Colombia

Talking Points

Third Quarter 2003

COINVERTIR
INVEST IN COLOMBIA CORPORATION

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"Colombia is the only Andean country whose economic prospects look better now than they did several months ago, and it is projected to grow by 2.5% in 2003. This country has taken action to address its structural fiscal problems, and took advantage of its recent situation of near-recession to achieve a more competitive exchange rate. It is one of the few economies that will increase its investment rate in 2003, thus beginning a recovery from the historic lows of recent years."

Current Conditions and Outlook. Economic Survey of Latin America and the Caribbean 2002-2003
August 2003

Economic Development Division – ECLAC

During the third quarter of 2003, the Colombian economy registered lower unemployment rates, a less volatile nominal exchange rate and high real exchange rate levels. Annual inflation, which had reached a level of 7.8% by the end of the first quarter, stood at 7.1% in September.

Ample primary liquidity continued to be experienced during this quarter, as well as an increased dynamism in the broad M3 aggregate and in the financial system's loan portfolio. The Central Bank (Banco de la República) did not change its intervention rates, or interbank interest rates, and the saving and lending rates continued to be stable during the quarter.

Monetary and Financial Sggregates, Monetary Policy and Interest Rates

Deceleration in the monetary base and currency in circulation growth rates was observed during the third quarter of 2003. For the first semester of the year, the base recorded an average annual growth rate of 18.6%, which then dropped to an average annual growth rate of 13.8%, between July and September. Similarly, currency in circulation growth decelerated from an average 19.9% annual growth rate, between January and June 2003, to 14.0%, for the third quarter of the year. Broad M3, on the other hand, has been exhibiting an accelerated dynamism, posting an annual 12.4% growth rate for the third quarter of the year, compared to 10.2% in the first semester, and 8.4% during the same period of 2002.

In general terms, financial system indicators show good results. The traditional loan portfolio index (overdue loan portfolio / gross portfolio) has been showing steady recovery, from 9.8% in August 2002, to 8.7% in the first quarter of 2003, to 8.1% in August. The gross loan portfolio in domestic currency, which had an 8.8% average annual growth rate for the first half of the year, increased 10.2% in August. Also, it is important to highlight the accelerated growth of the consumption and commercial loans, which went from 22.8% and 14.0% on an annualized average, to 24.2% and 15.5% respectively for the same dates. At the same time the financial sector shows significantly higher earnings than those of 2002, reaching cumulative profits that exceed COP$ 1.1 billion (b) by August 2003.

Between July and September 2003, the Central Bank did not modify its intervention rates, maintaining them at 7.25% and 6.25% yearly for expansion and contraction auctions, respectively.

The average pasive interest rate (DTF) for September 2003 reached 7.80%, a 12 basis points increase over January's rate, and 13 basis points lower than that of September 2002. Despite the slight recovery in the DTF between January and September 2003, the average rate (7.77%) continues to be below the level observed for 2002 (8.94%).

Average lending rates for September 2003 were: consumption, 27.11%; ordinary, 18.40%; preferential, 11.21%; and treasury, 9.69%[1] . These rates indicate slight variations with respect to those recorded for December 2002. The lowest increase was observed in the consumption rates (11 basis points) and the highest in the treasury rates (72 basis points). Compared to September 2002, consumption interest experienced a reduction (37 basis points), while the other rates increased: The most significant increase being that of ordinary credit (87 basis points).

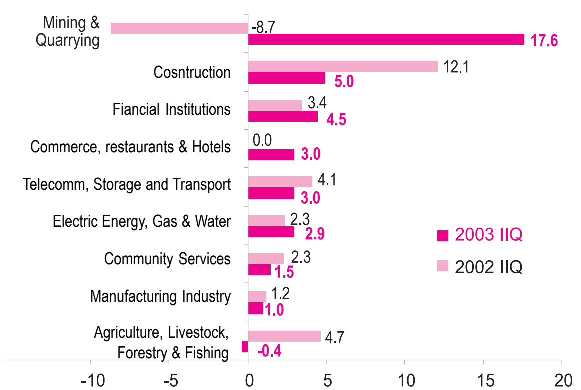
Economic Growth and the Labor Market

During the second quarter of 2003, the Colombian economy grew at a 2.2% annual rate. For the first half of the year, gross domestic product registered a 3.1% cumulative annual variation, 2 percentage points higher than the cumulative growth of the first two quarters of the previous year (1.1%).

