



# Colombia

## Talking Points on the Economy

*First Quarter 2004*



**COINVERTIR**  
INSTITUTO COLOMBIANO DE INVESTIGACIONES ECONÓMICAS



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Colombia recorded one of the highest growth rates in Latin America during 2003. With an economic growth of 3.7%, compared to 1.5% in the region, the performance of the Colombian economy was better than expected and presented the highest growth of the last eight years. Government forecasts show that the economy could grow around 4.0% in 2004.

The acceleration of the economic growth during 2003 was mainly due to a greater internal demand and a gradual recovery of the external demand. The good performance of the internal demand was supported by a regained trust and the good expectations for the macroeconomic variables that came as a result of the government's democratic security policies and the advances in fiscal adjustments. Other contributing factors were low real interest rates, investment growth and utilization of installed capacity, availability of financing credit and inflation rate reduction. The reactivation of the external demand, expressed in the increase in the country's traditional and non-traditional exports, was the result of the economic growth of the United States, which offset the negative impact of the economic contraction in Venezuela.

Due to this good economic performance and better growth perspectives, on May 3, the credit rating agency Fitch Ratings upgraded the outlook on Colombia's sovereign debt from negative to stable. This positive news, along with the fact that Colombia was the only Latin American country that substantially improved its position in the 2004 world competitiveness ranking<sup>1</sup>, improves the business environment and encourages the arrival of foreign investment flows to the country.

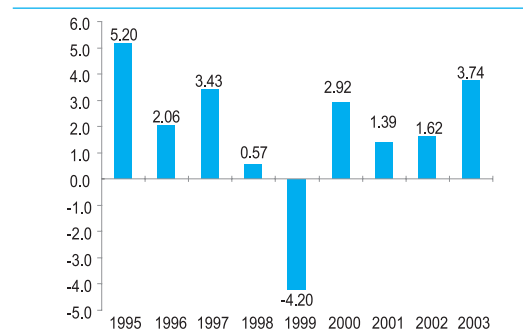
## GDP Growth - 2003

In 2003, the Colombian economy grew 3.7%, compared to the 1.6% growth rate recorded in 2002. This is the highest growth since 1995 when the economy grew 5.2%.

The annual variation during the fourth quarter of 2003 was 4.5%, a figure higher than the annual variations recorded during the first quarter (4.1%), second quarter (2.2%) and third quarter (4.1%).

<sup>1</sup> World competitiveness ranking of the International Institute for Management Development (IMD).

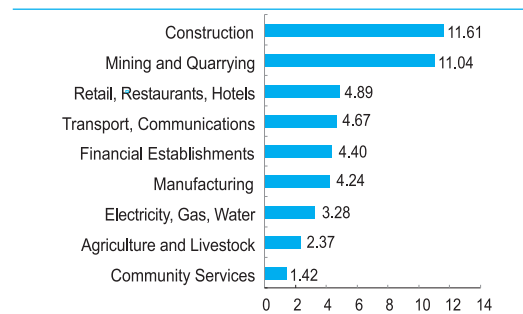
Graph 1  
GDP, Annual Variation  
1995 - 2003 (Percentage)



Source: National Statistics Department (DANE).

From the supply perspective, the economic sector that showed the largest growth in 2003 was construction, with an annual growth rate of 11.6%; followed by mining and quarrying with 11.0%. The strong activity of the construction sector can be explained by the performance of the buildings construction subsector, which grew 19.2%. The good performance of the mining and quarrying sector was due to a 35.9% increase in coal production and a 60.5% increase in metallic minerals production.

Graph 2  
GDP by Sectors  
Annual Variation (2003) (Percentage)



Source: National Statistics Department (DANE).

On the demand side, the economic growth in 2003 was explained mainly by the increase in investment (18.7%). The investment activity was represented by the increase in capital goods imports (15.7%) and the growth in buildings construction (19.2%). This increase in investment indicates that the agents' expectations on the economic performance are positive, therefore maintaining high economic growth rates in the long term. The strong performance of Colombian imports can be explained by the increase in imports of refined oil products, machinery and electric supplies, common metals, chemicals, beverages, glass, and rubber and plastic products.

During 2003, exports grew 4.2%, as a consequence of external sales of gold, coal, yarns, threads and fabrics, printed products, leather and by products, and sugar, among others. Final consumption grew 2.1%, as evidenced by the increase in home consumption (2.4%) and government consumption (1.4%).

