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**Analyst Contacts**

Marcelo De Gruttola +54.11.5129.2624
*VP-Senior Analyst*
marcelo.degruttola@moodys.com

Alexandre Albuquerque +55.11.3043.7356
*VP-Senior Analyst*
alexandre.albuquerque@moodys.com

Luis Fernando Baza +52.55.1253.5735
*Lead Ratings Associate*
luis.baza@moodys.com

Ceres Lisboa +55.11.3043.7317
*Associate Managing Director*
ceres.lisboa@moodys.com

*» Contacts continued on last page*

## Banks – Colombia: Q4 2023 Update

# Still-high loan-loss provisions and low business volumes drive lower profit

*Below are key takeaways from the Q4 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 Q3 2023 unless otherwise stated.*

The four biggest banks in Colombia (Baa2 stable) had combined net income of COP 1,199 billion ($309 million) in Q4 2023, a 16% decline from Q3. This fall largely reflected higher loan-loss provision expenses at most banks and continued subdued business volumes, as operating conditions remain difficult, including an economic deceleration and persistently high inflation. Key credit developments in the quarter included:

» Bottom-line results within the peer group showed a downturn. Despite a slight deterioration, Bancolombia continued to report sound profit above its peers, backed by strong margins. While Bogotá reported a drop in earnings from an increase in the effective income tax rate, BBVA Colombia and Davivienda reported net losses, because of higher loan-loss provisions and lower net interest income for the former. Policy interest rate has started to come down, while term deposit rates have fallen even more rapidly in early 2024, signaling that margin pressure will likely subside. However, low business volumes will constrain earnings through 2024, and profitability will take longer to recover.

» The group's average problem-loan ratio, measured as Stage 3 loans[2] to gross loans, increased slightly to 5.8%, 10 bps higher than in the previous quarter. 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, while we expect that the consumer portfolio's deterioration will likely stabilize through 2024. However, a steady recovery remains contingent on falling inflation and interest rates, while economic activity is likely to remain subdued, making a full recovery in asset quality not likely before 2025.

» Banks' funding mix stabilized after shifting toward higher-cost fixed term deposits earlier in the year. Core demand and savings deposits still dominated, at 45% of the group's combined funding structure. Total deposits grew 1.5% in the quarter.

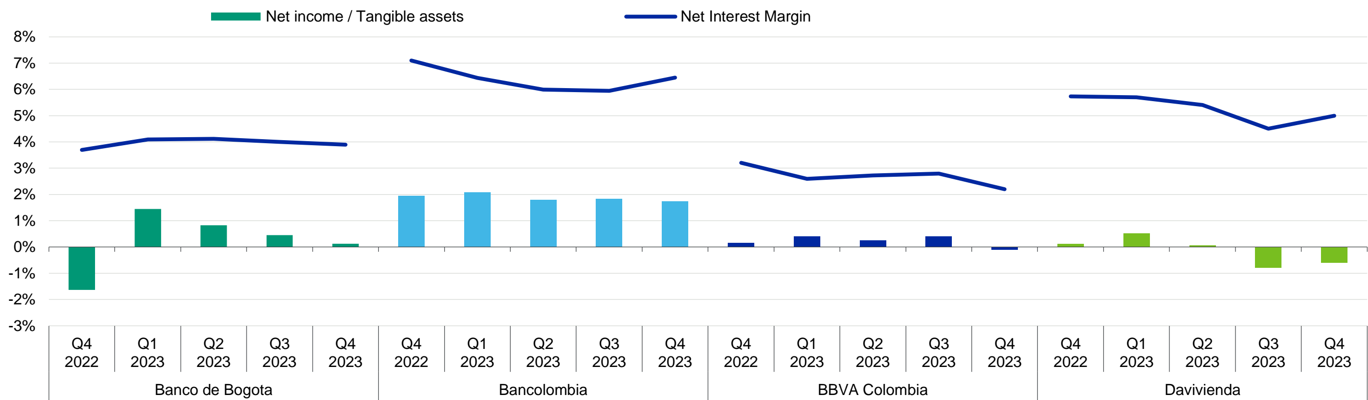
» The average Moody's ratio of Tangible Common Equity to risk-weighted assets (TCE/RWA)[3] for the four banks improved 20 bps to 10.5%, mainly because of Bancolombia's strong capital replenishment from earnings. All banks' capital metrics benefited from subdued loan growth, which we expect will continue through 2024 and in turn sustain capital levels.

