Financial Stability Report - March 2014

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During the second semester of 2013, the international environment was characterized by the gradual recovery in the Eurozone and the U.S. economy, as well as by an upturn in the Chinese economy. Although overall uncertainty regarding the moderation of the United States monetary policy impacted the performance of Latin American economies, Colombian financial markets have shown adequate liquidity levels and less volatility in the second half of the year compared with the first.

Financial intermediation activities of credit institutions showed a slowdown in the second semester of 2013, after a period of stability that began at the end of 2012. The gross portfolio grew at an annual real rate of 10.5% in December 2013, a figure less than the observed 6 months before (12.5%). This behavior is explained by a slowdown in all types of portfolios, with the exception of mortgage loan portfolio On the other hand, the accumulated profits during the last twelve months had exhibited a stable behavior between June and December 2013, while the return on assets (ROA) and the return on equity (ROE) indicators showed a downward tendency. On side of liability, a slower growth in deposits was observed, along with a restructuring of the fixed term certificates of deposits (CDT for its acronym in Spanish) to shorter maturities.

By December 2013, the portfolio share of non-banking financial institutions in the total financial system remained stable at a level close to 48%. Additionally, portfolios for mandatory pension funds (MPF), insurance companies (IC) and funds managed by trust companies (TC) were characterized by high participation of domestic public debt securities. It is worth noting that the return on investments for MPFs has declined, and that these funds had a higher exposure to unhedged foreign currency investments. In terms of profitability, measured by the entities' ROA and ROE, it is remarked that it has increased for stock brokerage firms and investment management companies in the last half of 2013, while it declined for the other sectors.

Regarding the debtors of the financial system, it is emphasized that for the analyzed sample of private corporate sector companies in September 2013, financial indicators show a good situation in terms of profitability and liquidity.

Under stress tests that suppose extreme and hypothetical scenarios, it has been found that the firms analyzed by the private corporate sector would not show a substantial deterioration in their financial status, nor a significant materialization in the system's credit risk would be observed.

8 Moreover, during the second semester of 2013, an increase in the levels of indebtedness and household income was observed. Although these expansions were lower than those reported six months earlier, the financial burden indicator recorded an increase, explained by the greater growth of debt versus the one shown for income. However, household incomes remain above the past two years average levels, which has resulted in expectations

indicators remaining in positive and high levels. In recent months, greater demands are being recorded by credit institutions to extend consumer lending, which could influence on the households' future debt and financial burden growth.

With regard to credit risk, quality (QI) and default (DI) indicators did not show significant variations during the last year. In December 2013, QI and DI stood at 6.6% and 3.1% respectively, similar figures to those found a year ago (6.6% and 3.2%). By type, microcredits showed the greatest increase, both in QI and DI, while consumption and housing showed improvements. In the case of the commercial portfolio, stability in its indicators was observed.

When analyzing exposure to market risk, it appears that this increased, given the greater balance exposed for different entities, which was reflected in the increase in potential losses of the portfolio due to interest rate changes. With this analysis, the TCs, the ICs and the funds administered by the pension and severance funds management companies would be the most vulnerable to a decline in the prices of these assets. On the other hand, during the second semester of 2013, credit institutions registered liquidity levels above the minimum established by regulation. In addition, banks have shown an increasing trend in their liquidity indicator.

In summary, by December 2013, the financial system portfolio showed a decrease in its growth rate, after the stable behavior recorded since late 2012.

This was accompanied by an evolution without significant variations in the quality and default indicators compared to December 2012. On the debtors' side, considering different stress scenarios on the private corporate sector firms, a substantial deterioration on their financial status is not observed, nor a significant materialization on the system's credit risk. In the case of households, an increase in the financial burden during the studied period is highlighted. Also, an increase in potential losses for the financial system derived from market risk was noticed, together with an increase in the banks liquidity level.

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