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Banks – Colombia: Q3 2023 Update

Continued pressure on margins and asset quality hit bottom-line results

Below are key takeaways from the Q3 2023 results reported by the four largest Colombian banks: Bancolombia S.A. (Bancolombia, Baa2 stable, ba1)[1], Banco Davivienda S.A. (Davivienda, Baa3 stable, ba2), Banco de Bogotá S.A. (Bogotá, Baa2 stable, ba1), and BBVA Colombia S.A. (BBVA, Baa2 stable, ba1). All comparisons are to Q2 2023 unless otherwise stated.

The four biggest banks in Colombia (Baa2 stable) had combined net income of COP 1,410 billion ($346 million) in Q3 2023, a 24.1% decline from Q2 and a 48.8% drop from Q3 2022. This fall largely reflected lower net interest income (NII) at some banks and higher volume of loan-loss provisioning expenses at others. Challenging operating conditions, including an economic deceleration and persistently high inflation led banks to remain prudent in loan origination. Key credit developments in the quarter included:

» Bottom-line results within the peer group were mixed, with Bancolombia and BBVA Colombia reporting higher earnings supported by lower provisions, while Bogotá and Davivienda posted a drop in earnings due to increasing loan loss provisions and lower NII, as funding costs remained high for all four banks.

» The group's average problem-loan ratio, measured as Stage 3 loans[2] to gross loans, remained flat at 5.7%. However, loan delinquencies measured by 90 days past-due loans continued to rise for the four banks, though at a slower pace than previous quarters, signaling that the consumer portfolio's deterioration will likely stabilize between 2023 year-end and beginning of 2024. Gross loan volumes declined 0.2% for the group amid banks' more prudent stance on originations because of recent asset quality concerns and lower credit demand.

» Depositors continued to migrate to high-interest-rate investments – driving higher funding costs – although core demand and savings deposits still dominated at 43% of the group's combined funding structure, followed by term deposits at 37%. Total deposits grew 1.5% from Q2 2023.

» The average Moody's ratio of Tangible Common Equity to risk-weighted assets (TCE/RWA)[3] for the four banks remained broadly flat at 10.3%, although capitalization levels diverged in line with earnings, with higher capital posted by Bancolombia, stable at Bogotá and lower at Davivienda and BBVA Colombia. All banks' capital metrics benefited from subdued loan growth.

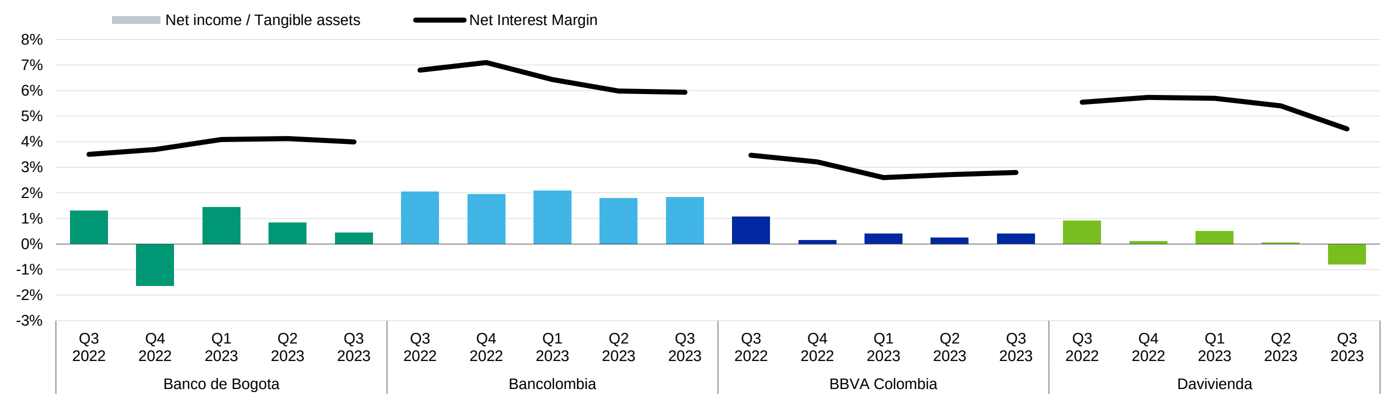
Profit declined, although with mixed results within the peer group

