Inflation Report

June 2001

Banco de la Republica
(Central Bank)
Colombia

Presentation, summary and conclusions

Review of inflation to june 2001

✠ Annual consumer inflation remained stable over much of the first half of the year (February to June) at a level very close to the 8.0% target for 2001. Specifically, annual inflation in June ran at 7.9%, slightly higher than three months earlier (7.8%) but 1.8 percentage points lower than in June 2000. Accumulated inflation in the first half of 2001 was 6.2%, lower than in the same period last year (7.0%).

✠ The Consumer Price Index rose by 1.6% in the second quarter, slightly more than in the same quarter last year (1.5%). The particular CPI items exerting the greatest inflationary pressure over the quarter included some foodstuffs (particularly beef), utilities, and banking services.

✠ The annual price rise was higher in June than in March for the following major CPI groups: food, education, clothing, culture and entertainment, and diverse expenses, and lower for the remaining groups: housing, transport, and health.

✠ The case of beef deserves special attention, in view of its large share (4%) in the CPI basket. Beef prices registered an accumulated second-quarter rise of 16.6%, accounting for over a third of consumer inflation in the quarter. The growth in beef prices, anticipated in the previous Inflation Report, is associated with the retention stage of the cattle-breeding cycle coming into full swing and thereby reducing the supply of beef. This stage was intensified in the first half 2001 by scanty rainfall and is expected to continue over the rest of the year. It should however be accompanied by an easing of price variations, if these follow their typical seasonal pattern of decreasing in the second half of every year.

✠ Education prices registered a greater annual rise in June (10.6%) than twelve months earlier (9.7%), largely because of higher enrollment and tuition fees. By the end of the year, therefore, inflation in this group is very likely to be higher than in 2000.

✠ The sectors with lower annual price growth in the second quarter included notably transport. The transport sector drove consumer inflation during last year and the first quarter of 2001, by steep rises in the domestic price of fuel. Fuel prices are is expected to become relatively stable in the second half of this year.

✠ At annual rate, the prices of nontradable goods and services rose faster in the second quarter than in the first, largely because of rising food prices. In contrast, inflation in tradables fell for the first time to under 10%, though, at 9.5%, it was still higher than headline inflation, suggesting moderate inflationary pressures from devaluation.

✠ In June, the non-food CPI and inflation nucleus, the two most reliable measures of core inflation calculated by the Banco de la República's, stood at 7.7% and 8.2% respectively, both lower than in March, and their 7.9% average was five percentage points below the March figure.

✠ Annual producer inflation ran at 10.2% in June, down by 0.7 percentage points on March and by 5.4 points on a year earlier (15.6%). Breakdown of the PPI by origin shows the second-quarter fall in producer inflation to have been a direct outcome of slower price growth in imported goods: 7.6%, down from 12.5% in March, at annual rate. In contrast, the prices of domestically produced and consumed goods grew at a faster annual rate over the second quarter: 11.1%. The breakdown by industrial activity attributes the fall in producer inflation between March and June to a fall in the mining sector's price growth: from 27.0% to 23.5% over that period, at annual rate. Beef and cattle prices were among the individual product prices most accountable for second-quarter producer inflation.

✠ The latest inflation forecasts from the Bank's transmission-mechanism model are lower than the first quarter's on all time horizons. The central path of the forecast currently shows inflation averaging 7.3% by the fourth quarter of this year (0.6 percentage points below the previous forecast) and 5.3% by the end of 2002 (0.9 points below the previous forecast). It should be noted however that these central forecast come with an upward biased risk balance that tries to capture, among other things, the risks associated with a possible intensification of the crisis in Argentina and its potential effect on devaluation and inflation rates in Colombia. That is to say, inflation is quite likely to end up a little higher than the central forecast.

✠ Core inflation as the average of the two most reliable indicators (the nucleus and non-food CPI) is forecast to run at 7.1% by December 2001, down from 7.3% predicted in March.

✠ To judge by various indicators of real activity for part of the second quarter, the economy seems to have grown slowly in this quarter, much as it had in the previous two. And slow growth has continued to be attended by weak domestic demand. Circumstances such as today's high rate of unemployment, lower coffee and oil prices, and an uncertain business climate-as evidenced by several expectations surveys-make a reversal of this situation unlikely in the coming months. But that is not to rule out a pick-up in growth in the second half of the year compared with the first, since some of the supply shocks identified in previous Reports have now been overcome, as indicated by an acceleration of industrial growth. Even so, the economy is unlikely to become sufficiently dynamic over the rest of the year to meet the government's initial growth target. Nor is demand expected to generate any strong inflationary pressure in the coming months.

✠ In June the Board of Directors approved a new reference line for the monetary base. At the end of the second quarter, the monetary base's 20- and 45-month moving averages stood 1.0% and 0.5% below the new reference line's respective averages, because cash holdings were lower than the level envisaged for them in the new line. The financial system's portfolio shrank more slowly between March and June, in both nominal and real terms, largely as a result of real growth in non-mortgage loans from March on.

✠ Deposit and lending rates edged down over the second quarter in both nominal and real terms. In June the nominal deposit rate was12.7%, down by 0,3 percentage points on March, while the overall nominal lending rate calculated by the Banco de la República was 18.6%, also 0,3 points lower than in March. In real terms, the deposit rate fell from 4.8% in March to 4.4% in June, and the lending rate calculated by the Bank from 10.4% to 9.9%. The nominal interbank rate hovered around 11.0% during the second quarter, but ended up with a slightly higher average (11.4%) than in March (10.8%).

✠ On price information to June, most inflation forecasts indicate a greater likelihood of inflation for 2001 running lower than the 8.0% target. The transmission-mechanism model suggests that in 2002, too, inflation will undershoot the respective target of 6.0%. In addition to these forecasts, there is the fact that the economy is still growing slowly, mainly because of weak domestic demand. Moreover, with the monetary base standing slightly below the reference line, analysis of the economy's domestic conditions points to the possibility of a more relaxed monetary-policy stance.

✠ In contrast, analysis of the international situation reveals a disturbing climate of uncertainty in Latin America, which worsened in early July. This situation has led to sharply rising spreads on the foreign debts of countries such as Argentina and Brazil and to a large devaluation in Brazil. Although Colombia has not been adversely affected by the Southern-Cone crisis thanks to macroeconomic-adjustment efforts, constitutional and legislative reforms and external pre-financing, it is not immune to contagion effect. In that event, an interest-rate cut by the Bank's Board of Directors might produce significant capital outflows, which could hold back economic recovery and make it difficult to meet the inflation targets.

✠ Since the Board's monetary-policy strategy takes into account inflation and growth risks arising from the international context, the Board has decided to leave the Bank's intervention rates unchanged. Accordingly, the Lombard expansion and contraction rates remain at 15.5% and 8.0% and the auction expansion and contraction rates at 11.5% and 10.5%, respectively.

Inflation Report
June 2001

Prepared by the
Programming and Inflation Unit
Economic Studies Division

Economic studies division
Hernando Vargas Herrera
Manager

Programming and inflation unit
Javier Gómez Pineda
Director

Inflation section (*)
Adolfo León Cobo Serna
Chief

Angélica María Arosemena Martán
Yanneth Rocío Betancourt García
Édgar Caicedo García
Alexandra Espinosa Dussán

(*) This report has been prepared with the assistance of Luis Fernando Melo Velandia, Rocío Clara A. Mora Quiñones, Jorge Enrique Ramos Forero, Norberto Rodríguez Niño and Rodrigo Avella Guzmán.

Contents

I

Price indices

A. Consumer Price Index

1. Overall behavior

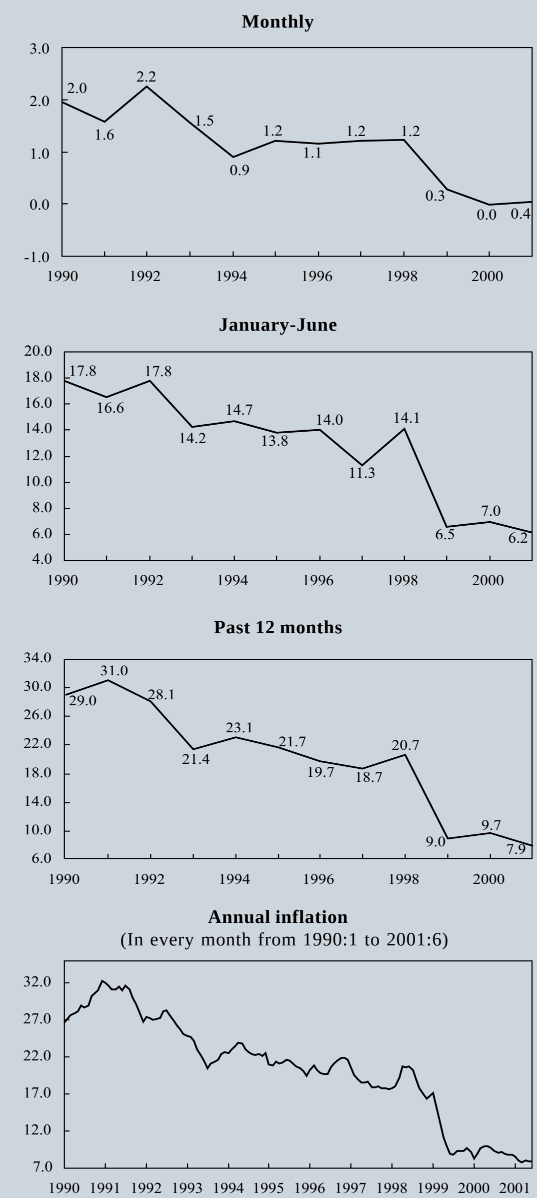
Consumer inflation, measured as annual change in the Consumer Price Index (CPI), was 7.9% in June, much the same as three months earlier but 1.8 percentage points less than in June 2000 (9.7%). It was also Colombia's lowest inflation since 1970, when the rate was 7.6%. Over the first half of 2001, consumer prices showed an accumulated growth of 6.2%, down by 0.8 percentage points on the same period last year.

Accumulated second-quarter inflation was 1.6% this year, much the same as last year (1.5%) and, typically, lower than the first quarter's accumulated inflation (4.5%). June, in particular, tends to be a month of greater price stability in the year, and this June was no exception, with the lowest monthly inflation (barely 0.04%) for any June since 1986, when the rate was -0.7%. (Figure 1 and Table 1).

The two most reliable measures of core inflation, non-food CPI and the inflation nucleus, stood lower at the end of the second quarter (7.7% and 8.2% respectively) than at the end of the first. Core inflation calculated as the average of these two measures has been falling gradually since last year, down to 7.9% in June, 0.5 percentage points below the March average.[1] (Table 1 and Figure 2).

The cities with the highest annual inflation rates in June were Montería (10.8%), Cúcuta (10.1%) and

Figure 1
Consumer price index
(percentage change to June)



Sources: National Statistics Agency (DANE). Calculations by Banco de la República.

Table 1
Inflation indicators
(% Change to june)

	Monthly			January-March			Annual		
	1999	2000	2001	1999	2000	2001	1999	2000	2001
I. CPI 0.3	(0.0)	0.0	6.5	7.0	6.2	9.0	9.7	7.9	
Food	(0.4)	(0.7)	(0.6)	5.6	7.9	9.0	0.3	9.9	8.5
Housing	0.4	0.2	0.1	4.2	3.6	2.5	11.4	5.2	3.8
Clothing	0.1	0.4	0.4	2.1	1.7	1.9	5.3	2.8	3.7
Health care	1.0	0.6	0.5	11.0	7.2	7.5	16.0	11.2	10.7
Education	0.1	0.1	0.0	10.6	7.9	9.0	12.9	9.7	10.6
Culture & entertainment	0.6	0.4	0.9	5.4	6.0	5.7	n.d.	3.0	11.3
Transport	1.2	0.1	0.6	11.0	10.7	7.5	16.8	18.4	12.9
Diverse expenditures	0.6	0.5	0.2	11.2	12.4	7.0	20.9	17.4	9.7
II. Core inflation 1/	0.6	0.3	0.3	7.0	6.6	5.0	11.5	9.0	8.3
Non-food CPI **2/**	0.6	0.3	0.3	7.0	6.6	5.0	13.0	9.6	7.7
Núcleus **3/**							11.9	8.9	8.2
Trimmed mean **4/**							10.9	8.7	9.6
Asymmetric mean **5/**							10.3	8.7	7.7
III. PPI	0.6	0.6	(0.1)	4.9	7.6	6.8	6.1	15.6	10.2
By economic use or destination									
Intermediate consumption	0.9	1.0	(0.2)	4.1	6.7	7.6	6.6	15.2	11.9
Final consumption	0.3	(0.2)	(0.0)	5.6	8.4	6.7	3.5	15.4	9.0
Capital goods	0.9	2.0	(0.4)	5.5	9.5	5.2	12.1	20.2	6.5
Building materials	0.9	1.3	0.6	7.3	6.3	5.5	16.7	13.3	12.0
By origin									
Domestically produced and consumed	0.5	0.1	0.1	4.9	7.1	7.6	5.4	13.8	11.1
Imported	1.4	2.2	(0.7)	4.5	9.4	4.6	11.4	21.4	7.6
Exported **6/**	5.2	2.5	(3.9)	7.7	11.4	3.0	12.7	31.1	(1.7)
By industrial activity (ISIC)									
Farming. forestry, fishing	1.0	(2.3)	(1.8)	3.6	5.6	9.4	(6.0)	13.9	9.8
Mining	4.5	4.7	(1.1)	25.2	16.4	12.9	27.1	22.0	23.5
Manufacturing	0.4	1.3	0.4	4.9	7.9	6.0	10.6	15.9	10.0

n.a. Not available.
1/ The average of the four core-inflation indicators calculated by the Banco de la República.
2/ CPI excluding all food-group items.
3/ CPI excluding 20% of the weight of items showing the greatest price volatility between January 1990 and April 1999.
4/ The weighted mean trimmed by 5% in each tail. calculated by the CPI-60 methodology. See Luis Fernando Melo et al. Un análisis de las medidas de inflación básica para Colombia, mimeo 1997, Banco de la República.
5/ The asymmetric mean trimmed by 15% in the left tail and 13% in the right tail, calculated by the CPI-60 methodology.
6/ The total PPI does not include exported goods. It is calculated from the weighted sum of domestically produced and consumed goods and imported goods.

Sources: Economic Studies Division (SGEE) of the Banco de la República, and DANE's PPI and CPI Lists.

Neiva (9.0%), and those with the lowest Bogotá (7.4%), Villavicencio (7.5%) and Pasto (7.6%) (Table 2). Annual inflation was lower in June than in March in only four cities (Bogotá, Barranquilla, Manizales and Pasto), and higher in the other nine included in the National Statistical Agency's (DANE's) list, particularly in Montería, Cali and Bucaramanga.

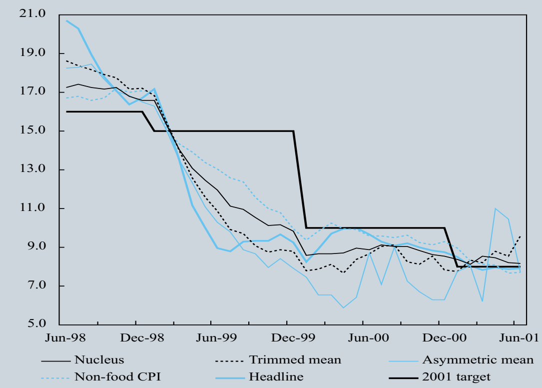
2. Behavior of main CPI components

The CPI groups exhibiting higher annual inflation in June than in March, and thereby helping to accelerate consumer inflation, were food, clothing, education, culture and entertainment, and diverse expenditures.

The other three groups (housing, health care, and transport) reduced their rate of annual inflation over the second quarter.

Among the inflation-speeding groups food was the most important, on account of its CPI weight. This year's

FIGURE 2
HEADLINE AND CORE INFLATION
(ANNUAL PERCENTAGE CHANGE)



Source: DANE. Calculations by Banco de la República.

[1] The other two measures usually discussed in these Inflation Reports have been showing too great a variability to be suitable as indicators of core inflation. They will therefore be replaced in the coming months by a new indicator, on the basis of the findings of a new study on core-inflation measures now being carried out by the Banco de la República.

TABLE 2
CONSUMER PRICE INDEX, TOTAL AND BY CITY
(PERCENTAGE CHANGE TO JUNE)

	Monthly			January-June			Annual		
	1999	2000	2001	1999	2000	2001	1999	2000	2001
Total	0.3	(0.0)	0.0	6.5	7.0	6.2	9.0	9.7	7.9
Bogotá	0.4	(0.1)	0.0	7.3	7.5	6.0	10.1	9.4	7.4
Medellín	0.0	(0.2)	(0.3)	6.2	6.1	5.2	9.1	9.8	7.8
Cali	0.1	0.1	0.1	4.9	5.9	6.4	8.2	8.5	8.7
Barranquilla	(0.0)	0.6	0.1	5.4	6.8	7.0	8.4	11.2	8.3
Bucaramanga	0.3	(0.2)	0.2	6.9	7.7	6.5	7.4	10.9	8.4
Manizales	0.2	0.1	0.0	6.1	6.8	6.2	8.6	11.0	7.6
Pasto	0.6	(0.4)	0.1	7.6	7.7	4.9	11.0	11.1	7.6
Pereira	0.1	0.2	0.3	6.5	6.3	5.9	8.9	10.2	8.5
Cúcuta	0.7	0.1	0.2	6.7	8.3	7.9	9.4	11.6	10.1
Montería	0.4	0.3	1.0	5.8	7.5	8.5	8.8	10.3	10.8
Neiva	0.2	0.1	0.6	6.9	7.1	7.6	8.2	9.2	9.0
Cartagena	0.2	0.1	0.1	6.2	7.5	7.8	8.4	9.2	8.9
Villavicencio	0.5	(0.4)	(0.2)	6.2	7.0	6.7	5.0	8.8	7.5

Source: DANE's Lists. Calculations by Banco de la República, SGEE.

second-quarter rise in food prices was 1.8%, significantly higher than last year's 0.5%, raising the annual rate to 8.5% in June, up from 7.1% in March. Annual food inflation has quickened steadily since the beginning of the year, driven by price surges in meat and root crops. In the case of meat this has been the outcome of the cattle-breeding cycle's holding-back stage, which is currently in progress and usually reduces supply for several quarters (see Box at the end of this chapter). Prices can therefore be expected to remain high for beef, and probably for its closest substitutes, over the rest of the year.

During June, however, meat prices grew at a significantly slower pace and potato prices fell sharply, both developments helping to curb the rising trend in annual food inflation.

Education was another major CPI group, by weight, that exhibited a substantial price acceleration in the second quarter: 2.5%, compared with 0.3% for the same period last year, raising annual inflation in education from 8.2% in March to 10.6% in June. Given the weakness of domestic demand, it is surprising that education prices should have risen by more than this year's inflation target and last year's. Moreover, it appears quite likely at the moment that education inflation for the whole of 2001 will end up higher than this year's target, and even last year's, since further rises are expected in September, the beginning of the academic year for calendar-B institutions [most Colombian centers of education operate on calendar A, with the academic year starting in January or February].

The CPI groups that helped to slow inflation in the second quarter included notably housing. The annual price rise in housing was only 3.8% in June, down from 4.2% in March and 5.2% in June 2000, thanks, as last year, to minimal annual increments in housing rents, amounting to barely 0.9% in June. In contrast, because of the dismantling of consumer subsidies and other factors, inflation in utilities has continued to far outstrip overall inflation this year, though the annual rate slowed over the second quarter to 18.6% in June, down from 23.0% in March.

Transport prices have benefited from the fact that fuel inflation this year, particularly in the second quarter, has been lower than last year, with the result that annual inflation in transport declined from 15.2% in March to 12.9% in June. As no surge is expected in fuel prices for the rest of the year, the transport group should continue to help curb inflation.

Table 3 shows the specific CPI items that most contributed to accelerating inflation in the second quarter. In addition to beef and other food-group items, such items include some utilities such as water supply and sewerage, as well as banking services. These are the same items that helped to drive inflation in the first quarter, with the notable exception of potatoes, which stopped exerting inflationary pressure. It is to be noted that a 16.6% increase in the price of beef between March and June accounted for a third of accumulated second-quarter inflation over the.

Table 3
Greatest contributors to second-quarter Consumer inflation, 2001

Item	Variation	Contribution	
		Points	Percentage
Total	1.6	1.6	100.0
Beef	16.6	0.5	36.5
Water supply. sewerage waste collection	5.0	0.1	5.2
Banking services	2.1	0.1	4.8
Lunch	1.6	0.1	4.6
Tomatoes	30.7	0.1	4.6
Other	0.8	0.7	44.3

Source: DANE's Lists. Calculations by Banco de la República, SGEE.

3. Alternate classification: inflation speeding or slowing groups

Figure 3 presents CPI inflation under an alternate classification that divides the basket of goods into tradables[2] and nontradables, with the latter subdivided into indexed,[3] flexible[4] and cyclical[5] items. Two patterns of behavior can be observed in the figure. The first is a gently falling trend in tradables inflation since early 2000, but running always above the path of overall inflation-probably because of substantial devaluation in the past two years.

The pass-through of devaluation to tradables is illustrated in Figure 4. The upper panel shows how exchange-rate movements pass through almost perfectly to inflation in imported goods of the Producer Price Index (PPI). Similarly, inflation in PPI imported goods is passed through in more abated form and with a longer lag to the tradables component of the consumer inflation. Market competition, intermediaries, world-price changes, tariff protection, changing demand, menu costs and other factors all combine to account for the fact that CPI tradables are affected by less than full devaluation (lower panel of Figure 4).

The second pattern of behavior in Figure 3 is that of nontradables inflation, which has continued to run below headline inflation over the past twelve months, displaying a declining trend for the better part of 2000 through to the end of the first quarter of this year. In the second quarter, nontradables inflation began to rebound as cyclicals (meat)

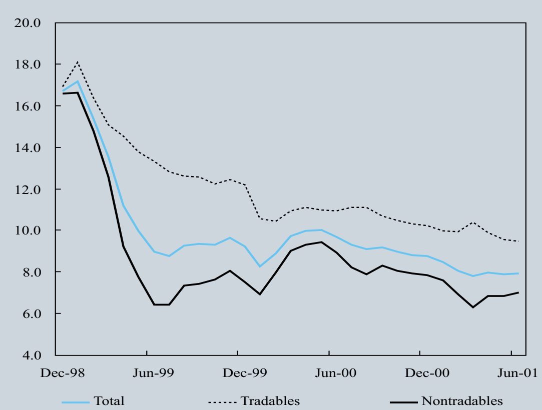
[2] Tradables: textiles, footwear, tobacco, beverages, cereals, dairy produce, cooking fats, drugs, vehicles, electrical appliances, etc.

