Colombia

Talking Points on the Economy

Fourth Quarter 2004

PROEXPORT COLOMBIA

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INVEST IN COLOMBIA CORPORATION

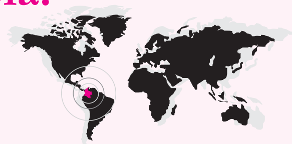
www.proexport.com.co
www.coinvertir.org
info@coinvertir.org

Cll. 28 No. 13A-15,
Piso 35 y 36
Tel: +57 (1) 5600100
Fax: +57 (1) 5600118

www.banrep.gov.co
www.banrep.org
wbanco@banrep.gov.co

Cra. 7 No. 14-78
Conmutador: +57 (1) 3431111
Fax: +57 (1) 3427654

¿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.

In 2004, different internal and external factors continued to favor the Colombian economic growth. Among the internal factors is worth to mention the dynamism of investment, which was the driving demand component of economic growth; exports, which posted the highest annual growth rate in the last 10 years; interest rates, that stood at the lowest level since 1992; inflation, that showed the lowest rate of the last 30 years; fiscal deficit, which recorded the lowest level since 1999; and security conditions, that improved due to the Government's Democratic Security and Defense Policy.

Regarding the external factors, the world growth that was driven by the United States´ economy, and the notable recovery of the Latin American region boosted the exports and improved the households' income, favoring the recovery of the internal demand. Other factors that strengthened Colombian external sector were the high commodities´ prices, the improved interchange terms, and the better use of the ATPDEA[1], which during 2004 was of 52.2%, compared to 43.0% in 2003.

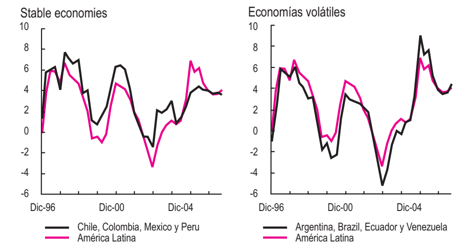
For 2005, the short and mid-term prospects for the Colombian economy continue to be favorable. According to Central Bank's data, local and foreign analysts forecasted an average economic growth of 3.9%.

GDP Growth 2004

Colombia has been a great example of macroeconomic stability. Recently, JPMorgan placed Colombia among the most stable economies in Latin America for the period 1996 – 2004, nevertheless the crisis occurred during the last decade. (Graph 1).

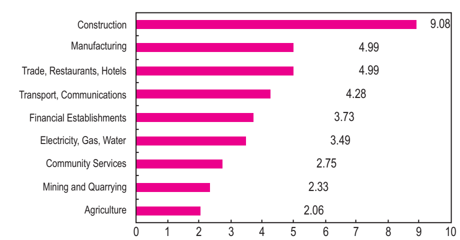
During the period January - September of 2004, Colombian economy grew 3.6%, compared to the same period in 2003. On the supply side, growth was driven by the construction sector, with an annual growth of 9.1%, manufacturing industry with 4.9%, and trade, restaurants and hotels with 4.9%. (Graph 2).

Graph 1
Real GDP Growth
(1996-2004)
(Percentage)



Source: J.P. Morgan

Graph 2
GDP by Aectors, Annual Variation
(January-September 2004)
(Percentage)



Source: National Stadistics Department (DANE).

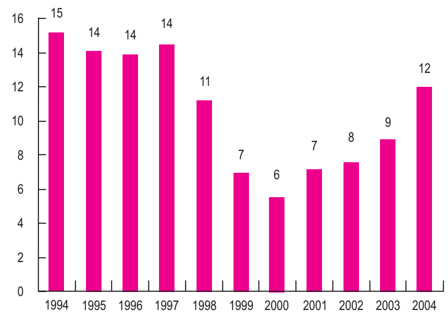
As for the demand side, it is worth to mention the growth of investment (10.0%), exports (8.1%) and final consumption (3.5%).

Regarding investment in 2004, especially significant was the recovery of private investment growing nearly 20%, accounting for almost 12% of GDP and reaching the share levels recorded before the 1999 deceleration, when investment share decreased to 7% of GDP. Total investment also showed an important recovery reaching average historical share levels of approximately 18%.(Graph 3).

Graph 3

Private Investment as Percentage of GDP

(1994-2004)



Source: Central Bank

Final consumption was largely driven by a 3.6% increase in household consumption and in a lesser degree, by a 3.3% increase in government consumption. It is important to note that the household consumption and labor market activities are related. 2004 saw a drop in the unemployment rate, and an important improvement in employment quality, which meant a lower share of under-employed workers in total employment, moving from 31.9% in December of 2003 to 30.6%.