Combined net income for the four banks dropped for the second consecutive quarter, although profitability varied among the peer group. Bancolombia continued to report the strongest bottom-line results, supported by lower loan-loss provisions and despite slightly lower margins. BBVA Colombia reported improved net income backed by lower loan loss provisions in the quarter. Performance of Bogotá and Davivienda was particularly affected by high loan loss provisions in the quarter and lower NII, which in the case of Davivienda led to net losses in the quarter. The four banks posted a total net income of COP 1,410 billion ($346 million), down 24.1% compared to the previous quarter and a 48.8% decline compared to the third quarter of 2022. The average Moody's ratio of net income to tangible assets (NI/TA) stood at 0.5% in Q3 2023 from 0.7% in the previous quarter (Exhibit 1).

The average net interest margin (NIM) for the group fell 30 basis points (bps) to 4.3%, with most of the deterioration explained by Davivienda. While interest income continued to benefit from Colombia's high policy interest rates, at 13.25% in September 2023, funding costs continued to increase. Bogotá, Bancolombia and BBVA Colombia's interest income increased in the quarter and supported overall stable NIMs, while Davivienda's decreased due to a drop in income from investments and from lower income from the bank's loan portfolio, especially the consumer segment as loan origination has remained constrained in recent quarters amid asset quality deterioration.

Exhibit 1

Profitability remained pressured in the third quarter of 2023



Source: Banks' financial reports, Moody's Investors Service

Bancolombia's net income increased 2.1%, with a Moody's ratio of net income to tangible assets (NI/TA) of 1.8%, the most favorable quarterly performance within this group, supported by a large decrease in loan-loss provisions (-22.7%), which remain however above historical averages. Part of the bank's decrease in net provisions in the quarter was caused by the sale of a large corporate loan in Colombia.

Changing the direction reported in previous quarters, BBVA Colombia's net income jumped 56.1%, supported by a significant 30.3% drop in provisioning expenses. The 4.8% quarterly increase in NII benefited from higher interest income (+4.3%), while results were also supported by lower operating expenses (-1.6%). However, BBVA Colombia's NI/TA ratio increased just 10 bps to a still-modest 0.4%.

In contrast, Bogotá and Davivienda reported the weakest quarter within the group. Bogota's net income shrank 45.6%, primarily on a 33.0% increase in loan-loss provisions. Although the bank reported the lowest level of credit costs within the peer group in the first half of the year, loan loss provisions increased significantly in the quarter, reflecting the deterioration of the bank´s consumer loans portfolio (23% of total loans in September 2023). Operating expenses also went up by 19.1% sequentially, pressuring the profitability metric (NI/TA ratio) that declined to 0.5%, from 0.8% one quarter prior.

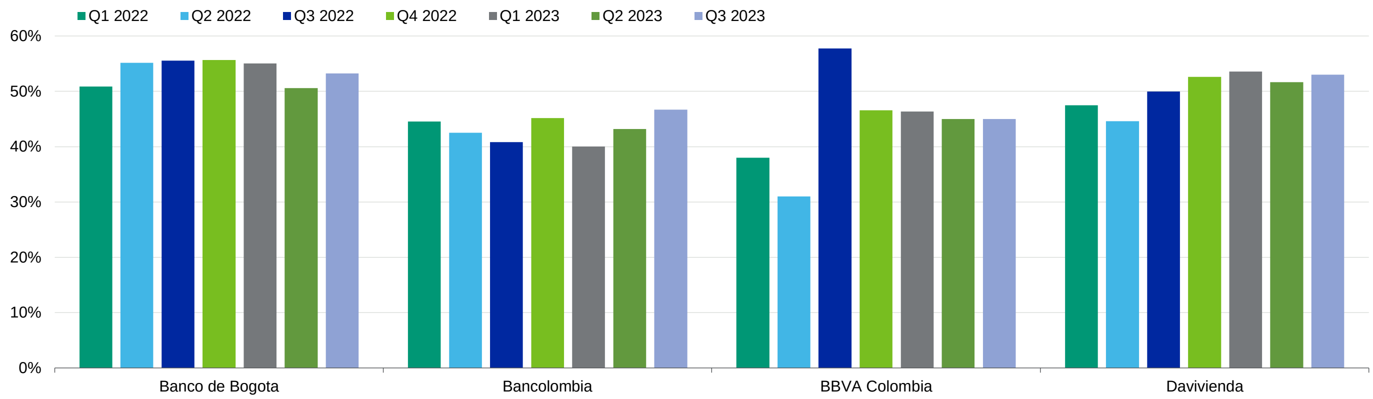
Davivienda had the weakest performance within the peer group in the quarter and for the second consecutive quarter, reporting a net loss of COP 364 million. NII fell 17.9% affected by moderation in loan origination and lower investment income, while the bank's loan-loss provisions increased 7.2% from already high levels.

