



# Colombia

## Talking Points on the Economy

*Fourth Quarter 2003*



**COINVERTIR**  
INVEST IN COLOMBIA CORPORATION



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*Colombia*

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Colombia continued consolidating its economic reactivation process. By the end of 2003, the economy grew 3.64%, which represents a significant improvement, compared with the growth of 1.7% recorded for the year 2002. Due to the good overall performance of the economy, the government adjusted in several times the economic growth forecast. In December of 2002, the growth forecast for 2003 was 2.0%, and in September, the forecast was raised to between 2.5 and 3.0%.

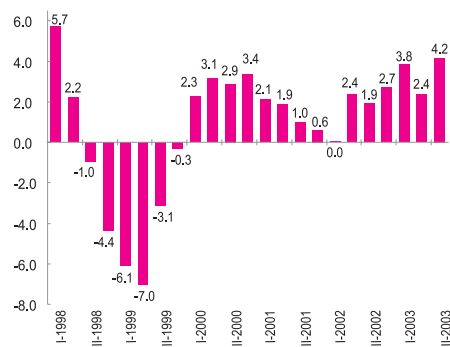
This document presents an overview of the Colombian economy for the fourth quarter of 2003. The first section describes the factors that contributed to the economic growth consolidation recorded by the end of 2003, highlighting the recovery private demand of particularly investment. The second section highlights the reduction in inflation levels and the prospects for meeting the 2004 inflationary target. The third section analyzes the recent exchange rate behavior and concludes that despite the revaluation trend, the competitiveness level of Colombian exports continues to be high. Additionally, the paper concludes that this is a phenomenon that affects many countries in the Latin America region and the world. The next section highlights the achievement of the fiscal goals agreed with the International Monetary Fund (IMF), and the government's objective of achieving a better fiscal discipline. Finally this document describes the main facts of the evolution of the external sector.

## GDP Growth, Third Quarter 2003

The Colombian economy grew at a 4.17% annual rate in the third quarter of 2003, 1.8% higher than the growth recorded in the second quarter of 2003, and the highest increase since the first quarter of 1998 when the economy grew by 5.69%. (See Graph 1)

Compared to the previous quarter, the GDP grew by 1.78%, a figure higher than the March quarterly variation (0.36%) and higher than the second quarter variation (0.75%). The accumulated growth as of September 2003 was 3.45%, two points higher than the growth in the same period of 2002.

Graph 1  
Quarterly GDP: Annual Variation  
I Quarter 1998 - III Quarter 2003 - (Percentage)

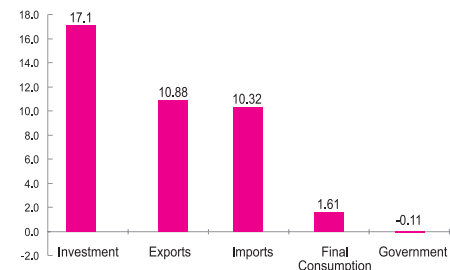


Source: National Statistics Department (DANE).

As for the supply side, the dynamism of the economy observed during the third quarter of 2003 can be largely explained by the behavior of the financial intermediation services sector, with an annual growth of 24.92%, followed by mining and quarrying with 21.58%, and construction with 11.31%.

Regarding the demand side, the economic growth in the third quarter of 2003 was mainly due to the increase in investment (17.10% annual), encouraged by the low real interest rates and their positive impact on the credit reactivation; the high liquidity, the good results of the democratic security policy, and the confidence in the long term performance of the public finances. The increase in capital goods imports (12.3% annual) and in building construction (22.72% annual) are indicators of the investment dynamism. Additionally, exports during the third quarter of 2003, showed an important annual increase of 10.88% amidst a high real exchange rate environment. Finally, the period showed signs of a rebound in final consumption (1.61% annual), evidenced by the increase in home consumption (2.2% annual), while annual government expenditure decreased by 0.11%; consistently with the current fiscal deficit reduction policy.