[3] Indexed items: rent, fuel, utilities, education, transport, and other items.

[4] Flexible items: root crops, plantains, vegetables, legumes, and fruit.

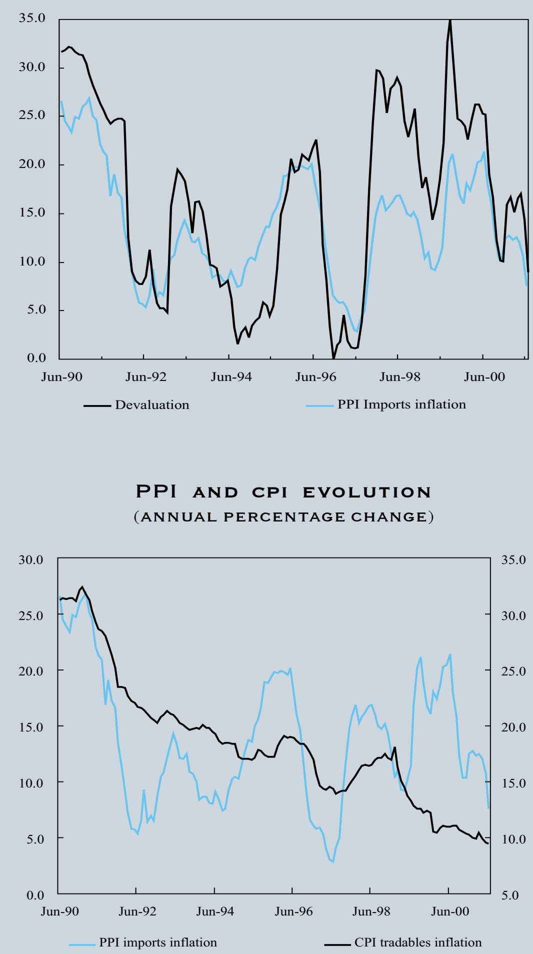
[5] Cyclical items: meat, and meat products.

Gráfico 3
IPC bienes transables y no transables
(Variaciones porcentuales anuales)



Source: DANE. Calculations by Banco de la República.

Figure 4
PPI and exchange-rate evolution
1990:6 - 2001:67
(Annual percentage change)

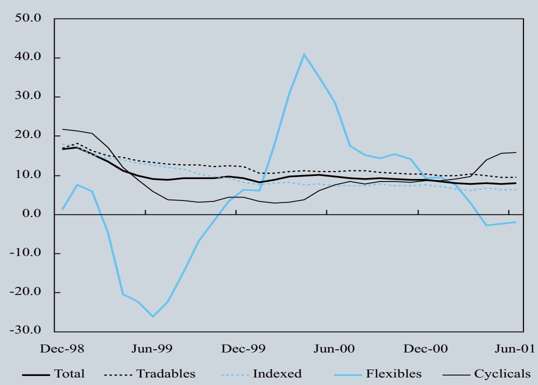


Source: DANE. Calculations by Banco de la República.

went up in price, from the increasing effect of the holding-back stage in cattle-breeding (see Box and Figure 5).

Table 4 shows that, under the alternate classification, all groups except cyclicals contributed substantially to reducing consumer inflation, by 1.7 percentage points in the 12 months to June 2001. The greatest downward pressure came from the CPI basket's nontradables, which accounted for 71% (1.2 percentage points) of the reduction by registering a 7.0% annual price rise in June, down from 8.9% twelve months earlier. This decline may have resulted from weak domestic demand, and also from a more moderate seasonal price rise for potatoes in the first half of this year (32.2%) than in the same period last year (95.1%).[6] Tradables, for their part, contributed 0.5 percentage points to the fall in inflation by dropping from a 10.9% price rise in June 2000 to one of 9.5% in June this year.

FIGURE 5
PRICE EVOLUTION OF TRADABLES AND NONTRADABLES BY COMPONENT
(ANNUAL PERCENTAGE CHANGE)



Source: DANE. Calculations by Banco de la República.

B. PRODUCER PRICE INDEX

Overall behavior

Annual producer inflation was 10.2% in June, 5.4 percentage points lower than 12 months earlier and 0.7 points lower than in March. In the first half of this

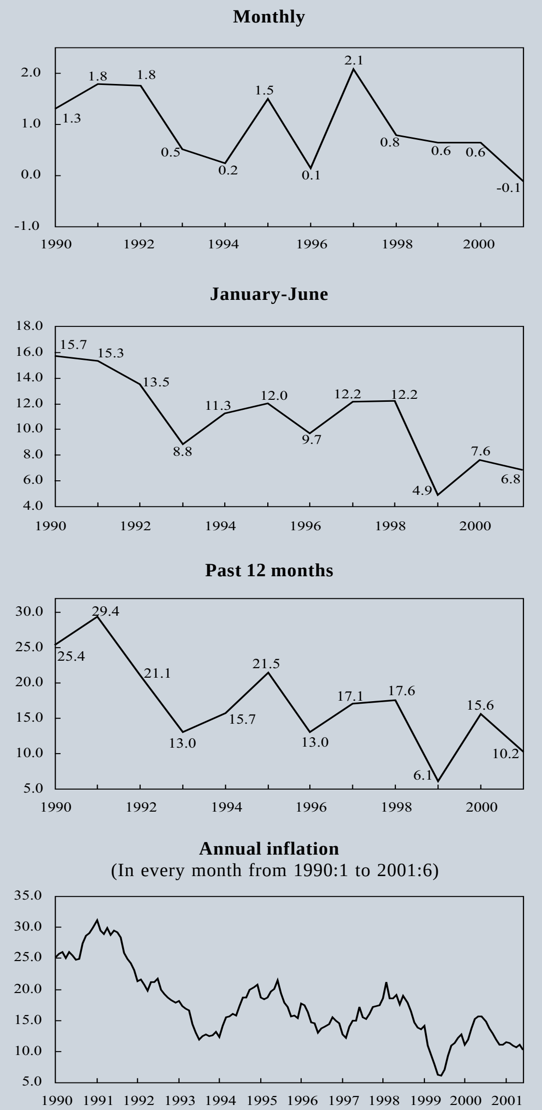
6 In determining which groups have most helped to reduce inflation, it is as well to remember that a group with lower-than-average national inflation in a given period is not necessarily contributing to reduce inflation from one period to another. This only occurs if its contribution to inflation in the current period is lower than its contribution in the previous period.

TABLE 4
CONSUMER PRICE INDEX, 2000-2001
(TO JUNE)

Item	12-month change		Contribution to change		Contribution infln. reducn. (*)
	2000	2001	2000	2001	2001-2000 Points
Total	9.7	7.9	9.7	7.9	(1.7)
Tradables	10.9	9.5	4.1	3.6	(0.5)
Nontradables	8.9	7.0	5.6	4.4	(1.2)
Indexed	7.4	6.4	3.7	3.1	(0.6)
Flexibles	28.5	(2.1)	1.3	(0.1)	(1.4)
Cyclicals	7.5	15.9	0.7	1.4	0.7

(*) Each item's contribution to inflation reduction is the difference between its contributions to inflation in 2000 and 2001. Discrepancy between figures is caused by rounding.
Sources: DANE's Lists. Calculations by Banco de la República, SGEE.

Figure 6
Producer price index
(Percentage change to March)



Sources: Banco de la República, SGEE.

year, the PPI rose by 6.8%, a decline of 0.8 points on the same period last year (Figure 6). The PPI's monthly variation in June was -0.1%, the lowest June rate since the Index was introduced in 1970. Its satisfactory performance in the second quarter, particularly in June, reflects price falls in farm produce (-1.8%) and mining (-1.1%) over the month of June, which were offset to some extent by a 0.4% rise in industrials.

Breakdown of producer inflation by origin of goods shows the annual price rise in domestically produced and consumed goods going up from 10.4% in March to 11.1% in June, far outpacing the rate for imported goods (7.6%), which declined substantially over the second quarter, from 12.5% in March.

Breakdown of the Index by ISIC economic activity reveals mining as the worst performer, with a 12-month inflation of 23.5% in June, despite a 3.5 percentage-point slowdown over the second quarter. This performance is accounted for by price surges in natural gas (64.4%) and crude oil (28.7%).

It is to be noted, however, that price rises in mining fell substantially in June, thanks to a 6.5% drop in the price of crude oil in June. Manufacturing prices went up by 10.0%, reducing their pace of growth by 2.4 percentage points with respect to March. In contrast, inflation in farm prices jumped from 4.2% in March to 9.8% in June, as the retention stage of the cattle-breeding cycle pushed up the price of beef and cattle.

The cattle-breeding cycle and inflation in Colombia

In economic literature, supply shocks (for instance, food-supply shocks) are known to cause only a transitory acceleration of consumer inflation rather than one lasting into the long term. In the case of meat, however, a prolonged phase of rising prices might occur and could make it difficult for a monetary authority to meets its aim of price stability in a given year. The following is a brief description of the price cycle that cattle-breeding is presently going through in Colombia, and its potential impact on inflation over the rest of the year.

The cattle-breeding cycle in Colombia, as in most countries, presents a more or less regular oscillating dynamic, with clearly identifiable, alternating phases of expansion and contraction in cattle slaughter and prices. As can be seen from Figure 1, one feature of these oscillations is that the real prices of live and slaughtered cattle move in cyclically opposite directions.

What can analysis of the cattle-breeding cycle tells us about future meat-price movements in Colombia?

The cycle of cattle slaughter in Colombia lasts a little over five years, comprising an expansion phase of about three and a half years and a contraction phase of about two years.[1] Exceptions have occurred, as in 1977, when the contraction phase of cattle slaughter lasted only a year (Figure 1). As can be seen from Figure 2, from 1993 to 1999 the cattle cycle was in a phase of supply expansion, which brought down the real prices of cattle on the hoof and beef. In 2000 the cattle-breeding cycle went into a holding-back stage without greatly raising the price of cattle on the hoof or beef, partly because of weak domestic demand. But in January 2001 prices began to rebound. The cattle-retention stage is currently expected to continue over 2001 and 2002, with real prices rising this year and probably next year. The current retention stage might last longer than usual, because the last expansion stage was unusually long and stock levels may have fallen very low.

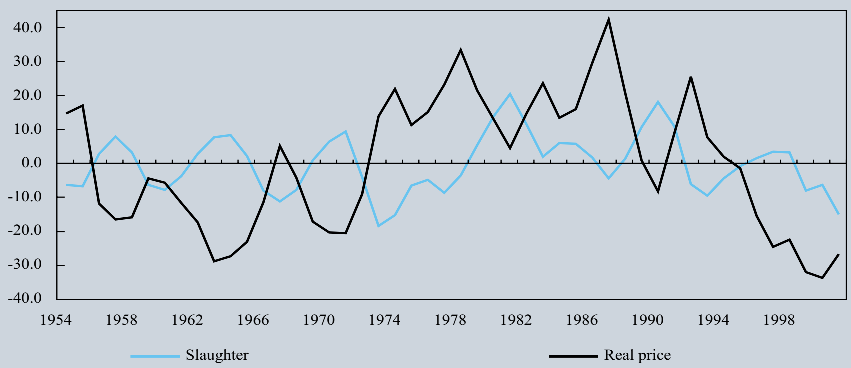
What has been and will be the inflationary impact of beef in 2001?

In the 12 months to June, beef prices rose by 24.2%, accounting for just over 10% of accumulated inflation over that period. The upward trend in beef prices was heightened by very low rainfall in the first half of this year, for the lack of rain set back the fattening of cattle and reduced the supply of meat by lowering the weight of cattle reaching the market.[2]

Figure 3 illustrates the seasonal pattern of meat inflation, which tends to rise in the first half of the year and fall off in the second.[3] This pattern suggests that no further surges should be expected in the price of beef over the coming months. This year, however, meat-price behavior over the second half might prove less favorable than in previous years because of the nature of the current retention stage.

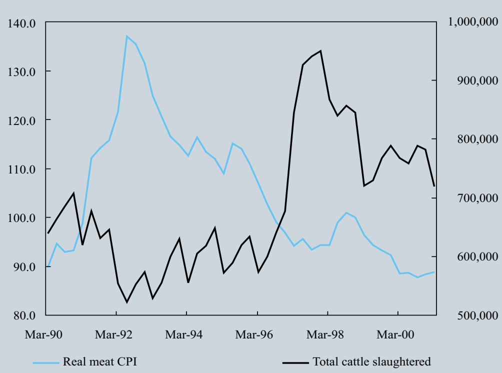
Inflationary pressure from the price of beef does not at the moment seriously compromise attainment of this year's 8% inflation target, for CPI inflation excluding meat is relatively low: 7.0%. The 0.9 percentage-point difference between overall inflation (7.9%) and non-meat inflation (7.0%) is the extent of the inflationary effect of beef prices over the past 12 months.

Figure 1
Cattle cycle, 1954-2001 (*)
(% deviation from trend)



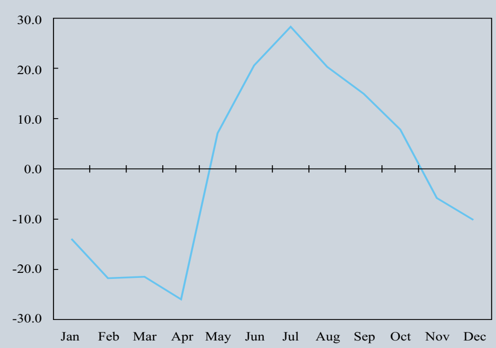
(*) Estimates for 2001 are based on actual data to May.
Sources: Prices: Medellín Livestock Fair and PPI of the Banco de la República. Data on slaughter: DANE.

Figure 2
Total cattle slaughtered and real meat CPI, quarterly figures
(1990:3 - 2001:1)



Source: Banco de la República.

Figure 3
Seasonal pattern beef-price inflation
(seasonal factor)



Source: Banco de la República.

---

[1] In this connection, see Jaramillo and Caícedo "La dinámica del ciclo ganadero," in Boletín de Estadística, DANE, April 1997, No. 529.

[2] The northern region of Colombia was declared free of foot-and-mouth disease in May. Some analysts believe this fact caused both beef exports and the domestic price of beef to rise. But a careful review of the foreign-trade data shows that by value Colombia's meat exports amounted to no more than 0.5% of domestic production. According to the Ministry of Agriculture, by the end of 2004 annual exports are expected to reach 40,000 metric tons of boned meat, representing by then not quite 5% of the country's meat production and having little effect on the domestic price.

[3] It is important to point out that the decrease in meat supply during the cattle-retention stage does not alter the annual pattern of meat-price behavior.

II

Determinants of inflation

A. Monetary aggregates, interest and exchange rates

1. Monetary-policy measures

The Board of Directors made no changes in the Bank's intervention rates during the second quarter. So the Lombard expansion and contraction rates remained respectively at 15.5% and 8.0%, and the auction expansion and contraction rates at 11.5% and 10.5%.

In March this year the Board adopted, on a preliminary basis, a new reference line for the monetary base in 2001. The new estimate took into account changes in cash-demand behavior caused by the financial-transaction levy having been raised to three per thousand from the beginning of the year. It also corrected the M3 estimate, which was not showing the constant velocity initially assumed for it. On the basis of the new reference line, one-day REPO expansion and contraction limits were defined in April, May and June. Predetermined amounts for One-day REPO auctions averaged 467 billion pesos in April, 931 billion in May and 1,114 billion pesos in June; the market made partial use of them, in proportions ranging from 50% to 60%. Similarly predetermined amounts for one-day reveise REPO auctions in April, May and June averaged 252, 337 and 444 billion pesos respectively and were used in proportions ranging between 20% and 40%.

In mid-March, withdrawals of up to 3.9 million pesos a month from some savings accounts in mortgage entities were exempted from the three-per-thousand levy. The behavior of both the public's cash holdings and the monetary base may have been altered anew by this measure. This would explain why over the second quarter these aggregates ran below the level estimated in the reference line adopted in March. This development, plus a revision of the statistical data and M3's expected path, led to a new reference line being estimated for the monetary base and adopted by the Board on June 27. The new line envisages a 4.8% growth in the monetary base by the end of the year and a 16.6% growth in its 2001average, both rates being lower than those envisaged in the previous reference line.

2. Monetary and credit aggregates

The monetary aggregates' behavior over the past three months is analyzed below by examining movements in the monetary base, M1 money supply, broad money M3, and the financial system's loan balance.

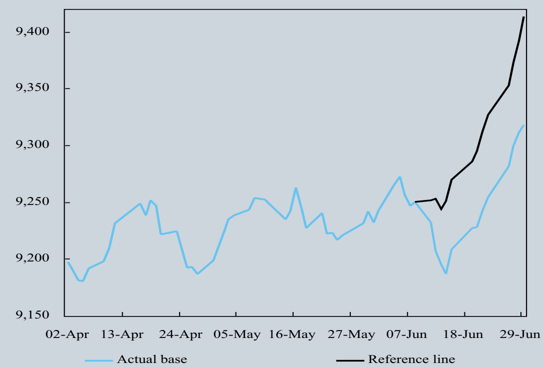
Monetary base

On June 29 the monetary base amounted to 9,477 billion pesos, with a 12-month growth rate of 13.2%, and its 20-day and 45-day moving averages stood respectively 1.0% and 0.5% below the new reference line's (Figure 7).

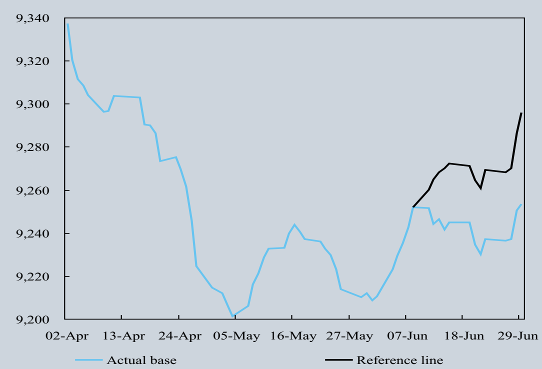
The monetary base's average balance expanded by 15.4% in the 12 months to June, down by 5.4 percentage points on the rate to March. Breakdown of the monetary base into its uses shows its behavior to have been accounted for by slower growth between March and June in both cash (from 28.0% to 19.9%) and reserves (from 7.5% to 7.0%) (Figure 8).

Figure 7
Monetary base and reference line
(billions of pesos)

Promedio móvil diario de orden 20

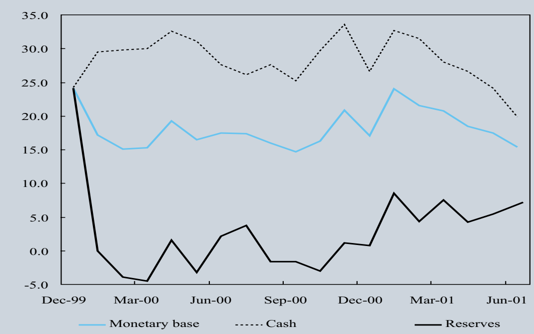


20-month daily moving average



Source: Banco de la República, SGEE.

Figure 8
Monetary base and its uses
(annual % change in monthly average)



Source: Banco de la República, SGEE.

Figure 9
M1 and its components
(annual % change in monthly average)

Source: Banco de la República, SGEE.

M1 money supply

The M1 balance[7] stood at 14,107 billion pesos on June 29, with a 12-month growth of 10.9% and a January-to-June variation of -15.6%. Annual growth in M1's average balance fell from 17.9% in March to 10.2% in June, owing to slower expansion in cash holdings (as indicated above) and in current accounts (from 10.4% to 2.7%) (Figure 9).

M3

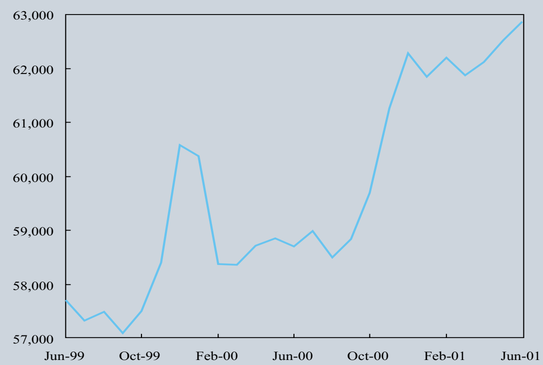
M3,[8] the broader measure of money supply, showed a balance of 62,838 billion pesos on June 29, with a 12-month growth rate of 7.1%, up from 6.0% in March (Figure 10). M3's average balance, too, registered a higher 12-month growth rate in June (6.7%) than in March (6.1%). So did liabilities subject to reserves (5.7%, up from 4.6%). As in the first quarter, despite a sharp slowdown in current accounts, M3 and liabilities subject to reserves increased their pace of growth in the second quarter, thanks particularly to an expansion in current accounts (5.0% in June, up from -1.1% in March). In contrast, CDs, which had helped to quicken M3 growth in the f irst quarter, failed to

---

[7] From June 29, 2001, M1 no longer includes the current-account deposits of entities in the process of liquidation.

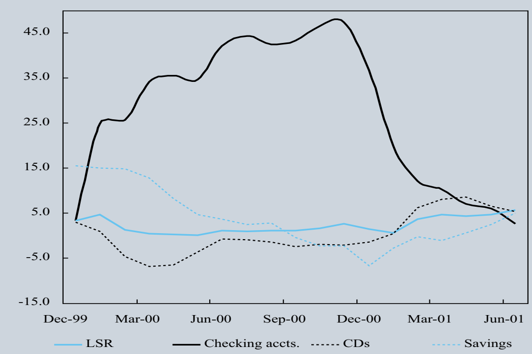
[8] From June 29, 2001, M3 includes CDs issued by special financial entities and the sight deposits of non-banking financial entities. Likewise, the deposits of entities in the process of liquidation are reclassified as restricted deposits.