In terms of economic activity performance of the Mining and Quarrying sector is noteworthy, with a 17.6% yearly growth, compared to the same quarter of 2002. Other economic sectors showed the following annual growth: Construction 5.0%; Financial to Institutions 4.5%; Commerce, Restaurants and Hotels 3.0%; Telecommunications, Storage and Transportation 3.0%; Electricity, Gas and Water 2.9%; Community Services 1.5%; Manufacturing Industry 1%; and Agriculture, Livestock, Forestry and Fishing -0.4%. (Graph 1).

Recovery of the Mining and Quarrying sector, during the second quarter of 2003, compared to the same quarter of 2002, is explained by increases in the production of coal (77.0%), gold (208.2%), silver (103.4%), nickel

Graph 1
Gross Domestic Product by Sector
2002 - 2003 II Quarter Annual Percentage Variation



Source: National Statistics Department (DANE).

(21.0%), rocks and materials used in construction (6.2%), and non-ferrous minerals (6.77%).

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The internal demand's annual variation for the second quarter of 2003 was 2.4%. During the first half of the year, demand grew at a 4.8% rate, four percentage points higher than the cumulative growth of the first half of 2002. By expense components, investment grew 26.9% during the first half of the year, an increase of 32.5 percentage points compared to the same period of 2002. On the other hand, growth in consumption between January and June 2003, was 1.1%; 0.8 percentage points less than the rate observed in the first half of 2002.

Figures for the labor market indicate that in August 2003, there was a rise in employment and therefore the unemployment rate decrease with respect to that observed the year before. According to the ongoing home survey of the National Statistics Department (DANE), the total national occupation and unemployment rates, for August 2003, stood at 53.0% and 14.8%, respectively, showing an annual increase of 2.1 percentage points for the first and a decrease of 1.2 percentage points for the latter.

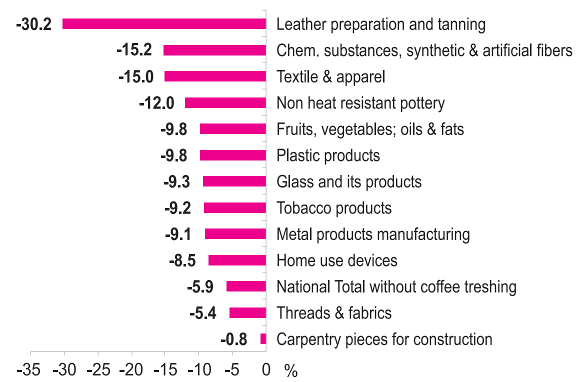
Competitiveness: Labor Cost Reduction in the Colombian Industry

The labor reform enacted by the Law 789, issued on December 27th of 2002, extended the day shift from 6:00 a.m. to 10:00 p.m. and reduced the night shift, from 10:00 p.m. to 6:00 a.m. It also reduced wages for work on sundays. These changes reduced the cost per worker for companies in Colombia, and it is reflected in the statistics published by DANE.

The unit labor cost index, measured as the ratio between the average real wage and labor productivity, recorded a cumulative reduction of 5.9%, between January and July, for the national industry, excluding coffee threshing. This contrasts with the cumulative increase for the same period of 2002 (5.1%).

The manufacturing industry groups that experienced the greatest reduction in labor costs, as indicated by cumulative annual variations as of July were: Leather Tanning -30.2%, Chemical Substances -15.2%, Garment Manufacturing -15.0%, and Ceramic Products -12.0%, among others (Graph 2).

Graph 2
Sectors with the Largest Hourly Labor Cost Reductions - *Annual Variation*
January - June 2002-2003



Source: National Statistics Department (DANE).

Fiscal Policy: Pro-active Public Debt Management[2]

Five debt management operations, both internal and external, have taken place in 2003, as part of the government's strategy to manage liabilities properly. These operations were able to improve the profile of public debt maturities, as well as public debt duration and average life, injecting greater liquidity to bond issues and portfolio.

Internal Debt Operations

The first transaction took place in March 2003 and consisted of swapping 2003 maturity Treasury Bonds (TES)[3] for COP$ 53.1 b[4], for two Treasury Bonds, maturing in 2005 and 2006. The total amount was not changed.

The second transaction for internal debt management consisted of three separate swaps with public entities that held TES: the Finance Institutions Guarantee Fund (Fogafin), the Social Security Institute (ISS), and the Military Housing Promotion Fund. All of these aimed at improving the profile of maturities.