Efficiency metrics deteriorated at most banks, particularly impacted by high inflation rate and subdued business growth. However, the metric improved to 49.5% in Q3 2023 from 51.0% in Q3 2022 (Exhibit 2).

Exhibit 2

Banks' efforts to improve efficiency will be challenged by a slow economy and high inflation

Banks' cost-to-income ratios, as calculated by Moody's



Source: Banks' financial reports, Moody's Investors Service

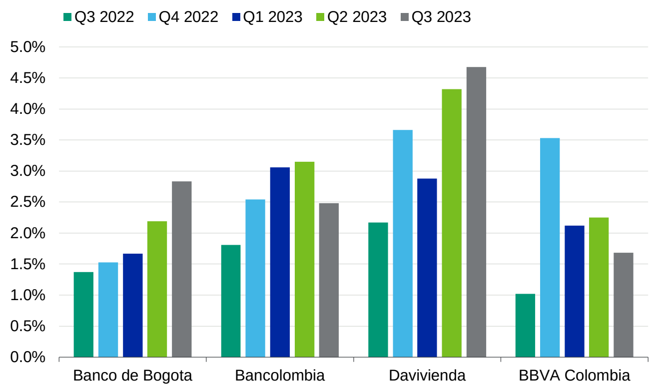
Credit costs remained high in the quarter, albeit with a reduction at some banks

The group's combined loan-loss provisioning fell 6.8% to COP 4,257 billion, with credit costs (loan-loss provisions to gross loans) averaging 2.9%, a slight 10 bps quarterly decline but well above 1.6% a year ago. While Bogotá and Davivienda continued to report sequential increases in loan loss provisions, Bancolombia and BBVA Colombia reported a decline. Davivienda maintained the highest credit costs within the peer group (Exhibit 3 and 4).

Exhibit 3

Davivienda´s provision expenses remained well above the peer group

Loan-loss provision expenses / gross loans

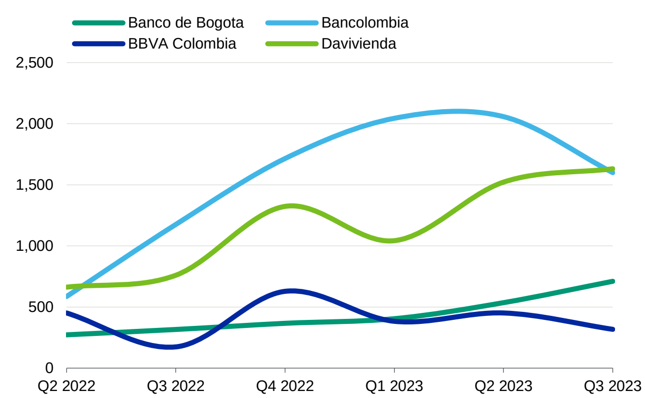


Source: Banks' financial reports, Moody's Investors Service

Exhibit 4

Banks' provisions remained high, although with differences between banks

Quarterly loan-loss provision expenses



Source: Banks' financial reports, Moody's Investors Service

Deterioration in asset risk moderated, reflecting banks' more conservative risk approach

