

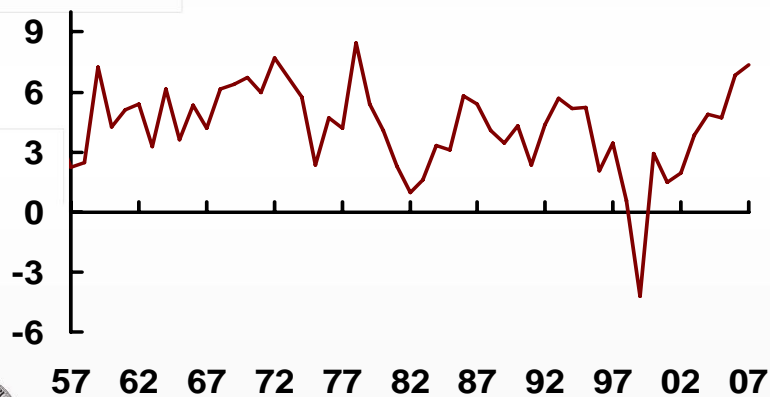


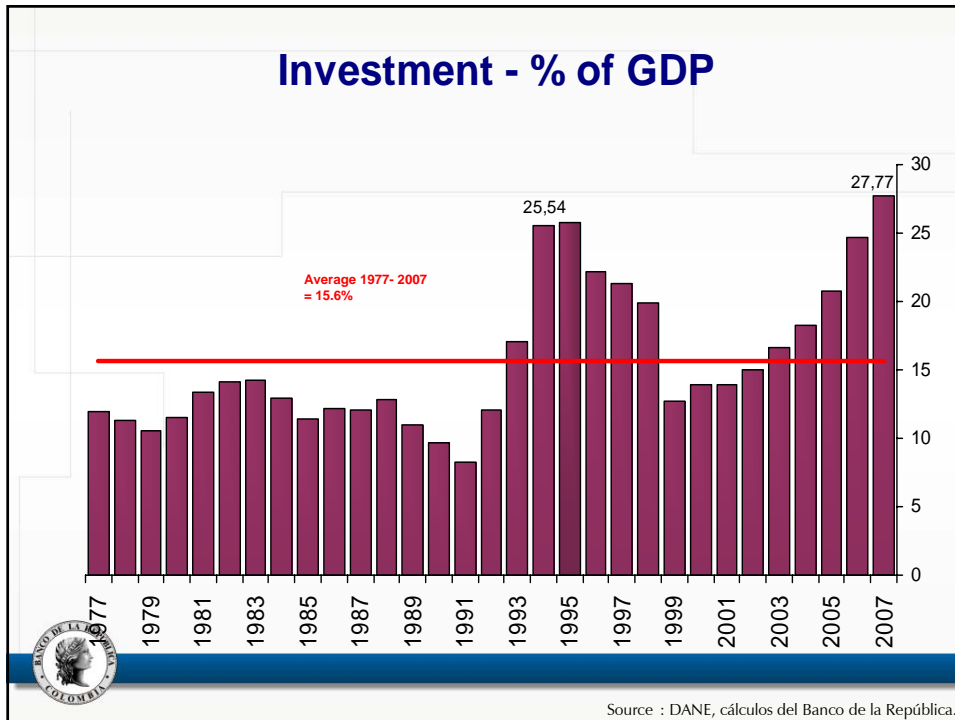
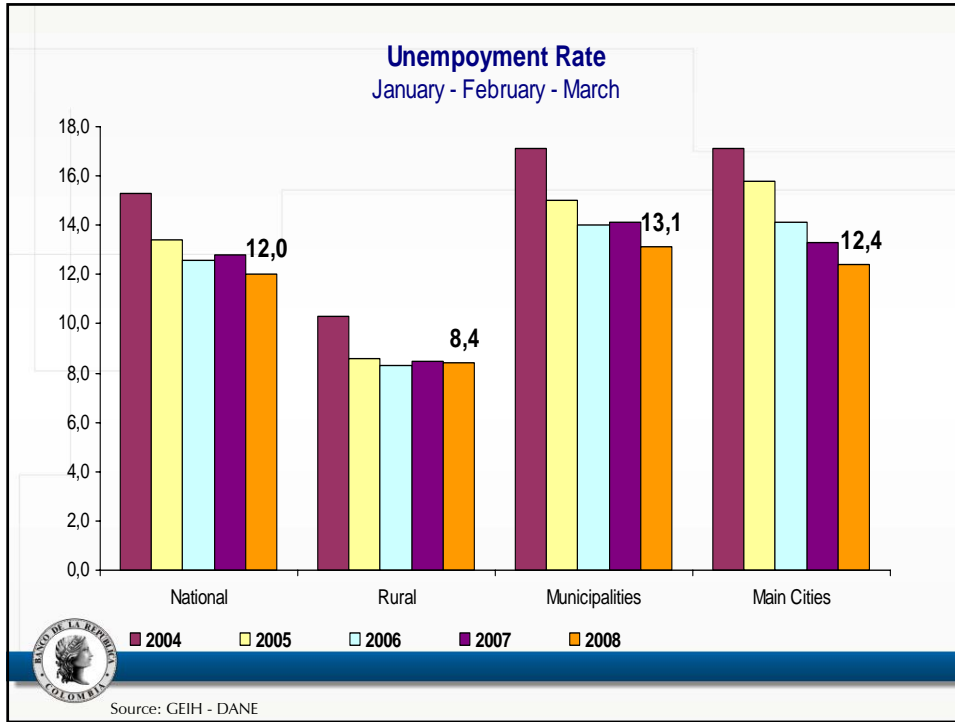
Colombia: Economic Outlook and Monetary Policy