## Economic Activity Indicators

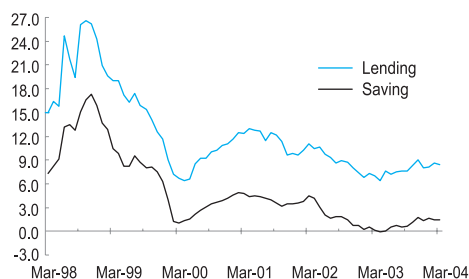
The positive performance of the Colombian economy has been supported by an increased trust of consumers and business people. Consumer expectations suggest an important increase in consumption, particularly in durable goods; and according to business activity indicators, the economic and socio-political investment conditions are at high levels.

The good results of the real sector of the economy are an evidence of the strong business and aggregate demand activity. As of 2003, companies' profits grew 138% and sales 23%, indicating that the companies consolidated their growth and are achieving a sustained development.

Profits of the financial system recorded important growths by the end of the first quarter of 2004, up to \$837.0 billion (b) from \$407.8 b in the same period of 2003, representing a 105% increase. Profits of the domestic private banking grew 78%, while profits of the foreign banking increased 285%. During the same period, total portfolio of the financial system increased 4.5%, while bad loan portfolio fell 17.8%, as a result of the lower perception of credit risk.

The first quarter of 2004 was also characterized by the reduction and stability of the real interest rates. In March, the lending interest rate stood at 8.4%, and the saving interest rate stood at 1.5% in real terms.

**Graph 3**  
**Real Interest Rates:**  
**Lending and Saving (Percentage)**

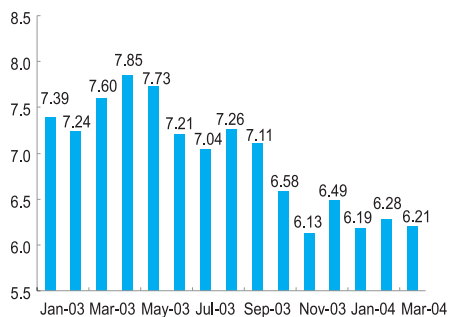


Source: National Statistics Department (DANE).

## Monetary Policy

In April of 2004, the annual inflation continued its downward trend, recording a consumer price index variation of 5.5%, compared to 7.9% in the same month of the previous year. This can be explained by the reduction in basic inflation, which offset the increase in food, fuels and public utilities' inflation.

**Graph 4**  
**Annual Inflation (Jan/03-Mar/04)**  
**(Percentage)**



Source: National Statistics Department (DANE).

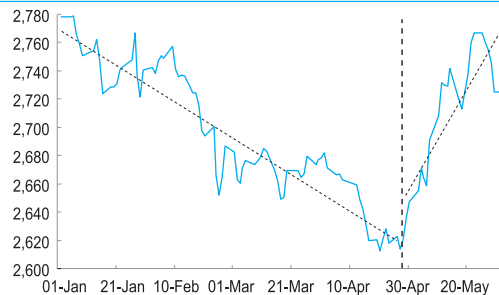
The monetary policy is framed within the inflation targeting strategy. Accordingly, the intervention rates of the Central Bank are the main policy instrument. As a consequence of the lower inflation prospects for 2004, partly due to the exchange rate appreciation, the Central Bank reduced its intervention interest rates by 25 bp in two occasions, (February 20 and March 19), reducing the cost of primary liquidity in the economy. In this way, the expansive monetary policy has encouraged the overall economic activity.

As of April 2004, monetary aggregates recorded annual nominal increases higher than 11.5%. The monetary base grew to COP \$14.2 b, with an annual growth of 11.7%, and the broad M3 aggregate presented an upward trend with 12.3%. In April, consumer credit showed strong activity, with an annual growth of 27.3%, while commercial portfolio showed a slowdown with 4.5%.