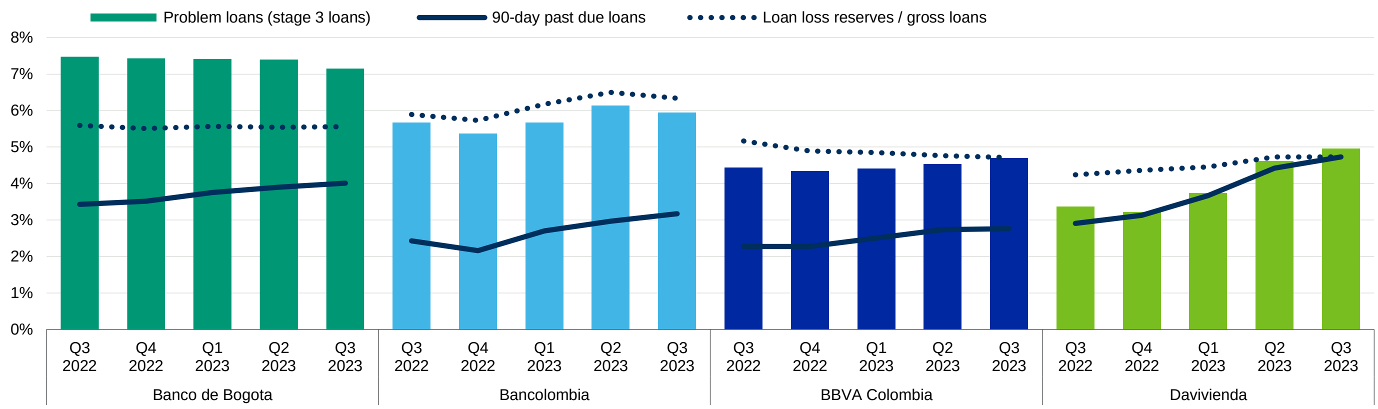
Problem loans, measured as Stage 3 loans under IFRS 9, remained broadly flat on average for the four banks at 5.7% of gross loans, although loan delinquencies measured as 90-day and 30-day past-due loans continued to increase. Among the four banks, Bogotá and

Bancolombia already reported slight improvements in Stage 3 loans, while impaired loans continued to increase at BBVA Colombia and Davivienda. Bogotá maintained the highest problem-loan ratio at 7.2%, slightly down from a quarter earlier, followed by Bancolombia at 5.9% (Exhibit 5). However, the pace of deterioration at all four banks slowed down from the previous two quarters to an average non-performing loan ratio (NPL, measured as 90 day past-due loans) of 3.7% for the peer group from 3.5% in Q2 2023 and 2.8% in Q3 2022.

Exhibit 5

Weakened economic activity and high interest rates will constrain banks' asset quality before stabilization in H1 2024