## Profit declined at all banks dragged by higher loan loss provisions and operating expenses

Combined net income dropped for the third consecutive quarter, down 16%, with overall higher provisions and expenses explaining most of the deterioration. The average ratio of net income to tangible assets (NI/TA) stood at 0.3% in Q4 2023, from 0.5% in the previous quarter (see Exhibit 1). Bancolombia continued to report the strongest earnings of the peer group, while Bogotá's performance weakened and BBVA Colombia and Davivienda reported net losses. The group's average net interest margin (NIM) was flat, although the pressure on funding costs eased in the fourth quarter, signaling that negative margin pressure will likely subside. The policy rate was already reduced by 100 basis points (bps) between December 2023 and the first months of 2024, supporting funding cost stabilization. Average term deposit rates have come down even at a faster pace than the monetary policy rate (Exhibit 2).

Exhibit 1

**Profitability remained under pressure in 2023's fourth quarter**



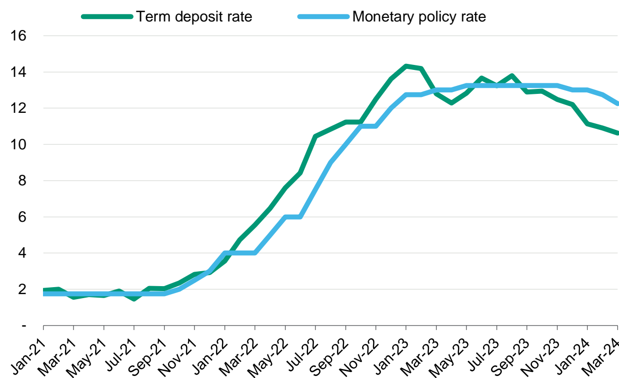

Moody's net interest margin = net interest income as percentage of average interest earning assets

*Source: Banks' financial reports, Moody's Ratings*

Bancolombia has sustained a strong performance mainly due to its high interest margins, supported by a favorable funding profile and a high share of variable rate loans within its loan book. Bogotá reported a 74% drop in net income, mostly explained by an increase in income tax expense related to the sale of shares of BAC Holding International. BBVA Colombia's net losses in the quarter were driven by a 24% drop in NII on higher interest expenses. Davivienda had the weakest performance of the peer group for the third consecutive quarter, reporting net losses, with margins improving but loan-loss provisions increasing from already high levels. Efficiency metrics deteriorated at most banks, with cost to income metric increasing both quarterly and annually (Exhibit 3).

Exhibit 2

**Funding costs increased sharply in 2022 and 2023, although the trend has started to reverse as policy rate comes down**