Figure 10
M3 broad money
(monthly balance, billions of pesos)



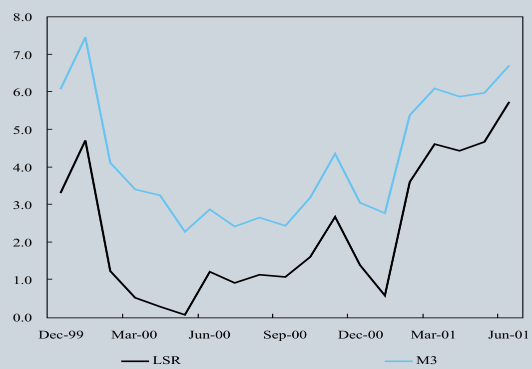
Source: Banco de la República, SGEE.

Figure 12
Liabilities subject to reserve (LSR) and their components
(annual % change in monthly average)



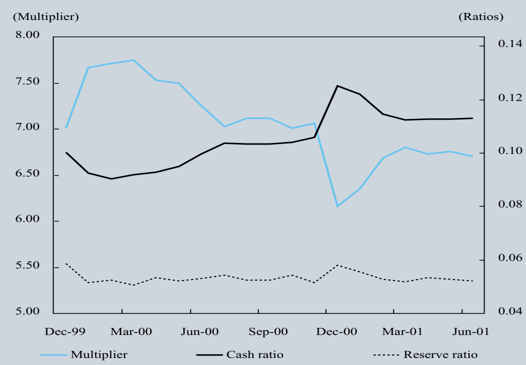
Source: Banco de la República, SGEE.

Figure 11
M3 and liabilities subject to reserve (LSR)
(annual % change in monthly average)



Source: Banco de la República, SGEE.

Figure 13
M3 multiplier



Source: Banco de la República, SGEE.

do so in the second, their rate of increase falling from 8.1% in March to 5.4% in June (Figures 11 and 12).

The average M3 multiplier dropped between March and June, from 6.804 to 6.703, owing to a rise in both the cash ratio (from 0.112 to 0.113) and the reserve ratio (from 0.052 to 0.054) (Figure 13).

Credit

The financial system's overall loan balance continued to decline in nominal terms over the second quarter, though at a slower pace than before. Specifically, the overall net balance of local- and foreign-currency loans extended by the financial system, excluding FEN, amounted to 45,537 billion pesos on June 29, with a 12-month contraction of -2.4% and a first-half shrinkage of -0.4%. Local-currency loans contracted by -0.3% over the past 12 months, foreign-currency loans by -23.0%, and the dollar equivalent of foreign-currency loans by -28.6%. The average gross nominal balance of local-currency loans held by all financial intermediaries registered a lower 12-month contraction in June (-1.1%) than in March (-3-1%).

The loan portfolio's smaller contraction over the second quarter was accounted for by recovery in non-mortgage loans. In effect, leaving out the mortgage banks shows that in nominal terms the average balance held by the rest of the system registered a faster annual growth (10.5% in June, up from 8.9% in March), resulting in a real expansion for the second quarter in a row (Figures 14 and 15).

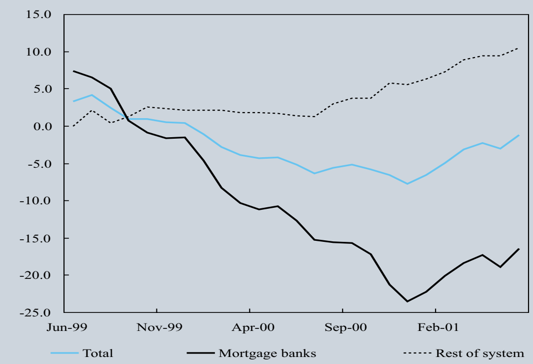
A breakdown of loan balances by groups of financial intermediaries reveals that recovery in non-mortgage loans occurred mostly in the private sector. In effect, private institutions saw annual growth in their average non-mortgage loan balance rising from 8.8% in March to 10.8% in June, while state-owned entities saw growth in theirs (5.0%) declining slightly relative to March (Figure 16).

It is important to point out that the portfolio behavior described above can be partly explained by the statistical effect of loan removals from the financial intermediaries' balance sheets. These removals were brought about by the liquidation of a number of financial entities, the writing-down of unproductive assets, reductions by reason of property received in payment, portfolio securitizations and sales to institutions outside the system, and recalculations of mortgage loans.

Cleaning up the loan portfolio in this way gives a better idea of the performance of new loans extended by the financial system. Table 5 presents an estimation of the portfolio's behavior if the above removals had not taken place. In contrast to the gross portfolio, this corrected portfolio has been expanding in nominal terms since January 2000, at annual rates ranging between 3.1% and 7.0%. On the basis of these figures, the gross local-currency portfolio would have shown a 4.2% annual growth in May.

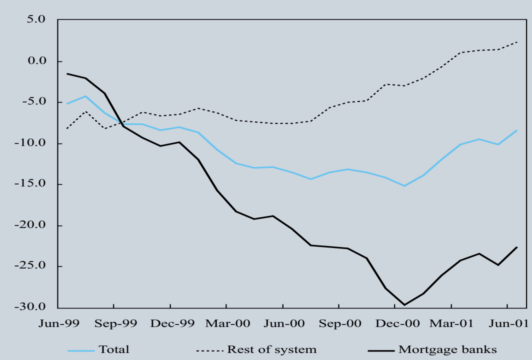
Lastly, Figure 17 shows annual variations in commercial and consumer loans. After shrinking continuously since April 1999, both these types of loans started expanding

Figure 14
Gross nominal local-currency loan balance
Financial system excluding FEN
(annual % change in monthly average)



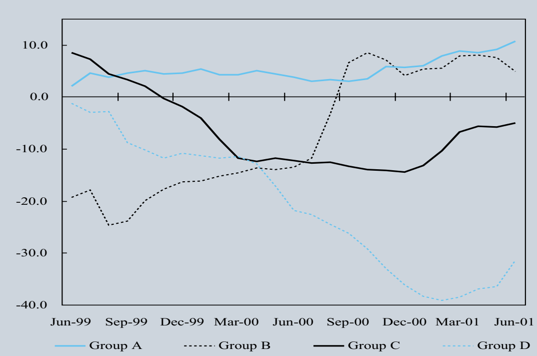
Sources: Banco de la República and Banking Superintendency.

Figure 15
Gross real local-currency loan balance
Financial system excluding FEN
(annual % change in monthly average)



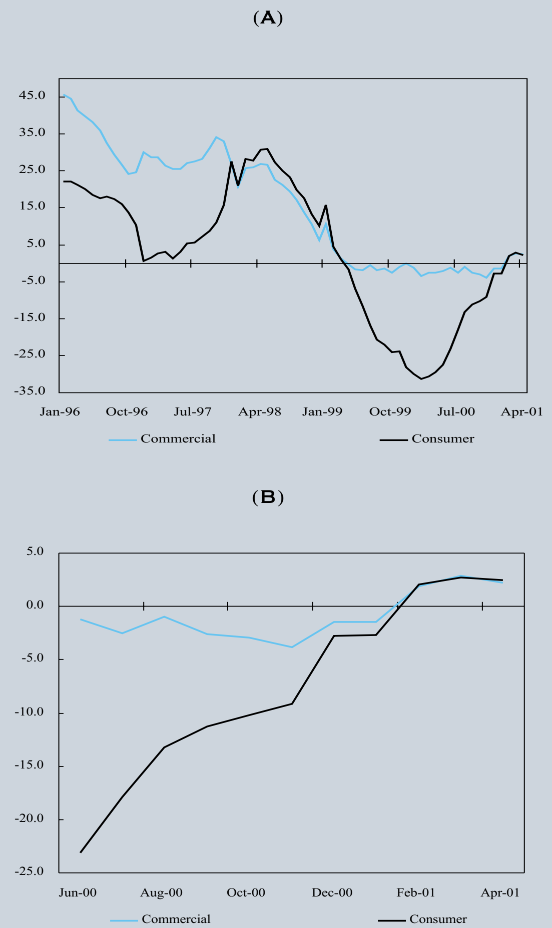
Sources: Banco de la República and Banking Superintendency.

Figure 16
Total net local-currency loan balance
By type of intermediary
(annual % change in monthly average)



A: Private non-mortgage banks. **B**: State-owned non-mortgage banks. **C**: Private mortgage banks. **D**: State-owned mortgage banks.
Sources: Banco de la República and Banking Superintendency.

Figure 17
Commercial and consumer loans
Entire financial system (nominal figures)
(annual percentage change)



Sources: Banco de la República and Banking Superintendency.

in February this year and continued to do so over March and April, though slightly more slowly in April than in March. The growth rate for commercial loans was 2.2% in April, down from 2.9% in March; for consumer loans it was 2.4%, down from 2.7%

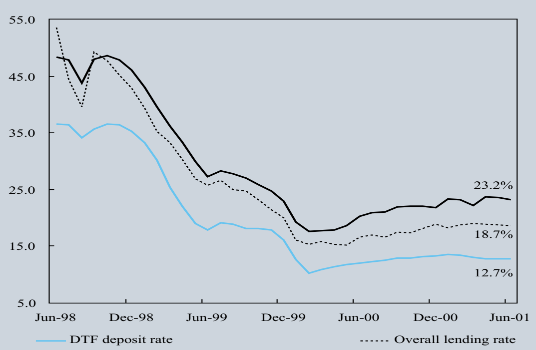
3. Interest rates

At the end of June 2001 the average DTF deposit rate stood at 12.7%, the same level as in May but 0.3 percentage points lower than at the end of March. The overall lending rate calculated by the Banco de la República[9] stood at 18.6%, down by 0.1 percentage points on May and 0.3 points lower than at the end of the first quarter (Figure 18). The average interbank interest rate ran at 11.4% in June, 0.2 percentage points lower than in May and 0.6 points lower than the average at the end of March (Figure 19).

In real (ex-post) terms, the deposit rate fell from 4.8% at the end of the first quarter to 4.4% at the end of the second, and the overall lending rate calculated by the Banco de la República from 10.4% to 9.9%, while the latter excluding Treasury loans rose from 13.3% to 14.2%. The real interbank rate

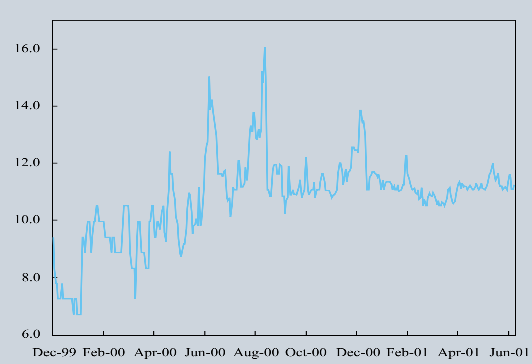
[9] The overall lending rate calculated by the Banco de la República is a rate that includes consumer, common, preferential and Treasury loan rates, weighted by total mount of placement.

Figure 18
Lending and deposit rates
(annual effective rate)



Sources: Banco de la República and Banking Superintendency.

Figure 19
Nominal interbank interest rate



Sources: Banco de la República and Banking Superintendency.

Table 5
Financial system's adjusted gross local-currency loan portfolio 1/
(millions of pesos)

Períod		Gross portfolio 2/ (a)	Change %	Loans removed 3/ (b)	Change %	Law 546 Treasury paper (c)	Corrected gross portfolio (d)	Change %
1999	Dec,	47,230,673	1.1	7,231,853	73.4		54,462,526	7.0
2000	Jan.	46,107,279	(1.4)	7,530,062	64.6		53,637,341	4.5
	Feb.	45,444,189	(2.7)	7,608,283	60.7	188,984	53,241,456	3.5
	Mar.	44,908,963	(4.3)	7,842,072	56.1	1,009,811	53,760,845	3.5
	Apr.	45,047,163	(3.1)	7,735,471	53.8	1,424,182	54,206,815	5.2
	May.	44,330,299	(4.9)	8,533,174	62.7	1,554,655	54,418,128	4.9
	Jun.	44,405,167	(5.7)	8,549,994	56.7	1,606,548	54,561,709	3.8
	Jul.	44,396,256	(4.5)	8,358,096	38.0	1,888,354	54,642,705	4.0
	Aug.	43,866,250	(4.4)	8,411,890	35.2	1,875,198	54,153,338	3.9
	Sep.	44,313,825	(5.3)	8,800,999	38.4	1,865,097	54,979,921	3.4
	Oct.**4/**	43,722,658	(5.7)	10,274,021	59.2	1,859,460	55,856,139	5.8
	Nov.	43,725,868	(7.3)	10,179,676	56.8	1,888,094	55,793,637	3.9
	Dec.	44,026,625	(6.8)	10,229,230	41.4	1,879,428	56,135,283	3.1
2001	Jan.	43,641,768	(5.3)	10,150,433	34.8	1,873,579	55,665,780	3.8
	Feb.	43,594,076	(4.1)	10,085,970	32.6	1,939,551	55,619,598	4.5
	Mar.	43,814,625	(2.4)	10,096,405	28.7	2,210,940	56,121,970	4.4
	Apr.	43,550,702	(3.3)	10,437,012	34.9	2,231,097	56,218,810	3.7
	May.	43,921,355	(0.9)	10,539,444	23.5	2,254,746	56,715,545	4.2

(d) = (a)+(b)+(c).

Note: The loans-removed series was revised in January 2000 on new data from the BCH (state-owned mortgage bank). Moreover, on December 7, 2000 Coopcentral, a high-grade cooperative, bought loans held in administration for 3,255 million pesos.

1/ The information contained here is provisional, because some items are calculated on estimates, since financial intermediaries are continually updating their financial statements.

2/ Starting from March 2000 the gross portfolio includes the liquidation balances of the BCH furnished by the Banking Superintendency.

3/ Portfolio adjustments were made on the following criteria:

-Mortgage-debt relief does not include the financial system's accounts receivable from the government.

-The 1999 loan-administration portfolio held by Fogafin (state financial guarantee fund) is not included, because account 821905 was opened by the Banking Superintendency at the end of 1999 and has not been reprocessed backward in time.

-The loans of entities under liquidation figuring in the gross portfolio calculated by SGEE are included.

-Write-downs in respect of property received in payment are not included.

4/ Fogafin has been authorized by government Decree 1814 dated September 18, 2000 to provide capital for public-law corporations principally engaged in acquiring, administering and disposing of unproductive assets owned by establishments of this nature. Fogafin has therefore created an entity for this purpose, called Central de Inversiones (CISA), which carried out the following operation in October:

Bancafé sold loans worth 1,153,000 million pesos, receiving payment for them in Fogafin bonds, but will continue to administer the loans itself. In October 2000 Bancafé sold loans worth 33,600 million pesos to the National Coffee Fund. In November of the same year it sold loans worth 34,000 million to Finagro for cash. In April 2001, Bancafé sold to CISA a second lot of loans worth 350,061,867 million pesos and a trust fund worth 58,771,616 million.

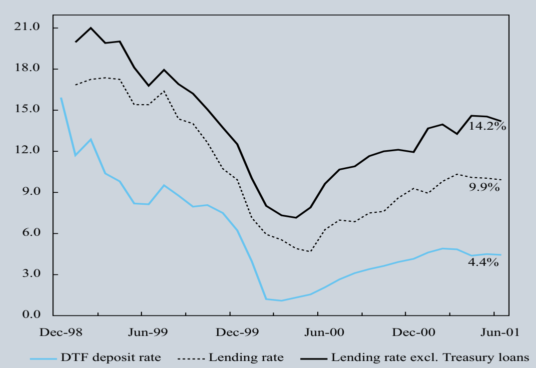
Source: Banco de la República, calculations by SGEE, on balances provided by the Banking Superintendency and information obtained through telephone enquiries.

averaged 3.0% over the second quarter, much the same level as in the first quarter (Figures 20 and 21).

Deposit rates for different maturities are not expected to undergo any substantial changes over the next few months. Figure 22 shows how the yield curve of the Banking Superintendency's basic rates (TBS) for different maturities has evolved over the past 12 months. The basic rates for all maturities rose fairly strongly throughout 2000 but moderated their rise in the first half of this year, especially in June, when lower long-term rates reduced the yield curve's slope. In June rates for 90-360 days ranged between 12.5% and 13.5%, compared with a range of about 13.0% to 14.5% three months earlier. This might imply that the markets expect interest rates to remain stable in the medium term.

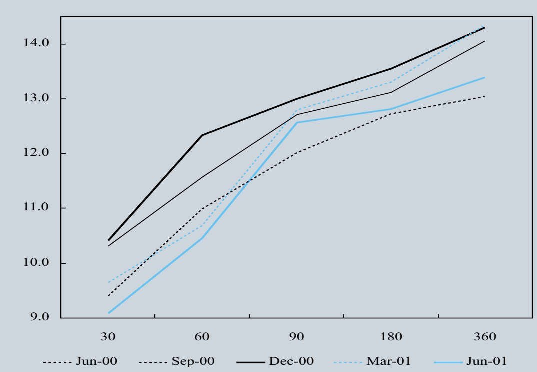
Figure 23 displays the evolution of the TBS rate's spot and forward curves over the past 12 months. The spot curve (thick line) shows movements in the actual 90-day basic rate, while the points on the forward curves (thin lines) represent agents' expectations regarding the level of the 90-day rate currently (the first point), in 30 days (second point), and so on up to 360 days.

Figure 20
Real deposit and lending rates, financial system



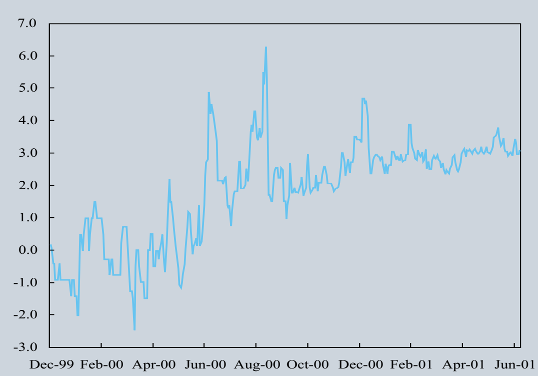
Sources: Banco de la República and Banking Superintendency.

Figure 22
Basic deposit rate (TBS) for different maturities, calculated by Banking Superintendency



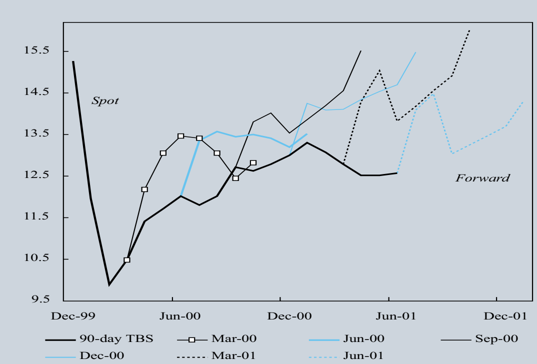
Sources: Banking Superintendency.

Figure 21
Real interbank interest rate



Sources: Banco de la República and Banking Superintendency.

Figure 23
90-day TBS projections



Sources: Banking Superintendency.

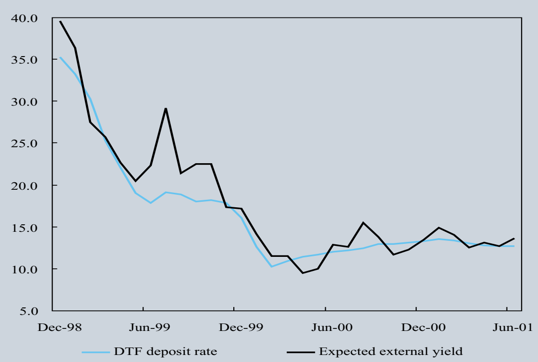
The forward curves show the 90-day rate running at 14.0% in the next few months, which suggests that the markets expect interest rates to rise, though by less than predicted three months ago.

4. Yield differentials

This section deals with the differential between external and domestic yields. External yield is defined as the return that local investors expect to obtain if they decide to invest in dollar-denominated assets. It is estimated on the basis of an external interest rate of reference and devaluation expectations. The devaluation expectations used for this purpose are those implicitly contained in the financial system's forward (80- to 100- day) dollar sales contracts. The external reference rate is the 90-day CD rate in New York. The DTF deposit rate is used as the domestic rate of reference.

Figure 24 compares expected external yield with the rate of return on domestic investments (as measured by the DTF). The two rates were very similar over the first half of this year. In the second quarter, domestic yield ran slightly below the external return expected by investors, because of higher devaluation expectations implicit in forward contracts for June. Analysis of such contracts revealed an expected devaluation rate of 10.1% in June.

FIGURE 24
DOMESTIC AND EXPECTED EXTERNAL YIELDS:



Source: Banco de la República.

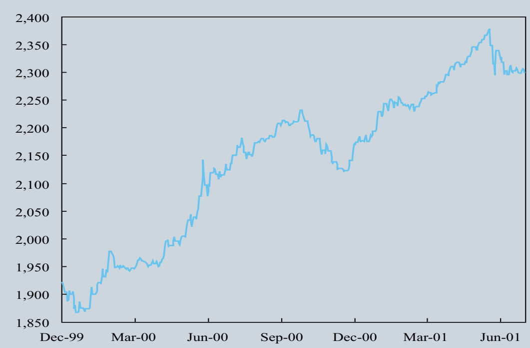
5. Nominal exchange rate

At the end of June, the nominal exchange rate stood at 2,299 pesos to the dollar, as against 2,311 pesos at the end of the first quarter, giving a 12-month devaluation of 7.5% and a 1.1% appreciation in the month of June (Figures 25 and 26).

Though the peso lost value in the first two months of the second quarter, it rallied in June, driven by the supply of foreign exchange made available by the Treasury.

This intervention, combined with the government's successful placing of bonds abroad and statements

FIGURE 25
MARKET EXCHANGE RATE
(PESOS TO THE DOLLAR)



Sources: Banco de la República and Banking Superintendency.

FIGURE 26
NOMINAL ANNUAL DEVALUATION
(PERCENTAGE)

Sources: Banco de la República and Banking Superintendency.

