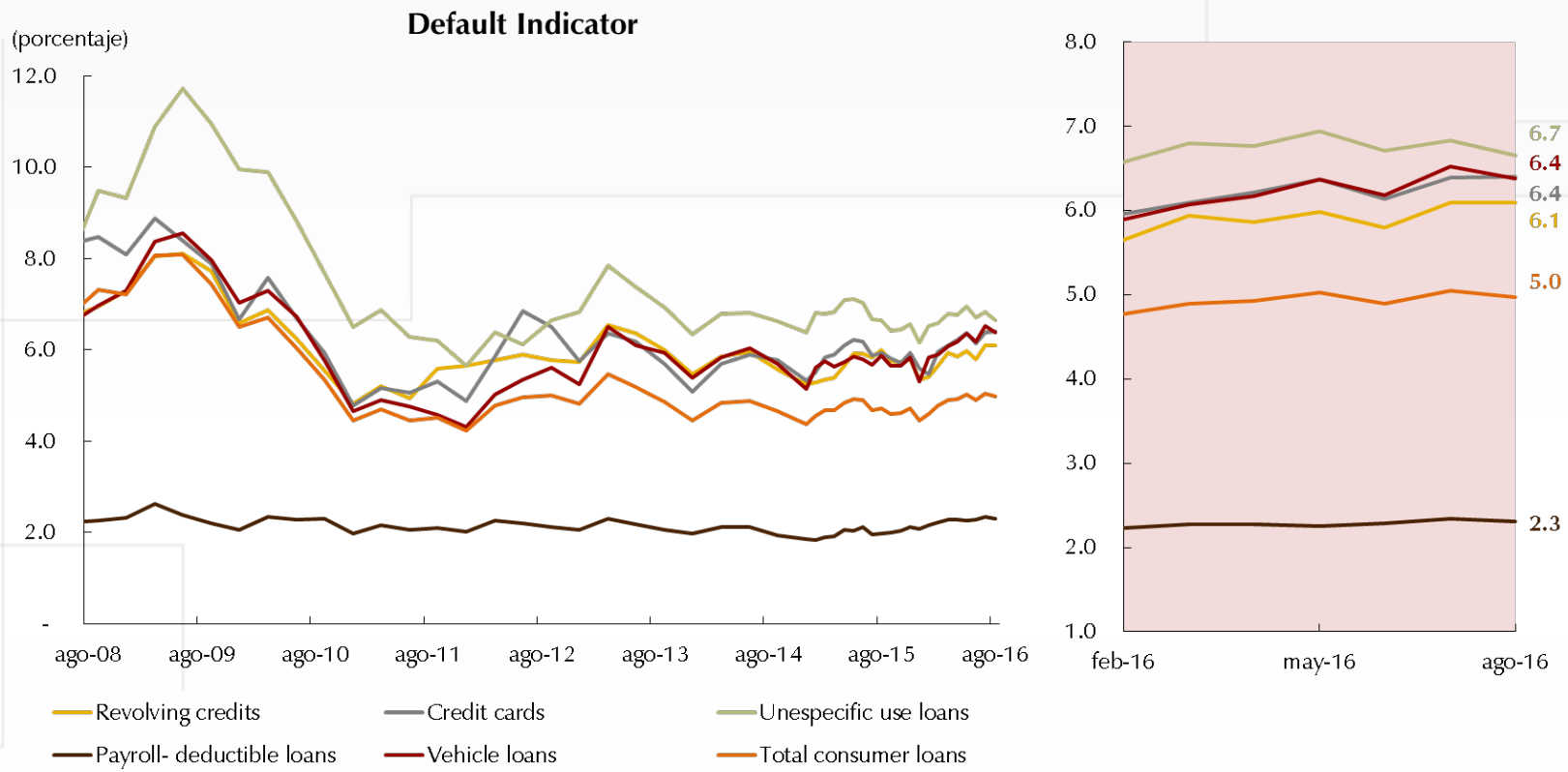

- No significant risk materialization has been observed…
- …however, non-performing loans have slightly increased in vehicle and credit card loans.

Source: Superintendencia Financiera de Colombia (SFC); Banco de la República calculations.