Graph 2  
GDP by Demand Components  
Annual Variation (III Quarter 2003) - (Percentage)



Source: National Statistics Department (DANE).

## Economic Activity Indicators for the Fourth Quarter

Although unemployment rates for the period showed a downward trend, it still remains at high levels. In December 2003, the unemployment rate was 12.3%, which represents a reduction of 3 percentage points as compared with the 15.6% rate recorded in December 2002. It is important to note that the unemployment rate recorded in December was the lowest of the year 2003.

Financial institutions also had a favorable performance. Due to the low interest rates, the high liquidity, and the lower credit risk perception; in November 2003, the financial sector's gross portfolio had an annual growth rate of 7.4%. It is highlighted the growth in mortgage loans, which increased by 28.1%, with an accumulated amount of COL\$ 1.8 billion (b). The higher activity in the credit business is consistent with the good performance of the economy's real sector, the improved conditions in the labor market, the internal demand dynamism and the favorable international financial environment for emerging economies, among others.

The profits and the portfolio quality<sup>1</sup> of the financial system showed good results. During the January-November 2003 period, profits amounted to COL\$ 7.2 b,

<sup>1</sup> The portfolio quality refers to the ratio between bad loan portfolio and gross loan portfolio.

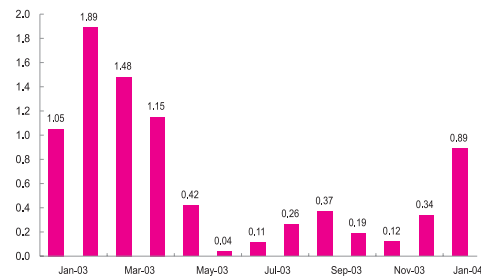
compared to COL\$ 4.2 b in the same period of 2002. As for the portfolio quality, the financial system recorded an annual reduction of 1.9 percentage points, from 9.3% in November 2002 to 7.4% in the same month in 2003.

## Monetary Policy

In December 2003, Colombia recorded the lowest inflation rate in the last 40 years. Continuing with the downward trend observed since 1999, in 2003 the inflation rate stood at 6.49%, half a point lower than the rate recorded in 2002 (6.99%). Accordingly with the inflation components, non-tradable goods prices increased by 4.9% in December 2003; while tradable goods prices, which were affected by lagged effects of the 2002 devaluation, had an inflation rate higher than the target (7.3%).

Despite the price reduction, at 2003 year-end close, inflation was higher than the expected and higher than the Central Bank's (Banco de la República) target (5-6%). Although in November, with a recorded accumulated inflation of 5.85%, everything suggested that the target would be met; the price increase in public utilities and fuels, due to fiscal measures, and the food price increase (1.25 % in December) as a result of changes in supply factors, generated inflationary pressures by the end of the year.

**Graph 3**  
Monthly Inflation  
(January 2003 - January 2004) - (Percentage)



Source: National Statistics Department (DANE).

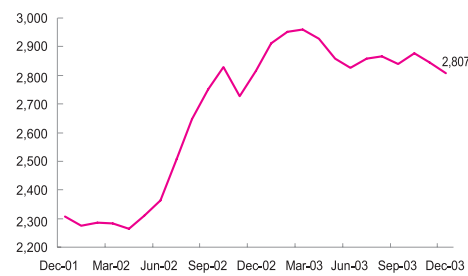
In general, the monetary policy continued to be expansionary despite the increase in intervention rates in January and April. During the January-December period the monetary aggregates showed increases higher than 12%. In December, the monetary base rose to COL\$ 16.5 b, with an annual growth of 17%, and the broad M3 aggregate recorded an annual increase of 12%.

