

EXECUTIVE SUMMARY

The increase in financial activity slowed during the second half of 2007, due to the monetary-policy measures adopted by Banco de la República's Board of Directors since 2006 and the effect of new reserve requirements.

The loan portfolio continued to reflect less momentum. In fact, real annual growth in the overall portfolio was 20.1% by December 2007. This is 200 basis points below the rate in June. The slowdown in consumption loan growth was even more pronounced: 28.1% compared to 36.9% growth in June, followed by micro-loan (11.2% compared to 19.9%) and commercial loans (16.3% compared to 17.3%). The mortgage loan portfolio (with securitizations) maintained its momentum, registering an increase of 14.4% by December compared to 12.4% in June. The slowdown in lending contrasts with the increase in the non-performing loans of all types, especially commercial and consumption credit.

There was sustained growth in deposits, with a real increase of 13.3% by December following 12.2% in June. A considerable shift in liabilities from checking and savings accounts to certified deposits was observed. Part of this substitution is explained by the marginal reserve requirements and the changes in ordinary reserve requirements. The investment portfolio held by credit institutions declined by 12.2% in real terms, due to the disposal of government bonds, mainly during the first half of last year.

The profits reported by financial intermediaries rose at a pace similar to the increase in the gross loan portfolio, despite the marginal reserve requirements and the loan-loss provisions made for portfolio deterioration and implementation of the Credit Risk Management System (SARC in Spanish) for the commercial loan portfolio.

Non-bank financial institutions experienced problems due to the drop in prices for government bonds and stocks, particularly during the first six months of 2007.

As a result, several severance pay funds failed to meet the minimum profitability requirement. The situation also prompted some institutions to move part of their portfolio into investments in the banking system, such as certified deposits (known as CDTs in Colombia).

The risks to the financial system in 2008 will depend on the force of the economy, the volatility of international financial markets, the funding required by the government, and the effect of monetary policy measures. The anticipated slowdown in the economy will mean smaller increase in lending.

The household financial burden will influence how the risky loan portfolio behaves, mainly because of the increase in consumption lending and respective interest rates. It is important to point out the tendency among borrowers with first-time consumption loans in 2005 or 2006 to default a year later. This has more than doubled the risky loan indicator for credit of that type.

Exposure to liquidity risk has been on the rise since last year. Liquidity risk will depend on the extent of uncertainty in the international economy, in as much as liquidity in the government bond market is influenced by the external situation. This makes the Liquidity Risk Management System (SARL in Spanish) particularly important. It is scheduled to be up and running by the second half of 2008.

Board of Directors, Banco de la República