Box 4
Outlook for the Credit Markets Based on *Banco de la República* Surveys

Each quarter, the Financial Stability Department at *Banco de la República* gives a set of surveys to participants in the credit markets in order to obtain first-hand knowledge about their outlook and opinions. This exercise is crucial for the Bank's work of closely monitoring the credit scenario and the stability of the Colombian financial system. These surveys include the *Survey of the Credit Situation in Colombia, the Survey of the Microcredit Situation in Colombia, the Survey of the Perception of Financial System Risks, and the Survey on External Indebtedness and Quotas*.1[1] This box presents a combined analysis of the surveys from the last quarter of 2017 in light of the recent changes in macroeconomic conditions and to offer an analysis of the outlook for the credit market in 2018.

1. General aspects

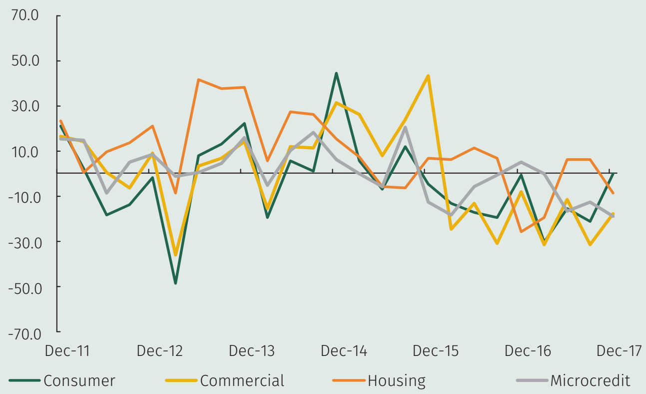
As a result of several macroeconomic shocks, the growth rate of the Colombian economy experienced a relative slowdown between 2014 and 2017. Economic theory and historical experience suggest that the performance of the financial system is closely related to the aggregate performance of the economy, which is reflected in the behavior and the outlook expressed by the agents in the surveys done by *Banco de la República*. Therefore, the analysis of these surveys makes it possible to distinguish trends that are important to the markets that are not easily discernible from the actual information in the entities' financial statements. The foregoing gains relevance as long as the performance of the Colombian financial system goes hand in hand with the recovery of economic growth, as was identified in the September 2017 *Financial Stability Report* issued by the Bank.

2. Balance of credit markets at the close of 2017

In a fashion consistent with the slowdown in the growth rate of the Colombian economy, the credit institutions surveyed in December 2017 indicated that they perceived a weak demand for all types of loans (housing, consumer, commercial, and microcredit) on the part of the economic agents. As shown in Graph B4.1, the perception of demand indicator has been in negative territory since the end of 2015 for the consumer and commercial credit markets, and since more recent dates, in the case of housing loans and microcredit.

The banks surveyed, in turn, also showed weakness in their supply of all types of loans although with less intensity than in the case of the demand and, in particular,

Graph B4.1
Indicator of Perception of Demand for Loans

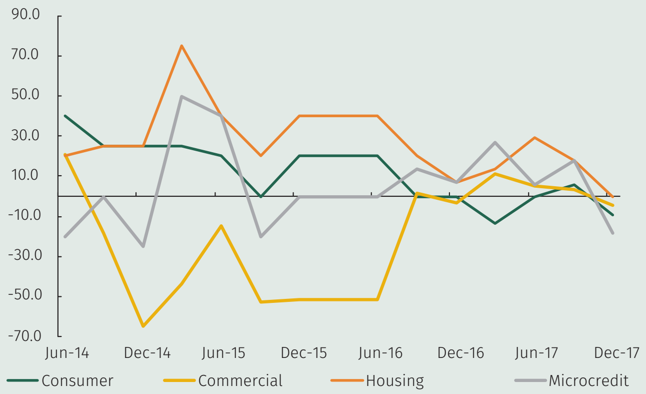


Note: to build this indicator, the credit establishments were asked how the demand for new loans has changed during the last three months (scale was: 1 = lower; 2 = slightly lower; 3 = the same; 4 = slightly higher; and 5 = higher. The indicator consists of the difference between the percentage of those surveyed who answered with 4 and 5 and the percentage of those who answered 1 and 2. A negative result in the balance is interpreted as a general perception of a decline in demand.
Source: *Banco de la República* (Report on the loan situation in Colombia), December 2017.