The Central Bank has set an inflation target of 5 to 6% for 2004. It seems likely that this target will be achieved, because it will largely depend on the evolution of the exchange rate, the behavior of the economy's productive capacity and the inflation expectations. In the first case, the appreciation of the US dollar between 3.0% and 3.5% since late 2003 and early 2004 has relieved the pressure on price levels. According to the Central Bank's forecasts, in 2004 the exchange rate will present an appreciate on average. Regarding the productive capacity degree of utilization, although it has been increasing, the excess capacity is still below the average observed since 1990. Therefore, no important demand-related pressures on the inflation are expected. Finally, the latest polls on inflation expectations, done by the Central Bank, show a downward correction of the expectations throughout 2003.

## Exchange Rate Behavior

The average exchange rate recorded by the end of December 2003 was COL\$ 2,807.2 per US dollar, with an

**Graph 4**  
Nominal Exchange Rate  
(Pesos per Dollar)



Source: Central Bank.

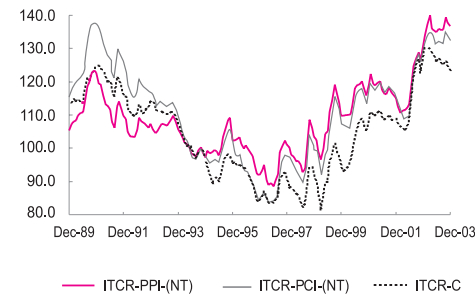
annual devaluation of -3.02%. This figure contrast with the devaluation observed throughout 2002 (25%) and the first quarter of 2003 (3.26%).

The recent appreciation of the Colombian peso can be explained by the strong devaluation of the US dollar against other currencies, partly as a result of the large U.S. fiscal imbalance and the current account deficit, which by the end of 2003 approached the unprecedented level which is 5% of the GDP. Furthermore, U.S. low interest rates have encouraged capital inflows into emerging economies where higher returns can be obtained. Within this context, it is important to note that the exchange appreciation affects other countries besides Colombia. In Latin America, Chile, Brazil, Mexico and Argentina have also experienced large currency appreciations.

Despite the appreciation of the Colombian peso against the US dollar in the last months, the real exchange rate stands at historically high levels. In December, the RERI (Real Exchange Rate Index) increased by 4.5% when compared to the same month in 2002, which indicates that the revaluation observed has not implied losses in Colombian exports competitiveness level.

It is important to note that all through 2003 commodity prices recorded positive and high growth rates, generating

**Graph 5**  
Real Exchange Rate Index  
Moving Average  
(Geometric Average, 1994 = 100)



Source: Central Bank.

positive impacts on the country's terms of exchange. In this way, the increase in international prices for agricultural goods and raw materials partially offset the losses associated with the recent exchange rate appreciation, as high prices limit the possibilities of importing these goods, and the prices for domestically produced goods remain competitive.

## Fiscal Policy

On the fiscal side, in September 2003 the consolidated public sector showed a fiscal deficit equivalent to -1.4% of the GDP, while the accumulated deficit in September 2002 was -2.1%. As a result, the third quarter of 2003 closed with an overachievement of COL\$ 110,000 m with respect to the deficit target agreed with the IMF for the period (COL\$ 3,315,000 m, -1.5% of the GDP).

This reflects the government's commitment to achieving the fiscal goals. Following the failure of the referendum, first plan to adjust the public finances, a series of reforms concerning revenues and expenditures were submitted to the Congress. Some expenditure cuts were made; the government submitted a bill to revise the Budget Organic Law; changes to the Law 80 to improve the administration of State contracts were approved; and Bancafé, a state bank, was readied for sale. On the revenues side, Congress approved a tax reform bill to guarantee better tax collection; which includes equity tax for the years 2004, 2005 and 2006 (0.3% on equity higher than COL\$ 3,000 m), financial transactions tax (4 x 1.000), and a 10% surtax on income taxes for the taxable years 2004, 2005, and 2006.

The market reacted appropriately to the above-mentioned measures, as evidenced by the low EMBI for Colombia (423 basis points at the end of December 2003), a stable dollar at year-end (\$2,778.21 per dollar), and the renewal, in January 2004, of the Stand-By Agreement between Colombia and the IMF, ratifying the quantitative compliance of many of the performance indicators. A consolidated public sector deficit of about 2.8% of the GDP is expected by the end of 2003 and of about 2.5% of the GDP in 2004.

