EXECUTIVE SUMMARY

Macroeconomic conditions favored solid growth in the financial system throughout 2005. Moreover, the economic outlook, both domestic and external, indicates this expansion could continue.

At December 2005, the country's credit institutions reported real positive growth in their two main assets. On the one hand, loan portfolio growth was up by an annual rate of 11.3%, mainly due to an increase in the share of consumer credit. On the other, investments rose by 13%. This increase in financial activities has been consistent with appropriate of solvency levels.

As to sources of financing for credit institutions, the rise in deposits has slowed, but increased funding through the inter-bank market and repo operations offset this situation. In addition, the country's financial entities continued to restructure their liabilities in the direction of less costly sources of funding. This was evident in the declining share of certificates of deposit (CD) and the increased growth in current accounts.

Households, where credit institutions have concentrated 26.7% of their total exposure, showed highly favorable results. The continued growth in household consumption was the main reason why, backed by significant improvements on in the job market, such as less unemployment and stability in real wages.

The positive situation in the private sector, accompanied by more portfolio coverage and good asset soundness on the part of financial institutions, suggests that credit risk, at least for the time being, does not pose a threat to the financial system. However, the continued momentum in consumer credit, which saw 32% real annual growth in 2005, will have to be carefully monitored. A prolonged increase in this portfolio could extend to lower quality debtors. Moreover, increased borrowing makes households more sensitive to changes in the economy. This underscores the importance of continuing to design ways and means to measure, monitor and assess the credit risk posed by the consumer loan portfolio. This should be done through the credit-risk management system (CRM) operated by the Colombian Superintendency of Financial Institutions.

Because investments account for a growing share of assets in the financial system, their valorization also represents a larger share of the system's earnings. This makes financial institutions more sensitive to interest-rate changes. Hence, progress towards market-risk measurement, regulation and monitoring is of vital importance to the stability of the financial system.

Board of Governors
Banco de la República