# Colombia

## Talking Points on the Economy

*Second Quarter 2004*

COINVERTIR
INVEST IN COLOMBIA CORPORATION

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Colombia has presented a positive economic performance in 2004, a trend that is expected to continue for the rest of the year. The government's economic growth forecast was increased from 3.8% in March, to 4.0% in June. This is mainly a result of the higher confidence and optimism of the business community and consumers in the country.

According to the IMD[1] World Competitiveness Ranking 2004, Colombia was the only Latin American country to improve its position. Without taking into account the new regions added to the ranking, Colombia ascended 13 positions to 32nd place, next to tough competitors such as Israel, India, Korea, Portugal and Hungary. The aspects considered by the IMD for the competitiveness report, range from government and business efficiency, to unemployment rates, including productivity, exports, infrastructure and communications, among others.

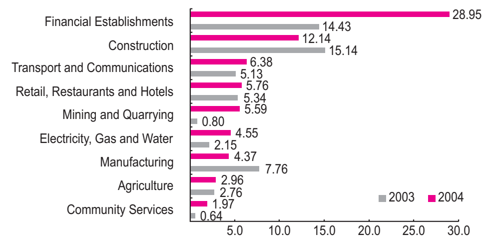
The positive economic performance, in addition to the potential opportunities of a Free Trade Agreement (FTA) currently being negotiated with the United States, place Colombia as one of the most promising and attractive countries of the region.

## GDP Growth First Quarter 2004

In the first quarter of 2004, GDP had a 4.1% annual growth rate, driven primarily by the growth of financial intermediation services (28.9%), construction (12.1%), and the transport and communications sectors (6.4%). The financial sector is not in a recovery stage anymore, but undergoing a true reactivation process. After the severe crisis of the previous years, it has reached enough solvency and liquidity to support the growth of the Colombian productive sector. The construction sector has also presented an important dynamism, explained by the 55.9% growth of the building construction subsector. The positive performance of the transport and communications sector was primarily due to the 23.5% increase in water transportation activities.

[1] International Institute for Management Development (IMD).

Graph 1
GDP by Sectors, Annual Variation
(I Quarter 2003-I Quarter 2004) *(Percentage)*



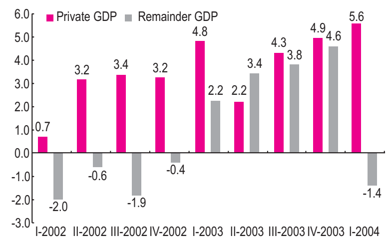

Source: National Statistics Department (DANE).

GDP growth in the first quarter was largely associated with a 5.6% private GDP growth, which comprises the agriculture, electricity, gas and water, industrial, buildings construction, retail, transportation and financial services sectors. The remaining GDP, that includes government services, civil works and mining, declined 1.4%. This can be partially explained by a 41.6% decrease of the construction and civil works sectors, and by the small growth of oil GDP; a result of the normal depletion of the country's oil reserves.

It is expected that by the end of 2004, economic growth will continue to be driven primarily by the GDP's private component, which has shown important activity since the second half of 2003.

Private demand has also shown a good performance, with a 4.9% growth in the first quarter, which is higher than the 2.4% average growth rate of the last 10 years. Within this item, private consumption stands out with a 4.6% growth, the highest since 1995. The increase in private consumption can be largely explained by the 18.9% raise in durable goods consumption. Finally, private investment presented a noteworthy performance with a 8.9% growth, as a result of: higher investments in machinery and equipment, private construction dynamism, the business community´s improved perception of the political and economic investment conditions, higher capital inflows, and the increase of companies profits.

Graph 2
Private GDP vs. Remainder GDP
Annual Variation
(2002-I Quarter 2004) *(Percentage)*

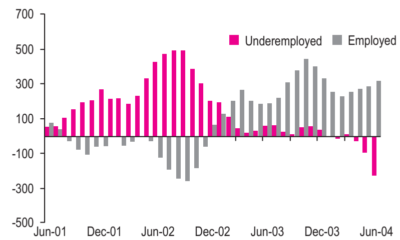



Source: DANE.