In accordance with the Stand-By Agreement between Colombia and the IMF, in March 2004, the Government will submit to Congress a pension system reform bill, in order to ease the pension load on the next years' budget.

Graph 6  
External Debt Spreads, 2003  
(Basis Points)



Source: National Planning Department (DNP).

## External Sector

### Balance of Payments

During the January-September 2003 period, the country's balance of payments current account recorded a US\$ 1,100 m deficit (1.9% of the accumulated quarterly GDP), US\$ 28 m less than the one recorded in the same period in 2002. The capital account recorded a net income of US\$ 495 m, US\$ 318 m less than the income recorded in the first three quarters of 2002.

The current account deficit was explained by the income outflows (US\$ 2,446 m), and the non-factorial goods and services balance outflows (US\$ 872 m), partially offset by the net incomes from current transfers (US\$ 2,218 m). The net resources inflow recorded in the capital account can be explained by the long term capital flows behavior, which reached the amount of US\$ 1,214 m, compensating the short term capital outflow of US\$ 720 m. In the group of long term capital, the income from foreign direct investment of US\$ 1,377 m was highlighted, especially the one channeled toward coal exploitation (29%), financial activities (15%) and manufacturing (14%).

During the first three quarters of 2003, international reserves recorded a variation of -US\$ 141 m, and an amount of US\$ 10,863 m by the end of September; which is equivalent to 10 months of goods imports, 8.1 months of goods and services imports, and 2.8 times the short term external debt balance.

### Trade Balance

For the January-November 2003 period, the trade balance recorded a US\$ 99 m deficit, as a result of US\$ 11,786 m in imports and US\$ 11,687 m in exports. Imports increased by 8.0% annually, especially imports of capital goods (US\$ 367 m) for the industrial sector. The exports performance can be explained by the dynamism in external sales of traditional products (US\$ 715 m), particularly the US\$ 429 m increase in coal sales, US\$ 141 m increase in oil exports and oil products, and the US\$ 97 m increase in ferronickel exports. Also, non-traditional exports showed an annual growth of US\$ 68 m, as a result of the US\$ 463 m increase in gold sales, which were offset by a reduction in industrial products sales (US\$ 377 m), particularly transportation material and chemical products.

Colombian exports outlook is encouraging. On the one hand, it is expected that the Free Trade Agreement (FTA) negotiations between the Andean Community of Nations (CAN) and the United States will be completed between April and December 2004. This will enable Colombia to optimize its comparative advantages and will strengthen its entrance into the North American market. On the other hand, the initiative of the 34 American countries, except for Cuba, to build a free trade area by the year 2005, gives Colombia the opportunity to make the most of its productivity and privileged location, and to increase and diversify its exportable offer. Finally, the Economic Complementation Agreement between Argentina, Brazil, Paraguay and Uruguay (members of Mercosur) and Colombia, Ecuador and Venezuela (members of CAN) signed on December 16, 2003, will be effective on April 1, 2004. This agreement will boost the free flow of goods and services and will reduce or eliminate tariff and non-tariff barriers, and thus will lead to a substantial growth in Colombian exports.