limited to the most recent period: based on Graph B4.2, the indicator of change in the banks' supply of each type of credit registered negative values at the end of 2017. The above does not completely apply in the case of financing companies and cooperatives as the change in their supply of credit is more heterogeneous and volatile. Fundamentally, the weak supply of loans on the part of the banks can also be seen through the greater number of requirements that these credit establishments have recently introduced for new loan applications for each of the types of credit.

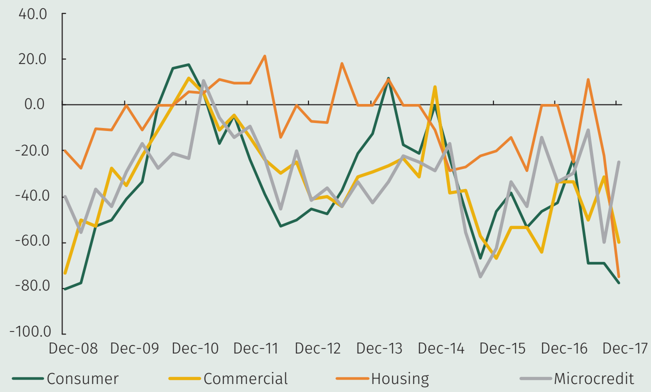
1 The results of the surveys are published quarterly in January, April, July, and October on *Banco de la República* website. The surveys are answered by different agents that include credit establishments (banks, financing companies, and cooperatives), non-banking financial institutions, business associations, and universities.

Graph B4.2
Indicator of the Change in Bank Loan Supply



Note: to build this indicator, the credit establishments were asked how the supply of new loans has changed during the last three months (scale was: 1 = lower; 2 = slightly lower; 3 = the same; 4 = slightly higher; and 5 = higher. The indicator consists of the difference between the percentage of those surveyed who answered with 4 and 5 and the percentage of those who answered 1 and 2. A negative result in the balance is interpreted as a general perception of a decline in supply.
Source: *Banco de la República* (Report on the loan situation in Colombia), December 2017.

Graph B4.3
Indicator of Change in Requirements



Note: to build this indicator, the credit establishments were asked how their requirements for granting new loans has changed during the last three months (1 = more restrictive; 2 = moderately more restrictive; 3 = have remained the same; 4 = moderately less restrictive; 5 = less restrictive) The indicator consists of the difference between the percentage of those surveyed who answered with 4 and 5 and the percentage of those who answered 1 and 2. A negative result in the balance is interpreted as a change towards greater demands.
Source: *Banco de la República* (Report on the loan situation in Colombia), December 2017.

These manifest themselves in the indicators of change based on persistently stricter requirements2[2] (Graph B4.3).

3. Outlook on risk and credit markets in 2018

During 2018, the Bank and most economic analysts agree on an outlook and a long-term trajectory of gradual recovery of economic growth. However, the entities surveyed expressed their intention of maintaining or increasing their requirements for granting loans in the short term. As shown in Graph B4.4, no bank surveyed indicated any intention of reducing its requirements during the first quarter of 2018. In the case of commercial and microcredit loans, most of the banks reported that they intended to increase the requirements.

In this context, the financial stability faces risks that must be monitored and mitigated. Based on the surveys, 48.2% of the agents stated that the main risk in this regard is a possible additional deterioration in their loan portfolio, which would be associated with weak economic growth. In this respect, the respondents surveyed agree with the September 2017 *Financial Stability Report*, which identified the risk of a weaker than expected economic recovery as the main vulnerability financial stability faces during 2018. The entities indicated that a stronger manifestation of credit risk and deterioration in Colombia's economic outlook are the contingencies that could potentially have a greater impact on the performance of the financial system. At the same time, the entities perceive these factors as the ones that have the highest probability of taking place.