## Economic Activity Indicators

The Colombian labor market is recovering. Not only unemployment has been reduced, but there is also an important improvement in its quality. In fact, unemployment in the 13 main cities (urban unemployment) declined to 16% in June of 2004, compared to 17% in June of the previous year, while under-employment fell from 32% to 28%, and informal employment decreased 2.2%. The reduction in urban unemployment can be mainly explained by the good performance of some labor-intensive sectors such as construction and retail.

Graph 3
Under-employment and Formal
Employment in 13 Cities
(Jun. 2001-Jun. 2004) *(Thousands of people)*




Source: DANE.

Unemployment reduction was accompanied by the reduction and stabilization of real interest rates, favoring household consumption. In June, the active interest rate reached 8.2% while the passive rate was 1.7% in real terms.

The financial system profits and the portfolio quality[2] showed good results. At the end of the first half of 2004, the profits of the financial system grew 69.2%, to $1.35 billion (b) from $0.79 b in the same period of 2003. Profits of the domestic private financial institutions grew 50%, while foreign banking profits grew 125%.

The consumption credit portfolio quality indicator fell by 9.4% in June of 2004, from 6.2% to 5.6%. Due to higher profits, lower credit risk perception and higher liquidity, the financial system is undergoing one of its best moments. The positive results of the financial sector are consistent with the good performance of the economy's real sector, whose operational profits increased 27.7% in the first quarter of 2004, as a result of the improved labor market conditions and the internal demand activity, among other factors.

## Monetary Policy

According to the inflation targeting strategy, intervention interest rates of the Central Bank (Banco de la República) is the monetary policy's main instrument. During the first quarter of 2004, the Central Bank reduced its intervention interest rate by 50 basis points (bp), as a result of the lower inflation forecasts, given the exchange rate appreciation. During the second quarter, the intervention rates remain constant at the same time with the appreciation of the currency, after a slight exchange rate rebound.

In the second quarter of 2004, basic inflation[3] recorded a downward trend, situating around 6%, mainly as a result of productive capacity surpluses, which restrained the inflation of non-tradable goods and services; and of the exchange rate appreciation, which contributed to the reduction of tradable goods inflation. In June, annual inflation was 6.1%, as a result of a 6.5% food inflation and a 5.9% non-food inflation rate.

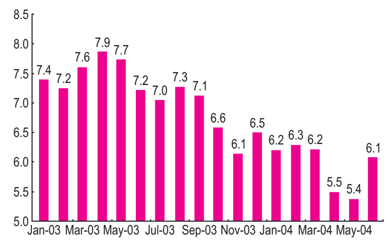
2 The quality of the portfolio refers to the ratio between the non performing loans and the gross loan portfolio.

3 Excluding fuels.



The Central Bank's inflation target for the end of 2004 fluctuates between 5.5 % and 6.0%, with high possibilities of being achieved. As previously mentioned, the strong activity of private investment, according to the figures of capital goods production and imports, indicates that the industry's productive capacity tends to expand, therefore relieving possible inflationary pressures. Also, according to the Central Bank's surveys, inflation expectations during the first half of 2004 show no indication of a rebound, since by the end of 2004 market analysts expect the inflation to stand at 5.7%, below the target ceiling.

Graph 4
Annual Inflation (Jan. 2003 - Jun. 2004)
*(Percentage)*




Source: DANE.

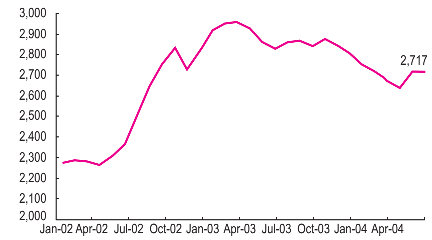
## Foreign Exchange Policy

During the first half of 2004, the exchange rate decreased 2.8%, from $2,778 in December 31, 2003 to $2,700 in June 30, 2004. In May, the exchange rate showed high volatility, increasing 2.9% as a result of the agents' expectations of an increase in the American interest rates. These expectations widely spread to emergent markets, forcing an increase in the region's foreign exchange rates. In June, after the US interest rates increase, foreign exchange rate in Colombia returned to its revaluation trend, with a 0.9% appreciation in that month; and the country risk indicator declined 6.6%, reflecting a calmer international financial market.

