



# Box 3: Financial Stress in the U.S. Banking System and a Stress Test of Credit Institutions' Capital Adequacy - Financial Stability Report, First Half of 2023

Download Keep in mind

The main purpose of these documents is to provide semiannual information on the vulnerabilities and risks of the financial system. The views presented and potential errors are the sole responsibility of the authors and their contents do not compromise the Board of Directors of *Banco de la República*

AUTHOR OR EDITOR Diego Cuesta Camilo Gómez Eduardo Yanquen Publication Date: Wednesday, 4 of September 2024

After the 2008 financial crisis, the U.S. Federal Reserve (Fed) drove the benchmark interest rate to historically low levels that became more pronounced in the wake of the covid-19 pandemic. At the same time, starting in March 2020 several measures to provide the market with liquidity were adopted, including the expansion of the asset purchase program in treasury and mortgage-backed securities. As a result, the Fed's balance sheet rapidly enlarged.<sup>1</sup> Given this expansionary monetary policy stance, the global financial system experienced high levels of liquidity until 2021. However, in a context of a global recovery in output and employment during 2021 and 2022 in which inflation levels and expectations for it exceeded policy targets, a sustained increase in global benchmark interest rates has been seen. Specifically, the Fed moved the rate from a range of 0% to 0.25% in March 2022 to a range of 4.75% to 5.0% in the same month in 2023. It also reduced liquidity facilities gradually by reducing the value of asset purchases as of the end of 2021 and beginning the process of reducing its balance sheet as of April 2022.<sup>2</sup> This rapid tightening of monetary policy has been accompanied by destabilizing events in regional banks in the United States due to the materialization of interest rate and market risks associated with the devaluations of their portfolios.

This box recounts the events that led to the closure of Silicon Valley Bank (SVB), Signature Bank (SB), Silvergate Bank (SGB), and First Republic Bank (FRB) in the United States. Following this, it delves into the direct and indirect consequences that said banking stress events had and could have on the Colombian financial system. Finally, a static stress test of the capital adequacy of credit institutions (CIs) in Colombia is presented to assess their resilience to the materialization of losses associated with interest rate and market risks similar to the ones that occurred in the abovementioned U.S. banks. In conclusion, when the problems of the regional banks in the United States materialized in March 2023, the CIs in Colombia were not highly exposed directly. Nevertheless, there could be indirect effects on the financial markets that might affect them. The static stress test of capital adequacy, which assumes losses due to the valuation of held-to-maturity TES at market prices in the case of a hypothetical need for liquidity on the part of CIs, shows that the system is resilient. This result is related to the fact that all CIs maintain a low exposure to TES at maturity in their portfolios since, as of February 2023, these securities only represent 6.3% of the assets of the entities exposed to these investments. Furthermore, these exposed entities represent only 19.2% of the total assets of CIs. Notwithstanding the above, the impact on the local financial system should continue to be monitored in the coming months in case of further disruptions to the international financial market.