## Foreign Exchange Policy

As of the end of April 2004, the exchange rate showed an annual average revaluation of 8.2%. During this period, the Central Bank accumulated US\$ 600 million (m) through international reserves accumulation auctions. As of the last week of April, and especially in May, the exchange rate changed its trend, increasing COP \$113.1 (4.3%) between

**Graph 5**  
**Exchange Rate Evolution in 2004**  
**(Pesos per Dollar)**



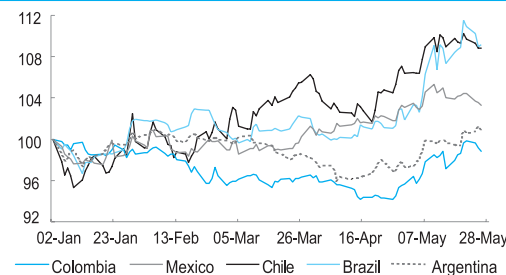
Source: Central Bank.

<sup>2</sup> Average of annual variations observed between January 1<sup>st</sup> and May 26<sup>th</sup>.

April 30 and May 26. In average, up to May 26, the rate decreased 7.6% in annual terms<sup>2</sup> (Graph 5).

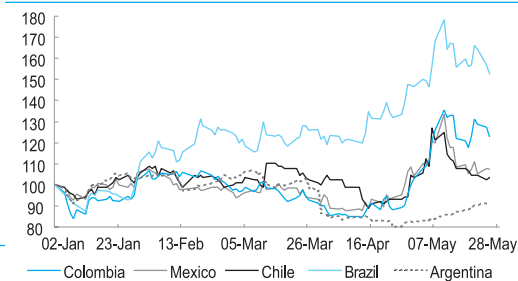
This exchange rate performance correlates to the currency's performance in some countries of the region, and to the country-risk indicator (Graphs 6 and 7). In parallel to the currencies appreciation observed up to April, in the majority of countries the country-risk indicator, measured through the EMBI, was reduced. Most likely, both reductions were associated to the lack of investment alternatives in other markets, given the prevailing low interest rates in other economies (particularly in the United States and the European Monetary Union). On the other hand, the change of trend in

**Graph 6**  
**Nominal Exchange Rate Index, 2004**  
**(Base 100 = January 2 / 2004)**



Source: Bloomberg.

**Graph 7**  
**EMBI Index, 2004 (Base 100 = January 2 / 2004)**



Source: Bloomberg.

the exchange rate during May was apparently associated to the market expectations of a rise in interest rates in the United States and the economic news from Brazil.

## Fiscal Policy

By the end of 2003, the consolidated public sector deficit was 2.8% of GDP, representing a reduction of 0.8%, as compared to 2002. As a result, the goal agreed with the International Monetary Fund (IMF) was met and the 2004 Stand by Agreement was ratified, so, Colombia will have access to approximately US\$ 1.05 b in Special Drawing Rights during 2004.

The improved performance of the public finances is associated to the improved performance of the National Central Government finances, which during 2003, recorded a deficit equivalent to 5.5% of GDP. Due to the greater growth in revenues (13.5%) compared to expenditures (8.9%), the National Central Government managed to reduce its deficit by approximately 0.7%.

Notwithstanding the fiscal deficit reduction, the adjustment of public finances is still a priority for the government, and the great challenge for 2004 will be the consolidation of larger fiscal adjustment to meet the deficit goal of 2.5% of GDP this year. Both the Government and Congress must continue to work in the search for structural reforms (pensions, territorial transfers and budget organic statute) to make feasible the public finances. It is necessary to avoid an exponential increase in pension payments in the next years, which at the current trend would reach 3.8% of GDP in 2004 and 4.8% of GDP in 2005, compared to 1.2% of GDP in 1994. It is also necessary to reform the territorial tax system to prevent a future unsustainable increase in territorial transfers that could absorb 39% of the Nation's current revenues. Finally, it is essential to finish the budget organic statute reform that seeks higher transparency and a more flexible budget handling within a mid-term fiscal framework.

## External Sector

Two important events will shape the course of the Colombian export outlook. First, in April of 2004 the negotiations of the Free Trade Agreement (FTA) between Colombia, Ecuador and Venezuela (members of the Andean Community) and Brazil, Argentina, Paraguay and Uruguay

(members of MERCOSUR), were closed. The FTA that will be effective on July 1<sup>st</sup> 2004 will boost the free flow of goods and services and will reduce or eliminate tariff and non-tariff barriers, thus leading to a substantial growth in Colombian exports.

