Anticyclical provisioning scheme for Colombia

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The financial system’s response to the various phases of the cycle is characterized by high credit growth during the upswing phase and its rationing during the downswing. This behavior is related to the financial system’s tendency to underestimate the credit risk during the upturn and to overestimate it during the downturn phase2 . This wrong perception of risk creates distortions in the incentives for financial institutions to lend, makes credit excessively volatile, which negatively affects corporate and investment funding, and conveys a climate of instability, thereby transmitting the instability to the real sector.

Furthermore, financial institutions generate high profits during the cycle upswing, which are distributed among their stockholders, to be followed by a crisis during the downswing, with the ensuing possibilities of bankruptcy, state intervention, or government support at the expense of the national budget. Thus, this argues for the need to set up an anticyclical provisioning scheme to lower profit volatility throughout the economic cycle.

The purpose of this document is to determine the impact of having an anticyclical provisioning system in Colombia similar to the one in place in Spain. The simulations put forth in this document suggest that credit institutions would

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