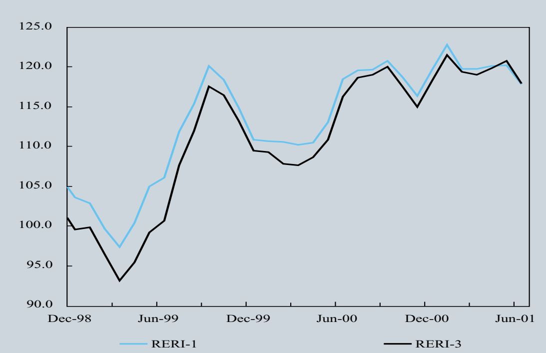
by the Finance Minister about the possibility of a further release of foreign exchange, has altered exchange-rate expectations and introduced a degree of stability into the market. In addition, a new resolution from the Banking Superintendency requires voluntary pension funds to keep their uncovered positions within certain limits.

Future dollar movements are not easy to predict at the moment, particularly because of the uncertainty created by external developments such as the crisis in Argentina. However, the second half of the year tends to be a time of ample supply of foreign exchange, thanks to coffee-export earnings flowing into the market and remittances from Colombians living abroad. This tendency may contribute to exchange-rate stability in the next few months.

6. Real exchange rate

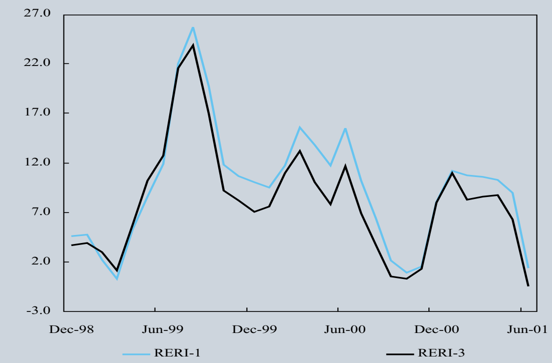
The real exchange rate, as measured by the RERI-1 index (1994 = 100), which is based on Colombia's Producer Price Index and those of its 20 trading partners, averaged 117.9 in June, giving an annual appreciation rate of 0.5% (a real devaluation of -0.47%). But using the RERI-3 index (1994 = 100), which is based on Consumer Price Indices, gives an annual devaluation of -1.4% to June. (Figures 27 and 28).

FIGURE 27
REAL EXCHANGE RATE INDICES
RERI-1 AND RERI-3 (1994 = 100)



Source: Banco de la República, SGEE.

FIGURE 28
REAL ANNUAL DEVALUATION
RERI-1 AND RERI-3 (1994 = 100)
(PERCENTAGE)



Source: Banco de la República, SGEE.

7. Asset prices

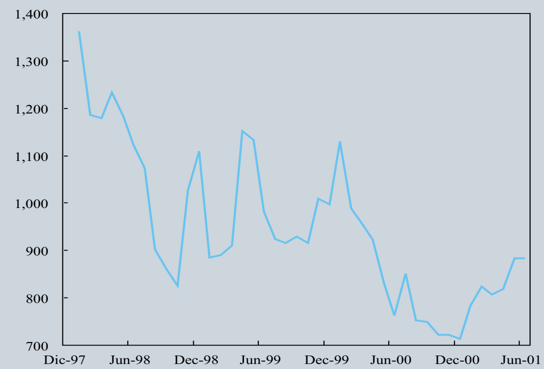
A description follows of a number of variables that indicate the price behavior of certain assets in Colombia. The first is the Bogotá Stock Exchange Index (IBB), a weighted price index of the shares of 20 Colombian companies having registered the largest trading by volume and value on the Bogotá Stock Exchange in the preceding 48 fortnights. The weight of each of the 20 shares making up the Index depends on the volume and value of its trading and is recalculated every fortnight.

Over the second quarter, the IBB index continued the upward trend it had started to show at the beginning of the year, and by June it was registering a 12-month rise of 15.9% (Figure 29).

Another variable that provides information on asset-price behavior is the National Planning Department's housing-price index for Bogotá and Medellín, calculated on a monthly basis since 1994.[10]
Figure 30 shows housing-price movements for Bogotá and Medellín, together with consumer-price inflation. In April and May, housing prices for Bogotá continued

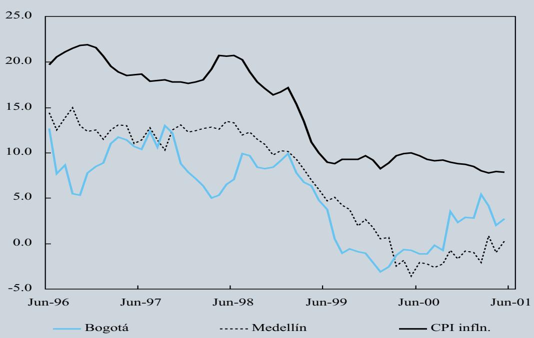
[10] Information on housing prices is taken from the National Planning Department's review La Guía, which contains data on intended purchase and sale transactions of new and used housing.

FIGURE 29
BOGOTA STOCK EXCHANGE INDEX
(JANUARY 1991 = 100)
(PERCENTAGE)



Source: Bogotá Stock Exchanges.

FIGURE 30
HOUSING-PRICE INFLATION IN BOGOTA AND MEDELLIN AND CPI INFLATION
(PERCENTAGE)



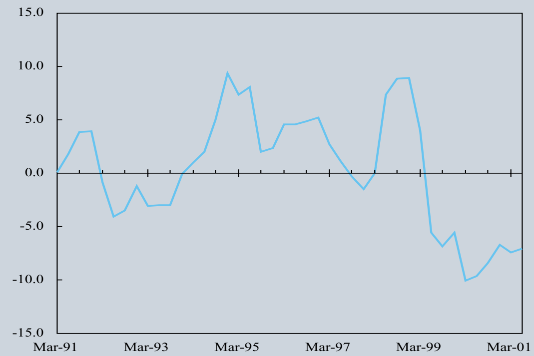
Source: National Planning Department.

to vary at rates of around 5.0%, much as they had at the beginning of the year, while those for Medellín still stagnated.

8. Monetary Conditions Indicator

Second-quarter movements in the Monetary Conditions Indicator for aggregate demand suggest that monetary policy has continued to be loose relative to the base period (1998:1 = 0). This trend, which has persisted for several quarters, continues to result from a combination of low real interest rates and low real devaluation, in this case both occurring in May and June (Figure 31).

FIGURE 31
MONETARY CONDITIONS INDICATOR (MCI)
FOR AGGREGATE DEMAND
(PERCENTAGE)



Source: Banco de la República, SGEE.

B. SUPPLY AND DEMAND

According to DANE, annual GDP growth in the first quarter of this year was 1.7%, lower than in the final quarter of last year. It is clear from this fact, and from further information available on the behavior of real-sector indicators between April and June, that the economy grew at a slower pace in the first half of this year than was initially forecast by the government. Nevertheless, the first quarter's GDP growth of 0.4% relative to the fourth quarter of 2000 signifies that the economy has not gone into a new recession.

There are several reasons for the slowdown, most of them identified in the previous Inflation Report. They include supply problems caused by reduced oil production from the Caño Limón field, lower investment in the mining sector because of public-order troubles, and a plunge in beverage production resulting from a strike of almost three months at the country's leading beverage maker. These situations, which already existed in the fourth quarter of 2000 and partly accounted for slower growth in December, grew worse in the first quarter of this year. Moreover, a number of industries such as sugar makers have seen their plans to expand production frustrated this year by problems connected with raw materials.[11]

If the effects of the above shocks are left out of account, annual growth in the first quarter represents no trend break relative to the economy's growth over the second half of 2000. According to Finance-Ministry estimates, the direct and indirect growth effects of semi-paralysis both in Caño Limón oil production and in mining investment amounted to 0.52 percentage points, and those of the beverage-sector strike to 0.43 points. The implication is that, in the absence of those shocks, the economy would have grown by 2.7%, annual rate, in the first quarter, faster than in the fourth quarter of 2000 and much the same as average growth in the second half of 2000, but still not fast enough to meet the government's original growth target.

Besides the above supply shocks, however, there were other factors in the first half of this year that helped to slow economic growth and, in particular, to weaken domestic demand. Notable among them were a reduction of purchasing power in the coffee sector caused by the collapse of world coffee prices, high unemployment, and an increase in the VAT rate from the beginning of the year. Moreover, the US economy's downturn has caused Colombia's exports to the United States to grow more slowly than last year.

1. General considerations

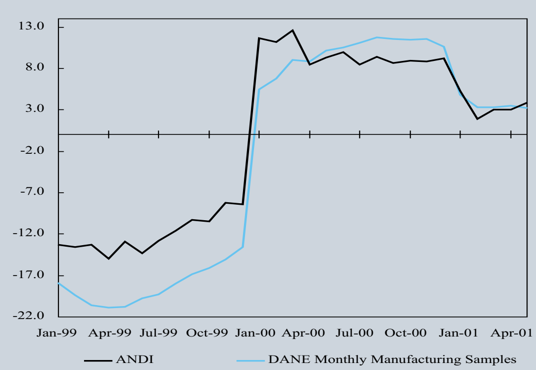
According to DANE's figures, slow growth in the first quarter was particularly evident in three sectors of production. First, in mining, because of the fall in oil production. Second, in manufacturing, because of contraction in the beverage industry's output and slow expansion in the food industry. And, lastly, in public works construction, because of both scant investment in mining, as mentioned above, and problems arising in various public projects carried out under concession agreements. (Table 6)

In March, growth in most other sectors of production was close to expected rates. In both commerce and transport, for example, growth was around 3.0%, similar to rates at the end of last year, though lower than those registered earlier this year.

Some sectors such as private construction (construction jobs, developments and buildings) grew even faster than expected in the first quarter. The 9.0% expansion in private construction was largely driven by low-income housing and may signal the beginning of a new upturn for the sector after several years of continuous contraction. Figures to April on building licenses and transactions suggest that this rising trend in private construction may have continued over the second quarter and may extend into the second half of the year (Figures 32 and 33).

Similarly, in manufacturing the first quarter saw production of capital goods and some intermediate goods maintaining annual growth rates of 10% to 20%, with some specific industries such as non-electric equipment and machinery expanding by over 20%.

FIGURE 32
TOTAL BUILDING LICENSES
12-MONTH GROWTH
(FIGURES TO MAY 2001)



Source: DANE. Building licenses research.

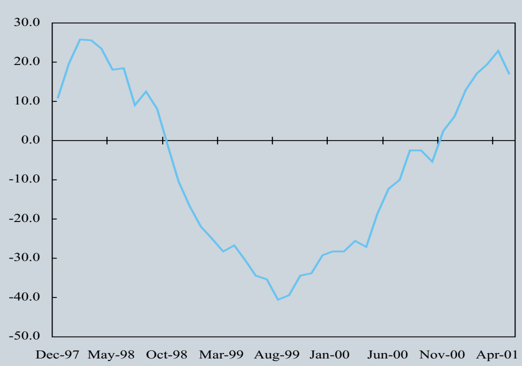
[11] Weather conditions last year were responsible for the fall early this year in the production of sugar cane in the area of Valle del Cáuca and its yield.

TABLE 6
QUARTERLY GROSS DOMESTIC PRODUCT, BY SECTOR
(ANNUAL PERCENTAGE CHANGE)

	2000 (e)					2001(e)
	I	II	III	IV	Full Year	I
GDP	2.4	3.4	3.2	2.3	2.8	1.7
Farming. forestry, hunting & fishing	1.9	7.5	3.5	7.9	5.2	3.4
Mining and quarrying	(0.9)	(7.3)	(7.5)	(5.8)	(5.4)	(4.0)
Oi, natural gas, other	n.a.	n.a.	n.a.	n.a.	n.a.	(11.1)
Electricity, gas and & water	3.6	1.7	1.0	2.9	2.3	1.8
Manufacturing	8.6	11.5	13.0	6.4	9.8	2.2
Beverages	n.a.	n.a.	n.a.	n.a.	n.a.	(10.8)
Sugar	n.a.	n.a.	n.a.	n.a.	n.a.	(0.5)
Construction	(6.7)	(1.8)	0.3	5.1	(1.0)	(3.4)
Construction work & building	n.a.	n.a.	n.a.	n.a.	n.a.	9.0
Civil works & projects	n.a.	n.a.	n.a.	n.a.	n.a.	(12.7)
Commerce, repairs, restaurants & hotels	3.9	7.3	6.2	3.0	5.1	3.1
Transport, warehousing & communications	3.4	4.0	3.9	3.2	3.6	2.6
Financial, insurance, real-estate & business-service entities	(1.3)	(0.0)	1.1	0.7	0.3	1.0
Social, community & personal services	0.6	(2.1)	(1.1)	(1.6)	(1.0)	(0.4)

(e) Estimated
n. a. Not applicable.
Source: DANE.

FIGURE 33
BUILDING TRANSACTIONS VALUE, TOTAL 8 CITIES 12-MONTH GROWTH
(FIGURES TO MAY 2001)

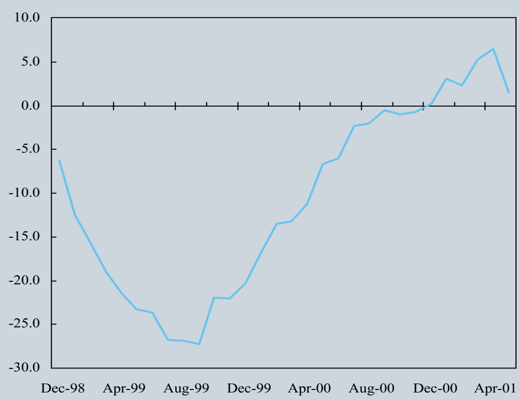


Source: Fedelonjas.

Various real-sector indicators show that the economy continued to expand over the second quarter, though more slowly. From January to May (the latest month for which information is available from DANE's Monthly Manufacturing Samples), industrial output, excluding threshed coffee, grew by 3.4%, slightly faster than the rate for January to March. This trend is confirmed by the findings of the monthly opinion poll conducted by ANDI (a major business association), which indicate a 3.9% growth for industry from January to May (Figure 34).

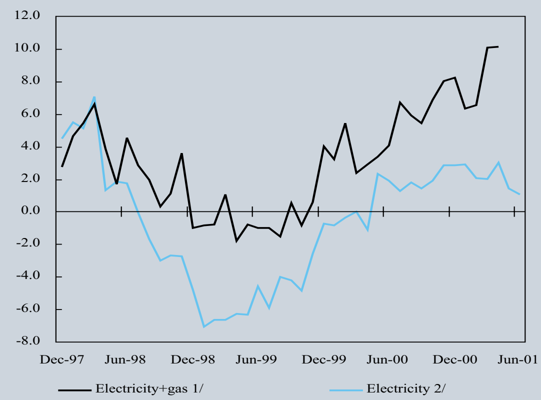
In May, the food sector was still growing slowly, whereas an appreciate number of makers of

Figure 34
Real industrial production index, To May 2001
(Annual % change, January to date)



Sources: ANDI and DANE.

Figure 35
Electricity and electricity+gas consumption
(Annual % change in monthly consumption)



Sources: ISA and Ecopetrol.

intermediate, capital and consumer goods continued to expand at a reasonable pace. This was particularly true of export production, boosted mainly by buoyant demand from Ecuador and Venezuela. In contrast, those industries more dependent on the domestic market have had greater difficulty in achieving stronger recovery.

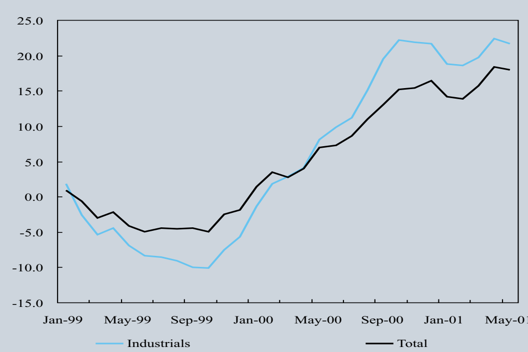
Electricity consumption, a convergent indicator of urban economic activity, continued to expand moderately, as it had been for over a year. Accumulated energy consumption in the second quarter was 1.8% higher than in the same period last year, but slightly lower than in the first quarter (2.3%)(Figure 35).

A similar conclusion can be reached about the behavior of imports to April and that of nontraditional exports to May. Overall imports registered an annual growth of 18.5 % from January to April. As can be seen from Table 7, there was rapid expansion in all import items and not just those connected with Plan Colombia or Bogotá's rapid transport project (Transmilenio).

The dollar value of nontraditional exports surged by 15.5% in May alone, a highly satisfactory result considering the already high value registered in May of last year. What is more, growth in accumulated nontraditional exports over the first five months of the year was 17.0 %, compared with 24.7% over April and May alone, indicating a strong acceleration in the second quarter relative to the first. Annual growth in the latest 12-month accumulated figure edged up in April and May, to 18.0% (Figure 36). The nontraditionals' good performance was partially offset by strong contraction in oil and coffee exports.

This year, as last year, buoyancy in nontraditional exports has been largely produced by a considerable expansion

Figure 36
Growth of nontraditional exports Accumulated in past 12 months



Source: DANE.

Table 7
Imports, accumulated annual growth to April
(millions of dollars FOB)

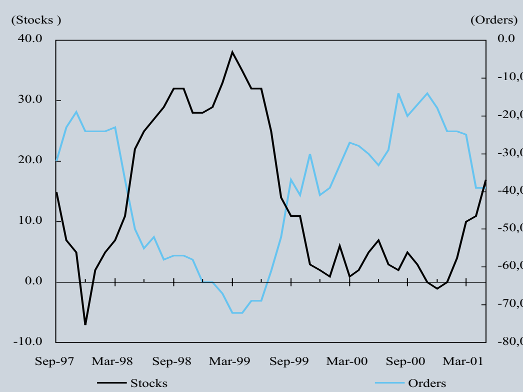
Description	January-April 2000	January-April 2001	Variation Absolute	Variation %
Nondurable consumer goods	409.3	453.1	43.8	10.7
Durable consumer goods	193.7	259.8	66.1	34.1
Private transport vehicles	78.5	100.8	22.3	28.4
Arms & military equipment (includes imports for Plan Colombia)	6.7	18.9	12.2	180.8
Other nondurable consumer goods	108.5	140.1	31.6	29.1
Fuel, lubricants & related goods	94.9	64.3	(30.6)	(32.2)
Inputs for farming	126.8	153.4	26.7	21.0
Animal feeds	49.6	50.8	1.2	2.5
Other raw materials	77.2	102.6	25.4	32.9
Inputs for industry	1,438.5	1,573.3	134.8	9.4
Construction materials	50.1	60.4	10.3	20.5
Capital goods for farming	6.5	8.6	2.0	31.3
Capital goods for industry	721.4	871.4	150.0	20.8
Transport equipment (includes imports for Plan Colombia & Transmilenio bus service)	385.3	617.8	232.5	60.4
Unclassified	2.2	1.7	(0.5)	(22.3)
Total	3,428.8	4,063.8	635.1	18.5

Source: DIAN manifests.

in industrial exports (20.5 % for the first five months of the year), thanks to substantial recovery of exports to Ecuador and mounting exports to Venezuela. Nontraditionals exported to the United States increased at an annual rate of 5.0% from January to May, more slowly than last year, maybe because of the slowdown in the US economy.

The Business Opinion Survey conducted by Fedesarrollo (a private research institution) shows that, for the second month in a row, orders were significantly lower in May than during much of last year and all this year. In contrast, stocks continued to rise in May, to a higher level than at any time in 2000, anticipating perhaps undesired stockpiling in industry (Figure 37).

Figure 37
Business opinion survey
(balances - to May 2001)



Source: Banco de la República-SGEE, on figures from Fedesarrollo's, Business Opinion Surveys.

Similarly, businessmen's perceptions of the economic situation currently and in six months' time also deteriorated somewhat in the past few months, as evidenced by the business-climate indicator (Figure 38).

The recent behavior of different indicators of real activity suggests that Colombia's economy continued to grow slowly in the second quarter. Nevertheless, economic growth in the second quarter may turn out to have been marginally stronger than in the first, for some of the supply shocks present earlier in the year were beginning to wane by then.

No major changes are anticipated in growth trends over the next few months, because the factors impeding stronger domestic demand are not expected to alter much. In addition to this, there is growing evidence of a slowdown in the world economy, and specifically in the US economy, which affects Colombia's not only through a smaller volume of export but also through lower export prices, especially for such key commodities as coffee and oil. Furthermore, uncertainty created by the crisis in Argentina might keep away capital flows required for financing growth.

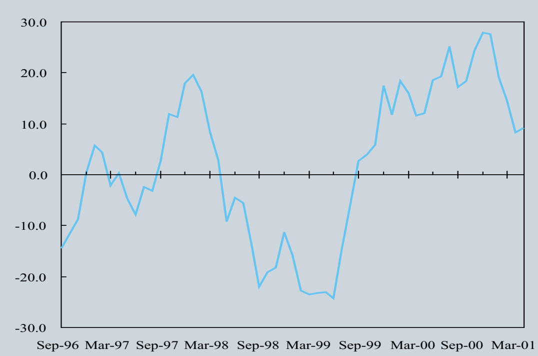
Yet, the past few months have also produced a number of developments that benefit the economy and improve the outlook for growth. They are the passage of a bill reforming the transfer regime, the successful issuance of foreign debt to prefinance public spending for 2002, and an advantageous exchange of domestic debt. These developments, together with the gradual reduction of inflation, ensure greater exchange-rate stability and lower the costs of external and domestic debt.

2. Consumption

Consumption has been the least dynamic component of overall demand in 2001 and the one most responsible for slow GDP growth. DANE's figures show that overall consumption rose at an annual rate of barely 1.2% over the first quarter, largely because of a 0.8% contraction in public spending but also because private consumption grew by only 1.9% (Table 8). Even so, growth in consumption, particularly private consumption, was stronger in the first quarter of this year than in the final quarter of 2000.