Other indicators that showed positive results for 2004 were imports of consumer goods which grew 18.3% and accounted for 18.9% of total imports; new vehicles sales that registered an increase of 24.4%; and retail sales that grew 6.0% in the last quarter of 2004.

The increase in coffee prices observed during these last months is expected to improve the household income, given the correlation of the two variables, and therefore to improve internal consumption in 2005. As of January of 2005, international coffee price was approximately US$120 cents/pound, compared to US$ 70 cents/pound in January of 2004.

External Sector Trade Balance

During 2004, Colombian trade balance recorded a US$ 857 million (m) surplus as a result of exports of US$ 16. 5 billion (b) and imports of US$ 15.6 b.

Exports grew 25.9%, driven by non-traditional exports which showed an important activity surpassing since the mid of 2004 (12-month accumulative period) the historical peaks observed in 2002. Non-traditional exports reached the amount of US$ 8.9 b.

Traditional exports grew 26.0%, reaching US$ 7.6 b in 2004. High commodities prices worldwide during the fourth quarter of 2004 favored the main Colombian exported products, offsetting the revaluation experienced in the last quarters. (Graph 4).

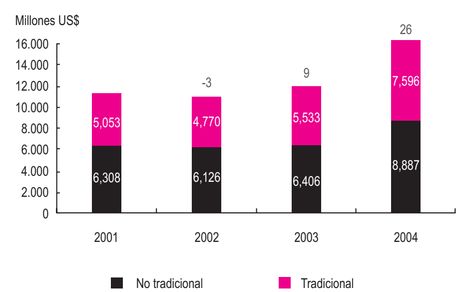
Graph 4

Total Exports

Tradicional and no Traditional

(2001-2004)

(US$ million, annual variation)



Source: Proexport Colombia.

Within traditional exports, is worth to mention the increases of 51% in ferronickel, 29% in coal and 24% in oil. Regarding non-traditional exports, the major increases were in vehicles sales (231%), plastics (41%) and apparel (33%). The main export destinations were the United States with a 39.5% share, the Andean Community with 19.4% and the European Union with 13.9%.

During 2004, imports grew 20.6%, as a result of greater purchases of electrical appliances and materials which increased 29.0%; vehicles and spare-parts with 38.4%; and organic chemical products with a growth of 31.8%. Imports of raw materials and intermediate products accounted for the largest share with 48%, followed by imports of capital goods and construction materials with 33%, and consumer goods with 19%. These imports came mostly from the United States, Venezuela, China and Mexico.

The outlook for Colombian exports in the next years is encouraging. On the one hand, the trade agreement signed between the Andean Community (CAN) and MERCOSUR entered into effect on February 1, 2005. In addition, the Free Trade Agreement (FTA), under negotiation with the United States, gives Colombia the opportunity to take full advantage of its productivity and privileged location and increase and diversify its export supply of goods and services.

Foreign Investment

During the period from January to September of 2004, Foreign Investment (FI) grew 123%, compared to the same period in 2003, from US$ 1.2 b to US$ 2.6 b. This increase was largely due to the good performance of Foreign Direct Investment (FDI), which grew 47%, moving from US$ 1.4 b to US$ 2.1 b. Foreign Portfolio Investment (FPI) also favored FI growth, moving from a capital outflow of US$ 273 m to a capital inflow of US$ 491 m.

It is important to highlight that FDI received by Colombia during the first nine months of 2004 was 18% higher than the total FDI received in 2003 (US$ 1.8 b). This situation allows a very positive year-end forecast.

[1] Andean Trade Preference an Drug Eradication Act: Unilateral trade preferences granted by the United States.

[2] According to The Economist Intelligence Unit, the World Commodity Forecasts *(WCF)* index increased by 13.6% in 2004.

By sectors, mining and quarrying received the highest FDI inflows, with an accumulated amount of US$ 922 m, which accounted for 44% of total FDI, followed by the oil sector with US$ 650 m and a 31% share. These two sectors accounted for 75% of total FDI. Other important sectors were manufacturing with an 8% share; transport, storage and communications with 5%; and trade, restaurants and hotels with 4%.

Some successful investment cases during 2004 were the arrival of Franklin Mining of the United States in the mining sector, and the arrival of PGT-Petroleum Geoscience Technology from Brazil and Power Well Service Holdings Netherlands Gamma from the Netherlands in the oil sector. As for the tobacco industry, is important to mention the arrival of Philip Morris International, which took the control of Compañía Colombiana de Tabaco S.A, Coltabaco, acquiring initially 51.8% of the country's largest and oldest tobacco company.

Monetary and Exchange Policy

The monetary policy in Colombia is framed within the inflation targeting strategy. Accordingly, the Central Bank's intervention rates are the main policy instrument. During the fourth quarter of 2004, those rates were reduced in 25 basic points (bp), standing at 6.5% for expansion auctions and at 5.5% for contraction auctions.