The revaluation observed in 2004 has been associated with the strong external demand, influenced by the Venezuelan recovery and higher growth in the United States; and with Colombia's improved exchange terms.



Graph 5
Nominal Exchange Rate Evolution
(2002-2004) *(Pesos per dollar)*




Source: Central Bank.

These facts generated a bigger foreign currency accumulation by the economy's real sector. The Central Bank purchased this currency through put auctions for international reserves accumulation, which amounted US$ 850 million (m) between April and July of 2004.

Through the foreign exchange market intervention, the country's external liquidity position was strengthen to face possible adverse shocks on the foreign exchange rate, and capital outflows that may affect future inflation performance. Colombia has substantially reduce its external vulnerability as a result of: the flexible exchange rate regime; the relatively balanced current account favored by the international prices of oil and other raw materials; and the healthy international reserves stock of US$ 11.3 b as of March of 2004.

Notwithstanding the nominal revaluation, the real exchange rate still stands at historically high and competitive levels. According to the competitiveness indicator with third countries[4] , the real revaluation has not prevented this index from reaching similar levels to those recorded in 1992. Additionally, comparing the first half of 2004 with the first half of 2002, Colombia has seen an important real depreciation (8.87%), in line with most Latin American countries.

4 It refers to the competitiveness degree with the main competitors in the markets of coffee, banana, flowers and textiles in the United States, Brazil, Canada, Ecuador, Costa Rica, Italia, Mexico, Netherlands, Peru, Venezuela, and Vietnam, are among the main competitors.

Graph 6
Real Exchange Rate with Third Countries
(1990 - 2004)
*(Geometric Average, 1994 = 100)*


Source: Central Bank

## Fiscal Policy

By the end of the first quarter of 2004, the consolidated public sector deficit was 0.3% of GDP, compared to 0.5% of GDP during the same period of 2003, surpassing the target agreed with the IMF (0.5% of GDP). The government's commitment to adjust its finances has been reflected both in the significant increase in revenues and in the expenditure restrictions.

The improved result of public finances is associated to the fiscal adjustment policy of the Central Government, which in the first quarter of 2004 recorded a deficit of 1.7% of GDP from 1.8% of GDP in 2003; and to the fiscal adjustment of the decentralized public sector, which recorded a surplus of 1.4% of GDP in the first quarter of 2004, compared to the 1.0% surplus in the same period of 2003. At the end of 2004, a deficit of 2.5% of GDP is expected, that is, 0.2 percentage points less than the deficit recorded at the end of 2003 (2.7% of GDP).

Mid and long-term public finance adjustment is a priority for the government. During the second half of 2004, the structural reform process will continue and the Congress will revise the Pension and Tax Reforms and the Budget Organic Statute Bill, with the objective of achieving a more efficient budget handling and balancing public finances.



## External Sector

Colombian exports have benefited from the world economy's dynamism, particularly in the United States, Japan and China; and from the acceleration of its main regional trade partners Ecuador and Venezuela, the last one favored by the high oil prices, which in June surpassed the barrier of US$ 40 per barrel.

The optimism about the world's economic performance remains for the future, favoring exports and exchange terms for Colombia. International analysts suggest that for 2004 and 2005, the world economy would grow 4.7% and 3.8%, respectively.

Colombia has good prospects of continuing strengthening its position in the North American market. Commercial relations with the US are in first row due to the on-going FTA negotiations. The rounds of negotiations, which began in May of 2004 and are expected to be completed in the first half of 2005, deal with subjects such as markets access, agriculture, environmental, institutional and labor issues, competition, state purchases, cooperation and strengthening of commercial capacity, dumping, investments, copyrights, financial services, telecommunications, crossborder services, and problem solving mechanisms. With the FTA, Colombia will be able to optimize and improve its competitive advantages, be stronger to enter the North American market, and substantially increase Foreign Direct Investment (FDI).

### Balance of Payments

During the first quarter of 2004, the balance of payments current account recorded a moderate deficit of US$ 722 m (3.3% of quarterly GDP), and US$ 96 m higher than the one obtained in the same period of 2003. The capital account recorded a net income of US$ 946 m, which is US$ 618 m higher than the amount recorded the previous year.