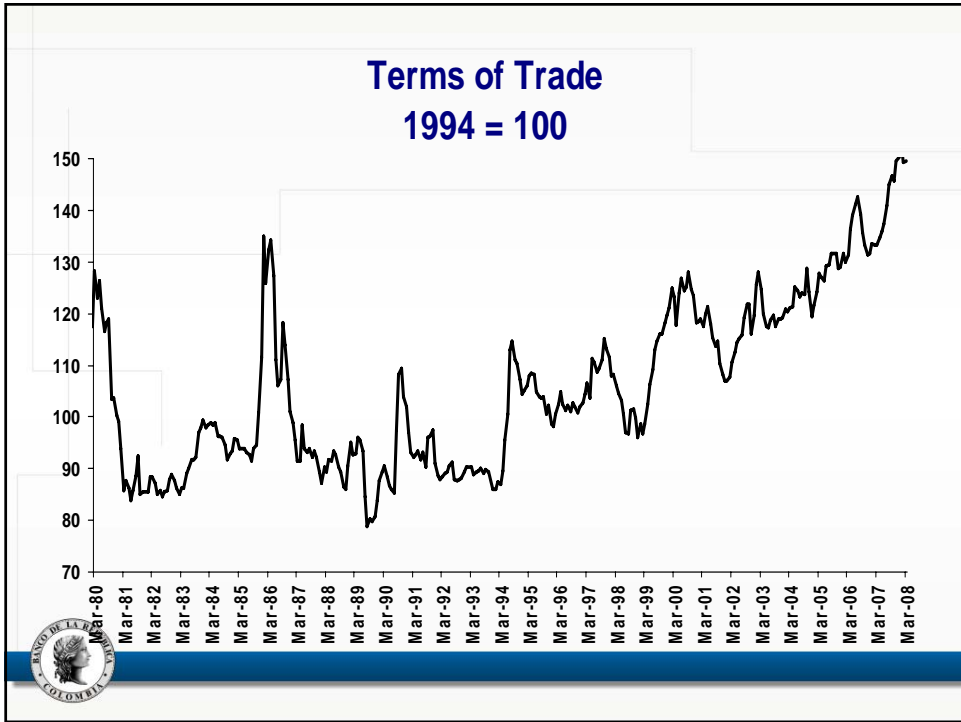
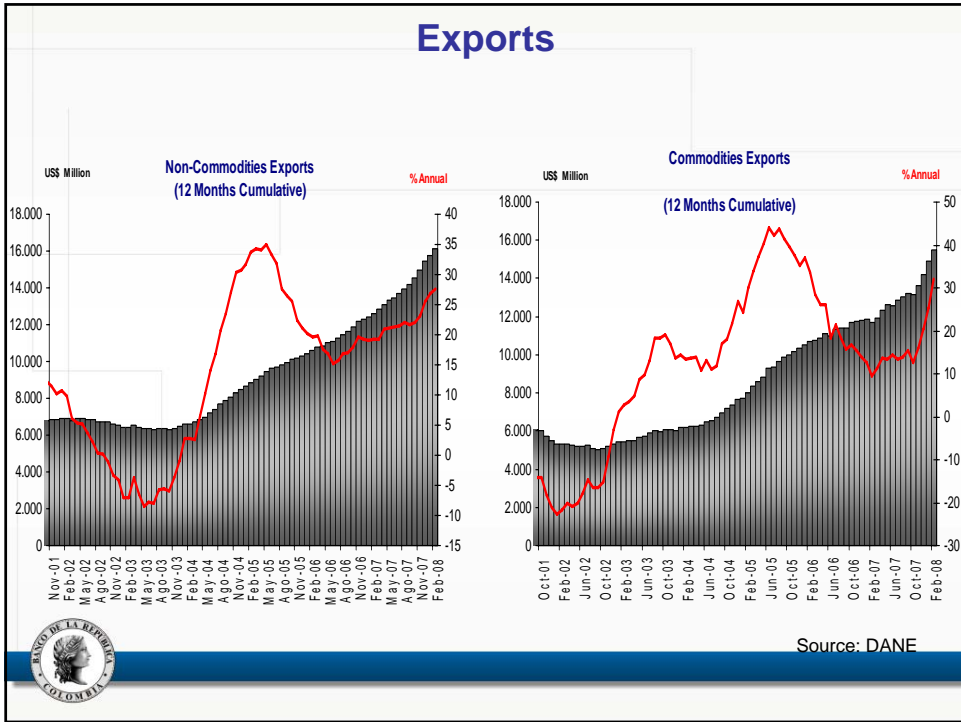
Carlos Gustavo Cano
Codirector of the Central Bank
- Banco de la República -

June 2008

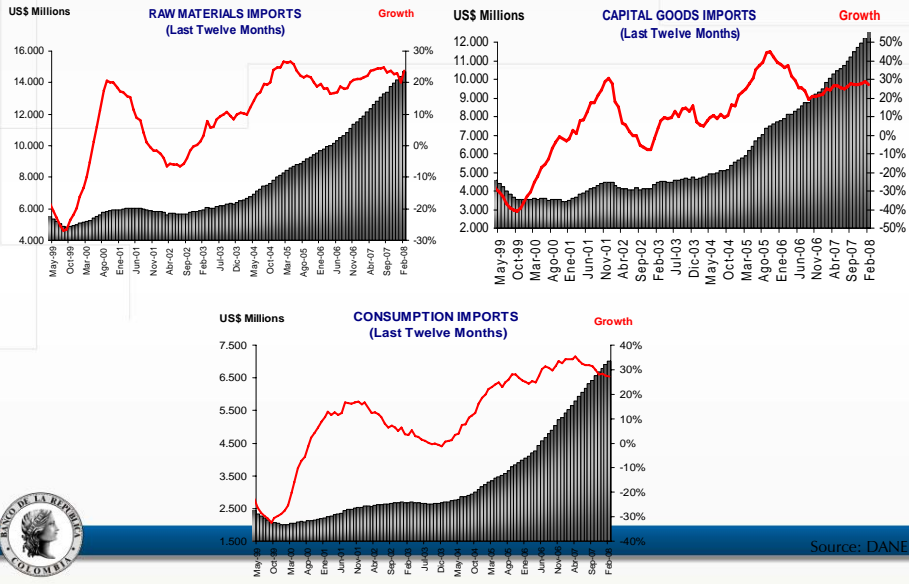
**GDP growth in 2007 was 7,5%, the highest
in the last 30 years. Projected income per
capita 2008 US \$3,800**



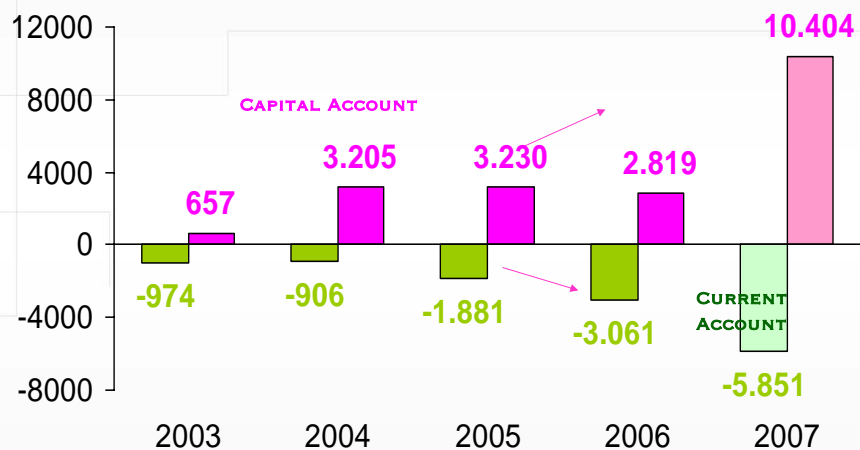




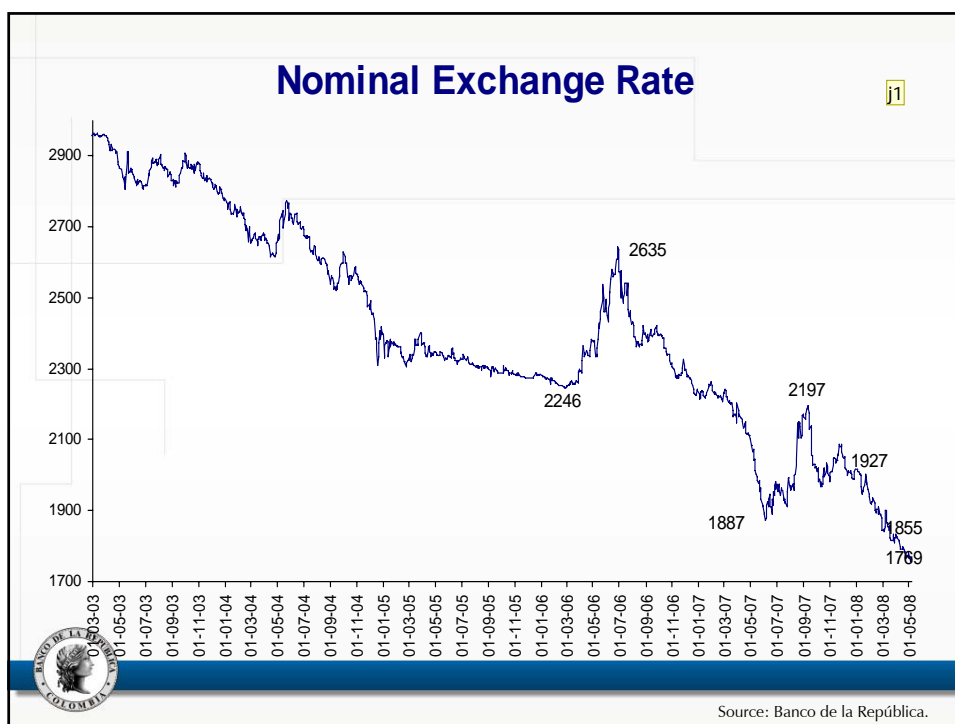
Imports of capital goods, consumption goods and raw materials