Table 1

## COLOMBIA: Key Data

ITEM	Units	Latest Data Period	Data	Data One Year Before
<b>Total Foreign Investment</b>				
Direct	US\$ million	Jul. 03 - Sept. 03	552	180
Portfolio	US\$ million	Jul. 03 - Sept. 03	96	28
<b>Demand and Unemployment</b>				
GDP	% variation year to year	Jul. 03 - Sept. 03	4.17	2.72
Production Index (MMS)	% variation year to year	Dec. 03	3.62	1.00
Retail Sales	% variation year to year	Dec. 03	3.79	2.73
Investment	% variation year to year	Jul. 03 - Sept. 03	17.10	15.26
National Unemployment Rate	(%)	Dec. 03	12.30	15.60
13 Main Cities Unemployment Rate	(%)	Dec. 03	14.70	15.70
<b>Prices and Interest Rates</b>				
Consumer Price Index	% variation year to year	Dec. 03	6.49	6.99
Producer Price Index	% variation year to year	Dec. 03	5.72	9.28
Savings Interest Rate (90 days)	Monthly average (%)	Dec. 03	7.83	7.64
Lending Interest Rate	Monthly average (%)	Dec. 03	14.98	14.93
<b>Exchange Rate</b>				
Nominal Exchange Rate	Pesos/dollar US\$	Dec. 03	2,807.20	2,814.89
Nominal Devaluation	% annual variation to date	Dec. 03	-3.02	25.03
Real Exchange Rate (ITCR)	1994=100	Dec. 03	135.88	132.11
Real Devaluation	% annual variation to date	Dec. 03	5.50	14.55
Peso/Yen Monetary Units	Peso/Yen	Dec. 03	25.82	24.12
Peso/Euro Monetary Units	Peso/Euro	Dec. 03	3,489.43	3,008.32
<b>Trade</b>				
Exports	US\$ million	Jan. 03 - Nov. 03	11,760.00	10,896.00
Traditional Exports	US\$ million	Jan. 03 - Nov. 03	5,485.30	4,770.50
Non-Traditional Exports	US\$ million	Jan. 03 - Nov. 03	6,274.00	6,126.00
Imports	US\$ million	Jan. 03 - Nov. 03	12,565.50	11,644.50
<b>Other</b>				
M1	% variation year to year	Dec. 03	15.60	15.50
M3	% variation year to year	Dec. 03	12.10	8.21
Net International Reserves	US\$ million	Dec. 03	10,605.02	10,570.46
Colombia General Stock Exchange Index	July 2001=1000	Dec. 03	2,333.70	1,608.66
Fiscal Deficit (Central Government)	% of GDP	Jan. 03 - Sept. 03	-3.30	-4.00
Fiscal Deficit (Non - Financial Public Sector)	% of GDP	Jan. 03 - Sept. 03	-1.70	-1.90

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							
Real GDP Growth (%)*	3.5	1.8	-10.8	1.9	2.1	3.8	0.8	4.9	-9.0
Population (millions)*	44.6	43.8	37.5	174.7	15.1	13.1	100.1	26.7	25.6
GDP (US\$ billions)	-	81.1	91.8	451.5	66.4	24.5	636.1	56.4	80.8
GDP per Capita (US\$)	-	1,850.0	2,446.0	2,099.0	4,394.0	1,869.0	6,352.0	2,109.0	3,451.0
GDP per Capita Growth (%)	-	-2.5	-11.9	0.6	0.8	1.9	-0.7	3.2	-10.7
Consumer Prices Variation	6.5	7.0	41.0	12.5	2.8	9.4	5.4	1.5	31.2
Fiscal Balance (% of GDP)*	-2.8	-3.6	-0.3	-1.1	-0.8	-0.8	-1.8	-2.2	-3.3
Total External Debt/GDP (%)	-	46.0	146.1	50.4	60.8	59.0	22.0	49.3	37.9
Exchange Rate (LC/US\$ eop)	2,877.0	2,469.0	3.4	3.5	712.0	-	10.4	3.5	1,401.0
Nominal Interest Rate (savings)	7.8	8.4	20.7	25.0	2.9	4.7	7.0	4.7	26.1
Current Account (% of GDP)	-	-2.0	9.4	-1.7	-0.8	-4.8	-2.2	-2.1	8.1
Foreign Direct Investment (US\$ million)	-	2,043.0	1,741.0	14,084.0	1,139.0	1,275.0	14,435.0	2,931.0	-241.0
Foreign Direct Investment (% of GDP)	-	2.5	1.9	3.1	1.7	5.2	2.3	5.2	-0.3

Source: ECLAC (Preliminary Balance Latin American Economies 2003), 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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