Stage 3 loans, 90-day past-due loans and loan loss reserves to gross loans



Source: Banks' financial reports, Moody's Investors Service

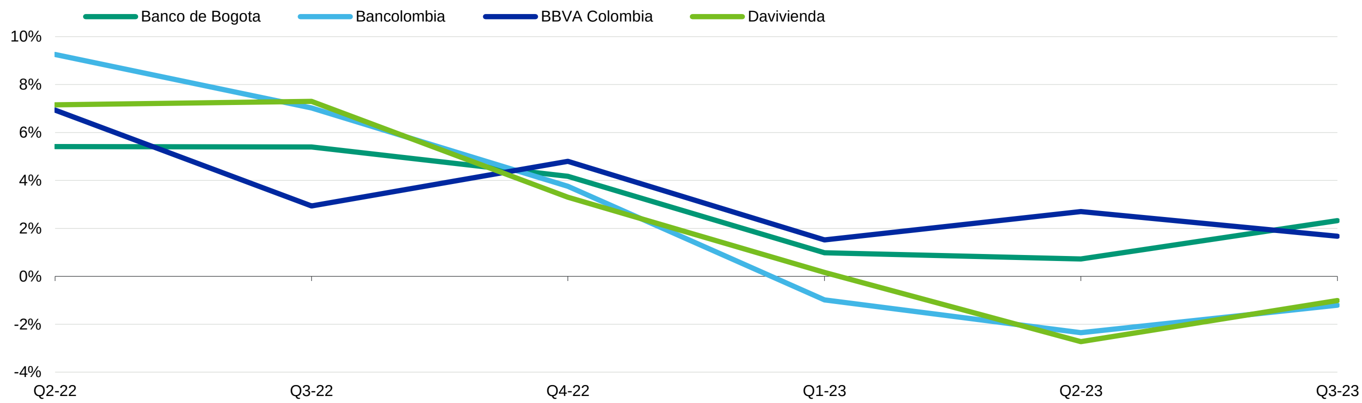
The average ratio of loan-loss reserves to gross loans was 5.3% for the group, down 10 bps from the previous quarter. Reserve coverage for problem loans remained above 100% at Bancolombia and BBVA Colombia (107% and 100%, respectively), while Davivienda's coverage decreased to 95% from 103% as Stage 3 loans increased. Bogotá continued to report the lowest reserve coverage within the group, at 78%, which was an improvement from 74% in Q2 2023.

All banks within the peer group continued to report increases in NPLs. As in previous quarters, the main driver of the deterioration has been the banks' consumer portfolios, while commercial loans and mortgages also deteriorated but at a much slower pace. The moderation of NPL formation signal a likely stabilization of asset quality in late 2023 and the first half of 2024, although a steady recovery remains contingent on the decline of inflation and interest rates and a gradual recovery of economic activity expected for 2024. The reduction of the banks' loan growth since Q4 2022 in response to asset quality pressures and lower credit demand - especially at Bancolombia and Davivienda and in consumer lending- will also help stabilizing asset risks in the coming quarters (Exhibit 6). In line with the past two quarters, Davivienda reported the sharpest rise of 90-day past due loans within the peer group, up 30 bps to 4.7%, mostly related to a 50 bps jump to 6.0% of the bank's consumer portfolio NPL.

Exhibit 6

Loan growth has moderated and remains below inflation amid asset quality pressures and lower credit demand

Gross loans, quarterly growth



Source: Banks' financial reports, Moody's Investors Service

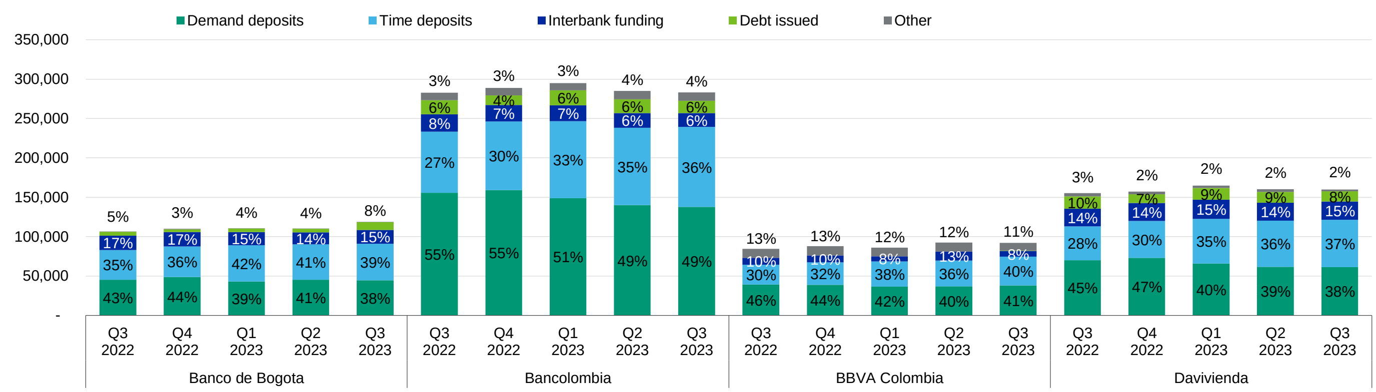
Shift towards higher-cost time deposits continued

The four banks posted another rise in time deposits as a percentage of total funding, on average more than 36% up in the quarter, driving margin pressure. This change also reflected banks' movement towards longer-term deposits to comply with a regulatory change that requires minimum net stable funding ratios (CFEN in Colombia) to reach a minimum of 100% since March 2023. Core demand and savings deposits still represented the lion's share of the four banks' total funding instruments, at 43.1% of total on average. On a combined basis, total funding remained broadly stable in the quarter, while total deposits grew below inflation at 1.5% (Exhibit 7).