Colombia Balance of Payments (2003- 2007e, US\$ Millions)



FDI: 2007=US \$8,600 m and 2008= US \$ 8,300 m



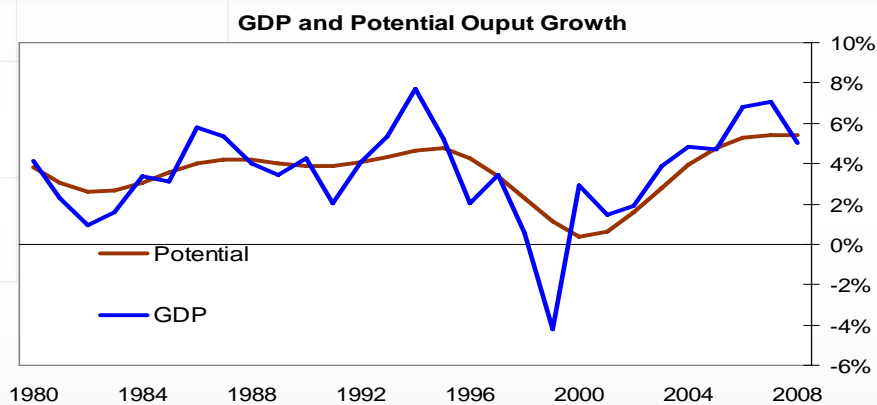
- ### Risks for growth sustainability
- **Inflation as a result of a demand excess over potential GDP**
 - **Excessive and lasting appreciation of the peso**
 - **External shocks, contagion and financial panic**
 - **Financial instability**

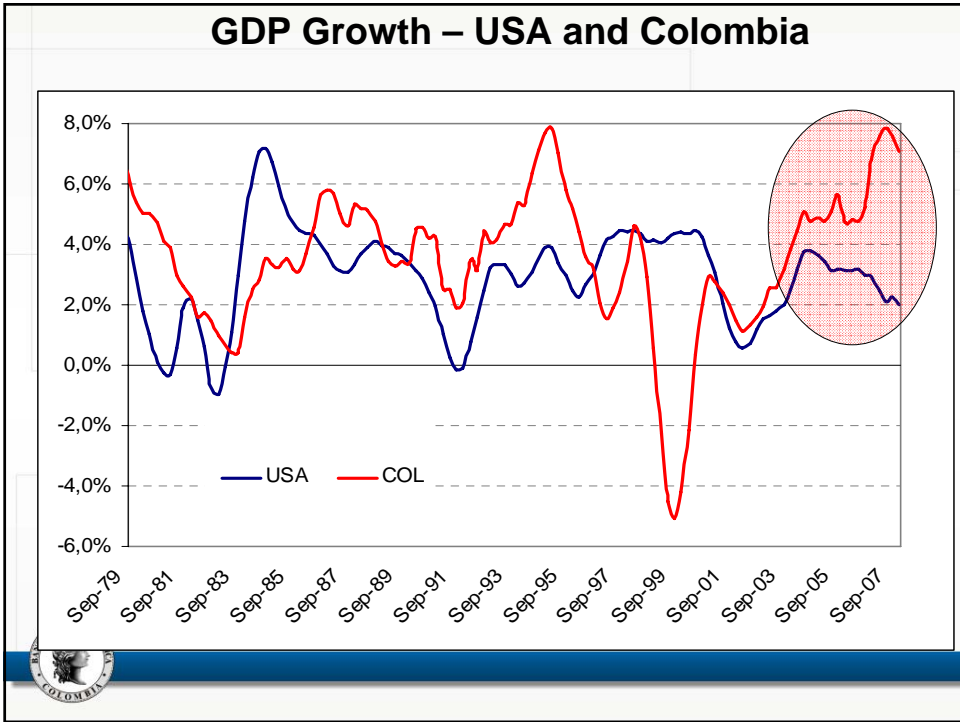
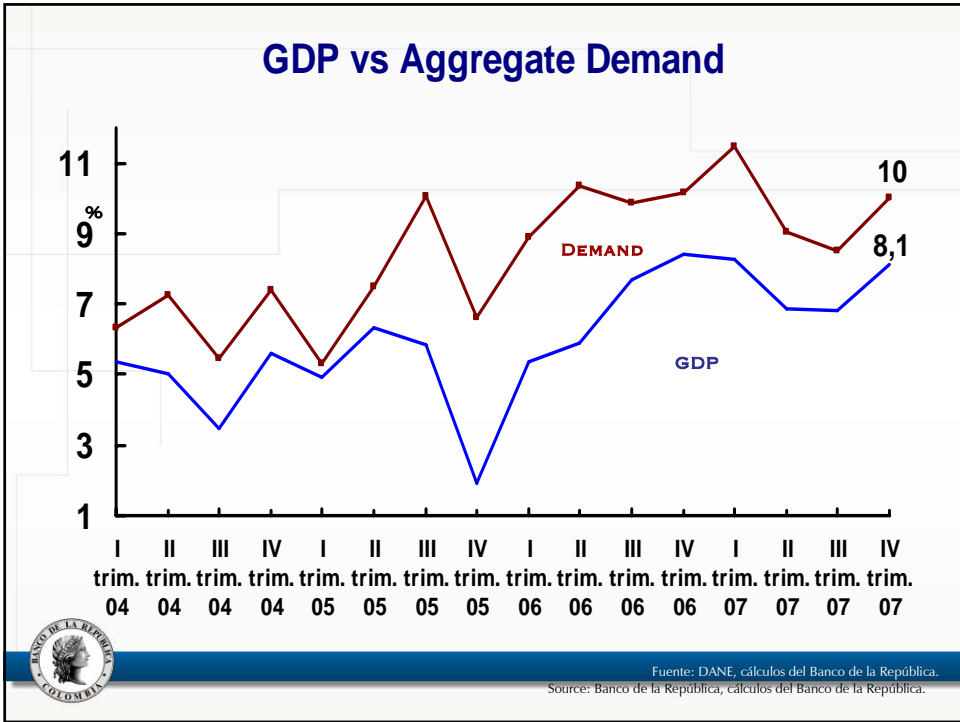
Inflation targeting in Colombia

- **Quantitative inflation targets:**
 - 2007: 3.5%-4.5% (mid point of 4% for legal aspects).
 - 2008: 3.5%-4.5% (mid point of 4% for legal aspects).
 - Long run: 2%-4%
- **Instruments:**
 - Interest rates of REPO operations (currently in 9.75%).
 - Occasional: FX intervention, reserve requirements, capital controls.



