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Stress Testing of the Financial System

Thursday, November 18, 2021 - 12:00

The Financial Stability Department at *Banco de la República* regularly conducts stress tests of credit institutions. These exercises involve a quantitative analysis to evaluate how resilient credit institutions are to a hypothetical, adverse and unlikely macroeconomic scenario. The adverse scenario being considered has been designed intentionally to reflect an extreme situation for the Colombian economy, since it incorporates a number of shocks that would occur simultaneously, but would be unlikely. In this sense, the test results do not constitute a forecast on the future of the Colombian economy. Instead, they should be interpreted as a quantitative assessment of how resilient institutions are in the face of an extreme scenario, based on their current financial conditions and under restrictive assumptions.

Stress testing is useful in that it provides an estimate of the potential losses that would be observed if the extreme scenario were to materialize. It also helps to illustrate the possible transmission channels through which the vulnerabilities that are identified could affect financial stability.

The technical details of the model used in this exercise, including characterization of the performance of the institutions in question in a hypothetical scenario and the channels through which their financial health would be impacted, are presented by *Banco de la República* in [Borradores de Economía, No. 1028: "Sysmo I: A Systemic Stress Model for the Colombian Financial System"](#).