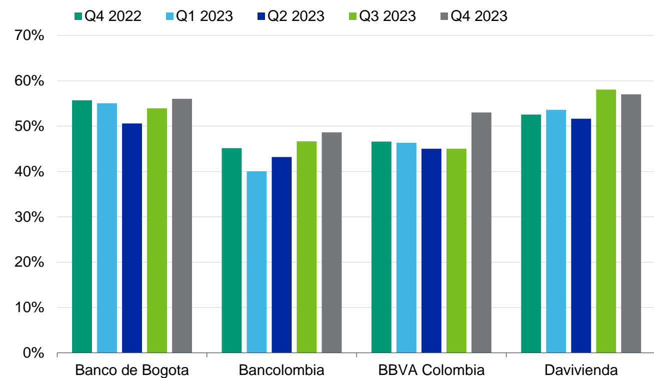



*Source: Banco de la República de Colombia, Moody's Ratings*

Exhibit 3

**Efficiency is challenged by slow business growth and inflation**

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




*Source: Banks' financial reports and Moody's Ratings*

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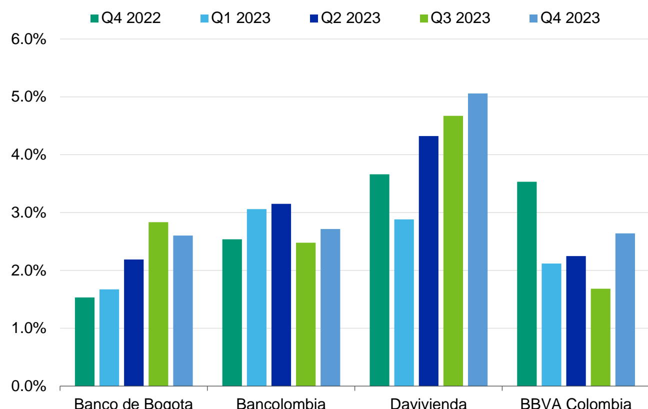
## Loan-loss provisions increased at most banks, signaling continued deterioration in consumer portfolios

Loan-loss provision expenses to gross loans averaged 3.3%, a 40 bps quarterly increase. BBVA Colombia had the largest increase, though it continued to report the lowest level together with Bogotá, which had lower provisions in the quarter. Davivienda reported the highest level of provisions, doubling the average of the other three banks, in line with the steeper increase in its non-performing loans reflecting its higher exposure to the consumer segment and the steep reduction of its loan book (Exhibit 4 and 5).

Exhibit 4

**Provision expenses remained high for all banks, while Davivienda's continued to report the highest level**

**Loan-loss provision expenses / gross loans**

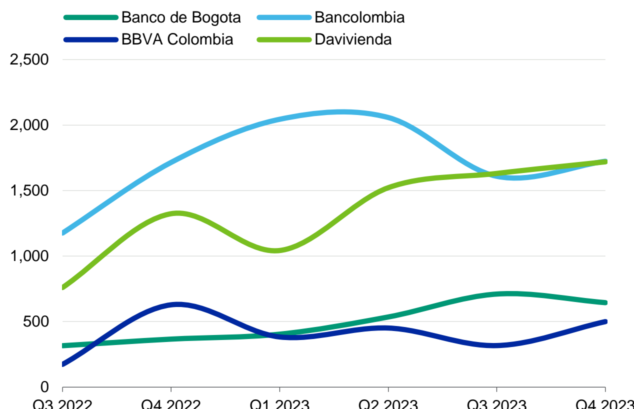



*Source: Banks' financial reports and Moody's Ratings*

Exhibit 5

**Banks' provisions remained high, but for varying reasons**

**Quarterly loan-loss provision expenses, in COP billion**




*Source: Banks' financial reports and Moody's Ratings*

## Asset risk deterioration continued but it moderated from previous quarters

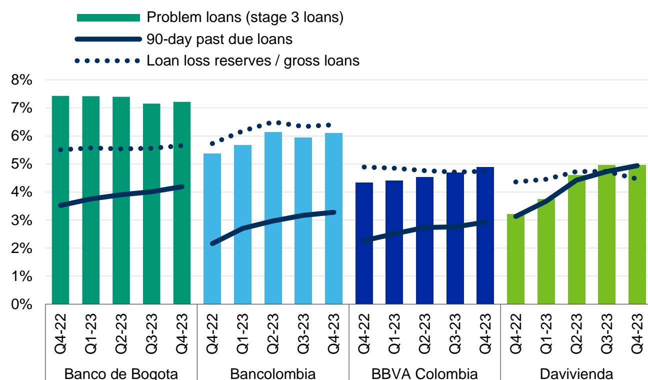
Problem loans, measured as Stage 3 loans, deteriorated 10 bps to 5.8% of gross loans on average. Nonperforming loans (NPLs) measured as 90-day past-due loans also continued to increase, albeit at a slower pace, reaching 3.8% in the quarter from 3.7% in Q3. Bogotá maintained the highest problem-loan ratio at 7.2%, followed by Bancolombia at 5.9% (see Exhibit 6). Preliminary information as of February 2024 shows that the consumer portfolio deterioration continued, though the rate of increasing NPLs is lessening.