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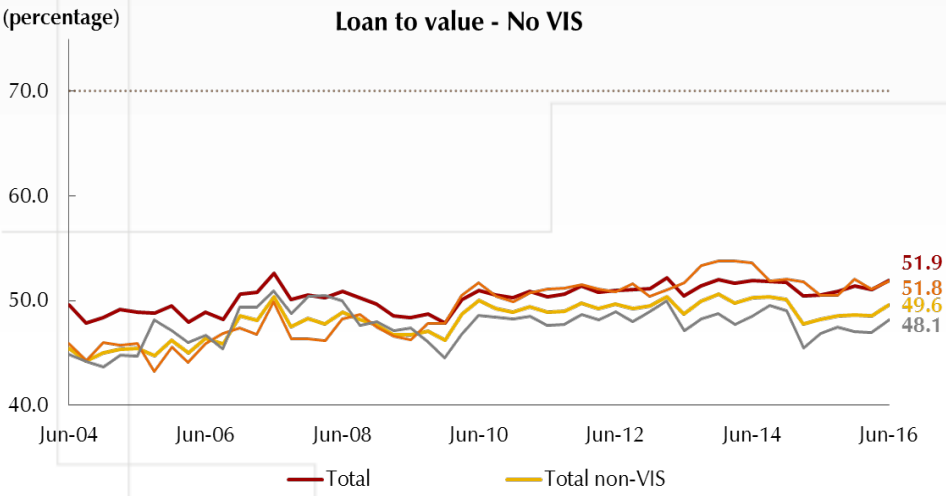
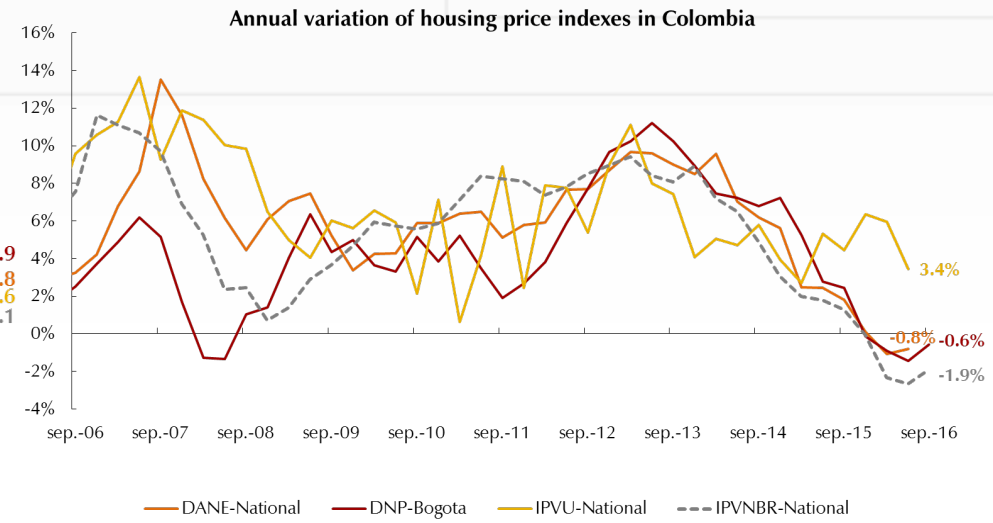