Secondly, successful Free Trade Agreement (FTA) negotiations between Colombia and the United States are expected. The negotiations, which began in May of 2004 and are expected to be completed during the first semester of 2005, will deal with subjects such as access to markets, agriculture, environmental, institutional and labor issues, competition, state purchases, cooperation and strengthening of commercial capacity, dumping, investment, copyrights, financial services, telecommunications, cross border services, and problem solving mechanisms. With this FTA, Colombia will be able to optimize and improve its competitive advantages; strengthen its entrance into the North American market, and substantially increase foreign direct investment (FDI).

## Balance of Payments

During 2003, the country's balance of payments current account recorded a deficit of US\$ 1.42 b (1.8% of GDP), US\$ 70 m lower than the one obtained in the same period of 2002. The capital account recorded a net income of US\$ 811 m, US\$ 498 m less than the amount recorded in 2002.

The current account deficit can be explained by the net outflows on the factors income account of (US\$ 3.4 b), and non-factorial goods and services balance (US\$ 1.2 b), partially offset by net incomes from current transfers (US\$ 3.2 b).

In 2003, international reserves recorded a negative variation of US\$ 184 m, reaching US\$ 10.9 b; equivalent to 9.9 months of goods imports, 7.9 months of goods and services imports, and 3.2 times the short-term external debt balance, according to the original maturity. The reduction in the international reserve balance was attributed to net sales of foreign currency of US\$ 238 m from the exercise of reserve accumulation options for the amount of US\$ 106 m and of reserve disaggregation options for US\$ 344 m; and to profits transfer to the government for US\$ 250 m. These outflows were partially offset by the net yield of the international reserves investment portfolio, which generated foreign currency inflows of US\$ 464 m.

## Trade Balance

In 2003, the trade balance recorded a US\$ 265 m surplus, as a result of exports for US\$ 13.5 b and imports for US\$ 13.3 b. Exports growth can be explained by the strong activity in external sales of traditional products (US\$ 694 m). Especially noteworthy were the increase of US\$ 431 m in coal sales, US\$ 122 m in ferronickel, US\$ 108 m in oil and derivatives, and US\$ 34 m in coffee. These exports were encouraged by the increase in commodities prices and the stronger world demand, particularly in the United States.

Non-traditional exports grew US\$ 264 m, as a result of a US\$ 480 m increase in gold sales, offset by the reduction in sales of industrial products (US\$ 237 m), particularly transportation material and chemical products. Other special trade transactions increased by US\$ 212 m in net terms.

Imports grew due to the increase on external purchases of capital goods (US\$ 666 m), particularly, industrial machinery; and to the increase on external purchases of industrial intermediate goods (US\$ 513 m).

## Foreign Investment in 2003

Foreign investment<sup>3</sup> (FI) rose 72% in 2003 with respect to 2002, from US\$ 1.1 b to US\$ 1.9 b. The net income from portfolio investments was US\$ 107 m, compared to the US\$ 1.0 b outflow recorded in 2003. FDI fell from US\$ 2.1 b to US\$ 1.8 b, equivalent to a 17% annual drop.

All through 2003, the mining and quarrying sector received the most FDI with US\$ 553 m, equivalent to 31% of the total investment flow, followed by manufacturing industry with US\$ 314 m, and oil with US\$ 312 m, both with about 18% of total FDI inflows. These three sectors accounted for 67% of the FDI and experienced a 10% increase in FDI share, as compared to the same period in 2002.

As for the origin of the FDI, the most important country for Colombia is the United States, which has remained in first place, with an average investment share higher than 13% during the last years. Spain has been among the top 5 investor countries with an investment share between 6% and 13%. During the last 3 years, Netherlands has been among the top 10 investors, with share of investments of up to 10%.

<sup>3</sup> Foreign direct and portfolio investment.

