Colombia

Talking Points on the Economy

First Quarter 2005

PROEXPORT COLOMBIA

COINVERTIR
INVEST IN COLOMBIA CORPORATION

BANCO DE LA REPÚBLICA COLOMBIA

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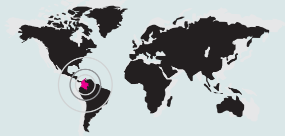
Colombia

¿Why Do Business in Colombia?



Strategic geographic location: easy access to the North American, European, Asian and Latin American markets.

Macroeconomic stability: economic growth above the Latin American average.

Human resources: availability of qualified, competitive and committed labor force.

Market size:
- 45 million inhabitants
- Third largest population in Latin America

Export platform: privileged access to more than 1 billion of consumers:

- Free Trade Agreements:
  - FTA in process with the United States
  - Andean Community, CAN (Colombia, Bolivia, Ecuador, Peru and Venezuela)
  - Group of Three, G-3 (Colombia, Mexico and Venezuela)
  - CAN - Mercosur
  - Colombia - Chile
  - Colombia - Caricom
- Tariff Preferences:
  - With the United States, ATPDEA
  - With the European Union, Andean SGP

Special foreign trade regimes:
- 10 Duty Free Zones
- 5 Special Economic Export Zones
- Incentives for large exporters
- Special Import – Export Systems

Export supply: unparalleled portfolio of high-value added and quality products and services in the industry, services and mining sector.

Colombia has returned to its historic growth path close to 4%. Economic growth is being driven by the private sector. Private investment, with a 12% GDP share was the demand component that contributed the most to economic growth in 2004. Exports, with a 19% GDP share showed the highest annual increment of the past 10 years. Economic growth was also characterized for being multisectorial; a characteristic given by the positive variations that with no exception affected all the sectors in 2004.

During the first quarter of 2005, several indicators show that the Colombian economy continues its growth dynamics. The unemployment rate during the first three months of the year was 1.9 percentage points below the rate recorded in the same period of 2004. Household consumption continues to recover. This is reflected in retail sales which in February of this year grew 3.2 percentage points over those in February of 2004. Meanwhile, inflation as of March kept reducing and reached the lowest figure of the past two years. In addition, it's important to note the greater confidence of the corporate environment towards the economic prospects of the country. This can be credited to the improvement of the security conditions, and the democratic security and defense policy of the Government.

Prospects for 2005, suggest that the economy will continue this trend, with an economic growth similar to the one of 2004. This will be led by consumption, exports, and private investment which will continue to be stimulated by the large liquidity and low interest rates of the Colombian market.

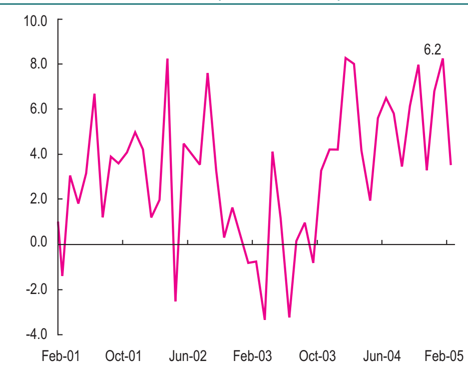
GDP Growth

During 2004 Colombian GDP growth was approximately 4% for the second year in a row. Non tradable sectors such as construction and trade were the most dynamic, showing a 4.4% growth. Tradable sectors grew 3.2% on average.

On the demand side, growth was driven by the investment which went from a 2% growth in 2001 to 13% in 2004. Simultaneously, the ratio Investment / GDP grew from 14% to 19% in the same period.

The increment of 4% in the household consumption was also relevant, mainly as a result of the dynamics of consumption of non-perishable goods (19%) and semi-perishable ones (4%). Retail sales grew 62% more than in 2003, showing a stronger dynamic in the household consumption, and therefore in the final consumption. As of February of 2005, retail sales grew 5.4% compared to those in February of 2004 when the growth was only 2.2%. One of the relevant factors that allowed this increment was the improvement of the labor market performance. Unemployment rate decreased from 14% in 2001 to 12% in 2004. Also, full time jobs grew 4%, the highest rate in several years. As of March of 2005, unemployment rate was 13.1% compared to 13.6% in March of 2004. Nonetheless, unemployment is still high which suggests that the economy can still absorb labor force.