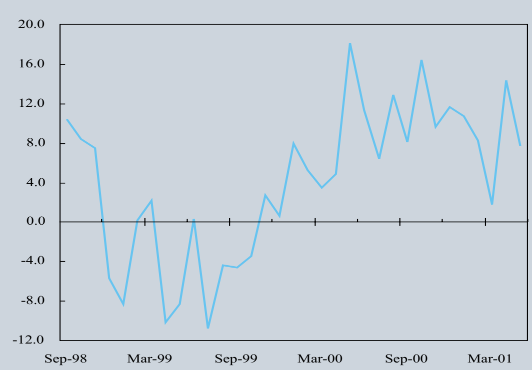
Consumption did not change overmuch in the second quarter, and to judge from the recent behavior of some indicators it may have risen slightly. In effect, nominal annual growth in credit-card sales averaged 10.8% for April and May, compared with 6.9% for the first three months of the year (Figure 39). Similarly, real retail sales excluding fuel showed an average annual growth of 1.3% for April and May, up from 1.1% for the first

FIGURE 38
BUSINESS CLIMATE
(TO MAY 2001)



Sources: Banco de la República-SGEE, on figures from Fedesarrollo's Business Opinion Surveys.

FIGURE 39
CREDIT-CARD SALES, ENTIRE SYSTEM
TO MAY 2001
(ANNUAL NOMINAL % CHANGE)



Source: Red Multicolor.

Table 8
Demand view of annual GDP growth
(percentage change)

Item	2000 (e)					2001 (e)
	I	II	III	IV	Full year	I
GDP	2.4	3.4	3.2	2.3	2.8	1.7
Total imports	8.2	9.1	6.5	(0.3)	5.8	9.2
Final supply	3.4	4.3	3.7	1.7	3.3	2.8
Final consumption	2.4	2.2	1.1	0.0	1.0	1.2
Household	2.7	3.9	2.6	1.3	2.6	1.9
Government	1.3	(2.2)	(3.3)	(3.8)	(2.0)	(0.8)
Gross capital formation	8.7	20.1	17.0	4.6	15.3	7.2
Machinery & equipment	10.7	14.9	19.8	10.7	13.9	15.1
Transport equipment	6.8	28.9	(9.9)	(15.7)	1.2	39.1
Construction & buildings	(16.1)	(11.5)	10.9	7.2	(3.2)	9.9
Civil works	(2.0)	4.3	(4.2)	4.5	0.6	(12.7)
Total exports	3.8	2.9	6.0	7.2	5.3	6.6
Final Demand	3.4	4.3	3.7	1.7	3.3	2.8

(e) Estimated
Source: Ministry of Finance and Public Credit, and DANE.

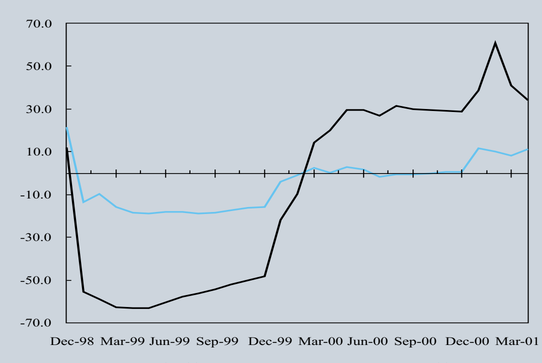
three months of the year. Lastly, expansion in imports of durable and nondurable consumer goods remained high in April, at around 20%. For January to April, growth in the value of consumer-goods imports was 18.5% (11.5% for nondurables and 34.3% for durables) (Figure 40).

3. Investment

Exports and investment have been the more dynamic demand components in recent months. Moreover, the latest results would appear to contradict the Expectations Surveys' findings about some sectors' perceptions of the economic situation in six months time. In fact, according to DANE, investment expanded at an annual growth of 7.2% in the first quarter of 2001, faster than in the fourth quarter of last year (4.6%), but more slowly than earlier in 2000 (Table 8).

Although no separate figures are available on public and private investment, it seems clear from the breakdown presented by DANE that the private sector accounted for most of the growth in this variable, with its investments concentrated in machinery and equipment and in construction and buildings. In contrast, public investment was largely centered on civil works and shrank in the first quarter of 2001.

Figure 40
Consumer-goods imports to appril 2001
(% change, january to date)



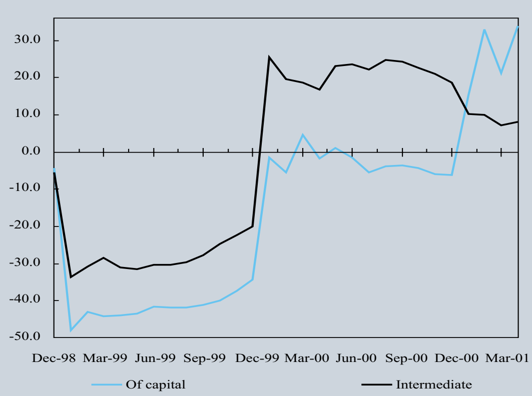
Source: Tax and Customs Administration (DIAN) manifests.

Trends in investment growth are not expected to have changed over the second quarter. This is particularly true of private investment, to judge from the satisfactory behavior of imports of capital goods and intermediate goods, two indicators of private spending. These imports expanded significantly in April, outpacing the first-quarter's average growth, even without including the capital goods imported for Plan Colombia (Table7). From January to April, imports of intermediate goods grew by 8.1%, while those of capital goods surged by 33.9% (Figure 41).

Since interest rates are relatively low, at least those (such as on ordinary loans) usually associated with investment funding, and since investment levels are still below historical averages, current conditions are favorable for investment to continue growing in the next few months at much the same pace as in recent quarters.

That is assuming no developments occur to generate strong uncertainty about the economy's future performance and thereby discourage investment. In this connection, the decline referred to above in the business-climate indicator is troubling and needs to be carefully monitored, for it might signify that fewer investment projects will be carried out over the rest of the year.

FIGURE 41
IMPORTS TO APRIL 2001
(% CHANGE, JANUARY TO DATE)



Source: DIAN manifests.

C. WAGES AND EMPLOYMENT

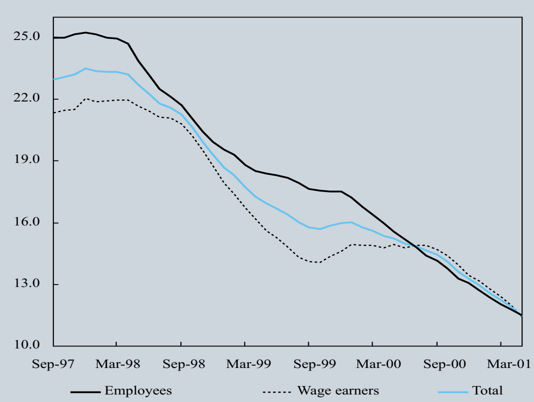
1. Industrial pay

Up to May, nominal industrial pay rises were still on the decline, as they had been during 2000 and the first two months of this year. Average nominal industrial pay for the 12 months to May rose by 11.5%, which compares favorably both with 13,3% for December 2000, and with the 12.6% rate for February-the latest available information presented in the March 2001 Inflation Report. As in previous quarters, pay rises have been decreasing for both wage earners and employees, and doing so at similar rates (Figure 42).

Smalles rises in nominal industrial pay continue to result in lower increases in real pay. In the 12 months to May, average real pay for all workers increased by 2.4%, down from 3.6% in December 2000, and from 3.0% in February this year. As in the case of nominal pay, real pay has been rising at an ever slower pace for both wage earners and employees (Figure 43).

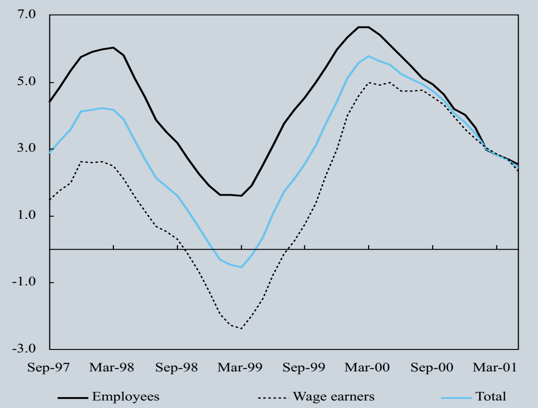
Taking benefits into account gives an even lower rate of increase for real remuneration (pay plus benefits), which is more consistent with the current

FIGURE 42
NOMINAL MANUFACTURING PAY
TO MAY 2001
(PERCENTAGE 12-MONTH CHANGE)



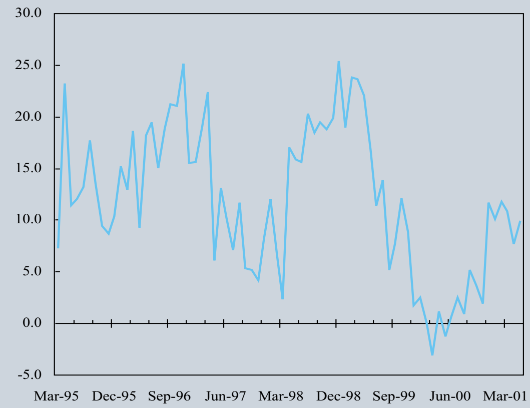
Source: DANE, Monthly Manufacturing Sample.

Figure 43
Real manufacturing pay
To may 2001
(annual % change in 12-months[1] accumulated)



Source: DANE, Monthly Manufacturing Samples.

Fgure 44
Nominal unit labor cost
Industrial wage earners to may 2001
(annual change)



Source: DANE. Calculations by Banco de a República, SGEE.

level of unemployment and slow economic growth. In effect, in the 12 months to April, average real remuneration rose by barely 1.3% for all permanent workers and by 1.0% for temporary wage earners, while shrinking by 2.4% for temporary employees.

Although pay rises have continued to decrease all year, labor costs may have become more likely to generate inflationary pressure. For pay rises have been higher than inflation and the difference has not been offset by labor-productivity increases. In fact, implicit productivity in industry fell in February-April relative to the same period last year. Unit labor costs have thus begun to rise by more than this year's 8.0% inflation target and, if they continue to do so, may cause industrial prices to climb by more than 8.0%. In the first five months of this year, unit labor costs rose at an annual average rate of 10.1% (Figure 44).

2. Employment

According to DANE's Continual Household Surveys, unemployment in May for the 13 largest cities was 18.1%, up by one percentage point on a year earlier, but lower than the 19.6% average for the first three months of this year. Unemployment for the country as a whole was 14.3% in May, also lower than the first-quarter average (16.2%).

No figures are available on last year's overall unemployment to compare it with this year's.

Up to April, the rise in unemployment for the 13 major cities stemmed from a labor-supply increase not fully absorbed by the expansion in employment. Thus, the average global participation rate for January to April was 2.2 points up on the same period last year.

In May, however, the global participation rate registered its first annual decline for several quarters, suggesting a lowering of supply pressures on the labor market. So, in contrast to annual unemployment increases in previous months, the increase in May should be mostly attributed to weaker job creation rather than to stronger labor supply. In effect, over the first quarter the number of employed workers increased by 274,000, on average, relative to last year's levels, whereas over April and May the corresponding increase amounted to only 122,000 jobs.

The 13 cities' declining rate of employment growth in recent months does not appear to be ascribable to industrial employment, for industrial employment continued to recover in April and May at much the same pace as its upturn in January and February, described in the corresponding Inflation Report (March 2001). According to information from DANE's Monthly Manufacturing Samples, in May overall employment in industry showed a 2.3% growth with respect to a year earlier, a slightly higher rate than in February. In May, as in February, growth in industrial employment continued to be driven by strong recovery in temporary industrial employment exclusively. Temporary jobs in industry increased at an annual rate of 18.5% in May, slightly faster than in February (17.9%) (Figure 45).

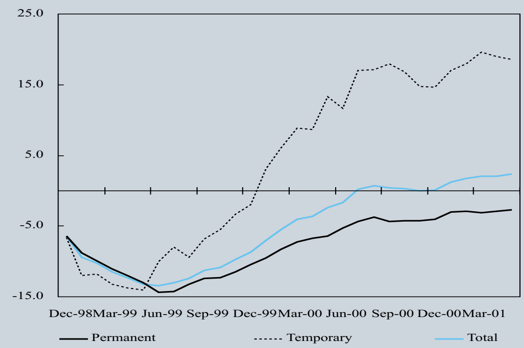
Permanent employment continued to shrink at annual rates of 2.7%, more slowly than last year but at about the same pace as earlier this year (Figure 45). It is clear therefore that businessmen continue to replace permanent employment by temporary jobs, a common trend in times of sluggish economic growth, and will not go back to hiring permanent workers until there is less uncertainty about the economic situation and a more robust recovery.

3. Pay settlements

Table 9 presents figures on one- and two-year pay rises established in collective bargaining agreements reported to the Ministry of Labor and Social Security. The upper part of the table shows the percentages of workers from public- and private-sector companies covered by one-year pay settlements negotiated in the first half of the year, by level of pay rise. By the end of June, one-year pay rises of 8.8% -11.0% had been accepted by 55.9% of workers, a higher proportion than in March (47.3%). In contrast, though the percentage of workers with a pay increase of 8.75% was still substantial in June (28.8%), it had fallen by10 percentage points since March. The percentages of workers obtaining pay rises of under 8.75% or over 11.0% also declined relative to the first quarter.

The bottom part of Table 9 shows the percentages of workers by range of two-year pay rises also negotiated between January and June this year. Under two-year settlements, the highest percentage of workers (41.0%) obtained pay rises ranging between CPI+0.2 and CPI+2.2, a substantially higher proportion than the first-quarter figure of 28.4%. In contrast, the percentage getting a two-year pay increase equal to the CPI dropped sharply from 59.7% in March to 36.7% in June. The surge in two-year settlements in ranges far above the CPI might be a signal of heavier inflationary pressures likely to arise next year from higher labor costs.

Figure 45
Monthly industrial employment index
To may 2001



Source: DANE.

Table 9
Pay settlements: january-june 2001
% of beneficiaries by pay-rise level

One-year negotiated rises			
<8.75	**8.75**	**[8.9-11.0]**	**>11.0**
9.6	28.8	55.9	5.8

Two-year negotiated rises				
<10.0	**[10.0-15.0]**	**CPI**	**[CPI + 0.2-CPI + 2.0]**	**MLW**
17.6	3.0	36.7	41.0	1.8

MLW = Minimum legal wage.
Source: Ministry of Labor and Social Security.

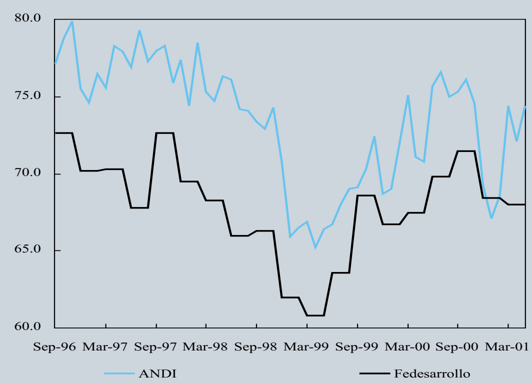
D. Capacity utilization

Capacity utilization picked up in the first two months of the second quarter, relative to the same period last year, according to both Fedesarrollo and ANDI.

In May, the level of utilization estimated by Fedesarrollo was 67.7%, up by 0.2 percentage points on a year earlier, while the level estimated by ANDI was 74.4%, some 3.6 points higher than in May 2000 (Figure 46).

Both measures, however, are still below levels registered in times of more sustained economic growth like the 1990s. As in previous Reports, therefore, it is considered that there is still no reason to fear a surge in inflationary pressures from demand over the coming months, at least as far as industrial prices are concerned.

FIGURE 46
CAPACITY UTILIZATION
TO MAY 2001



Sources: ANDI and Fedesarrollo.

E. FISCAL SITUATION

1. First-quarter results

On preliminary estimates, the consolidated public-sector deficit at the end of the first quarter stood at 855 billion pesos, equivalent to 0.5% of annual GDP. This result was in line with the terms of the agreement with the International Monetary Fund, which envisages a quarterly deficit target of 1,000 billion pesos. The fiscal situation deteriorated with respect to the first quarter of 2000, largely because of a higher central-government deficit and a lower surplus for the rest of the nonfinancial public sector (Table 10).

The central government's finances registered a first-quarter deficit of 1.0% of GDP, up by 0.4% of GDP on a year earlier. Relative to the first quarter of 2000, revenues increased by 12.6% and expenditures by 14.8%. The fastest growing revenue items were the gasoline tax (45.9%), the financial-transactions levy (40.7%), and external VAT (35.4%) (Table 11).

On the expenditure side, interest on debt grew by 11.5%, operating expenses by 15.8%%, and investment by 13.5%. Under operating outlays, personal services climbed by 26.2%, general expenditures by 101.4%, and transfers by 7.7%. The surge in general expenditures was connected with the purchase of military equipment worth 206 billion pesos in the first quarter. Net loans totaled 188 billion pesos, including notably credit operations amounting to 83 billion through the Special Foreign-Debt Account (CEDE), and debt guarantees worth 84 billion.

The government's deficit was largely financed from foreign and domestic loans, and the transfer of profits amounting to 1,452 billion pesos produced by the Banco de la República's operations. Net foreign financing came to 1,685 billion pesos, from disbursements totaling 1,936 billion, less 251 billion in amortizations. Net domestic financing amounted to 682 billion pesos, from 3,957 billion in disbursements, less amortizations totaling 3,275 billion. Placements of Treasury paper produced 3,931 billion pesos, with 2,688 billion of this amount in the form of agreed or compulsory investment, and 1,243 billion through auctions.

2. Results to May

At the end of May, the central government showed an accumulated deficit of 2,797 billion pesos, representing 1.5% of annual GDP. Relative to January-May of 2000, revenues increased by 20.5% and

Table 10
Consolidated public-sector fiscal balance,
First quarter

Item	Billions of pesos		Percentage of GDP	
	2000	2001(pr)	2000	2001(pr)
Electricity sector	238.0	228.0	0.1	0.1
Carbocol (coal)	65.0	0.0	0.0	0.0
F.A.E.P. (oil stabilization fund)	410.0	238.0	0.2	0.1
Ecopetrol	607.0	701.0	0.4	0.4
Telecom	(100.0)	(112.0)	(0.1)	(0.1)
Other entities **1/**	(95.0)	(67.0)	(0.1)	(0.0)
Social security	482.0	129.0	0.3	0.1
Local & regional	308.0	(156.0)	0.2	(0.1)
National Coffee Fund	(1.0)	28.0	(0.0)	0.0
1. Subtotal rest of public sector	1,914.0	989.0	1.1	0.5
2. Central government	(1,044.0)	(1,899.0)	(0.6)	(1.0)
A. Total nonfinancial public sector (1 + 2)	870.0	(910.0)	0.5	(0.5)
B. Banco de la República cash profit/loss	226.0	452.0	0.1	0.2
C. Fogafin cash profit/loss	(171.0)	64.0	(0.1)	0.0
D. Financial restructuring costs	(163.0)	(442.0)	(0.1)	(0.2)
E. Adjustments	(22.0)	(18.9)	(0.0)	(0.0)
F. Total public-sector consolidated (A + B + C + D + E)	740.0	(854.9)	0.4	(0.5)

(pr) Preliminary
1/ Includes EPM and EMCALI (Medellïn and Cali municipal utilities companies).
Source: CONFIS.

expenditures y 18.0%. The revenue items registering the fastest growth were the gasoline tax (44.4%), the financial-transaction levy (42.7%), and external VAT (36%) (Table 12).

On the expenditure side, interest on debt grew by 7.0%, operating expenditures by 18.7%, and investment by 52.6%. Under operating outlays, personal services climbed by 21.1%, general expenditures by 72.0%, and transfers by 14.1%. As in the first quarter, the surge in general expenditures is attributable to the purchase of military equipment, amounting to 285 billion pesos over the first five months of the year. Accumulated net loans totaled 283 billion pesos, mostly channeled through the Special Foreign-Debt Account (CEDE).

The deficit was financed from loan funds as well as profits from the Banco de la República's operations. Net external funding came to 4,929 billion pesos, from 6,125 billion received in disbursements, less 1,196 paid out in amortizations. Net domestic funding amounted to 1,535 billion pesos, with disbursements totaling 5,534 billion, and amortizations 3,999 billion. Placements of Treasury paper produced 5,349 billion pesos.

Table 11
Central government, January-March
(billions of peso)

		Enero-Marzo		Crecimiento
		2000	2001	anual
I.	**Total revenues (A + B + C + D)**	5,845.0	6,581.0	12.6
	A. Tax revenues	5,240.0	6,043.0	15.3
	Income tax	2,186.0	2,252.0	3.0
	Internal VAT	1,689.0	1,967.0	16.5
	External VAT	523.0	708.0	35.4
	Customs	397.0	478.0	20.4
	Gasoline	185.0	270.0	45.9
	Financial-transactions levy	253.0	356.0	40.7
	Other	7.0	12.0	71.4
	B. Nontax revenues	282.0	225.0	(20.2)
	C. Special funds	72.0	54.0	(25.0)
	D. Capital income	251.0	259.0	3.2
	Financial returns	134.0	183.0	36.6
	Financial surpluses	28.0	61.0	117.9
	Other	89.0	15.0	(83.1)
II.	**Total expenditures (A + B + C + D)**	7,830.0	8,991.0	14.8
	A. Interest payments	1,889.0	2,107.0	11.5
	External	557.0	753.0	35.2
	Internal	1,332.0	1,354.0	1.7
	B. Operating costs	5,303.0	6,141.0	15.8
	Personal services	916.0	1,156.0	26.2
	General expenses	277.0	558.0	101.4
	Transfers	4,110.0	4,427.0	7.7
	C. Investment outlays	489.0	555.0	13.5
	D. Net loans	149.0	188.0	26.2
III.	**Adjustments**	941.0	511.0	(45.7)
IV.	**Cash deficit or surplus (I-II+III) 1/**	(1,044.0)	(1,899.0)	81.9
V.	**Financing (A + B + C)**	1,044.0	1,899.0	81.9
	A. Net external credit	1,526.0	1,685.0	10.4
	Disbursements	2,351.0	1,936.0	(17.7)
	Amortizations	825.0	251.0	(69.6)
	B. Net domestic credit	2,098.0	682.0	(68.6)
	Disbursements	3,916.0	3,957.0	1.0
	Amortizations	1,818.0	3,275.0	88.0
	C. Banco de la República profits	516.0	1,452.0	181.4
	D. Other	(3,096.0)	(1,920.0)	(82.4)
VI.	**Deficit as percentage of GDP**	(0.6)	(1.0)	63.5

1/ Does not include financial restructuring costs.
Source: CONFIS.