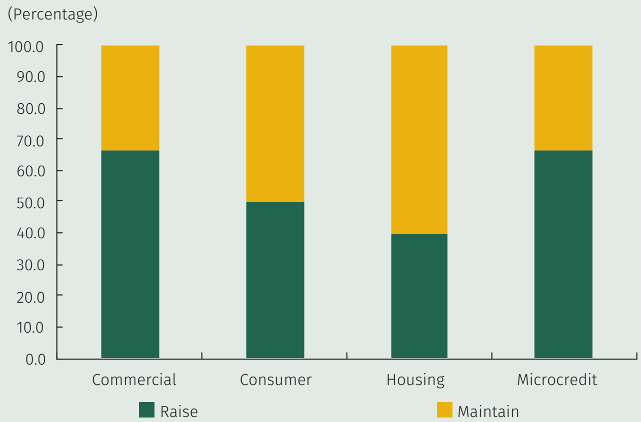
When compared with the September 2017 surveys, the percentage of entities that mentioned an additional deterioration of the portfolio as the main risk declined significantly (in September, it was 64%), which is consistent with the recent recovery of the economic growth. Simultaneously, a higher percentage of entities mentioned the political uncertainty (possibly associated with the legislative and presidential elections) and the reduction in the rating of Colombian public debt as the main risks for 2018.3[3]

In any case, according to the survey respondents, confidence in the soundness of the financial system remains high. Based on Graph B4.5, 71.1% of the respondents stated that they had a high or very high level of confidence, while only 1.2% reported having a low level of confidence, and no entity indicated a very low level of confidence.

2 In this regard, the entities have consistently stated in the surveys that the most important criterion for assessing the risk of new debtors is their credit history. That is why, it is essential to ensure that the information on credit histories stored by the credit bureaus is accurate, reliable, and timely.

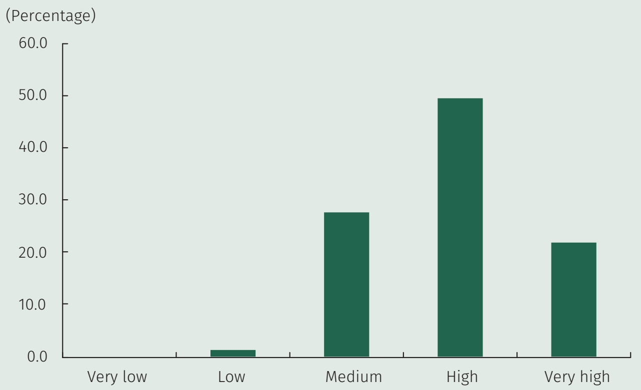
3 Considering the fact that the rating agency, Standard & Poor's, lowered the rating of short- and long-term Colombian debt denominated in foreign currency on December 11 last year, the *Survey of External Indebtedness and Quotas* for December 2017 asked the entities about the impact that this could have on their indebtedness under contract with financial institutions abroad. At that time, most of the entities claimed to have preserved the condition of indebtedness they had before that decision.

Graph B4.4
Percentage of Banks that Expect to Maintain, Raise, or Reduce their Requirements during the First Quarter of 2018



Source: *Banco de la República* (Report on the loan situation in Colombia), December 2017.

Graph B4.5
Confidence in the Stability of the Financial System in 2018 (percentage of responses)



Source: *Banco de la República* (Report on the loan situation in Colombia), December 2017.

4. Conclusions

Along with the rebound in the growth of the Colombian economy, the credit markets are expected to gradually recover their trajectory of expansion and mitigate the deterioration of the credit portfolio. The empirical evidence indicates that with respect to aggregate shocks such as those experienced by the Colombian economy, the credit variables have a lagged reaction with respect to economic growth. Thus, it is likely that the recovery of the credit markets will come at a slower pace in comparison to the better performance of the rest of the Colombian economy.

According to the respondents, the main vulnerability the stability of the financial system has remains associated, as was mentioned in the September 2017 *Financial Stability Report*, with the risk of a more pronounced economic slowdown or a weaker than expected recovery for the remainder of 2018. In this context, *Banco de la República* will seek to make those decisions that ensure a timely return to those trajectories of inflation and growth that are consistent with macroeconomic stability and long-term economic development.