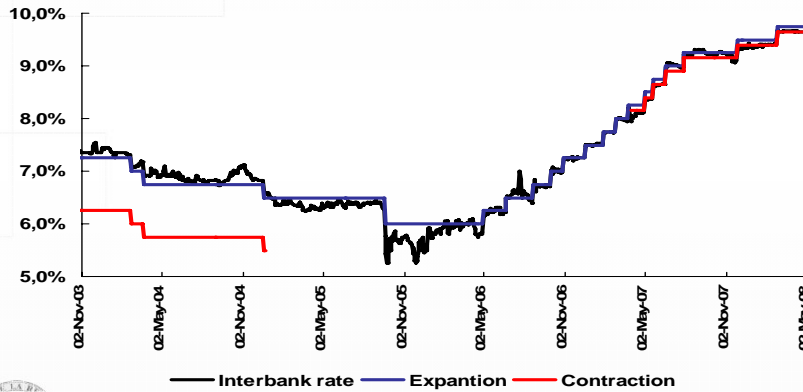
Real GDP had been growing at a greater pace than the potential output, as a result of a higher domestic demand





For this reason, the Board of Directors decided to raise interest rates between April 2006 and February 2008 from 6% to 9.75% in 15 movements of 25 bp each

Interbank rate and Central Bank Rate

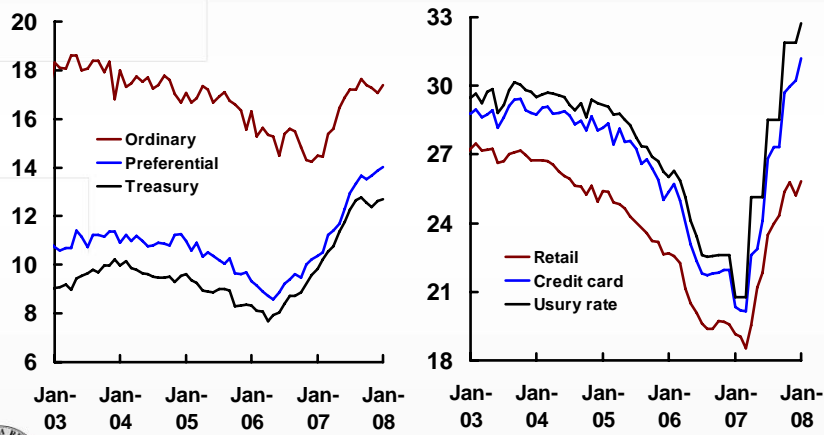


Since 2006, the BR has raised its interest rates in 63%, one of the highest increases in the world, whereas US has cut its interest rates in 62%

Country	(1) Nominal Interest Rate Today	(2) Nominal Interest Rate one Year ago	(1) / (2)	Inflation today	Real Interest Rate today
US	2,00	5,25	0,38	3,90	- 1,83
EU	4,00	3,75	1,07	3,30	0,68
Canada	3,00	4,25	0,71	1,70	1,28
Brazil	11,25	12,50	0,90	5,04	6,39
Mexico	7,50	7,25	1,03	4,55	2,82
Colombia	9,75	8,75	1,11	5,73	3,80
Chile	6,25	5,00	1,25	8,30	- 1,89
Perú	5,50	4,50	1,22	5,52	-0,02

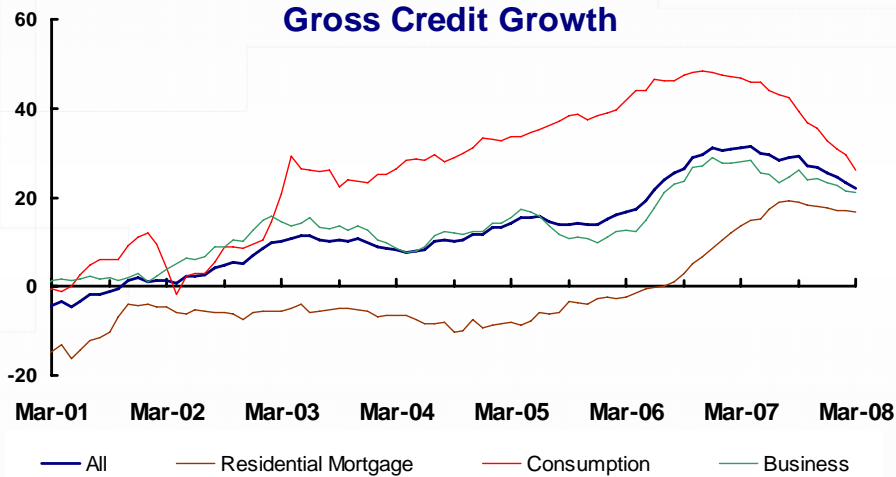


As a result, lending interest rates have increased and will raise further because of monetary policy lags (between 18 and 24 months)

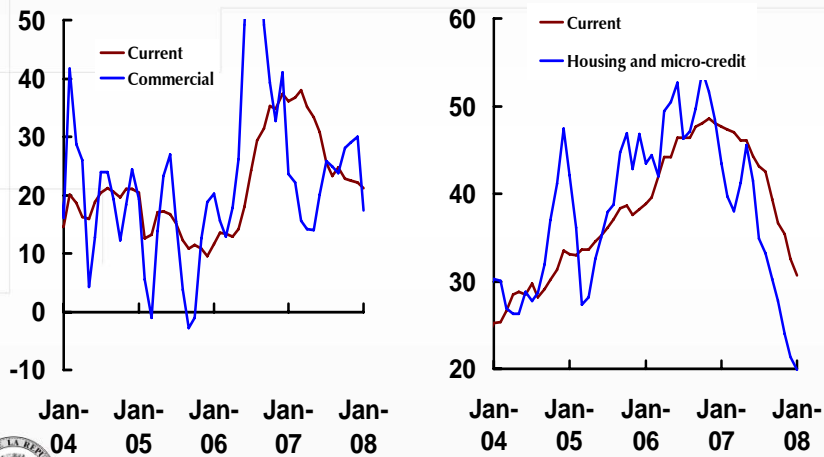


Loan portfolio continues descending at an accelerate pace

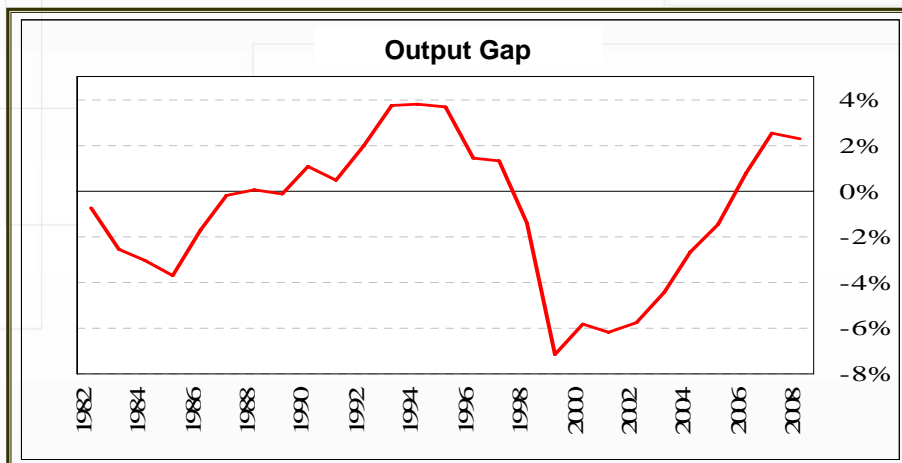
Gross Credit Growth



In particular, consumption and commercial loan portfolios have been decelerating for the last 12 months