Slowing NPL formation signals a likely stabilization in asset quality, although a steady recovery remains contingent on falling inflation and interest rates, while economic activity is likely to remain subdued, making a full recovery in asset quality not likely before 2025. The reduction of loan growth will also help stabilize asset risks in the coming quarters (see Exhibit 7). The average ratio of loan-loss reserves to gross loans was 5.3% for the group, while only Bancolombia reported reserve coverage for problem loans above 100%, at 105%, while the remaining three banks were below 100%: 97% for BBVA Colombia, 90% for Davivienda and 78% for Bogotá.

Exhibit 6

**Weakened economic activity strained banks' asset quality**

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

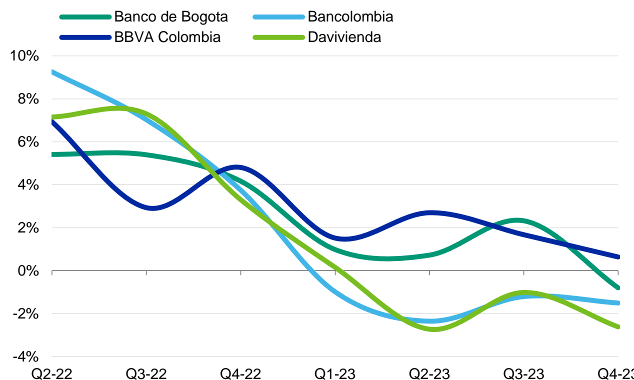



*Source: Banks' financial reports and Moody's Ratings*

Exhibit 7

**Loan growth continued to slow in the last quarter of 2023**

**Gross loans, quarterly growth**




*Source: Banks' financial reports and Moody's Ratings*

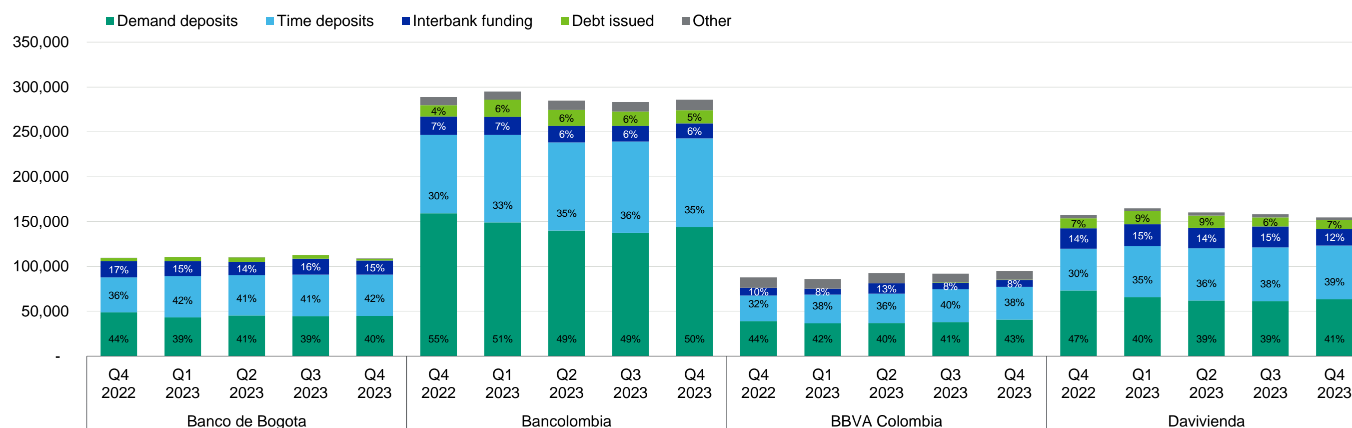
## Funding mixes stabilize after the shift toward higher-cost time deposits

The four banks posted a significant rise in time deposits as a percentage of total funding in the previous three quarters, although the funding mix stabilized in 2023's last quarter as interest rates peaked and started to slowly diminish. On average, time deposits represented 37% of total funding, compared with 38% in the previous quarter and 31% a year earlier. The funding shift towards time deposits was one of the main drivers of banks' negative margin pressure through late 2022 and 2023. The change also reflected banks' movement to longer-term deposits to comply with a regulatory change that has required minimum net stable funding ratios (CFEN in Colombia) to reach a minimum of 100% since March 2023. On a combined basis, total deposits grew 1.5% in the quarter (Exhibit 8).