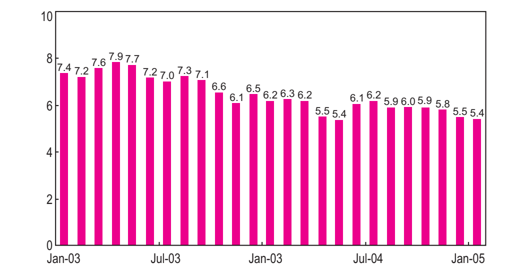
The exchange rate revaluation and the inflation expectation's reduction, led to a relatively lax monetary policy during 2004. This policy allowed to offer liquidity to the market and to maintain low interest rates: the monetary aggregates M1 and the monetary base expanded at approximately 17%, which was higher than the nominal GDP growth, while the inter-bank rate remained low and stable at 6%. Additionally, during the last quarter of 2004, the Central Bank accumulated international reserves for US$ 1.5 b, through discretional purchases.

By the end of 2004, inflation stood at 5.5%, thus achieving the target inflation fixed between 5.0% and 6.0%. Compared to the figure recorded in December of 2003, inflation declined 99 bp, as a result of a sharp drop in non-food inflation, which declined from 7.0% to 5.5%. Food inflation (5.4%) remained close to the figure recorded in 2003 (5.3%).

The reduction in non-food inflation was related to the 14% appreciation in the nominal exchange rate and its effect on the inflation of tradable goods, which as of December of 2004 declined to 3.5%, compared to 7.0% in the same month of 2003. Another key factor was the inflation of regulated goods and services such as fuels, public utilities and public transportation, which in December of 2003 stood at 14.8%, declining to 10.2% in December of 2004. Finally, inflation of non-tradable goods and services increased from 4.2% in December of 2003 to 5.3% in December of 2004.

The stability of food inflation was influenced by a strong increase in perishable food prices caused by the transportation strike in September and October of 2004. However, by the end of the year the strong bearish trend of perishable foods reduced the inflationary pressures, and food inflation moved from 7.2% in September to 5.4% in December.

Graph 5
Annual Inflation (2003-2005)
(Percentaje)



Source: National Stadistics Department (DANE).

For 2005, the Central Bank set an inflation target range between 4.5% and 5.5%. This target is likely to be achieved, considering that the recent decline in inflation and the accomplishment of the 2004 inflation target, contributed to the reduction of inflation expectations. Additionally, the accelerated investment increase suggests an expansion of the economy's potential GDP, and thus the product gap could have become wider by the end of 2004, reducing inflationary pressures.

The fourth quarter of 2004 saw a higher exchange rate appreciation (14%), as a result of private capital inflows different from foreign direct investment, within an international context characterized by the dollar weakness. While in 2002 and 2003 net capital outflows were US$ 915 m and US$ 473 m, respectively, as of the third quarter of 2004 capital inflows reached US$ 501 m and came mainly from portfolio investments of US$ 491 m.

The appreciation of the Colombian currency also occurred in real terms. Between 2003 and 2004, the Colombian peso recorded a real average appreciation of 11.5% against the US dollar. However, if comparing to 2002 and discounting the effect of the sharp depreciation of 2003 (9.8%), which was associated to transitory events such as political changes in Brazil and the drop in exports to Venezuela, the real appreciation was just 2.9%.

Capital flows are expected to be stable in 2005, consistent with gradual rises in the FED´s short term interest rates. This suggests that the exchange rate in Colombia would tend to increase in the second half of 2005, compared to the figures observed by the end of 2004.

Fiscal Policy

By the end of 2004, the consolidated public sector deficit was 1.2% of GDP, compared to 2.5% of GDP in 2003. As a result, the deficit target agreed with the International Monetary Fund (IMF) was over-achieved, and a new 18-month Stand -By Agreement that will enter into effect on April of 2005 was signed. The Government and the IMF set a fiscal deficit target of 2.2% of GDP for 2005, which could be increased up to 2.5% of GDP as priority infrastructure investment projects are included.

The improved result of the public finances during 2004 was a consequence of the fiscal adjustment policies of the national central Government that kept a restriction policy in operating expenses; and of the decentralized public sector that recorded a surplus of 2.9% of GDP compared to a surplus of 2.4% of GDP in 2003.

The 2005 legislative agenda includes the debate of the pension reform and the new budget organic law, intended to ensure a more efficient budget handling and to balance the public finances.