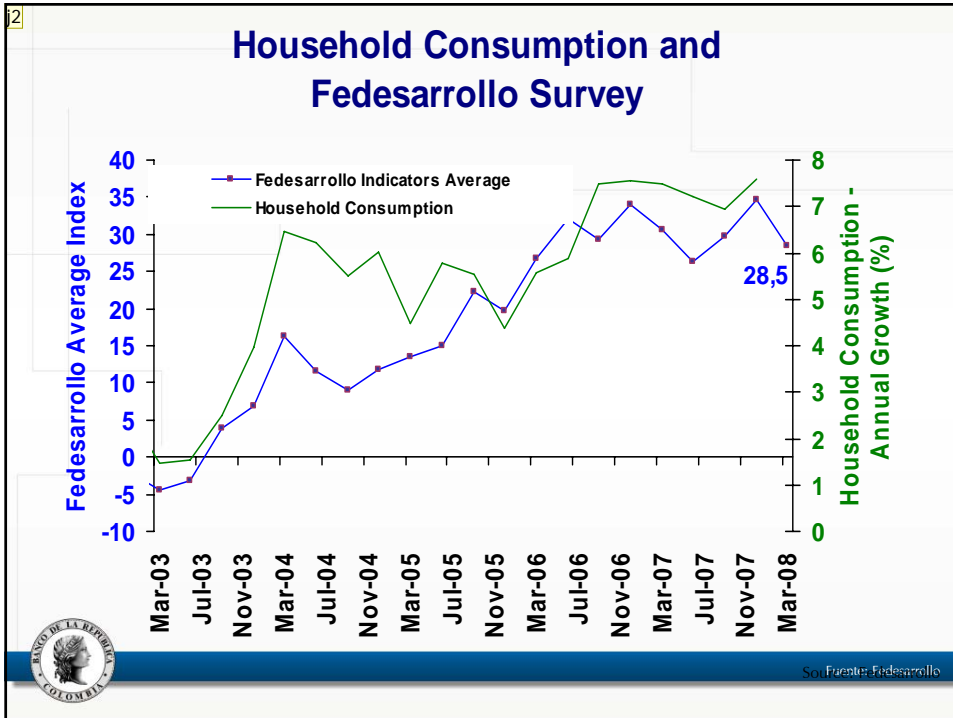
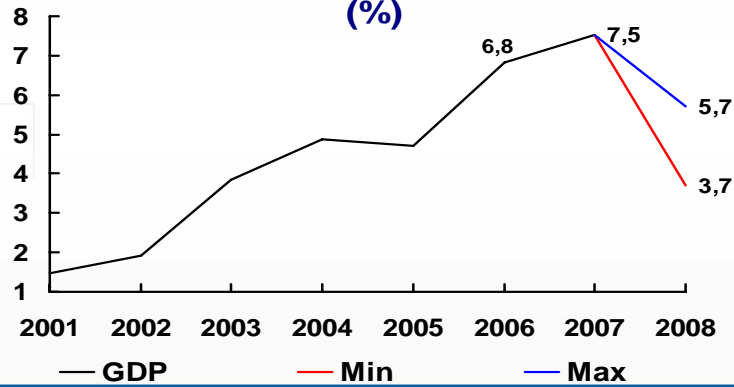


According to the models, the output gap would start to close as a consequence of the interest rate rise



In fact, in 2008 the Colombian economy would slow down to 5% (assuming US growth of 0.8% and military equipment purchases of US\$1,6 billion)

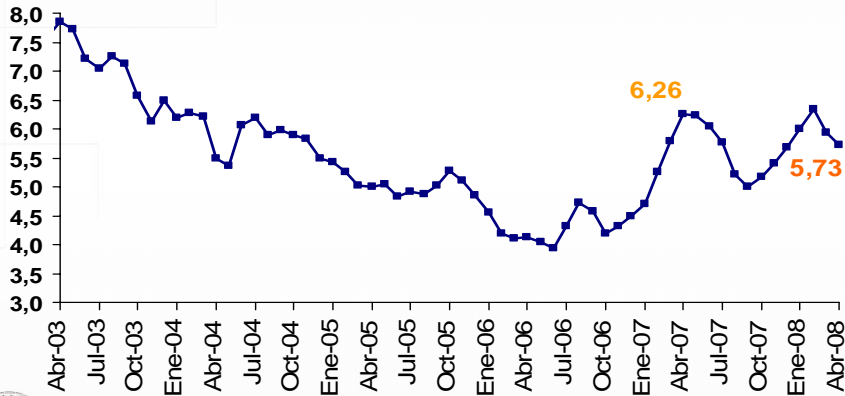
Economic Growth Forecasts 2008 (%)



So. Fuente: Fedesarrollo

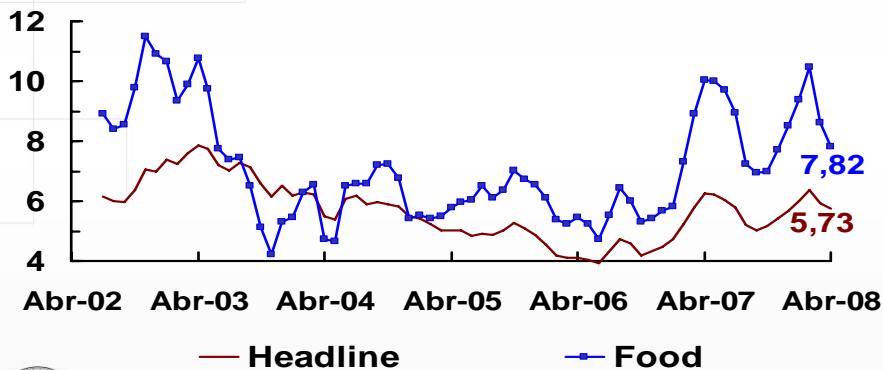
As a result, headline inflation decreased still further in April, the second month in a row

Annual Inflation - Headline (%)



Food inflation also decreased, in particular perishables. But still above target, mainly explained by high and rising prices of sources of animal protein: income-elasticity of demand in EM above one

Headline Inflation and Food Inflation (%)



WORLD INFLATION - 2007

País	Total	Alimentos
Emergentes sin Asia		
Republica checa	5,49	11,20
Israel	3,40	6,40
Kazakhstan	12,03	26,60
Polonia	3,86	7,60
Slovakia	3,42	7,60
Sur Africa	8,98	3,40
Turkia	8,39	12,00
Latinoamérica		
Argentina	8,47	8,60
Brasil	4,46	10,80
Chile	7,82	15,20
Colombia	5,69	8,50
México	3,76	6,00
Perú	3,93	6,00
Asia		
China	6,50	18,20
Hong Kong	3,77	6,90
Indonesia	6,59	11,30
Pakistan	8,79	3,30
Philipinas	3,94	12,20
Singapur	4,43	4,80
Taiwan	3,34	5,70
Thailandia	3,21	7,80
Desarrollados		
Estados Unidos	4,05	4,90
Zona Euro	3,07	4,80
Japón	0,70	1,81

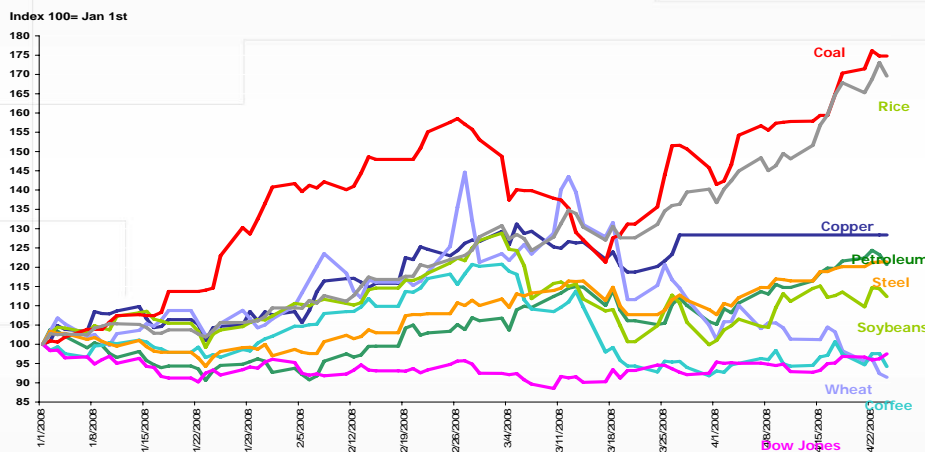
Fuente: Datastream y Deutsche Bank



Source: DANE, cálculos del Banco de la República.