Table 12
Central government, January-May
(billions of peso)

		January-May		Annual
		2000	2001	change
I.	**Total revenues (A + B + C + D)**	9,669.0	11,647.0	20.5
	A. Tax revenues	8,624.0	10,773.0	24.9
	Income tax	3,799.0	4,489.0	18.2
	Internal VAT	2,470.0	3,091.0	25.1
	External VAT	910.0	1,238.0	36.0
	Customs	679.0	855.0	25.9
	Gasoline	331.0	478.0	44.4
	Financial-transactions levy	424.0	605.0	42.7
	Other	11.0	17.0	54.5
	B. Nontax revenues	307.0	249.0	(18.9)
	C. Special funds	193.0	102.0	(47.2)
	D. Capital income	545.0	523.0	(4.0)
	Financial returns	370.0	411.0	11.1
	Financial surpluses	76.0	80.0	5.3
	Other	99.0	32.0	(67.7)
II.	**Total expenditures (A + B + C + D)**	13,038.0	15,390.0	18.0
	A. Interest payments	3,105.0	3,323.0	7.0
	External	802.0	932.0	16.2
	Internal	2,303.0	2,391.0	3.8
	B. Operating costs	8,848.0	10,502.0	18.7
	Personal services	1,523.0	1,844.0	21.1
	General expenses	514.0	884.0	72.0
	Transfers	6,811.0	7,774.0	14.1
	C. Investment outlays	840.0	1,282.0	52.6
	D. Net loans	245.0	283.0	15.5
III.	**Adjustments**	917.0	946.0	3.2
IV.	**Cash deficit or surplus (I - II + III) 1/**	(2,452.0)	(2,797.0)	14.1
V.	**Financing (A + B + C+D)**	2,452.0	2,797.0	14.1
	A. Net external credit	1,408.0	4,929.0	250.1
	Disbursements	1,826.0	6,125.0	235.4
	Amortizations	418.0	1,196.0	186.1
	B. Net domestic credit	2,934.0	1,535.0	(47.7)
	Disbursements	5,253.0	5,534.0	5.3
	Amortizations	2,319.0	3,999.0	72.4
	C. Banco de la República profits	516.0	1,452.0	181.4
	D. Other	(2,406.0)	(5,119.0)	112.8
VI.	**Deficit as percentage of GDP**	(1.4)	(1.5)	2.6

1/ Does not include financial restructuring costs.
Source: CONFIS.

III

Measures of expect ations

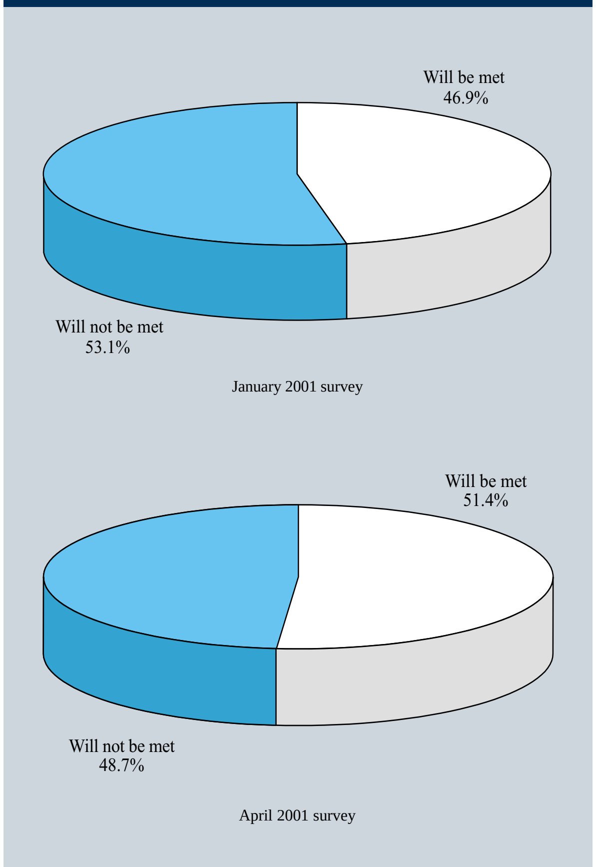
Section A of this chapter refers to the main findings of the Expectations Survey conducted in April 2001. Respondents were provided with information available at the end of the first quarter on the exchange rate, inflation, interest rates, monetary aggregates and GDP growth. This section highlights the fact that meeting the inflation target has become more credible. Section B discusses forecasts by local and foreign analysts and by investment banks regarding the behavior of the chief macroeconomic variables in 2001. Both local and foreign analysts have revised down their forecasts of GDP growth.

A. Main findings of April expectations survey

1. Inflation

Some 51.4% of the April survey's respondents believed this year's 8% inflation target would be met, as compared with 46.9% in January, which shows that the target has become more credible (Figure 47). The economic sectors believing more strongly in the inflation target are academics and consultants (62.5%) and large retail chains (61.1%). In contrast, only 16.7% of union representatives think the target will be met, and followed by 48.3% of the financial system.

Figure 47
Credibility of 8.0%
Inflation target for 2001



The average expectation is that inflation will edge up in the final quarter of this year, to 8.5%, with the minimum expected rate averaging 8.2% and the maximum 8.9% (Figure 48). The April survey's expected rate for December 2001 is 0.3 percentage points lower than the January survey's. The biggest price growth by the end of the year (8.9%) is expected by large retail chains, and the smallest (8.3%) by academics and consultants.

For June, respondents expected inflation to average 8.0% without falling below 7.7%. Actual inflation in June was 7.9%, thus running between the average and minimum expected rates.

Figure 48
Actual inflation and April/2001 expectations
(For 3, 6, 9 and 12 months later)
(Annual rate)

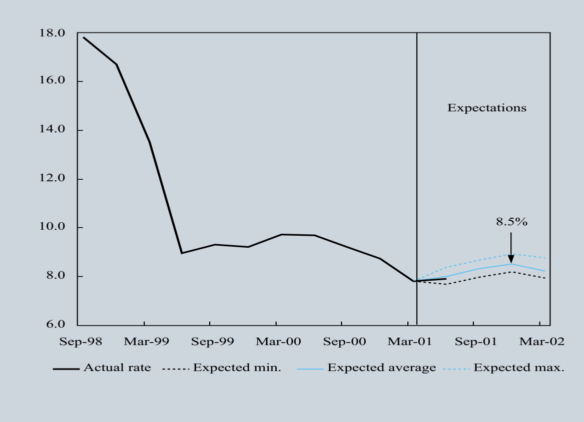


Figure 49
Actual inflation and
evolution of expectations
(Annual rate)

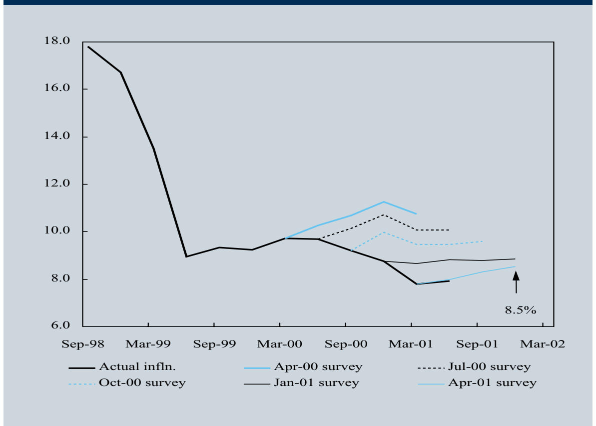


Figure 50
Inflation expectations of believers
and non-believers
in attainment of 8.0% target for 2001

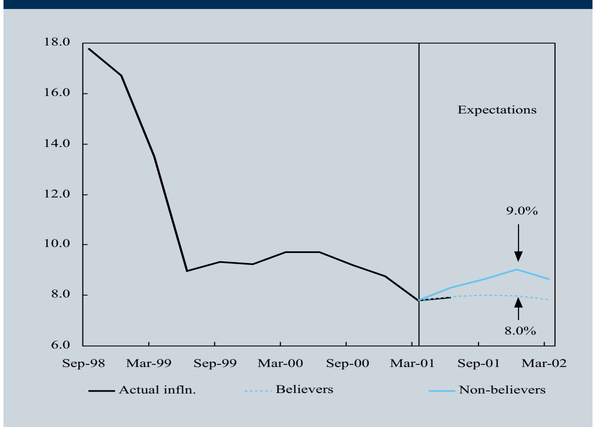


Figure 49 shows how inflation expectations have gradually fallen as actual inflation has decreased. The figure also shows a tendency in expected inflation to pick up by the fourth quarter in every survey conducted since April 2000. But the pick-up is less marked in this year's surveys than in those conducted last year.

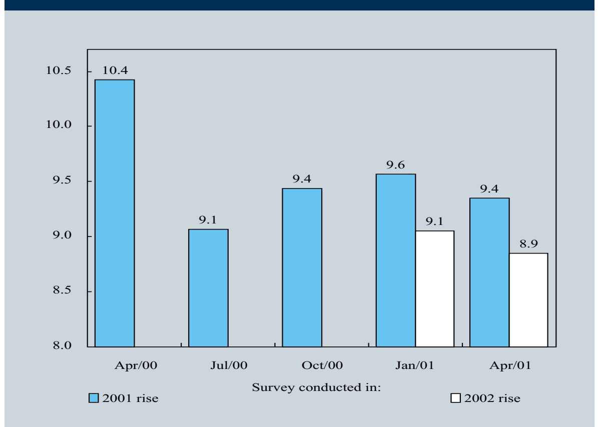
Respondents not believing that this year's 8.0% target will be met expect a 9.0% annual rate by December, revising down the January survey's worst-case expectations by 0.5 percentage points, while those believing it will be met expect an 8.0% rate (Figure 50). It is to be noted that actual inflation to June (7.9%) was in line with the latter's expectations.

2. Pay rises

In April, the expected pay rise for 2001 was 9.4%, down by 0.2 percentage points on the January figure, but the same rate as predicted in last year's October survey (Figure 51). April's expected pay rise for 2002 (8.9%) is also 0.2 percentage points lower than the January figure.

Breakdown of the findings by sector shows that the biggest pay increases for 2001 and 2002 are expected by the industry and mining group (9.4%, 9.0%), followed by large retail chains (9.0%, 8.9%), and the lowest by the group of academics and consultants

Figure 51
Expected average wage rises
For current and following year
(Percentage)



(8.0%, 7.6%), followed by the transport and communications sector (8.6%, 7.9%).

3. Perceptions of liquidity and credit availability

In April, the percentage of respondents considering the current level of liquidity in the economy to be high was 52.6%, an increase of 8.2 points on the corresponding figure in January (Figure 52A). As regards liquidity in six months' time, 62.7% of those polled in April expected it to remain unchanged from its April level, while 17.3% thought it would fall, and 23% saw it as rising (Figure 52B).

Unions were the sector with the largest percentage of agents (83.3%) considering liquidity to be low in the economy, while financial intermediaries exhibited the largest percentage (76%) considering it to be high.
In April, the level of credit availability in the economy was thought to be high by 36.8% of respondents and low by 52.6%. These percentages are quite similar to those reported in the January survey (39.5% and 50.6% respectively) (Figure 53A). Credit availability in six months' time was expected by 64.0% of respondents to remain at the April level, while 22.7% saw it as rising, and only 12.0% believed it would fall (Figure 53B).

As in January, all union respondents in April considered current credit availability to be low. Unions were also the most pessimistic sector about credit availability in six months' time, with 50% expecting it to be lower than in April, and the other 50% expecting it to remain unchanged.

4. Interest and exchange rates

The interest rate is predicted by respondents to remain fairly stable for the rest of the year, as evidenced by their expectations averaging 13.3% in the April survey

Figure 52

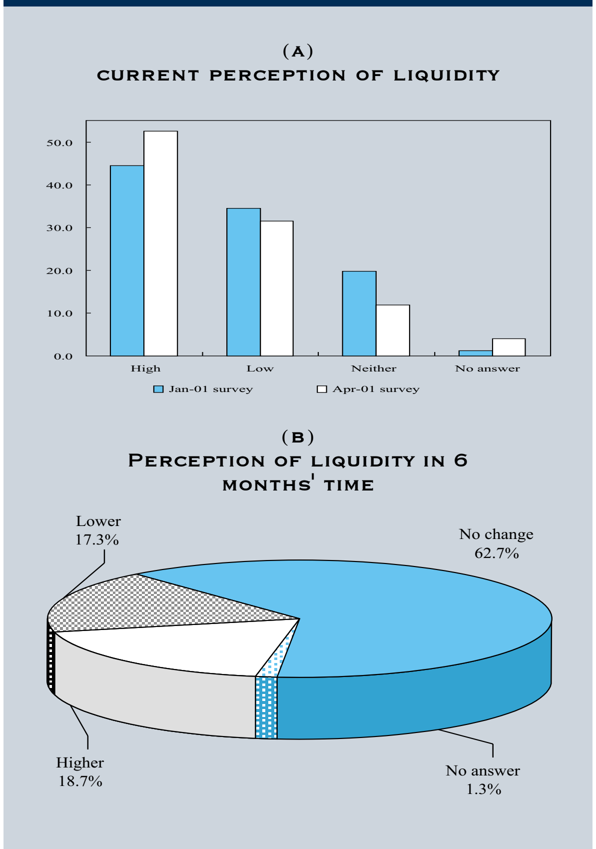
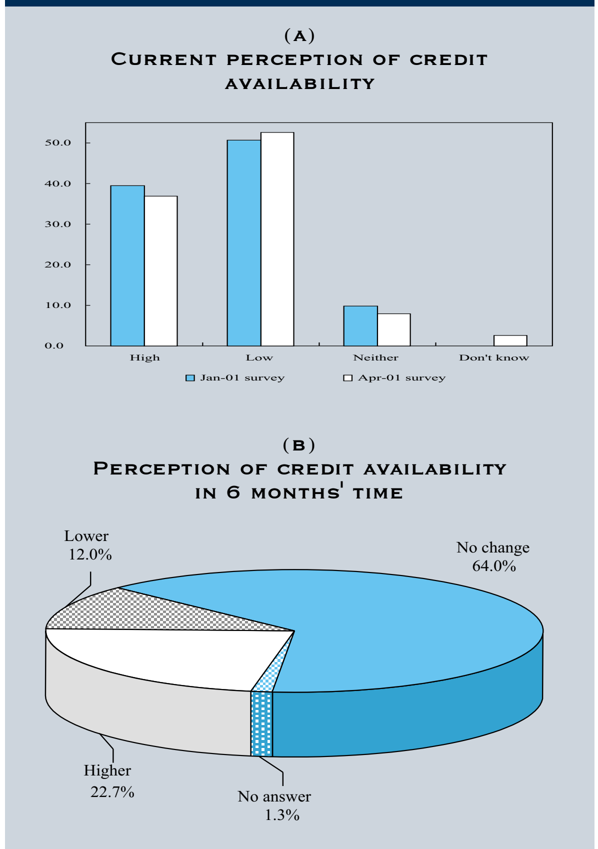


Figure 53



(Figure 54). The DTF rate expected by them for June proved to be 0.3 percentage points higher than the actual rate (12.7%). Although interest-rate expectations reported in the surveys have usually displayed a rising trend (Figure 55), in the April survey they exhibit a notable downward displacement in relation to those of January 2001 and October 2000.

By sector, it is the financial system that expects the biggest rise in the DTF deposit rate by the end of the year (13.7%), whereas large retail chains do not expect it to change substantially, their predictions averaging out to a rate of 13.2%.

In the April survey, the exchange rate is expected to end the year at 2,464 pesos to the dollar, within a range of 2,492 and 2,424 pesos, signifying expectations of a 10.5% annual nominal devaluation, within a range of 11.8% and 8.8% (Figure 56). It is to be noted that at the end of June the actual exchange rate was 2,299 pesos, running below the minimum predicted for June, as can be seen from Figure 56.

Figure 57 shows how the average expected nominal exchange rate has evolved across surveys conducted between April 2000 and April 2001. It is clear that expectations of nominal devaluation have

FIGURE 54
ACTUAL, AND APR-01 EXPECTATIONS
(FOR 3, 6, 9 AND 12 MONTHS LATER)
(ANNUAL EFFECTIVE RATE)

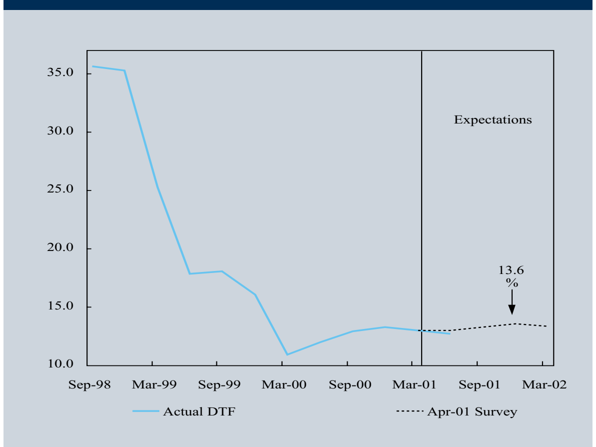


FIGURE 56
NOMINAL EXCHANGE RATE: ACTUAL,
AND APR-01 EXPECTATIONS
(PESOS TO THE DOLLAR)

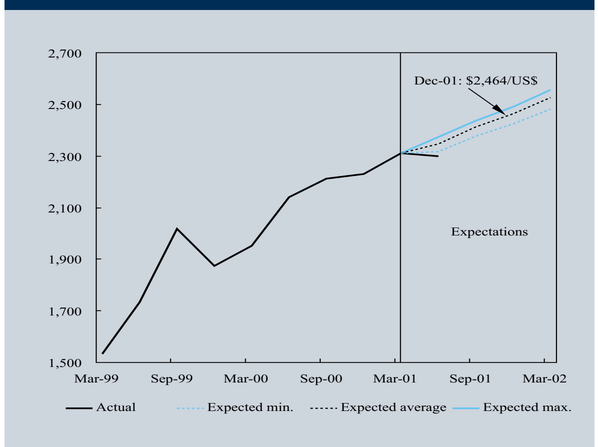


FIGURE 55
ACTUAL DTF DEPOSIT RATE AND
EVOLUTION OF EXPECTATIONS

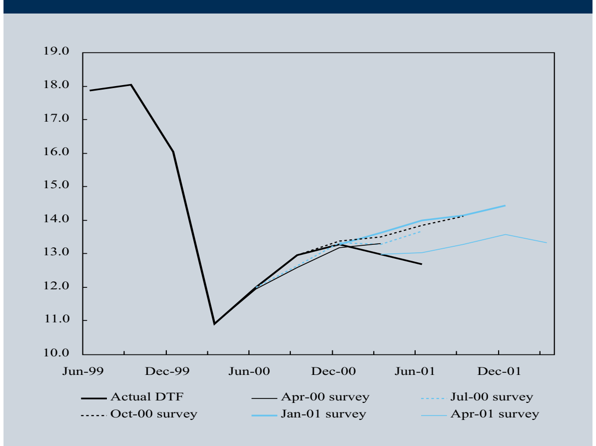
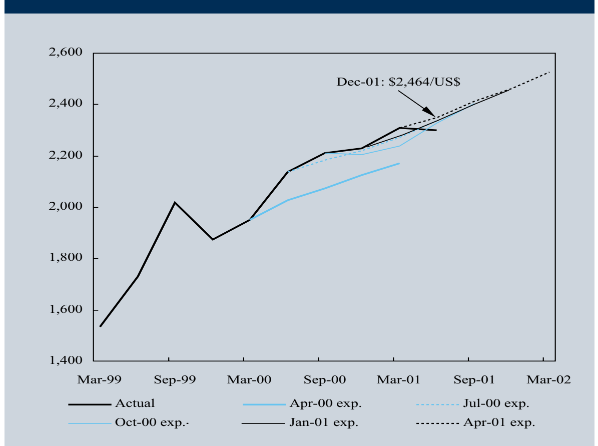


FIGURE 57
NOMINAL EXCHANGE RATE, ACTUAL AND
EVOLUTION OF EXPECTATIONS
(PESOS TO THE DOLLAR)



changed little from July 2000 on: for example, they averaged 10.3 % in January this year and much the same in April.

The biggest annual devaluation (12.6%) was predicted by the transport and communications sector, and the lowest (8.4%) by unions.

5. Growth and employment

In April, expected GDP growth rates for this year and next (2.8%, 3.4%) showed downward revisions from the levels predicted in January (3.3%, 3.8%) (Figure 58). Expectations in April ranged between 3.2% and 2.3% for 2001, and between 3.7% and 2.9% for 2002.

According to the April survey, the economic sector expecting the highest growth in output for 2001 and 2002 was the financial sector (3.0%, 3.5%), in contrast to the unions, which expressed the lowest expectations (2.4%, 3.0%).

As regards expectations about workforce changes in the short term (three to six months), Figure 59 shows that in April 60.0% of respondents expected to keep the same number of employees, while 14.7% planned to increase their workforce, and 21.3% to reduce theirs. These figures are a slight improvement on the January survey, which reported 13.9% planning to expand their workforce and 22.8% intending to reduce theirs. With regard to a longer period (six months to a year), 72.0% of respondents said they would keep the same number of employees, while10.7% expected to hire more people and 13.3% to have a smaller workforce.

B. Local and foreign analysts' forecasts of main macroeconmic variables

The latest forecasts of Colombia's main macroeconomic variables for 2001, made by a number of local and foreign analysts, are briefly discussed below (Table 13).

Real GDP growth for 2001 is the variable showing the biggest changes in forecasts relative to those presented in the first-quarter Inflation Report. The average of local analysts' forecasts has been reduced by 0.4 percentage points, from 2.9% in March to 2.5% in June, and that of foreign forecasters' has been revised down from 3.2% to 2.9%.