Graph 1
Retail Sales, Annual Variation
(2001-2004) *(Percentage)*



Source: National Stadistics Department (DANE).

External Sector
Trade Balance

Colombian exports reached US$16.4 billion (b) in 2004, the highest level in the history of the country with a

25.6% annual growth. Exports of non-traditional products grew 25.3% and those of traditional products grew 26.0%.

Due to this developments, Colombia registered for the second consecutive year a US$802 million (m) trade surplus, higher than the one registered in 2003 of US$ 752 m.

This significant growth of exports is explained by the following: i) the improvement of the terms of trade as the result of high international prices of basic exported goods, ii) the better performance of main trade partners of the country, and iii) the general world demand growth. The dynamism observed on exports propelled the growth of tradable sectors, particularly in the manufacturing industry which had a 5% growth in 2004, the highest reported since 2001.

Imports in 2004 showed important increments in all groups of goods. Raw materials and intermediate products stood out with a 24.2% growth; as well as capital goods for the industry with a 16.2% increase. These larger imports of capital goods constitute a positive sign for investment and for the industrial activity of the country.

Graph 2
Current Account Deficit
(2000-2004) *(Percentage of GDP)*

Source: Banco de la República.

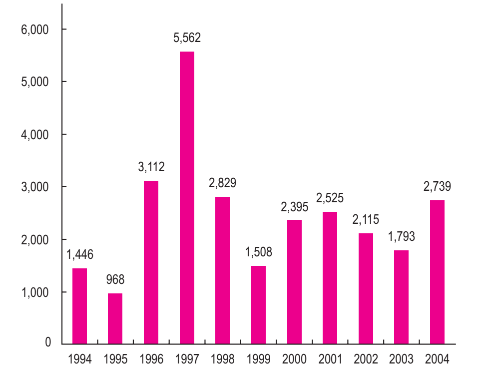
Growth of total exports (26%) surpassed the growth of total imports (20%) in 2004. This caused a reduction of the current account deficit from 1.3% of GDP in 2003 to 1.1% in 2004. According to provisional data from the National Statistics Department (DANE), as of March of 2005, the majority of traditional exports belonged to oil and its derivates, for a total of US$ 1.1 b (24% of total), and coal for a total of US$ 576 m (13%). Chemicals, textiles and apparel, and food and beverages stood out in the group of non traditional products with shares of 9%, 6%, and 6%, respectively. During the same month the main imports were raw materials and intermediate products (48%), followed by capital goods and construction materials (34%) and consumption goods (18%).

Foreign Investment

During 2004, Foreign Direct Investment (FDI) in Colombia grew 53% with respect to 2003, going from US$ 1.8 b to US$ 2.8 b; therefore, becoming the most important figure since 1998. At the same time, its growth rate (53%) was the fourth highest during the last ten years, after those observed in 1996 (221%), 1997 (79%) and 2000 (59%). This increment is mainly the result of the economic and political stability that the country offers, and thus the greater sense of confidence from foreign investors. According to figures of the Economic Commission for Latin America and the Caribbean (Eclac), Colombia is nowadays the fourth FDI hosting country, after Brazil, Mexico, and Chile.