Lastly, a transaction was performed in September, which swapped COP$ 652 b[5] of bonds with 2004 maturities for bonds expiring in 2007, 2008 and 2010. This exceeded the government's expectations, which were to place COP$ 500 b.

External Debt Operations

The first external public debt management operation, held in April of this year, was the total repurchase of a *Quarterly Adjusted Note* (QAN), for US$ 153.3 million (m). This repurchase was financed by reopening the 2013 global bond in the amount of US$ 250 m. The remaining funds were used to complete the bond financing target for 2003.

The repurchase of the *Floating Rate Notes* (FRN) maturing in October 2005 in the amount of US$ 300 m was announced in July. To carry out this operation, a new FRN-2009 was issued in the amount of US$ 160 m, with amortization in 2006, 2007 and 2009; also, the issue of sovereign bonds with a 2033 maturity was reinstated in the amount of US$ 135 m (with an average 14.5 year life).

These two operations represented a US$ 12.3 m reduction in the outstanding balance of the debt itself, and a US$ 453 m reduction in external debt amortization between 2003 and 2005, achieving a debt roll-over at historically low rates.

[1] Treasury loans are short-term preferential credit, equal to or less than 30 days.

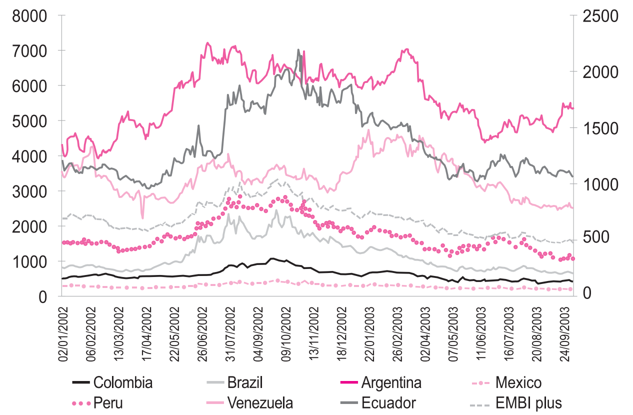
[2] Information provided by the Superior Council for Fiscal Policy (Confis) of the Ministry of Finance and Public Credit.

[3] Treasury Bonds (TES) are internal public debt instruments issued by the national government. There are two types of bonds: Class A and B. The first were issued with the purpose of substituting debt entered into open market operations by the Banco de la República. Class B bonds are to raise funds for budget appropriations and to carry out temporary treasury operations for the government's treasury. At present, only Class B bonds are issued. The term ranges from 90 days to 12 years. Bond yields are determined through auctions, for which the national government establishes a global quota for the various issues that are auctioned.

[4] Nominal value of deliverable instruments.

[5] *Ibídem.*

Graph 3
Emerging Market Bond Index
Main Latin American Economies
January 2002 - October 2003



Source: Bloomberg

External Market Performance

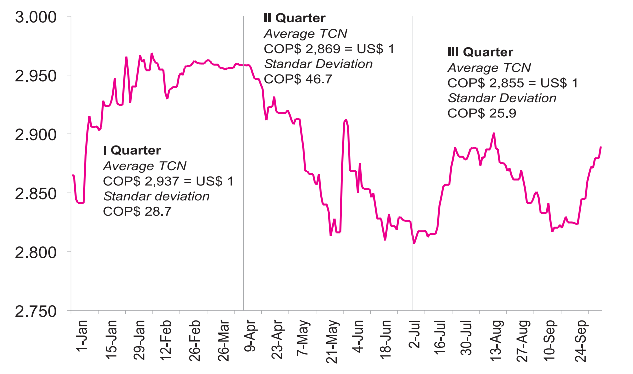
Nominal and Real Exchange Rate

In the third quarter of 2003, the nominal exchange rate exibited a greater stability than that experienced in the first half of the year. In fact, the average rate for the dollar during the quarter was COP$ 2,855, with mean deviations of COP$ 26 around the average. The deviations had been of COP$ 28.7 and COP$ 46.7 during the first and second quarters of 2003, respectively (Graph 4). Annual devaluation, comparing the average rate for the dollar in the third quarter of 2003, with the same period of the previous year, was 8.4%.

On the other hand, the different measurements for real exchange rate indexes (ITCR), weighted by bilateral trade, continued at historically high levels in September 2003. The ITCR deflated by the producer price index (IPP) showed a 7.0% annual depreciation, while the ITCR that uses the consumer price index (IPC) as a price measurement, exhibited a 4.2% annual variation.