During period, goods exports grew 10.2%, from US$ 2.9 b to US$ 3.3 b. The better export performance can be explained by the 15.0% increase in external sales of traditional products (US$ 1.6 b), where the rebound of



ferronickel exports (89.1%), coal (31.0%) and coffee (21.7%) are noteworthy. These exports were partially boosted by the increase in international prices. In June of 2004, coal prices reached US$ 60 per ton and coffee prices US$ 0.85 per pound, historically high prices compared to the average recorded in 2002 and 2003. According to the National Federation of Coffee Growers, during the first quarter of 2004, the number of exported coffee sacks increased 16.4%, as compared to the same period in 2003.

Non-traditional exports recorded a 6.0% increase, as a result of higher sales of industrial sector, particularly the textile and apparel sector (21.9% growth), and machinery and equipment (20.0%). The good performance of industrial exports was influenced by the recovery of the Venezuelan demand, the lower reduction of exports to Ecuador, and the dynamism in the United States.

Imports grew 8.0%, due to higher external purchases of intermediate goods (US$ 1.7 b), particularly raw materials and products for the industrial sector; and of capital goods (US$ 1.2 b) destined for the industry. This type of imports is consistent with the investment dynamism, the agents' positive expectations about the economic performance, and the prospects of obtaining high long-term economic growth indices.

International reserves showed a variation of US$ 420 m, and a balance stock of US$ 11.3 b as of March of 2004; equivalent to 9.9 months of goods imports, 8.0 months of goods and services imports, and 1.4 times the public and private external debt amortizations with one-year maturity. Colombia's wide international reserves stock supports the payments of country's external obligations.

Finally, it is important to note that the external debt balance was reduced by US$ 834 m in March of 2004 as compared to March of 2003, and stood at US$ 37.9 b, equivalent to 41.8% of GDP. Public sector's obligations increased 3.9% from US$ 23.2 b in March of 2003, to US$ 24.2 b in March of 2004, while the private external debt balance decreased 5.2% from US$ 14.6 b to US$ 13.8 b. The total external debt reduction was due to the higher economic growth, the lower private foreign indebtedness and the appreciation against the dollar.

Table 1

## COLOMBIA: Key Data

| ITEM | Units | Latest Data Period | Data | Data One Year Before |
|---|---|---|---|---|
| **Total Foreign Investment** | | | | |
| Direct | US$ million | Jan. 04 - Mar. 04 | 546.00 | 314.00 |
| Portfolio | US$ million | Jan. 04 - Mar. 04 | 163.00 | 14.00 |
| **Demand and Unemployment** | | | | |
| GDP | % variation year to year | Apr. 04 - Jun. 04 | 4.25 | 2.39 |
| Production Rate (MMS) | % annual variation to date | Jun. 04 | 11.72 | 0.51 |
| Retail Sales | % annual variation to date | Jun. 04 | 7.47 | -2.89 |
| Investment | % variation year to year | Apr. 04 - Jun. 04 | 8.98 | 49.07 |
| National Unemployment Rate | (%) | Jul. 04 | 12.90 | 14.30 |
| 13 Main Cities Unemployment Rate | (%) | Jul. 04 | 15.30 | 17.80 |
| **Prices and Interest Rates** | | | | |
| Consumer Price Index | % variation year to year | Jul. 04 | 6.19 | 7.04 |
| Producer Price Index | % variation year to year | Jul. 04 | 5.23 | 10.15 |
| Savings Interest Rate (90 days) | Monthly average (%) | Jul. 04 | 7.83 | 7.82 |
| Lending Interest Rate | Monthly average (%) | Jul. 04 | 14.82 | 15.07 |
| **Exchange Rate** | | | | |
| Nominal Exchange Rate | Pesos/dollar US$ | Jul. 04 | 2,653.32 | 2,858.02 |
| Nominal Devaluation | % variation year to year | Jul. 04 | -7.19 | 14.05 |
| Real Exchange Rate (ITCR) | 1994=100 | Jul. 04 | 127.08 | 135.22 |
| Real Devaluation | % variation year to year | Jul. 04 | -6.02 | 11.08 |
| Peso/Yen Monetary Units | Peso/Yen | Jul. 04 | 23.82 | 23.77 |
| Peso/Euro Monetary Units | Peso/Euro | Jul. 04 | 3,226.70 | 3,246.80 |
| **Trade** | | | | |
| Exports (FOB) | US$ million | Jan. 04 - Jun. 04 | 7,237.40 | 6,242.60 |
| Traditional Exports | US$ million | Jan. 04 - Jun. 04 | 3,388.10 | 2,961.20 |
| Non-Traditional Exports | US$ million | Jan. 04 - Jun. 04 | 3,849.30 | 3,281.40 |
| Imports (CIF) | US$ million | Jan. 04 - Jun. 04 | 7,681.70 | 6,632.70 |
| **Other** | | | | |
| M1 | % variation year to year | Jul. 04 | 14.60 | 12.90 |
| M3 | % variation year to year | Jul. 04 | 17.30 | 15.50 |
| Net International Reserves | US$ million | Jul. 04 | 11,587.82 | 10,499.79 |
| Colombia General Stock Exchange Index | 3 July 2001=1,000 | Jul. 04 | 3,009.80 | 2,135.80 |
| Fiscal Deficit (Central Government) | % of GDP | Jan. 04 - Mar. 04 | -1.70 | -1.80 |
| Fiscal Deficit (Non - Financial Public Sector) | % of GDP | Jan. 04 - Mar. 04 | -0.30 | -0.70 |