During the last four years the United States was ranked as the main investor in Colombia. In 2004 it invested US$ 874 m (49% share of total investment). Spain was ranked as the main investor from Europe during 2004, with a total amount of US$ 136 m (8% of total). Finally, Venezuela ranked as one of the main Latin American investors in Colombia during the last year, with an amount of US$ 62 m, representing 4% of total FDI. The sectors mostly benefited by FDI flows where mining and quarrying (including coal) with 45% share, followed by oil with 21%, and transport, storage and communications with 9%. The main investing cases in the mining and quarrying sector were represented by the companies Drummond and El Cerrejon, which allocated significant resources to increase production and to improve their plants and equipment. The new oil policy brought several legislative changes responsible for the increase of the oil sector's investment: According to the latest available data, 37 contracts were

Graph 3
Foreign Direct Investment
(1994-2004) *(US$ Million)*



Source: Banco de la República.

signed for exploration, exploitation, and technical assessment in 2004. In the transport sector, Grupo Sinergy from Brazil acquired Valorem's (former Valores Bavaria) Avianca stock share. In the communications industry Telefonica entered the country through its brand Movistar, taking over BellSouth operations.

During 2005, FDI is expected to continue to grow, motivated by factors such as the new oil policy that seeks to stimulate investment and the finding of new hydrocarbon reserves, in order to prolong the Colombian oil self-sufficiency. Also, the soon-to-be-signed trade agreement with the US will promote the arrival of new companies that will use Colombia as an export platform. Finally, improvement in Colombia's international image thanks to the results obtained with the democratic security policy will also become a relevant growth factor.

Monetary and Exchange Policy

According to the inflation targeting strategy, the Central Bank´s intervention interest rates are the main tool of the monetary policy. The foreign currency intervention in the exchange market is a complementary instrument of the strategy and has been consistent with the movement on Central Bank´s interest rates.

During the first quarter of 2005, the Central Bank kept its intervention rates unaltered. However, during 2004 it lowered them on three occasions (February, March, and December) for a total of 75 basis points (bp). Additionally, the Central Bank closed the monetary contraction windows since December 2004, creating higher liquidity on the market. This has had a clear effect on the reduction of the interbank´s interest rate of 42 bp between December of 2004 and March of 2005. The benchmark 90-day pasive interest rate also was reduced from 7.76% on December to 7.34% on March. Additionally, the interest rates of the domestic public debt bonds (TES) showed downward movements. Particularly, for the TES expiring on November of 2007, the interest rate decreased 3% between December and March.

The intervention of the Central Bank in the exchange market is an effective tool to avoid large and prolonged deviations of the exchange rate from its long term level. In this context, the Central Bank intervened in the exchange market during 2004 with discretionary purchases of foreign currency in an amount of US$ 1.3 b and through "put" options for foreign currency accumulation totaling US$ 1.6 b. The whole intervention totaled US$ 2.9 b. As of May of 2005, discretionary foreign currency purchases reached US$ 1.3 b, and the average annual appreciation of the exchange rate, for the same period was 12.7%. These interventions, which slowered down the appreciation, took place without affecting the acomplishment of the inflation target and without interrupting the continued reduction trend to its long term levels.

The Central Bank also sold US dollars to the Government: US$500 m in 2004 and US$1.3 b m, between February and March of 2005. The latter was used by the Government to pay in advance an extraordinary credit contracted with the Interamerican Developmt Bank (IADB).

In March of 2005, inflation was 5.0%, 48 bp less than that of December of 2004. The lower inflation was a result of the reduction of non-food inflation, at 4.8% meaning 70 bp lower than the inflation seen at the end of 2004. Food inflation fluctuated around 5.5% during the first quarter of 2005. By dividing non-food inflation on tradable, non tradable and regulated goods and services, there's a clear general reduction: on March the inflation of tradable goods (2.5%) lowered by 100 bp to the same inflation of December (3.5%); meanwhile the inflation of non tradable (4.8%) was lower by 50 bp, and the one of regulated (9.5%) lower by 70 bp.

It's important to note the reduction of inflation expectations as a favorable factor on the reduction of total inflation. According to surveys done by the Central Bank, since the ending of 2004 these expectations continue to decline, which points out a significant increase on the credibility of the Colombian monetary policy.

For 2005, the Central Bank set an inflation target within an interval of 4.5% and 5.5%, with a precise target of 5.0%. This goal seems to have a high probability of accom-plishment due to the over productive capacity of the economy.