Global Inflation Today: Raw Materials and Hydrocarbons

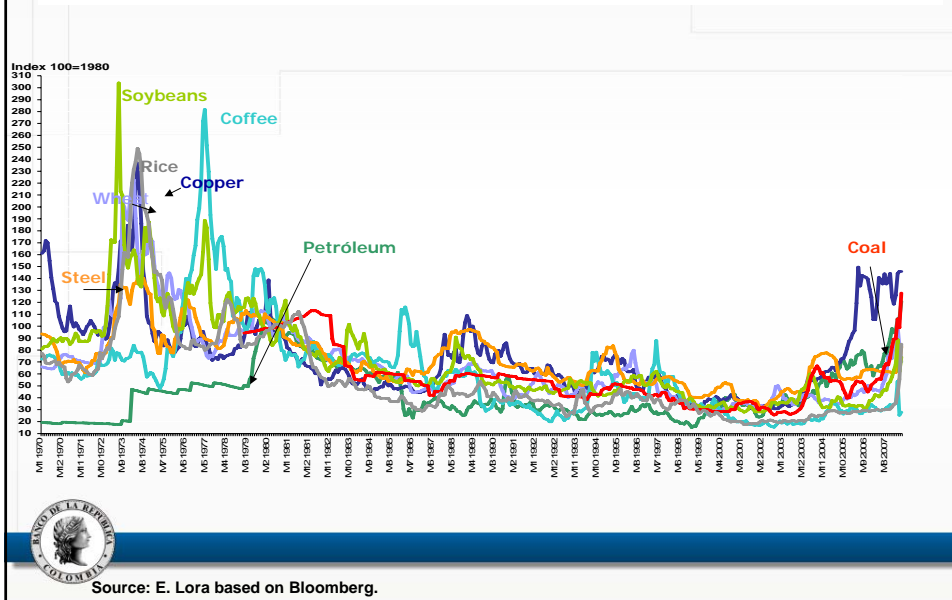
Prices of Raw Materials



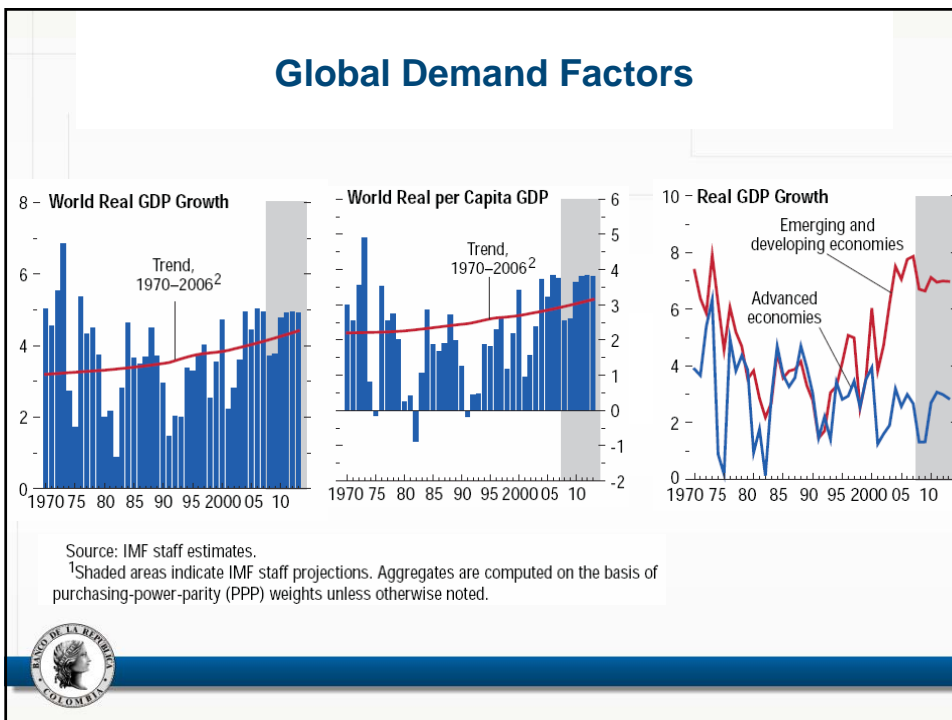
Source: E. Lora based on Bloomberg.

The last major shock was in the 1970s.

Real Raw Material Prices



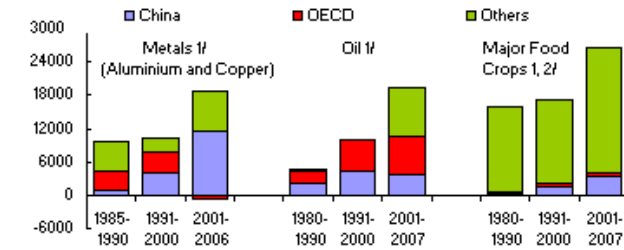
Global Demand Factors



Global demand for commodities has skyrocketed since 2001

Contribution to World Demand

(Annual variation, Period average)



1/ Metals are in hundred thousands metric tons. Major food crops and oil are in thousands of metric tons.

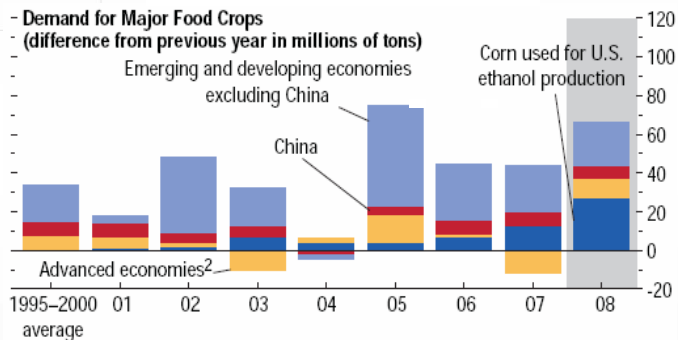
2/ Major food crops are corn, rice, soybean and wheat.

Sources: USDA, World Bureau of Metal Statistics, BP and IMF staff.