Source: Central Bank, DANE and Colombia Stock Exchange.

## Main Latin American Economic Indicators

| | Colombia 2004* | Colombia 2003 | Argentina 2003 | Brazil 2003 | Chile 2003 | Ecuador 2003 | Mexico 2003 | Peru 2003 | Venezuela 2003 |
|---|---|---|---|---|---|---|---|---|---|
| Real GDP Growth (%)* | 4.0 | 3.9 | 7.3 | 0.1 | 3.2 | 3.0 | 1.2 | 4.0 | -9.5 |
| Population (millions)* | 45.3 | 44.6 | 38.4 | 177.2 | 15.7 | 13.3 | 103.3 | 27.1 | 25.5 |
| GDP (US$ billions) | 90.3 | 78.6 | 132.0 | 493.4 | 72.4 | 27.1 | 606.9 | 60.2 | 81.4 |
| GDP per Capita (US$) | - | 1,764.0 | 3,474.0 | 2,756.0 | 4,730.0 | 2,028.0 | 5,980.0 | 2,217.0 | 3,055.0 |
| GDP per Capita Growth (%) | - | 9.4 | 6.0 | -1.2 | 2.0 | 0.2 | -0.3 | 2.4 | -11.2 |
| Consumer Prices Variation | 5.5 | 6.5 | 3.7 | 9.2 | 1.4 | 6.5 | 4.4 | 2.2 | 27.5 |
| Fiscal Balance (% of GDP)* | -2.5 | -2.8 | -0.2 | -1.1 | -0.8 | -0.9 | -0.6 | -1.9 | -3.0 |
| Total External Debt/GDP (%) | 42.3 | 49.2 | 140.0 | 43.4 | 59.1 | 54.0 | 22.9 | 48.8 | 36.7 |
| Exchange Rate (LC/US$ eop) | - | 2,877.8 | 2.90 | 3.08 | 691.43 | - | 10.79 | 3.48 | 1,607.79 |
| Nominal Interest Rate (savings) | - | 7.8 | 3.3 | 16.5 | 3.5 | 5.4 | 6.0 | 2.5 | 14.2 |
| Current Account (% of GDP) | -2.2 | -1.8 | 7.6 | 0.6 | -0.7 | -1.9 | -1.4 | -2.1 | 12.9 |
| Foreign Direct Investment (US$ million) | 1,293.0 | 1,762.0 | 1,103.0 | 7,137.0 | 1,164.0 | 1,637.0 | 11,000.0 | 958.0 | 2,100.0 |
| 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.

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- Colombia Outlook and Investment Potential
- Colombia: Foreign Investment Guide
- Foreign Investment Report
- Directory of Legal and Consulting Services
- Legal Framework
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