Regarding the exchange rate, it's important to mention that the appreciation is not happening only in Colombia, but in several different countries in the region, and also on developed economies such as Japan and the Euro´s zone which have been appreciating since the beginning of 2002. The appreciation of the Colombian peso can be explained partially by the macroeconomic imbalances in the US, which provided relevant capital flows towards emerging economies; and also by the wide liquidity of international markets reflected on the emerging markets spreads reduction. The increase in investor's confidence towards the Colombian economy as a result of the good growth rate also helped, as well as the exports expansion, the improvement on the terms of trade, the remittances flows from abroad, and the bigger capital inflows on portfolio and FDI. Something that is worth mentioning is that close to 70% of the amount of total capital inflows during 2004 was associated with FDI destined to finance traditional exporting sectors such as coal and oil.

Fiscal Policy

In 2004 the consolidated public sector registered a deficit of 1.2% of GDP. This way, the goal agreed with the International Monetary Fund (IMF) of 2.3% of GDP was accomplished. To continue with the fiscal consolidation strategy as the main pillar to reach a sustained economic growth, Colombia signed in April of 2005 a new Stand by Agreement with the IMF for 2005 and 2006.

By the end of 2005, the public expenditure is expected to reach a higher growth compared to 2004, as a result of the delay of the local and regional governments in implementing investment plans in that year. According to the agreement with the IMF the fiscal deficit goal for 2005 is 2.2% of GDP with a maximum margin of up to 2.5% of GDP. Other topics established on the agreement are the reduction of the public debt to less than 50% of GDP by the end of 2006, a maximum deficit of 4% of GDP in 2005 for the National Central Government (NCG), and the approval in 2005 of an amendment to the budgetary regime to reduce expenditure rigidities, and to the pension system to lighten the fiscal load of the NCG.

As a result of an increment of 16% on income against an increment of 17% on expenses, during 2004 the NCG showed a deficit of 5.6% of GDP. Regarding expenditure, the pensions payments expanded 30% because of the drainage of reserves from the Social Security Institute -Instituto de Seguros Sociales ISS-. To alleviate the imbalance and according to what was established with the IMF, currently a bill for the pension system is running in the Congress. Its main purposes are the elimination of pension plans above 25 minimum wages (Aprox. US$ 3.975 monthly), of special regimens, and of the "Mesada 14", which is an additional allowance equal to the earned salary, valid just for those affiliated to the Social Security Institute.

Table 1

COLOMBIA: Key Data

Item	Units	Period	Data	Data one year before
Total Foreign Investment				
Direct	US$ million	Jan. 04 - Dec. 04	2,739.00	1,793.00
Portfolio	US$ million	Jan. 04 - Dec. 04	1,224.00	84.00
Demand and Unemployment				
GDP	% annual variation	Jan. 04 - Dec. 04	3.96	4.02
Production Rate (MMS)(*)	% annual variation to date	Jan. 05	1.96	0.20
Retail Sales	% annual variation to date	Jan. 05	8.67	8.66
Investment	% annual variation	Jan. 04 - Dec. 04	13.30	21.50
National Unemployment Rate	(%)	Mar. 05	13.10	13.60
13 Main Cities Unemployment Rate	(%)	Mar. 05	15.10	16.20
Prices and Interest Rates				
Consumer Price Index	% annual variation	Mar. 05	0.77	0.98
Producer Price Index	% annual variation	Mar. 05	1.14	0.53
Pasive Interest Rate (90 days)	Monthly average (%)	Mar. 05	7.34	7.80
Lending Interest Rate	Monthly average (%)	Mar. 05	13.00	13.32
Exchange Rate				
Nominal Exchange Rate	Peso/dollar US$ average	Mar. 05	2,353.71	2,670.80
Nominal Devaluation	% annual variation	Mar. 05	-11.87	-9.74
Real Exchange Rate (ITCR)	1994 = 100	Mar. 05	116.69	128.20
Real Devaluation	% annual variation	Mar. 05	-8.98	-9.05
Peso/Yen Monetary Units	Peso/Yen	Mar. 05	22.17	25.70
Peso/Euro Monetary Units	Peso/Euro	Mar. 05	3,065.50	3,267.20
Trade				
Exports (FOB)	US$ million	Jan. 05 - Mar. 05	4,537.00	1,158.98
Traditional Exports	US$ million	Jan. 05 - Mar. 05	2,290.00	507.91
Imports (CIF)	US$ million	Jan. 05 - Mar. 05	4,251.85	1,195.34
Other				
M1	% annual variation	Mar. 05	18.60	14.40
M3	% annual variation	Mar. 05	18.40	12.50
Net International Reserves	US$ million	Mar. 05	12,779.62	11,329.89
Colombia General Stock Exchange Index	July 2001 = 1000	Mar. 05	4,652.96	3,321.15
Fiscal Deficit (Central Government)	% of GDP	Jan. 04 - Dec. 04	5.60	5.10
Fiscal Deficit (Non-Financial Public Sector)	% of GDP	Jan. 04 - Dec. 04	1.40	2.50