Neither local nor foreign analysts have much altered their inflation forecasts relative to the previous Report, with local projections now averaging 9.2%,

FIGURE 58
EXPECTED GDP GROWTH
FOR 2001 AND 2002
APRIL 2001 SURVEY

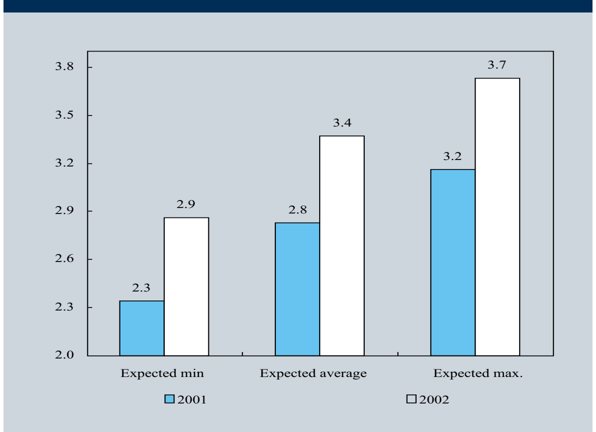


FIGURE 59
CORPORATE WORKFORCE PLANS,
SHORT AND MEDIUM TERM
(PERCENTAGE)

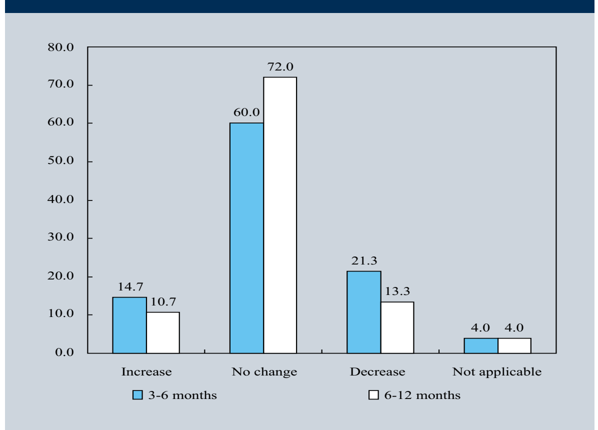


Table 13
Forecasts of main macroeconomic variables for 2001

	Forecast date	Real GDP growth %	CPI Inflation %	Nominal exchange rate (yearend)	Nominal DTF deposit rate %	Déficit (% of GDP): Fiscal,	Currt. acct.	Unemploy-ment %
Local analysts								
Revista Dinero **1/**	8-Jun-01	2.3	8.9	2,500	15.0 **2/**	3.2 **3/**	1.9	19.0 **2/**
Javier Fernández Riva **4/**	11-Jul-01	2.5	8.5	2,435	13.9	n.d.	2.8	15.8
Suvalor-Corfinsura **5/**	14-Jun-01	2.6	9.0	2,430	13.8	2.8	n.d.	n.d.
ANIF **6/**	24-May-01	2.0	8.5	2,452	14.0	3.2	2.7	17.5
Fedesarrollo **7/**	Jan-01	3.0	11.0	2,345	16.0 **2/**	n.d.	n.d.	17.0
Average		**2.5**	**9.2**	**2,432**			**2.5**	
Foreign analysts								
WEFA **8/**	30-May-01	3.0	8.2	n.d.		5.2	1.7	18.0
Goldman Sachs **9/**	22-Jun-01	2.0	9.0	2,425		3.0	1.7	n.d.
IDEA global **10/**	26-Jun-01	3.0	8.0	2,410		2.7	3.7	17.5
J. P. Morgan **9/**	22-Jun-01	2.7	8.0	n.d.		3.1	1.6	n.d.
ABN Amro Bank **9/**	22-Jun-01	3.0	9.5	2,475		3.0	2.2	n.d.
Salomón Smith Barney **9/**	22-Jun-01	3.3	10.0	2,430		3.0	1.3	n.d.
Deutsche Bank **9/**	22-Jun-01	2.9	9.8	2,480		3.3	3.3	n.d.
Morgan Stanley **9/**	22-Jun-01	3.0	9.5	2,415		2.8	0.7	n.d.
Merrill Lynch **9/**	22-Jun-01	3.1	9.0	2,410		2.9	1.5	n.d.
Average		**2.9**	**9.0**	**2,435**		**3.2**	**2.0**	**17.8**

n.a. Not available.
1/ Revista Dinero, June 8, 2001, No. 134.
2/ Average for the year.
3/ IMF methodology.
4/ Seminar on Economic and Financial Outlook, July 11, 2001.
5/ "La economía colombiana en el año 2001", June 14, 2001.
6/ ANIF-Fedesarrollo Seminar on Dollarization, May 24, 2001.
7/ "Perspectivas para el año 2001", January 2001.
8/ Document dated May 30, 2001.
9/ ? Cómo nos ven afuera? Report by the Banco de la República's Monetary and Reserve Department (SMR), June 22, 2001.
10/ Document dated June 26, 2001.

and the average of foreign projections remaining at 9.0%. The nominal exchange rate is predicted by local analysts to run at 2,432 pesos to the dollar by the end of the year, up from 2,410 pesos predicted in the first quarter, giving a 9.0% devaluation. In contrast, foreign analysts maintain their first-quarter forecast of 2,435 pesos to the dollar by December, with a devaluation rate of 9.2%.

There has been no change in interest-rate forecasts, either, and local analysts still expect the DTF rate to be around 14.0% by the end of the year.

Local forecasts of the fiscal deficit as a percentage of GDP remained virtually stable over the first half of the year, while the average of foreign forecasts was 0.2 points lower in June than in the first quarter.

The current-account deficit is expected by local forecasters to be about 2.5% at the end of the year. That is 0.5 percentage points lower than the average of foreign predictions.

Forecasts of the unemplo-yment rate have been revised down by local analysts, from 18.9% predicted in the first quarter, to 17.3%.

IV

International context

A. General aspects

The prospects of world economic growth have lessened in recent months relative to expectations in the March Inflation Report. The likelihood of an economic downturn in the world's three biggest economies was further strengthened by poor growth results in the second quarter.

In the United States, the Federal Reserve Board responded swiftly by cutting interest rates, in an effort to revive the economy. The real effects of this looser monetary policy on the US economy are not yet fully discernible, but inflation has gone up, making it difficult to anticipate future interest-rate movements in the US market.

The European Central Bank's reaction has been less dramatic, despite continual signs of economic cooling. Circumstances such as inflation rates far above the Bank's target in the past 15 months, and an accumulated devaluation of 11% for the first half of the year have prevented the authorities from applying a more forceful monetary policy. The ECB did not cut its interest rate until May10, and then did so by only 25 basis points.

In Japan, economic growth results have not been good in recent months, and there are now warning signs of a new recession occurring in the coming months. Yet the Bank of Japan's capacity for action is seriously limited by its near zero interest rate.

In emerging countries, too, the situation has deteriorated significantly, especially in some Latin American countries, such as Argentina and Brazil. Argentina's case is particularly critical, for recent measures taken by its new economic authorities to restore investor confidence have failed to do so, as evidenced by the rising cost of the country's borrowing. The risks of a possible economic crash in Argentina have increased considerably and with them the possibility of greater exchange-rate instability and slower economic growth in most other countries of the region.

The industrialized economies, however, are still expected by most analysts to expand faster in the second half of the year than they did in the first, because of lower expected prices for commodities, including oil, a looser US monetary policy, and the possibility of a further interest-rate cut by the European Central Bank in the coming months. Various analysts believe this faster expansion by the major economies should revive the world economy, ensuring a global growth of 2.3% for 2001 as a whole; this rate is somewhat higher than actual growth in the first half of the year, but lower than the 3.0% forecast reported in the March Inflation Report (Table 14).

1. United States

The downturn in the US economy became apparent in the first half of this year, with preliminary estimates giving an annual growth rate not exceeding 1.7%, one of the lowest in the past four years (Figure 60). This growth was mainly driven by consumer and government spending and by a decrease in imports.

It is now highly uncertain what direction the US economy will take in the coming months. On one hand, there are factors favoring growth, such as low interest rates, greater consumer confidence, and the Bush administration's planned tax cuts. Moreover,

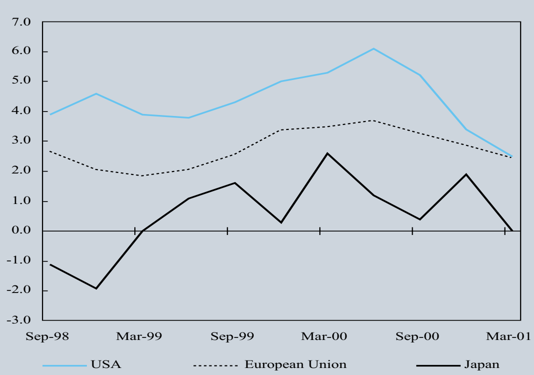
TABLE 14
ACTUAL AND FORECAST GROWTH
FOR COLOMBIA'S MAIN TRADING PARTNERS

	2000	2001		2002	
World 1/	**4.1**	**2.3**		**3.0**	
United States	5.0	1.9		3.0	
European Union	3.3	2.5		2.7	
Japan	1.7	0.9		1.5	
		Mínimum	**Máximum**	**Mínimum**	**Máximum**
Latin America 2/	**4.0**	**0.7**	**2.6**	**3.2**	**3.7**
Argentina	(0.5)	(0.4)	1.6	2.5	4.5
Brazil	4.5	2.0	2.9	2.0	3.8
Chile	5.5	3.3	4.0	4.5	5.0
Ecuador	1.9	3.5	6.0	3.0	3.6
Mexico	6.9	0.9	3.0	0.9	4.6
Peru	3.1	(0.3)	0.9	2.5	5.0
Venezuela	3.2	3.0	4.4	2.2	3.5

1/ Merrill Lynch June 2001 forecasts, from www.consensuseconomics.com.
2/ Latin America forecast ranges prepared on information from Ideal Global, Deutsche Bank, J.P. Morgan and Merrill Lynch.

manufacturers' orders increased in May and the index of the National Association of Purchasing Managers picked up in June. On the other hand, confusing signs have emerged in recent months about the behavior of a number of leading indicators. For instance, in April and May manufacturing weakened, orders slowed in other sectors and inventories climbed. Moreover, in the second quarter, consumption declined marginally while employment continued to rise.[12]

FIGURE 60
ANNUAL GDP GROWHT:
USA, EUROPEAN UNION, JAPAN



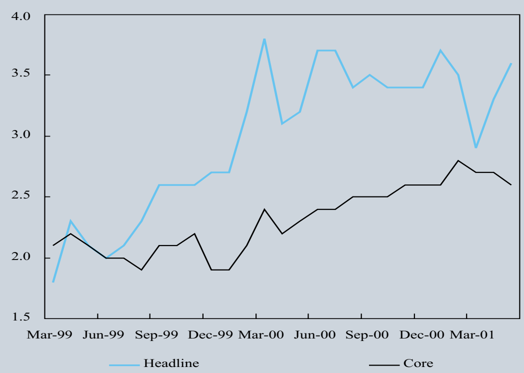
Source: Bloomberg.

The recent behavior of inflation in the United States is another factor that could reduce the US economy's chances of growth in the next few months. In May, the consumer price index showed a monthly growth of 0.5%, the highest in the past three months, giving, at annual rate, a headline inflation of 3.6%, and a core inflation of 2.6% (Figure 61). Faster price growth came largely from high energy and food prices.

The pick-up in inflation in May and higher inflation expectations, together with a considerable expansion of the monetary aggregates, have aroused fears that price growth may be turning into a risk for the country's

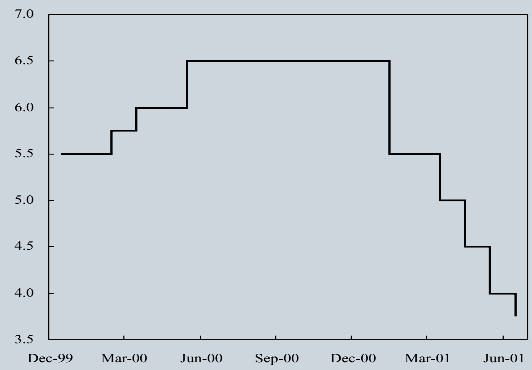
[12] Information taken from the Beige Book, a Fed publication summarizing the US economy's behavior, on economic information collected in the Fed's 12 districts: Boston, New York, Philadelphia, Cleveland, Richmond, Atlanta, Chicago, St. Louis, Minneapolis, Kansas City, Dallas and San Francisco.

FIGURE 61
UNITED STATES
HEADLINE AND CORE INFLATION RATES
1993:3 - 2001:5



Source: Bloomberg.

FIGURE 62
US FEDERAL-FUNDS INTEREST RATE



Source: Bloomberg.

macroeconomic management. Several international analysts agree, however, that these inflation movements are temporary, for energy and food prices are expected to stop putting pressure on consumer prices in the second half of the year, and the situation should be further improved by a softening of labor-market conditions.

Consequently, the Fed is considered to have scope still for continuing to loosen its monetary policy. So far this year, it has cut interest rates six times, each of the first five times by 50 basis points, and the sixth time by 25 points. The second-quarter cuts amounted to 75 points. By the end of June, the Fed's intervention rate stood at 3.75%, the lowest since mid-1994 (Figure 62).

In view of the above, analysts estimate that the US economy's growth for 2001 as a whole may come to about 1.9%, and for 2002 to about 3.0%. This new forecast for 2001 is higher than the 1.4% predicted three months earlier, but still lower than the 3.0% forecast at the end of 2000.

2. European Union

The 15 countries of the European Union showed a real annual GDP growth of 2.5% for the first quarter of 2001 (Figure 60), and a quarterly growth of 0.5%, poor but expected by international analysts. The region's slowdown was caused by weaker growth in domestic demand-mainly investment and government spending-, which was not sufficiently offset by a stronger external balance. Over the first quarter, the external balance expanded by 1.9% as a result of imports falling faster than exports.

The weakness of domestic demand is mainly caused by three factors that are greatly affecting economic growth in the euro area. First and foremost is the persistence of high inflation, which has been systematically reducing the real income of households and hence their consumption. The second is a growing climate of uncertainty since last year, which has led households to save rather than spend. The third factor has to do with capital investment, once an engine of Europe's GDP growth but now showing a considerably weaker increase.

The second quarter of 2001 brought clear signs of a downturn, with higher risks of the region's economy going into a recession. In May, the manufacturing-output index (IPM) fell for the thirteenth month in a row, to under 50 points, indicating a contraction in the manufacturing sector. Moreover, the economic-climate indicator for the 15 countries of the European Union confirmed in May that both consumers and the industrial sector expected lower future growth. Also in May, the German IFO monthly survey, which measures business confidence in the economy, registered its fourth consecutive fall, down to a two-year low, at the same time as capacity utilization decreased in the Union's member states. Lastly, economic downturn in the United States and Japan has begun to affect the region's growth negatively by reducing its exports.

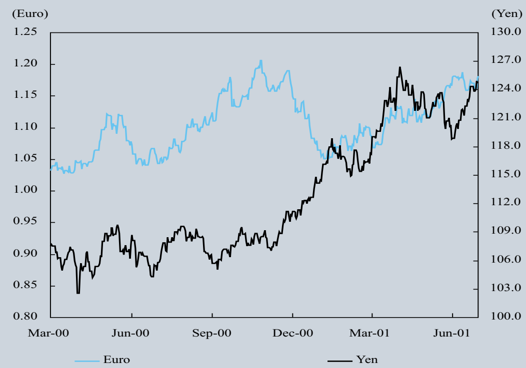
Surprisingly, the euro continued to decline against the dollar over the second quarter of 2001, though international analysts had predicted that, as the US downturn became more apparent, capital inflows into Europe would pick up, thereby strengthening the euro. Most international analysts still expect the euro to appreciate against the dollar by the end of the year because yield differentials are in Europe's favor, and also because corporate profits are falling in the United States (Figure 63).

The euro area's inflation situation has deteriorated this year, with the consumer price index rising by an annual rate of 2.9% in April, and 3.4% in May- the highest since the euro came into operation. Core inflation, too, has shown record growth, rising to 2.0%, its highest level since January 1997 (Figure 64).

The pick-up in headline inflation is considered by several analysts to be largely a reflection of the euro's devaluation and of rising relative prices of energy and food, which are all transitory developments. For this reason and in view of the cooling of the regional and world economies, inflation in the euro area is expected to drop down to an average of about 2.7%.

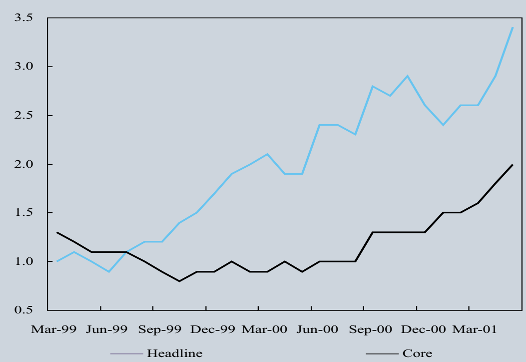
Rising inflation has made the ECB cautious about loosening monetary policy. Not until May 10 did it cut its intervention rate, by 25 basis points, to 4.5%. This, the first cut since April 1999, was clearly intended to invigorate the economy and counteract the fall registered over the first half of the year in domestic demand and exports (Figure 65). Decrease of the inflationary pressures referred to above might induce the ECB to reduce its interest rate by up to 50 points in the next few months.

Figure 63
Euro and yen exchange rates against the dollar



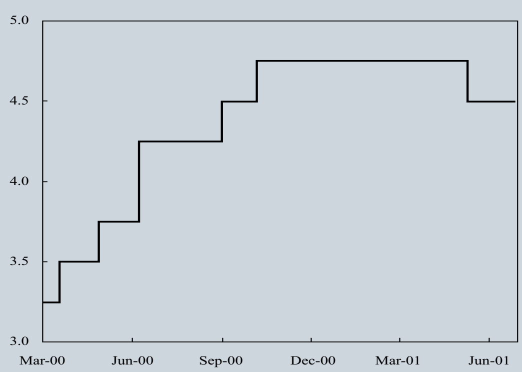
Source: Bloomberg.

Figure 64
European Union: Headline and core inflation rates 1999:3 - 2001:5



Source: Bloomberg.

Figure 65
European Central Bank's repo rate



Source: Bloomberg.

The European Union's second-quarter growth is not expected to be more than 2.0%, at annual rate, because of lower domestic demand and declining private investment. Several international analysts have revised down their previous quarter's prediction of growth for 2001, to 2.5%, on account of the negative factors described above.

3. Japan

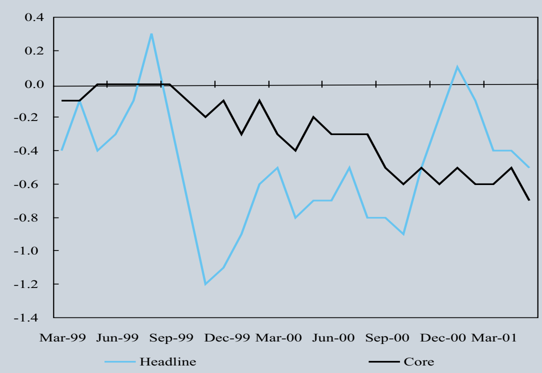
To judge from the recent behavior of its GDP, Japan may be facing a new recession. This year's first-quarter annual growth was nil relative to the same period last year, and represented a 0.2% contraction with respect to the fourth quarter of 2000 (Figure 60). International analysts expect that Japan's economic growth will be marginally higher than zero in the coming months, and that, if there is a recession, it will not be as deep or prolonged as the previous ones suffered by it.

The economy of Japan has been deteriorating because of weak private consumption and shrinking fixed private investment, the latter caused in turn by a worsening of both regional and global economic conditions. Although public investment has increased, it too is expected to begin to decrease in the near future. Net exports have been falling steadily, reflecting not only the economic downturn besetting Japan's main trading partners, but also a weakening of technology-related goods.

Prices remained highly stable over the first half of the year. Both headline and core inflation continued below zero in April and May, despite ever rising import prices in general-owing to devaluation of the yen -, and higher oil prices (Figures 63 and 66). Although these factors may generate some inflationary pressures, the weak state of the Japanese economy should work against them. Consequently, inflation is not expected to pick up over the rest of the year, and the Bank of Japan is likely to keep the interest rate around zero.

International analysts expect Japan's economy to grow by about 0.9% in 2001, but others, more pessimistically, see no possibility of growth. These new forecasts are, of course, downward revisions of predictions made in the first quarter.

FIGURE 66
JAPAN
HEADLINE AND CORE INFLATION RATES
1999:3 - 2001:5



Source: Bloomberg.

4. Latin America

A weakening US economy, lower prices for most of the region's commodity exports and the crisis in Argentina continued to be the main impediments to healthy economic performance in Latin America, in addition to each country's particular domestic risks, including political and public-order problems and, in Brazil's case, an energy crisis.

The biggest change in the region's economic conditions during the second quarter, relative to those described in the previous Report, has to do with developments in Argentina because of their potential impact on capital flows into the region. This situation is the one involving perhaps the most risks to economic stability in the medium term.

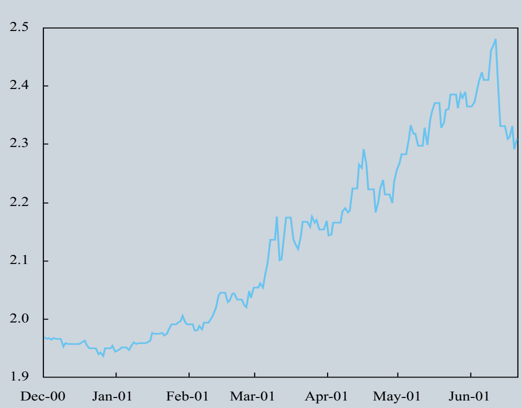
In the past three months, Argentina, with the economy minister Domingo Cavallo heading the country's economic team, has tried to restore confidence among local and foreign investors by a series of forceful measures on the domestic and external fronts. Such measures include, among others, introducing a differentiated exchange rate, creating smaller taxes, raising tariffs, and exchanging the foreign debt to extend repayment periods.

Investors, however, do not seem to have been fully convinced by these measures and are greatly concerned about the economy's continued stagnation. The economy is presently expected to grow by no more than 1.6%, and the government is due to assume a still considerable fiscal burden in the short term. Increasing uncertainty has caused a constant rise in the country's cost of borrowing, which, if prolonged, may become unsustainable, raising the possibility of default on its foreign debt.

The effects of Argentina's crisis have already been felt by several countries of the region, particularly Brazil, because of their close trade links with Argentina. Brazil's currency fell by 25% in the first half of the year, more steeply in the later months as uncertainty about its neighbor's economic solidity increased.