Ethanol: a major factor of growth of global demand, followed by Biodiesel

Demand for Major Crops



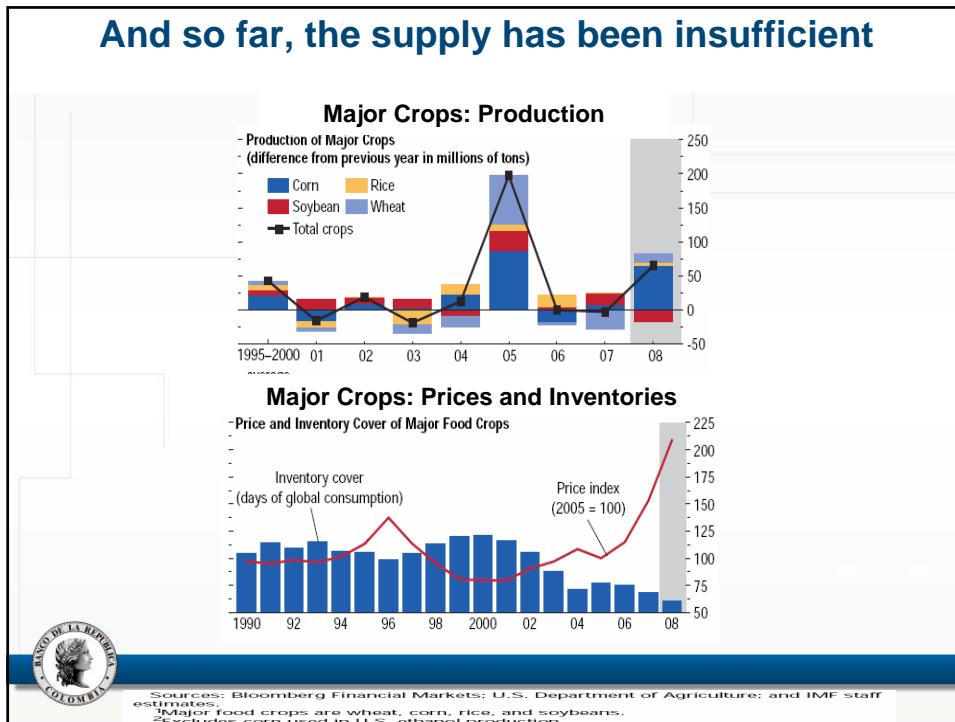
Sources: Bloomberg Financial Markets; U.S. Department of Agriculture; and IMF staff estimates.

¹Major food crops are wheat, corn, rice, and soybeans.

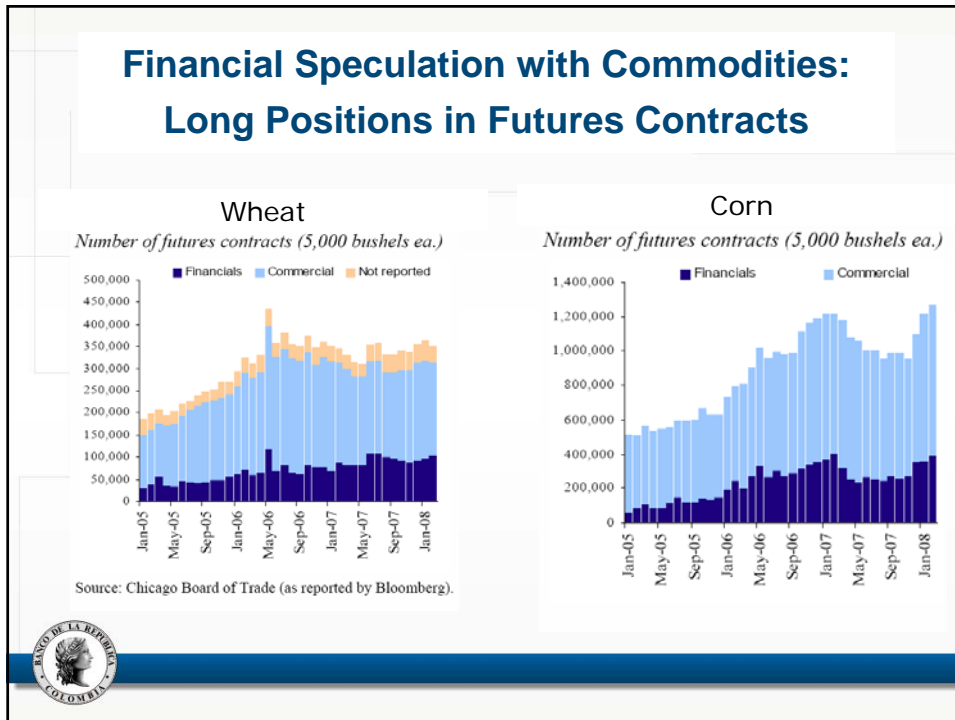
²Excludes corn used in U.S. ethanol production.



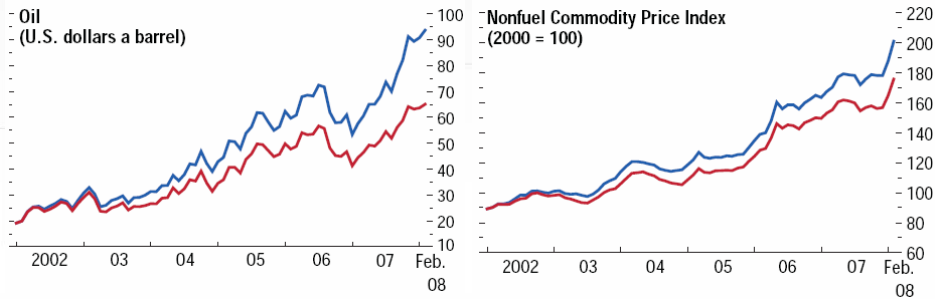
And so far, the supply has been insufficient



Financial Speculation with Commodities: Long Positions in Futures Contracts



Devaluation of the dollar has been reflected in higher commodity prices.

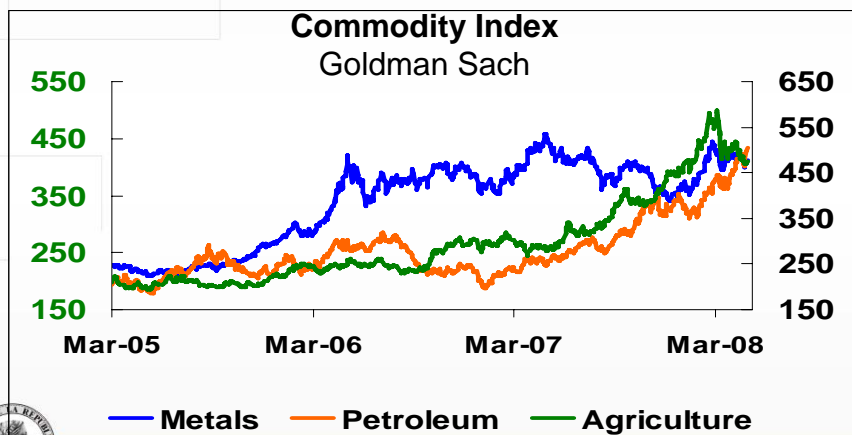


Effect on commodities of a 1% drop in the US dollar exchange rate			
Number of months after the shock	1	4	12
Gold	1.17	1.22	1.3
Petroleum	0.89	0.97	1.13
Non-energy commodity index	0.48	0.47	0.47
Aluminum	0.53	0.53	0.53
Copper	1.11	1.02	0.8

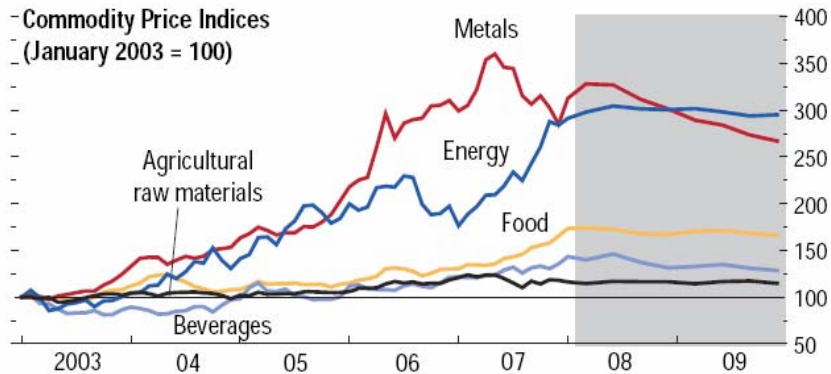
In current dollars, based on the US nominal effective exchange rate.