Source: Banco de la República, DANE.

Table 2

Main Latin American Economic Indicators

	Colombia 2005(*)	Colombia 2004	Argentina	Brazil	Chile	Ecuador	Mexico	Peru	Venezuela
			2004	2004	2004	2004	2004	2004	2004
Real GDP Growth (%)	4.0	3.96	8.2	5.2	6.1	6.9	4.4	5.1	17.3
Population (millions)*	46.0	44.6	39.1	179.1	15.4	13.0	105.0	27.5	26.0
GDP (US$ billions)	119.1	97.4	153.0	604.7	94.1	29.6	676.5	68.4	109.0
GDP per capita (US$)	-	2,151.0	3,958.0	3,380.0	6,120.0	2,274.0	6,450.0	2,483.0	4,191.0
GDP per capita Growth (%)	-	1.6	7.8	3.9	2.2	5.4	3.1	3.5	15.3
Consumer Prices Variation (%)	5.0	5.5	4.4	6.6	1.1	2.7	4.7	3.7	21.7
Fiscal Balance (% del GDP)	-2.2	-1.2	-2.6	-1.5	2.2	1.2	-0.3	-1.1	-3.0
Total External Debt / GDP (%)	32.3	40.4	105.1	36.0	46.0	58.0	21.4	45.7	33.3
Exchange Rate (LC / US$ eop)		2,628.5	2.9	2.9	609.4	-	11.3	3.4	1,891.0
Nominal Interest Rate (FTD)**	7.9	7.8	2.6	15.4	1.9	4.0	7.2	3.0	12.6
Current Account (% of GDP)	-1.4	-1.1	2.0	1.9	1.5	-0.4	-1.3	-0.1	13.4
Foreign Direct Investment (US$ millions)	2,496.0	2,739.0	1,800.0	18,165.0	7,602.0	1,200.0	16,601.0	1,392.0	1,144.0
Foreign Direct Investment (% of GDP)	2.1	2.8	2.8	3.0	8.1	4.2	2.5	2.6	1.0

* Forecast. ** Fixed term deposits.
Source: Economist Intelligence Unit, Cepal, Banco de la República, DNP.

PROEXPORT - COINVERTIR

With the clear objective of motivating a greater flow of foreign investment in Colombia, the Colombian government appointed Proexport to be responsible for all the promotional activities in this field; an activity previously performed by Coinvertir.

Therefore, since January of 2005, Proexport took charge of all the support offered to potential investors in Colombia, as well as to established investors. In the same way, Proexport will identify investment obstacles with the purpose of improving them. These efforts aim to promote and facilitate investment opportunities within the country.

In order to achieve this goal, Proexport created the Investment Division. This Division will offer the following services:

- Promote Colombia as an ideal investment country
- Provide up-to-date information relevant to the invest ment process.
- Provide all the necessary assistance to potential inves tors.
- Provide investor aftercare
- Work in the improvement of the Country's investment climate.

Pu blications

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