Exhibit 7

Participation of core deposits remained significant, while time deposits kept rising

Breakdown of funding instruments, in COP billion



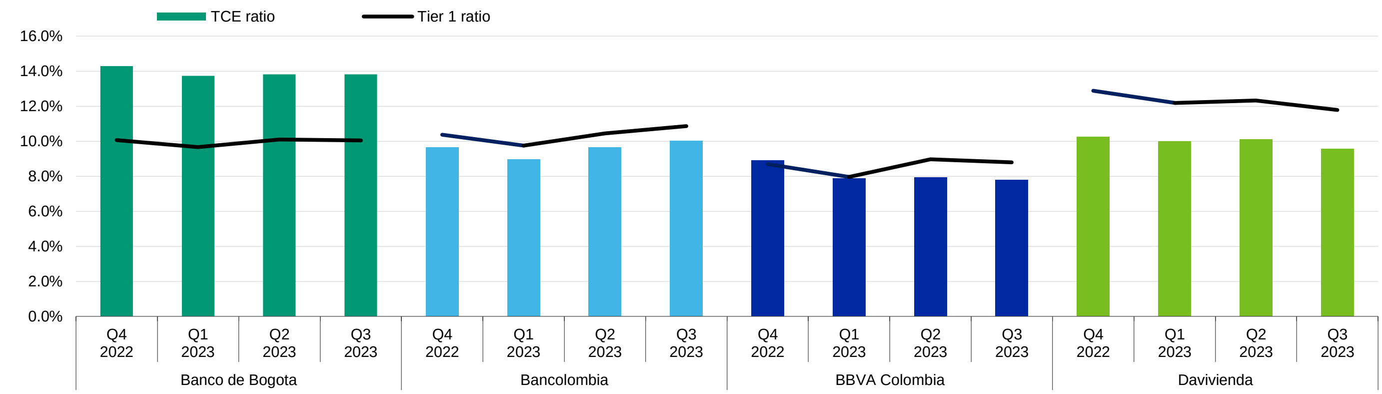
Source: Banks' financial reports, Moody's Investors Service

Capitalization trends mixed between banks

The average Moody's ratio of Tangible Common Equity to risk-weighted assets (TCE/RWA), our preferred measure of capital for reasons of global comparability, remained broadly stable for the four banks at 10.3% (Exhibit 8). However, the trend diverged among banks with Davivienda reporting a 54 bps decline in capital ratio after two quarters of earnings deterioration, BBVA Colombia's down by 17 bps, while Bogotá´s capital remained stable and Bancolombia had a 42 bps increase supported by its higher earnings. The Colombian banks' capitalization, measured by TCE/RWA, remained below that of their regional and global peers. In terms of regulatory Tier 1 capital ratio, the group's capital position stood at 10.4% on average, roughly flat in the quarter.

Exhibit 8

Slow origination of new loans will support stability of capital metrics amid modest earnings



Source: Banks' financial reports, Moody's Investors Service

Endnotes

1 The bank ratings shown in this report are the long-term deposit ratings and the respective Baseline Credit Assessment (BCA), where available.

2 Stage 3 loans include 90+ days past-due loans as well as impaired restructured loans and certain other risky exposures.

3 Our preferred measure of capital for reasons of global comparability. Tangible Common Equity (TCE) = (Common shares + retained earnings and related reserves + treasury stock + foreign currency translation) minus (Goodwill and other Intangible Assets) minus (Deferred Tax Assets) plus (Impact of Cap on Deferred Tax Assets).

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