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Bulletin:

Banking Industry Country Risk Assessment Industry Risk Trend For Colombia Revised To Positive; No Ratings Affected

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MEXICO CITY (S&P Global Ratings) July 10, 2018--Following a recent review of the Banking Industry Country Risk Assessment (BICRA) for Colombia, S&P Global Ratings revised its industry risk trend to positive from stable. The potential materialization of the positive trend, which would result in a stronger industry risk assessment, wouldn't change Colombia's BICRA group score or its anchor (currently at 'bb+'). In addition, the trend revision had no ratings impact on Colombian banks.

The industry risk trend revision reflects the improvement in Colombia's banking regulation that would extend the supervision capacity. The revision also reflects the regulator's potentially greater capacity to identify problems at earlier stages, ensuring that banks take corrective actions. In our view, this could bolster the institutional framework in terms of regulatory track record. Once we have greater clarity about the implementation plans of Basel III, along with the finalization of the regulations for supervision of financial conglomerates and for restructured loans, we could reassess Colombia's institutional framework to a stronger category.

Healthy competitive dynamics in Colombia's banking system with moderate risk appetite and absence of market distortions currently support the industry risk. The improvement in the regulatory framework--including the recently approved "conglomerates law", the introduction of standardized loan restructuring rules, and the expected adoption of Basel III capitalization rules--will strengthen the Colombian banking authority's capacity to address problems at earlier stages, ensuring that banks take corrective actions. (The "conglomerates law" allows for full supervision at the holding level, while the new loan restructuring rules increase transparency and allow for stronger credit risk surveillance.)

Nevertheless, Colombia's financial system remains heavily dependent on wholesale funding, which we consider as less stable during times of economic and market distress. This is due to the low share (about 25%) of retail deposits in commercial banks' total deposits. However, domestic debt capital market has mitigated this weakness given that it has proved to be moderately broad and deep, allowing investment- and speculative-grade entities to access funds with medium- to long-term maturities. In our view, capitalization remains the main regulatory challenge for Colombia's financial institutions, but the potential implementation of Basel III capitalization rules could remove this risk.

After growing at slightly more than 14% in 2014 and 2015, credit expansion decelerated to 7.6% in 2016 and 6.2% in 2017. This trend is strongly correlated with the economic performance. Political uncertainty has diminished following Ivan Duque's presidential election victory this year. Therefore, we expect business confidence and economic activity in Colombia to pick up, resulting in higher credit demand. We project real GDP growth at 2.5% in 2018 and to average 2.7% during 2019-2021. Therefore, we estimate lending to expand at around 7% in 2018 and 8.0%-8.5% in 2019. Starting in 2018, the tax reform of 2016 will gradually reduce the corporate income tax rate to enhance competitiveness, which could bolster credit demand among the corporate and commercial sectors. We expect the banking sector's nonperforming assets to total loans to stabilize at around 3.5% by the end 2018 and recover to around 3.0% in 2019 and 2020.

In particular, the performance of consumer loans will benefit from households' improving income capacity amid lower inflation and interest rates. In addition, the new loan restructuring practices will help improve asset quality thanks to early and greater surveillance of modified loans. In our view, stronger economic performance and increasing credit demand will improve asset quality. Credit losses represented 2.65% of total loans in the industry at the end of 2017, and we expect this metric to average 2.50% in 2018 and 2019.

BICRA Score Snapshot*

Colombia

	To	From
BICRA Group	6	6
Economic risk	7	7

Economic resilience	High Risk	High Risk
Economic imbalances	High Risk	High Risk
Credit risk in the economy	High risk	High Risk
Industry risk	5	5
Institutional framework	High Risk	High Risk
Competitive dynamics	Intermediate Risk	Intermediate Risk
System-wide funding	Intermediate Risk	Intermediate Risk
Trends		
Economic risk trend	Stable	Stable
Industry risk trend	Positive	Stable

*Banking Industry Country Risk Assessment (BICRA) economic risk and industry risk scores are on a scale from 1 (lowest risk) to 10 (highest risk). For more details on our BICRA scores on banking industries across the globe, please see "Banking Industry Country Risk Assessment Update," published monthly on Capital IQ.

RELATED RESEARCH

- Banking Industry Country Risk Assessment: Colombia, Sept. 14, 2017

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