Oil prices sustain food prices, in particular raw materials for animal protein and biofuels (28% of US corn and 60% of EU oilseeds for biofuels)



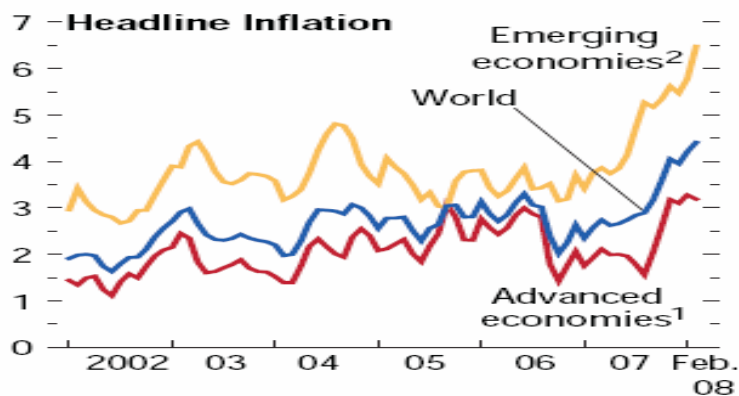
Commodity prices are expected to remain high, at least during two more years



Sources: Bloomberg Financial Markets; and IMF staff estimates.



Result: Inflation is returning



Sources: Haver Analytics; and IMF staff calculations.

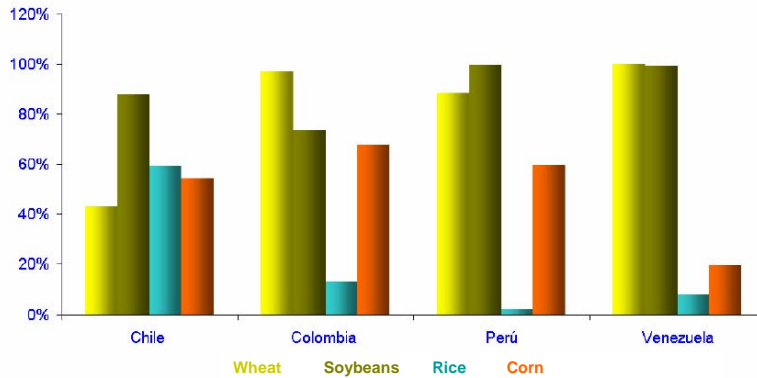
¹Australia, Canada, Denmark, euro area, Japan, New Zealand, Norway, Sweden, United Kingdom, and United States.

²Brazil, Bulgaria, Chile, China, Estonia, Hong Kong SAR, Hungary, India, Indonesia, Korea, Malaysia, Mexico, Poland, Singapore, South Africa, Taiwan Province of China, and Thailand.



Vulnerability of the Andean Countries in Terms of Major Grains

Imports as a share of consumption in the Andean countries



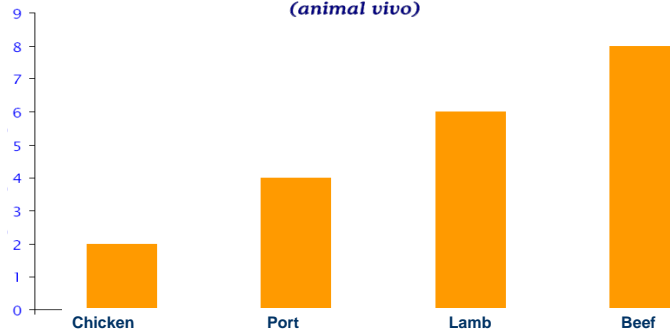
Source: BBVA Studies Services

Animal protein represents the number-one demand for grain. It also has the highest income-elasticity demand in EM (above one)

Rates of grain conversion to meat (live animals)

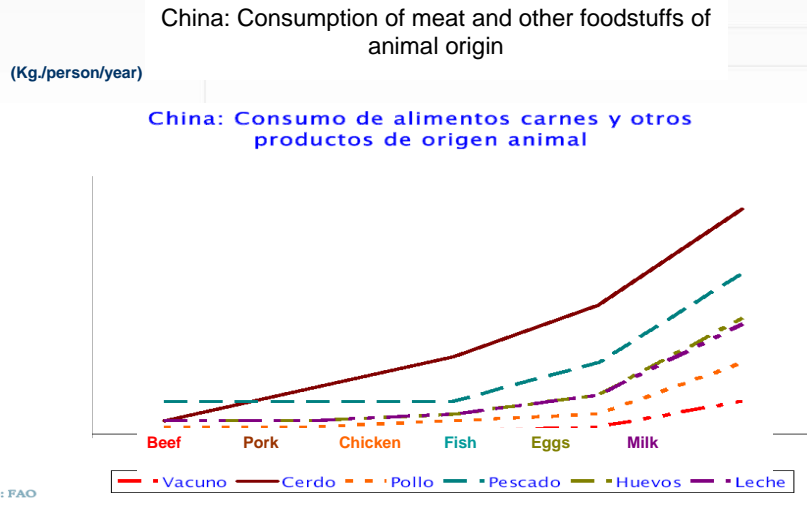
(Kg. of grain – Kg. of meat)

Tasas de conversión de granos en carne (animal vivo)



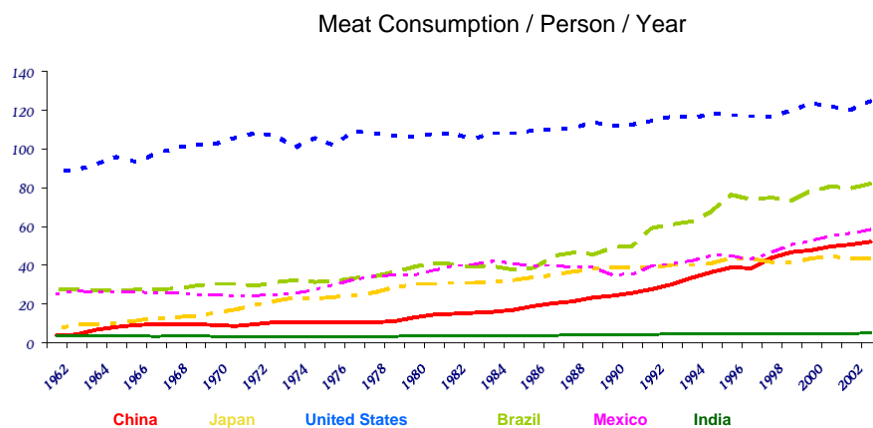
Source: BBVA Studies Services

For example, annual consumption per capita in China went from 20 to 52 kilograms in 20 years.



Source FAO

Like China, other EM are increasing their meat consumption at unprecedented rates



Source: FAO.

Balance of risks

- The source of food prices increase is not domestic but global demand (China, India, biofuels).
- “Coldness” of world economic activity, which in turn will moderate food consumption.
- Exogenous shocks (carry trade operations) vs. interest rates increases: currency appreciation.



Finally, technological innovation will help to dissolve food-driven inflationary pressure.

1

Biotechnology: substantial leaps in productivity and resistance to drought, erosion and soil salinity.

2

Biofuels based on new sources that do not compete with food: jatropha, micro-algae, biomass (bamboo, switchgrass), cellulose (wood).

3

Renewable Energy: nuclear (General Electric, Westinghouse, Toshiba, Hitachi and AREVA), wind power, solar thermal, hydro, geothermal, ocean.

4

Development of hybrid engines and mass use of hydrogen instead of gasoline.

5

Opening up new environmentally-sustainable agricultural frontiers, such as the Orinoquia region in Colombia (6 million hectares).



Thank you