In the second quarter of this year, Brazil itself suffered three major shocks, besides contagion from Argentina, and had to reduce its growth estimate. These other shocks were a domestic political crisis, lower direct foreign investment and an energy crisis, all of which also put pressure on the exchange rate (Figure 67). These developments led Brazil's central bank to raise the interest rate unexpectedly by 150 basis points. This move was accompanied by statements confirming the authorities' commitment to maintaining price and exchange-rate stability through a more active monetary policy. In view of the foregoing, analysts now expect Brazil to show a growth rate of 2.0% to 2.9% by the end of 2001.

Figure 67
Brazil's exchange rate
(reales per dollar)



Source: Bloomberg.

Perhaps the country that has been least vulnerable to the situation in Argentina is Mexico. In the second quarter, the Mexican peso was the only currency of the region to remain strong against the dollar-thanks to large capital inflows from the United States-, and interest rates stood at record lows.

Despite such positive factors, Mexico's economy has slowed faster than expected. There is deep persisting concern about both the US economy's growth and an expected fall in the price of oil. Mexico's economic growth for 2001 is therefore expected to be anything between 0.9% and 3.0%, far below last year's 7.0% expansion.

Up to the end of June, Argentina's situation had produced little impact on Latin American economies of key importance to Colombia, such as Venezuela, Peru and Ecuador. But a heightening of uncertainty in financial markets might have repercussions, especially in Venezuela and Peru, since Ecuador is shielded to some extent by dollarization.

Economic activity has improved in Ecuador in recent months, reducing unemployment at the same time as bringing inflation down by a satisfactory amount. Moreover, negative pressures on the economy have waned thanks to efforts by the authorities to make the country's public finances and banking system stronger. Ecuador's economy is therefore expected to grow by at least 3.5% this year. Venezuela continues to benefit from the high price of oil, using the extra oil revenues to finance public spending and stimulate private demand. Given the external sector's strong dependence on this export product, however, a possible fall in oil prices over the second half of the year could become a serious problem and cause the currency to depreciate in that period. Bearing this risk in mind, analysts expect Venezuela to show a real growth of 3.0% to 4.4% for 2001.

Except in the case of Brazil (and, of course, Argentina), the turbulence caused in financial markets by Argentina's plight had little effect on country-risk levels, to judge from spreads on Latin American sovereign debt relative to US Treasury bonds. These spreads, which are an indicator of external borrowing costs, remained fairly stable up to the end of June on 10 and 30-year bonds issued by such countries as Mexico, Colombia and Venezuela (Figures 68 and 69). There was even a drop in spreads on 10-year bonds. In Colombia's case, for example, they fell from 684.2 basis points to 538.6, a considerable fall reflecting greater confidence on the part of external markets in the country's ability to pay, possibly as a result of the adoption of transfer reform and the government's successful exchange of domestic debt.

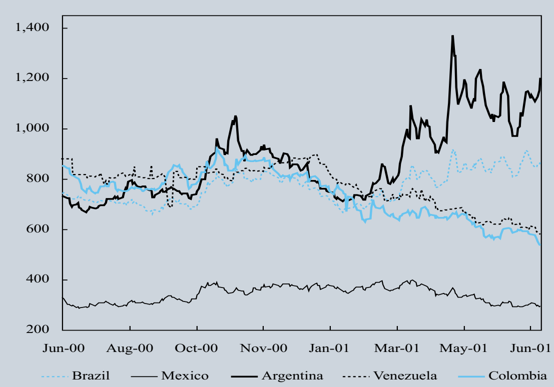
In contrast, Brazil saw its 10-year spreads rising by 35 basis points, as uncertainty mounted about Argentina. The latter's spreads soared by about 200 points, to 1,203 by the end of June. In early July, when this Report was being prepared, Argentina was in a worse plight, with spreads on its 10-year bonds at 2,000 basis points, while Brazil's topped 1,000 points. Other Latin American countries, including Colombia, registered spread increases, though far smaller ones (Figure 68).

On economic-growth projections for Colombia's main trading partners, discussed in detail above, the country's foreign trade is expected to show a 2.4% weighted overall expansion by volume for 2001, up from 2,2% predicted in the previous quarter.

B. Commodity prices

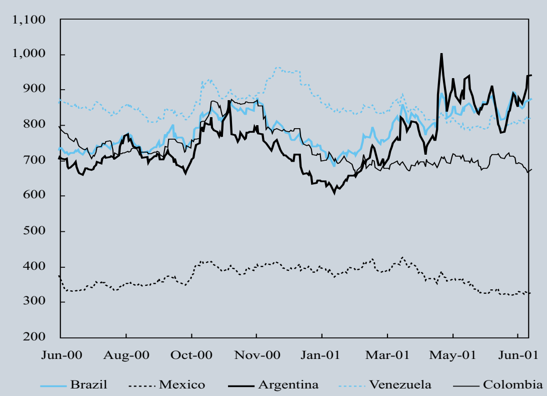
Over the second quarter of 2001, the prices of major commodities continued the downward trend they had followed since last year. The Economist's overall commodity price index fell by 1.7% between March and June, standing 5.5% lower at the end of June than a year earlier.

Figure 68
Spreads on 10-year Latin American bonds
(basis points)



Source: Bloomberg.

Figure 69
Spreads on 30-year Latin American Bonds
(Basis points)

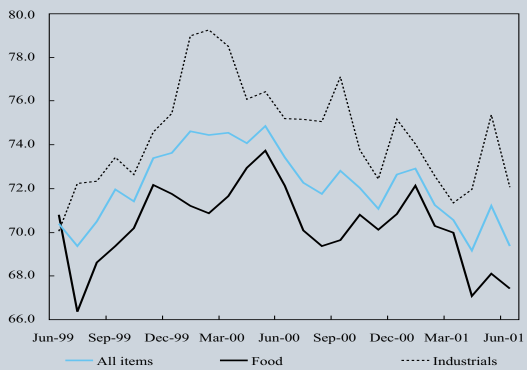


Source: Bloomberg.

The second-quarter fall in world commodity prices occurred mostly in the food group. The Economist's food-price index dropped by 3.6% over the quarter, down to a level 6.5% lower at the end of June than 12 months before. In contrast, the industrials index rose by 1.0% over the second quarter, though in June in was still 4.1% lower than a year earlier (Figure 70).

This Report presents updated projections of Colombia's commodity export index, which incorporates price information on coffee, oil, ferronickel, sugar, coal and bananas, products

Figure 70
Monthly main commodities index
(1995 = 100)



Source: *The Economist.*

Figure 71
Colombia
Main commodities export index
(1994 = 100)

Source: Banco de la República.

accounting for 51.% of the country's exports.[13] On information available at the end of the second quarter, the index is expected to fall by 8.7% this year relative to last year, a smaller fall than the 12.3% predicted at the end of the first quarter (Figure 71). This upward revision stems largely from more optimistic projections of oil and coal prices, with oil now expected to drop by less than the rate forecast three months ago, while coal is seen as rising by 11.9% this year.

The two together offset a fall in expected sugar inflation. In effect, at the end of the second quarter the price of sugar is expected to rise by only 4.4% in 2001, down frome the 13.0% growth predicted at the end of the first quarter.

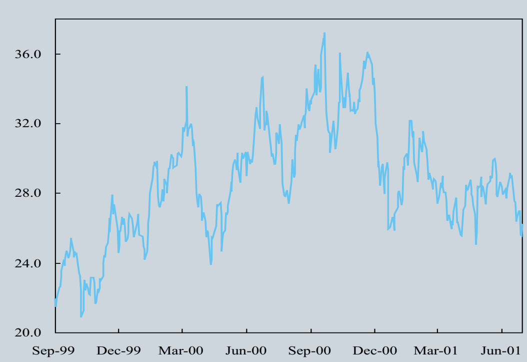
1. Oil

In the second quarter, the price of oil stayed within the range fixed in OPEC's band mechanism,[14] which has so far proved successful in stabilizing crude prices within that range.

Prices remained relatively stable over the second quarter though lower than in the first, averaging $27.9 a barrel (3.0% below the first-quarter average) between a minimum of $25.1 (April 24) and a maximum of $29.9 (May 21). The second half of June saw a steady slide in the price of crude, from $29.1 on June 15 down to $26.3 by the end of the month (Figure 72).

At the beginning of June, Iraq announced a suspension of oil exports in response to the decision by the United Nations to extend the oil-for-food program for only one month rather than the usual six months. Despite this suspension and contrary to

Figure 72
WTI oil prices
New York Stock Exchange
(dollars/barrel)



Source: Bloomberg.

---

13 Projections for this index were based on information from the IMF and exporters' associations.

14 Under OPEC's band mechanism, crude prices should remain between $22 and $28 a barrel for OPEC's basket of crude oils. In terms of the US West Texas Intermediate (WTI) indicator, this price range is approximately equivalent to $25 - $30 a barrel.

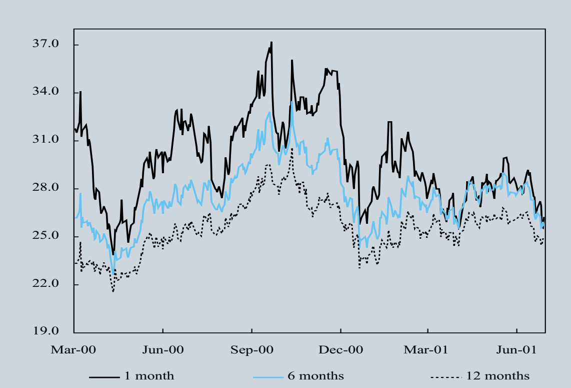
expectation, crude prices did not vary significantly. Some analysts thought that was because the markets had already allowed for the suspension, and also because OPEC's unused production capacity was considerable: some 4.5 million barrels a day, or 2.5 million higher than Iraq's daily production.

The price of oil is forecast to be lower by the end of this year than it was last year, though not as low as was predicted at the end of the first quarter. This new forecast is based on recent oil-price behavior, and on the fact that weakening global demand and the US economy's downturn have not had the expected effect of bringing down the price of crude. In fact, the price of crude was higher than expected over the second quarter. Oil prices are therefore forecast to average $26 to $27 a barrel for 2001, which means that they should average $25 to $26 in the second half of the year.

At all events, oil-price movements over the rest of the year will largely depend on OPEC's decisions regarding daily production quotas. These decisions should take into account, on the one hand, suspension of Iraq's exports and rising crude demand as winter approaches, and, on the other hand, the slowdown in world economic growth. If OPEC decides to reduce production quotas, however, there is a risk that member countries will begin to disregard them so as to increase their market share, thereby putting further downward pressure on oil prices.

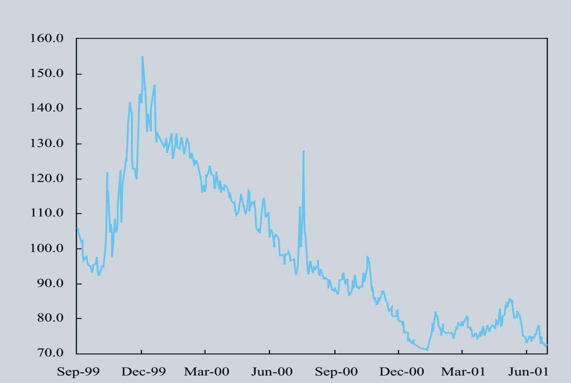
The prices of forward sales contracts on the New York Stock Exchange followed the second quarter's oil-price movements. Thus, on June 29, the prices of one, six- and twelve-month forward contracts were $26.3, $25.7 and $24.8 respectively, which, compared with the higher prices of two weeks earlier ($28.5, $27.3 and $25.7), clearly reflect the slide in crude prices that occurred in the second half of June. The six- and twelve-month contracts also suggest that the market expects oil prices to be lower in the second half of the year than they were in the first (Figure 73).

Figure 73
WTI oil forward sales prices
New York stock exchange
(dollars/barrel)



Source: Bloomberg.

Figure 74
Colombian arabica coffee price
New york stock exchange
(cents/pound)



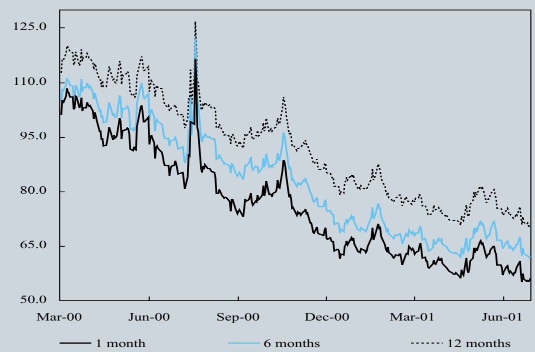
Source: Bloomberg.

2. Coffee

World coffee prices fell during the second quarter, continuing the downward trend that had started early last year. Despite application of the Coffee Retention Plan, the price of Colombian coffee averaged 77.9 cents a pound in the second quarter, with a June average of 74.3 cents, one of the lowest in recent years (Figure 74). This behavior was mirrored by forward sales prices (Figure 75).

The fall in world coffee prices since January 2000 is largely attributable to mounting coffee stocks in consumer countries, particularly the United States. The

FIGURE 75
ARABICA COFFEE FORWARD SALES PRICES
NEW YORK STOCK EXCHANGE
(CENTS/POUND)



Source: Bloomberg.

Retention Plan[15] adopted by the Association of Coffee Producing Countries[16] has so far had little effect on world supply, and coffee stocks were still high in consumer countries at the end of the second quarter. On information to May 14 provided by the Association, the Retention Plan's compliance rate is 72.4%: out of 9.7 million 60-kg bags planned to be withheld, only 7 million have been so far. But the Plan is still in operation, and Colombia has fixed its withholding quota for this year at 1.8 million bags.[17] The possibility is also being considered of removing 5% of lower quality exports from the market, as a further measure to curb the price fall.

Since the Association's measures have failed to reduce oversupply in the market, the price of coffee is unlikely to pick up this year and is expected to average about 75 cents a pound for 2001.

---

15 Under the Plan, coffee exports are to be reduced by 20% if the price drops below 95 cents a pound.

16 The ratified members of the Association are Brazil, Colombia, Costa Rica, El Salvador, India, Indonesia, Venezuela, Angola, Ivory Coast, Kenya, Tanzania, Togo, Uganda and the Democratic Republic of Congo.

17 Since September of last year Colombia has held back 980,000 bags. Colombia's coffee exports this year are expected to amount to 10 million bags.

V

Inflation forecasts

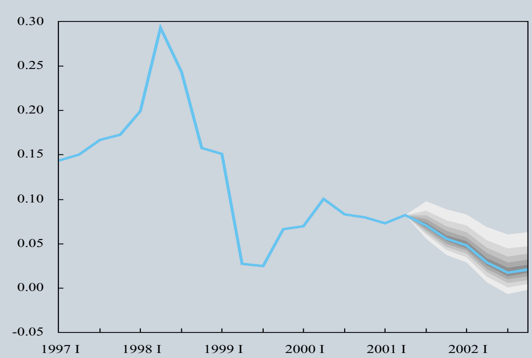
This Report's forecasting assumptions are not much different from the March Report's as regards exchange-rate movements and growth of monetary aggregates. Thus, the real exchange rate is assumed to remain relatively stable this year and next, at levels not very different from the current one. This scenario does not take into account any contagion effect on Colombia from a deepening of Argentina's crisis. The main monetary aggregates are assumed to show a growth consistent with the new reference line set for the monetary base by the Board of Directors. The new line takes into account the effect produced on cash demand by both the financial-transaction levy (raised to three per thousand from the beginning of the year), and the related exemption established in March for some financial-system liabilities.

Import prices are assumed to exhibit zero external inflation in 2001, down from the 3% envisaged in the previous Report. This assumption is based on the fact that commodity and manufacturing price indices in international markets have declined or remained stable so far this year and are not expected to change more than fractionally in the second half, given the world economic downturn. So, import prices measured in pesos are calculated to vary by the rate of nominal devaluation only.

As regards weather conditions, this Report, like the previous one, expects normal rainfall for the second half of the year. Moreover, according to IDEAM (thestate environmental agency) and various entities concerned with global climate, there is now much less likelihood of the, Niño climatic condition occurring again late this year or early next year. Weather conditions should therefore be about normal for much of next year, and hence food prices can be expected to be stable.

For this Report, as for the previous one, a "satellite model" was employed to forecast food inflation, because it uses information on farm supply shocks more accurately, thereby improving the quality of the central model's projections. The central path of food inflation forecast by the satellite model places it at 8.6% in the third quarter and at 7.5% in the fourth (Figure 76). This central palt comes with an upward biased risk balance that takes into account the effects of the cattle, breeding cycle's retention phase on beef prices, and the possibility of smaller harvests of potatoes and other

Figure 76
Food-inflation forecasts for 2001 and 2002
(Central scenario and risk balance)



Source: Banco de la República.

Period	50%	30%	10%	Central	10%	30%	50%
Mar-01	7.3	7.3	7.3	7.3	7.3	7.3	7.3
Jun-01	8.2	8.2	8.2	**8.2**	8.2	8.2	8.2
Sep-01	7.4	7.9	8.4	**8.6**	9.0	9.7	10.5
Dec-01	5.9	6.6	7.2	**7.5**	7.9	8.8	9.8
Mar-02	5.2	5.9	6.5	**6.8**	7.3	8.3	9.3
Jun-02	3.3	4.1	4.8	**5.2**	5.7	6.8	8.0
Sep-02	2.2	3.1	3.9	**4.2**	4.8	6.0	7.3
Dec-02	2.6	3.4	4.2	**4.5**	5.1	6.2	7.5

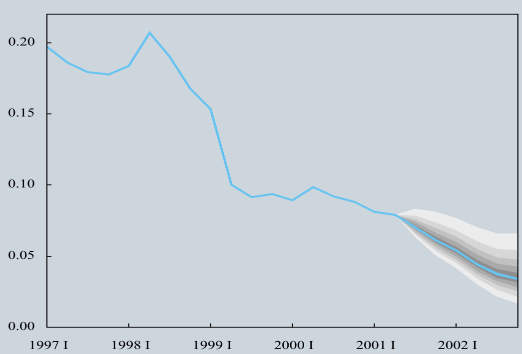
root crops in the second half of the year. Harvests may be smaller because in the first half of the year rainfall was very low on the highland slopes where such crops are grown. The central forecast's degree of uncertainty and balance of risks indicate that by December 2001 food inflation may lie between 5.9% and 9.8%, with a 50% probability.

On the basis of the above assumptions and shocks, the transmission-mechanism model forecasts a central inflation path of 7.3% for the fourth-quarter average of 2001, and 5.3% for the fourth-quarter average of 2002. The new central projection for the end of this year is lower than the 8.2% predicted three months ago. And both the forecast for this year and the one for next year are below the respective inflation targets (8% and 6%) set by the Board of Directors of the Banco de la República.

The expected central path shows inflation falling smoothly over the next six quarters. The level of uncertainty and balance of risks of this central path indicate that by December of this year consumer inflation may be within a range of 6.4% and 8.7%, with a 50% probability.

It is important to point out, however, that the central path of headline consumer inflation, as shown in Figure 77, has an upward biased risk balance. This upward bias reflects uncertainty surrounding the food-inflation forecast on account of the cattle-retention stage, and the possibility of higher devaluation of the peso if the Argentine crisis were to produce a contagion effect. The possibility of higher devaluation also gives an upward bias to the risk balance of the forecast of non-food inflation, as shown in Figure 78.

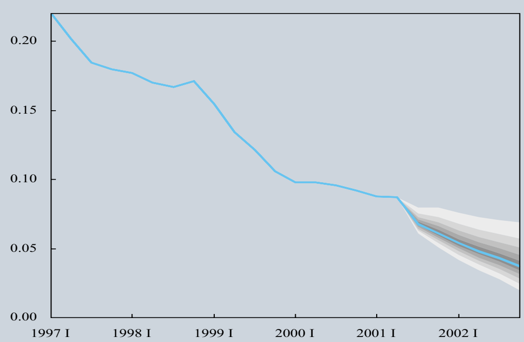
Figure 77
Consumer-inflation forecasts for 2001 and 2002
(central scenario and risk balance)



Source: Banco de la República.

Period	50%	30%	10%	Central			
Mar-01	8.1	8.1	8.1	8.1	8.1	8.1	8.1
Jun-01	7.9	7.9	7.9	7.9	7.9	7.9	7.9
Sep-01	7.2	7.5	7.7	7.8	8.0	8.3	8.7
Dec-01	6.4	6.7	7.1	7.3	7.5	8.1	8.7
Mar-02	5.7	6.1	6.5	6.7	7.0	7.6	8.3
Jun-02	4.7	5.2	5.7	6.0	6.3	7.0	7.7
Sep-02	4.1	4.6	5.2	5.4	5.8	6.6	7.4
Dec-02	3.8	4.4	5.0	5.3	5.7	6.5	7.5

Figure 78
Forecasts of non-food inflation for 2001 and 2002
(central scenario and risk balance)



Source: Banco de la República.

Period	50%	30%	10%	Central			
Mar-01	8.8	8.8	8.8	8.8	8.8	8.8	8.8
Jun-01	8.7	8.7	8.7	8.7	8.7	8.7	8.7
Sep-01	6.9	7.2	7.4	7.5	7.6	8.0	8.3
Dec-01	6.3	6.7	7.0	7.2	7.4	7.9	8.5
Mar-02	5.6	6.1	6.5	6.7	7.0	7.6	8.2
Jun-02	5.1	5.6	6.0	6.2	6.6	7.2	8.0
Sep-02	4.6	5.2	5.7	5.9	6.3	7.0	7.8
Dec-02	4.1	4.7	5.3	5.6	6.0	6.9	7.8

The reduction in the inflation forecast in this opportunity with respect to the presented in the March report is corroborated by the results obtained from other models used by the Central Bank. In particular, the forecast combination methodology of the different single equation models, as much of time series as structural, foresees an inflation for December of 2001 of 6.5%, lower than the figure obtained three months ago (6.8%). For the next year, this method also anticipates a decreasing inflation and lower than the level reached in December of 2001.

This report has been prepared
by the Economic Studies Division
of the Banco de la República.
Editing and diagramming by the
Economic Publications Section,
Department of Institutional Communications.
Translated by Fereshteh Ebrahimzadeh
in June 2001