Another measurement for competitiveness that is used in Colombia is the ITCR with third countries (ITCR-C). This indicator is obtained by comparing (in the same currency) the

Graph 4
Nominal Exchange Rate (TCN)
Daily Rate - *2003 (vs. US$ dollar)*



Source: Central Bank

IPC in Colombia with that for other countries that also export coffee, flowers, bananas and textiles to the United States. Despite the fact that the ITCR-C trend has been decreasing during 2003, the average for this indicator up to September has been higher than all annual mean values for the last 12 years. Its annual variation up to September 2003 was 0.2%. was 0.2%.

Balance of Payments

At the end of the first half of 2003, the country's current account of the balance of payments reached a US$ 806 m deficit (2.1% of the GDP for the semester), US$ 73 m higher than the deficit for the same period of 2002. The capital account recorded net income flows for US$ 124 m, US$ 613 m less than the net flows received during the first half of 2002.

The deficit in the current account in 2003 can be explained by the net outflows recorded in the factors' payment item (US$ 1,673 m), and in the balance of non-factor goods and services (US$ 493 m) This trend was partially offset by net income in current transfers (US$ 1,359 m). On the other hand, the capital account had net inflows for US$ 124 m, US$ 613 m lower than those obtained in the same period of 2002. The net capital inflows in 2003 is explained by US$ 659 m long-term capital inflows, offsetting short-term capital outflows of US$ 536 m.

Foreign Investment Cases and Announcements

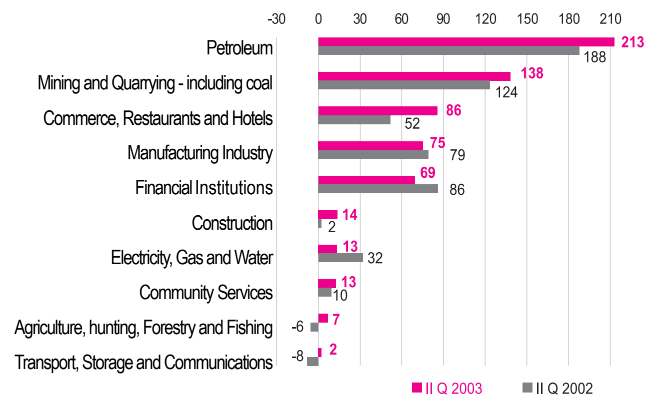
The evident dynamism that foreign direct investment has maintained throughout 2003 in the Petroleum sector, and Mining and Quarrying (including coal) is based on the arrival of certain multinational companies to the country, as well as the intent of those that are already established to increase their investments.

Some of the new multinational company arrivals in the country are: Coenco, a multinational company with headquarters in the Virgin Islands, and Meta Petroleum with headquarters in Cayman Islands.

Among the multinational companies that expanded their operations in the country are OXY, Omimex and Drummond (United States), Petrobank and Greystar Resources Ltd. (Canada), Lukoil and Rosneft (Russia), and the Ukranian Colombian Oil & Energy (Ukraine).

This trend ratifies the government's efforts to increase the country's petroleum and mining reserves through new exploration. Furthermore, it shows the favorable perception that foreign investors have regarding the country, as well as the government's intent to maintain legal stability.