Table 1

COLOMBIA: Keys Data

ITEM	Units	Latest Data Period	Data	Data One Year Before
Total Foreign Investment				
Direct	US$ million	Jan. 04 - Sep 04	2,117.00	1,441.00
Portafolio	US$ million	Jan. 04 - Sep 04	491.00	-273.00
Demmand and Unemployement				
GDP	% variation year to year	Jul. 04 - Sep. 04	2.43	4.17
Production Rate (MMS)(*)	% annual variation to date	Nov.04	4.82	3.69
Retail Sales	% annual variation to date	Oct.04	6.04	0.54
Investment	% variation year to year	Jul.04-Sep.04	7.59	19.23
National Unemployement Rate	(%)	Dec. 04	12.10	12.30
13 Main Cities Unemployement Rate	(%)	Dec. 04	13.00	14.70
Prices and Interest Rates				
Consumer Price Index	% variation year to year	Dec. 04	5.50	6.49
Producer Price Index	% variation year to year	Dec. 04	4.64	5.72
Savings Interest Rate (90 days)	Monthly average (%)	Dec. 04	7.76	7.95
Lending Interest Rate	Monthly average (%)	Dec. 04	15.04	14.98
Exchange Rate				
Nominal Exchange Rate	Peso/dollar US$	Dec. 04	2,411.37	2,807.20
Nominal Devaluation	% variation year to year	Dec. 04	-13.98	-3.02
Real Exchange Rate (ITCR)	1994=100	Dec. 04	120.75	135.09
Real Devaluation	% variation year to year	Dec. 04	-10.61	2.49
Peso/Yen Monetary Units	Peso/Yen	Dec. 04	23.32	25.83
Peso/Euro Monetary Units	Peso/Euro	Dec. 04	3,252.16	3,489.40
Trade				
Exports (FOB)	US$ million	Dec. 04	16,483.00	13,092.22
Traditional Exports	US$ million	Dec. 04	7,592.12	6,026.72
Non Traditional Exports	US$ million	Dec. 04	8,887.00	7,065.50
Imports (CIF)	US$ million	Dec. 04	16,744.85	13,880.61
Otros				
M1	% variation year to year	Dec. 04	16.80	15.20
M3	% variation year to year	Dec. 04	16.50	12.10
Net International Reservs	US$ million	Dec. 04	13,535.80	10,915.60
Colombia General Stock Exchange Index	3 July 2001=1,000	Dec. 04	4,345.80	2,333.70
Fiscal Deficit (Central Government)	% of GDP	Jan. 04 - Sep. 04	2.80	3.40
Fiscal Deficit (Non-Finantial Public Sector)	% of GDP	Jan. 04 - Sep. 04	-0.60	1.90

Source: Central Bank, National Stadistics Department (DANE) and Colombia Stock Exchange.

Table 2

Main Latin American Economic Indicators

	Colombia		Argentina	Brazil	Chile	Ecuador	Mexico	Peru	Venezuela
	2004*	2003	2003						
Real GDP Growth (%)*	4.0	3.9	8.7	0.6	3.3	2.3	1.2	3.8	-9.7
Population (millions)*	45.3	44.6	38.4	179.0	15.3	13.3	103.3	27.1	25.5
GDP (US$ billions)	94.9	79.1	132.7	522.7	71.9	27.5	626.0	60.6	85.4
GDP per capita (US$)	-	1,775.0	3,455.0	2,920.0	4,700.0	2,179.0	6,230.0	2,233.0	3,344.0
GDP per capita Growth (%)	1.6	2.4	7.7	-0.9	2.2	0.9	-0.2	2.2	-11.3
Consumer Prices Variation (%)	5.5	6.5	3.7	9.3	1.1	6.1	4.0	2.5	27.1
Fiscal Balance (% of GDP)	-2.3	-2.5	1.6	-2.9	-1.7	1.2	-0.6	-1.9	0.2
Total External Debt / GDP (%)	46.4	49.2	110.6	45.0	60.3	58.7	22.4	49.0	44.5
Exchange Rate (LC / US$ eop)	2,626.2	2,877.8	2.9	2.9	599.0	-	11.2	3.5	1,600.0
Nominal Interest Rate (savings)	7.8	7.8	3.7	16.7	2.6	5.3	5.1	3.6	14.2
Current Account (% of GDP)	-1.4	-1.7	6.1	0.8	-0.8	-1.7	-1.4	-1.8	13.5
Foreign Direct Investment (US$ million)	1,483.0	1,762.0	478.0	10,144.0	2,982.0	1,555.0	10,783.0	1,377.0	2,531.0
Foreign Direct Investment (% of GDP)	1.6	2.1	0.8	2.1	4.0	6.0	1.7	2.1	3.0

* Forecast
Source: Eclac, Unctad, Central Bank.

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 investment process.
- Provide all the necessary assistance to potential investors.
- Provide investor aftercare
- Work in the improvement of the Country's investment climate.

Pu blications

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- Colombia: Panorama y Potencial de Inversión
- Directorio de Servicios de Consultoría Legal
- Marco Legal

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