Exhibit 8

**After growing substantially through the first nine months of 2023, time deposits growth diminished in the last quarter**

**Breakdown of funding instruments, in COP billion**



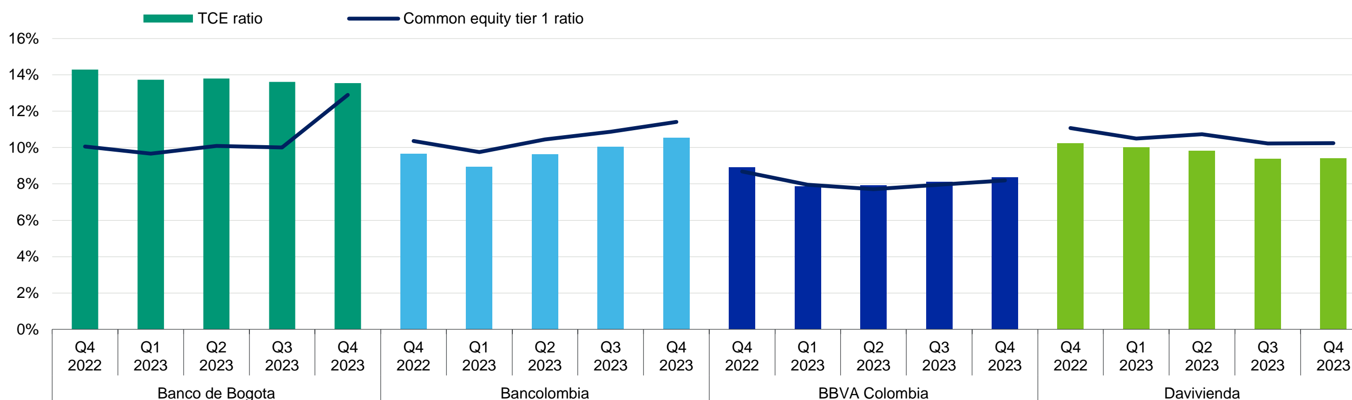

*Source: Banks' financial reports, Moody's Ratings*

## Capitalization improves because of slow asset growth

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, improved to 10.5% from 10.3% in the previous quarter (Exhibit 9). Davivienda and Banco de Bogotá were stable while Bancolombia and BBVA Colombia improved on slow asset growth and strong earnings in the case of Bancolombia. Bogotá reported the largest increase of its CET1 metric because as of December 2023 Corficolombiana -34% of which is owned by the bank- started to be consolidated by Bogota's sister bank Banco Popular S.A. instead of the holding company Grupo Aval Acciones y Valores S.A., (Ba2 negative), leading to a reduction of Bogotá's CET1 deductions. In terms CET1, the group's capital position improved close to 90 bps to 10.7%, driven by earnings retention and low asset growth at all banks, and Bogotá's abovementioned change.

Exhibit 9

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




*Source: Banks' financial reports and Moody's Ratings*

## 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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REPORT NUMBER 1401635

## Contacts

**Marcelo De Gruttola** +54.11.5129.2624
*VP-Senior Analyst*
marcelo.degruttola@moodys.com

**Luis Fernando Baza** +52.55.1253.5735
*Lead Ratings Associate*
luis.baza@moodys.com

**Alexandre Albuquerque** +55.11.3043.7356
*VP-Senior Analyst*
alexandre.albuquerque@moodys.com

**Ceres Lisboa** +55.11.3043.7317
*Associate Managing Director*
ceres.lisboa@moodys.com

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