Graph 5
Foreign Direct Investment by Sectors
II Quarter 2002-2003 US$ Million



Source: Central Bank

Table 1

COLOMBIA: key data

ITEM	Units	Latest data period	Data	Data One year before
Total Foreign Investment				
Direct	US$ millon	Jan. 03-Jun. 03	935	1,443
Portafolio	US$ millon	Jan. 03-Jun. 04	-336	-1,362
Demand and Unemployment				
GDP	% variation year to year	Apr. 03-Jun. 03	2.20	2.30
Production Index (MMS)	% variation year to year	Jan. 03 - Jun. 03	4.50	-0.40
Retail Sales	% variation year to year	Jan. 03 - Jun. 03	-0.20	3.03
Investment	% variation year to year	Jun. 03	10.24	5.73
National Unemployment Rate	(%)	Aug. 03	14.83	16.02
13 Main cities Unemployment Rate	(%)	Aug. 03	17.10	18.10
Prices and Interest Rates				
Consumer Price Index	% variation year to year	Sept. 03	7.12	5.97
Producer Price Index	% variation year to year	Sept. 03	6.87	6.75
Deposite (90 days)	Monthly Average (%)	Sept. 03	7.80	7.93
Lending interest rate	Monthly Average (%)	Sept. 03	15.24	15.38
Exchange Rate				
Nominal Exchange Rate	Pesos/dollar US$	Sept. 03	2,840.1	2,751.2
Nominal Devaluation	% annual variation to date	Sept. 03	0.89	19.26
Real Exchange Rate (ITCR)	1994=100	Sept. 03	136.14	127.18
Real Devaluation	% annual variation to date	Sept. 03	3.64	10.17
Peso/Yen Monetary Units	Peso/Yen	Sept. 03	25.47	22.62
Peso/Euro Monetary Units	Peso/Euro	Sept. 03	3,308.1	2,718.2
Trade				
Exports	US$ millon	Jan. 03 - Jun. 03	6,152.3	5,868.2
Traditional Exports	US$ millon	Jan. 03 - Jun. 03	2,937.8	2,557.2
Non-Traditional Exports	US$ millon	Jan. 03 - Jun. 03	3,214.5	3,311.0
Imports	US$ millon	Jan. 03 - Jun. 03	6,636.7	6,061.9
Other				
M1	% variation year to year	Sept. 03	14.70	26.30
M3	% variation year to year	Sept. 03	11.40	9.00
Net International Reserves	US$ millon	Sept. 03	10,863.0	10,727.0
Colombia General Stock Exchange Index	July 2001=1000	Sept. 03	2,101.9	1,271.0
Fiscal Deficit (Central Government)	% of GDP	2002	-5.48	-5.94
Fiscal Deficit (Non - Financial Public Sector)	% of GDP	2002	-3.58	-4.34

Source: Central Bank, National Statistics Department (DANE) and Colombia Stock Exchange.

Table 2

Main Latin American Economic Indicators

	Colombia		Argentina	Brazil	Chile	Ecuador	Mexico	Peru	Venezuela
	2003*	2002	2002						
Real GDP growth (%)	2.5	1.5	-10.9	1.5	2.1	3.4	0.9	5.2	-8.9
Populations (millions)	44.7	43.85	37.5	174.7	15.1	13.1	100.1	26.7	25.6
GDP (US$ billions)	-	81.2	86.1	451	68.2	26.3	636.1	56.9	99.5
GDP per capita (US$)	-	1,819	2,294	2,585	4,394	2,004	6,352	2,128	3,451
GDP per capita growth (%)	-	-7.7	-66.2	-12.6	-3.9	1.6	0.5	3.5	-32.0
Consumer prices variance	6.0	7.0	41.0	12.5	2.8	9.4	5.7	1.5	31.2
Fiscal balance (% of GDP)	-2.6	-4.6	-1.5	-10.3	-0.8	0	-1.3	-2.3	-3.3
Total External Debt/GDP (%)	52.1	45.9	155.9	50.4	60.8	54.8	21.6	49.2	33.1
Exchange Rate (LC/US$ eop)	-	2,865	3.35	3.53	712	-	10.4	3.5	1,401
Nominal Interest Rate (savings)	-	7.7	20.3	25.5	2.9	7	7	4.7	26
Current Account (% of GDP)	-2,4	-2,1	11.1	-1.7	-0.8	-4.5	-2.2	-2.0	7.8
Foreign Direct Invesment (US$ million)	-	2.034	1,500	13,402	858	1,335	13,500	1,943	1,200
Foreign Direct Investment (% of GDP)	-	2,48	1.39	2.48	1.36	6.36	2.14	3.41	0.13

Source: ECLAC (Preliminary Balance Latin American Economies 2002), IMF, IDB and Central Bank
* Forecast

COINVERTIR

Mission

COINVERTIR promotes, facilitates and consolidates Foreign Direct Investment in Colombia as a factor of development.

Characteristics

- Autonomous, mixed-economy entity, established under Colombian private law
- Staffed by a small group of highly qualified professionals from different disciplines and managed with an entrepreneurial spirit
- Acts as liaison between the public and the private sectors in order to achieve competitive and stable conditions for foreign investment

Activities

COINVERTIR works toward its objectives through four main activities:

- Promotes Colombia as an investment site
- Provides accurate and up-to-date information and assistance to potential investors
- Provides investor aftercare
- Works in the improvement of the Country's investment climate

Publications

- Colombia Outlook and Investment Potential
- Colombia: Foreign Investment Guide
- Foreign Investment Report
- Directory of Legal and Consulting Services
- Legal Framework
- Practical Legal Framework
- Colombia: Regional Investment Guides
- **Talking Points on the Economy**

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