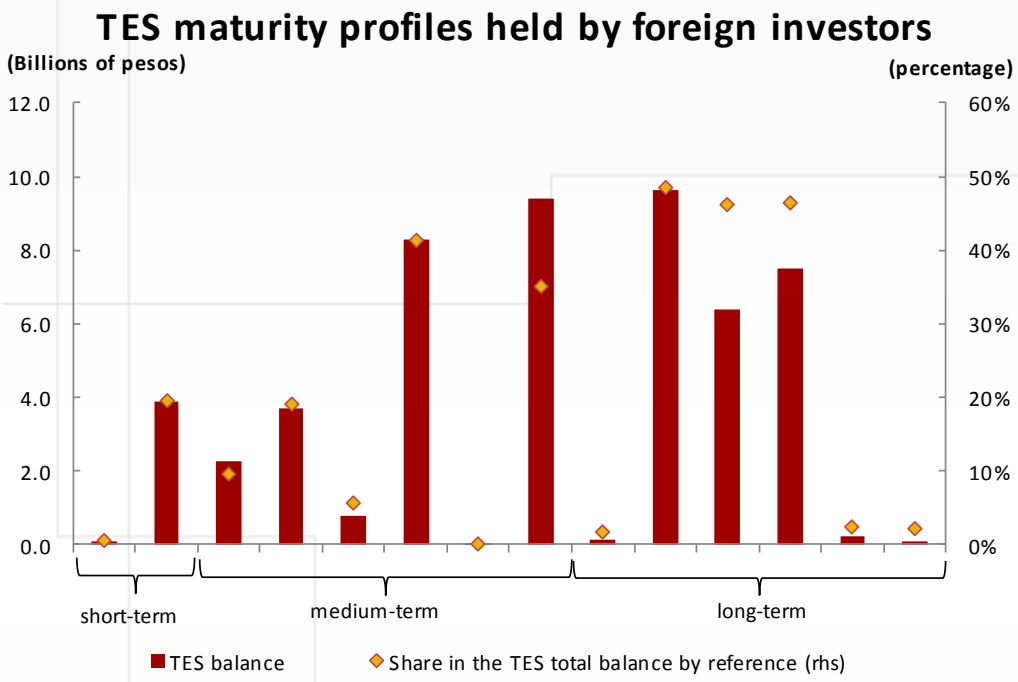


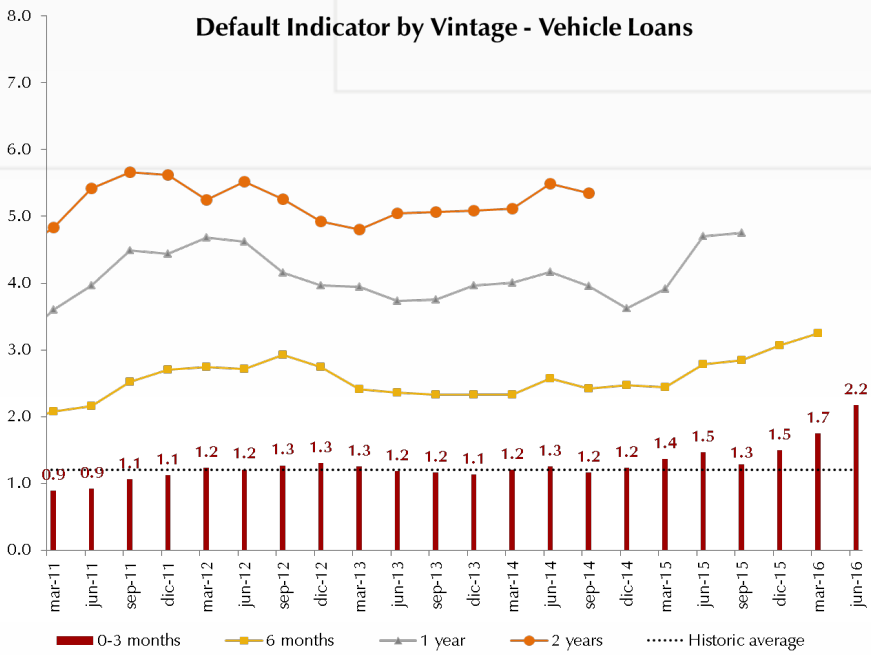
No apparent imbalances in the household market

- LTV has been around 50% during the last 5 years → low financial leverage.
- Housing prices have been falling for the last 3 years after exhibiting sustained growth between 2009-2013 → this dynamic was not credit-driven.
  - Mortgages represent close to 30% of household debt, and around 12% of the loan portfolio.

Source: Asobancaria, DANE, DNP, Banco de la República and La Galería Inmobiliaria; calculations by Banco de la República

Any concerns about the banking and financial system





1. Increased portfolio duration + higher share of foreign investors in the public debt market (medium and long-term) → exposure to **market risk** increased.

2. Current economic environment (lower growth and higher interest rates) implies a higher likelihood of **credit risk** materialization → Tax reform could have an additional effect on households' disposable income.

✓ These are the latent risks that we have analyzed in the sensitivity analysis of the latest FSR.

Source: Infovalmer, Depósito Central de Valores (DCV); calculations by Banco de la República.

Do these conditions in financial markets affect the monetary or exchange policy stance currently in place?

- Board of Governors analyzes all the information at hand to take policy actions, so by definition, market conditions frame the decision-making process.
- Recall: essential responsibility of the Board is safeguarding purchasing power of the national currency, in coordination with economic policy in order to achieve a long-term GDP growth trend.
- Therefore, when implementing MPP, the Board assesses its costs and benefits, including the risks over the inflation target and potential effects on financial stability.

In which way?

- For instance, (in)action in FX market is based on ample information set:
  - Exposure of intermediaries to firms vulnerable to a depreciation is low.
  - Financial system has low exposure to currency mismatches.
    - ✓ Bounded by regulation → close to 0 by choice
- Robustness of financial system has allowed MoP to be countercyclical
  - Lowering policy rates in 2008-2009.
  - Current period of policy tightening → no significant effects on financial health.

Have you adjusted macroprudential policies in response to recent developments?

- Adjustments in FX policies, to better mitigate currency mismatches and to take account of cross-border expansion of financial services.
- Superintendence is considering additional provisions for long-term consumer loans (+6yrs)

How are financial policies in place handling the new phase of economic slowdown?

- Seems to be going well → capitalization, profitability, low levels of credit risk (low forbearance) and adequate liquidity.
- After a strong shock to permanent income, we had an automatic stabilizer in the exchange rate → we were able to allow such floating because MPP in place help limit currency mismatches.
- Dealing with fiscal and current account deficits is another story… and possibly outside of MPP reach.

Does the macroprudential policy framework appear well prepared to deal with increasing financial stress?

Easy answer: Yes

- We have fared this particular set of (significant) shocks to the economy fairly well.
- Stress-testing exercises carried out with diverse shock scenarios also point towards resilience of the financial system (these exercises include (some) MPP in place, such as dynamic provisions and limits to FX positions).

But… our job is to be constantly worried

- We know there are areas of improvement → Critical: convergence to Basel III capital standards.
- We also know that the nature (and combination) of the shocks matters, and that it is uncertain, so we must always sleep with one eye open.