Table 1

## COLOMBIA: Key Data

ITEM	Units	Latest data Period	Data	Data One Year Before
<b>Total Foreign Investment</b>				
Direct	US\$ million	Oct. 03 - Dec. 03	336	430
Portafolio	US\$ million	Oct. 03 - Dec. 03	361	320
<b>Demand and Unemployment</b>				
GDP	% variation year to year	Oct. 03 - Dec. 03	4.49	2.20
Production Index (MMS)*	% annual variation to date	Feb. 04	6.11	4.82
Retail Sales	% annual variation to date	Feb. 04	7.09	3.88
Investment	% variation year to year	Oct. 03 - Dec. 03	13.71	24.79
National Unemployment Rate	(%)	Mar. 04	13.6	13.0
13 Main Cities Unemployment Rate	(%)	Mar. 04	16.2	17.8
<b>Prices and Interest Rates</b>				
Consumer Price Index	% variation year to year	Mar. 04	6.21	7.60
Producer Price Index	% variation year to year	Mar. 04	4.57	11.48
Savings Interest Rate (90 days)	Monthly average (%)	Mar. 04	7.80	7.76
Lending Interest Rate	Monthly average (%)	Mar. 04	15.19	15.12
<b>Exchange Rate</b>				
Nominal Exchange Rate	Peso/dollar US\$	Mar. 04	2,678.16	2,958.25
Nominal Devaluation	% variation year to year	Mar. 04	-9.47	30.82
Real Exchange Rate (ITCR)	1994=100	Mar. 04	128.51	140.85
Real Devaluation	% variation year to year	Mar. 04	-8.76	24.54
Peso/Yen Monetary Units	Peso/Yen	Mar. 04	25.71	25.06
Peso/Euro Monetary Units	Peso/Euro	Mar. 04	3,278.14	3,149.23
<b>Trade</b>				
Exports (FOB)	US\$ million	Jan. 04 - Feb. 04	2,165.00	1,950.00
Traditional Exports	US\$ million	Jan. 04 - Feb. 04	1,086.00	945.00
Non-Traditional Exports	US\$ million	Jan. 04 - Feb. 04	1,079.00	1,005.00
Imports (CIF)	US\$ million	Jan. 04 - Feb. 04	2,286.26	2,228.20
<b>Other</b>				
M1	% variation year to year	Mar. 04	14.36	20.60
M3	% variation year to year	Mar. 04	12.65	10.85
Net International Reserves	US\$ million	Mar. 04	11,329.89	10,616.21
Colombia General Stock Exchange Index	July 2001=1,000	Mar. 04	3,321.15	1,558.59
Fiscal Deficit (Central Government)	% of GDP	Jan. 03 - Dec. 03	5.5	6.2
Fiscal Deficit (Non - Financial Public Sector)	% of GDP	Jan. 03 - Dec. 03	3.3	3.8

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

(\*) For 2003 data as of April.

Table 2

## Main Latin American Economic Indicators

	Colombia		Argentina	Brazil	Chile	Ecuador	Mexico	Peru	Venezuela
	2004*	2003							
Real GDP growth (%)*	4.0	3.7	7.5	0.2	3.2	2.7	1.2	4.1	-10.3
Population (millions)*	45.3	44.6	38.0	177.0	15.3	13.3	101.5	27.1	26.6
GDP (US\$ billions)	90.3	77.6	132.0	487.7	72.4	27.1	606.9	60.2	81.4
GDP per Capita (US\$)	-	1,740.0	3,474.0	2,756.0	4,730.0	2,028.0	5,980.0	2,217.0	3,055.0
GDP per Capita Growth (%)	-	-5.2	42.0	31.3	7.6	8.5	-5.9	5.1	-11.5
Consumer Prices Variation	5.6	6.5	3.7	9.3	1.1	6.1	4.0	2.5	27.1
Fiscal Balance (% of GDP)	-2.5	-2.8	-0.2	-1.1	-0.8	-0.9	-0.6	-1.9	-3.0
Total External Debt/GDP (%)	42.3	49.2	109.2	45.6	57.6	54.0	24.9	45.8	36.7
Exchange Rate (LC/US\$ eop)	-	2,877.8	2.93	2.89	599.0	-	11.2	3.5	1,600.0
Nominal Interest Rate (savings)	-	7.8	3.3	16.5	2.6	5.4	6.0	2.5	14.2
Current Account (% of GDP)	-2.6	-1.8	6.8	0.8	-0.5	-2.5	-1.6	-1.9	11.5
Foreign Direct Investment (US\$ million)	1,293.0	1,762.0	1,103.0	10,144.0	2,902.0	1,637.0	10,731.0	1,332.0	2,531.0
Foreign Direct Investment (% of GDP)	1.4	2.1	0.8	2.1	4.0	6.0	1.8	2.2	3.1

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
- Surprising Colombia: Foreign Investment Guide
- Foreign Investment Report
- Directory of Legal and Consulting Services
- Legal Framework
- Colombia: Regional Investment Guides
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