INFLATION REPORT

March 2014*

* Submitted by the Technical Staff for the meeting of the Board of Directors on April 25, 2014.

Banco de la República
Bogotá, D. C., Colombia

ISSN - 2145 - 6526

The Inflation Targeting Scheme in Colombia

OBJECTIVES

Monetary policy in Colombia is based on inflation targeting, which is intended primarily to keep inflation low and to ensure stable growth in output near its long-term trend. Accordingly, the objectives of monetary policy combine the goal of price stability with maximum sustainable growth in output and employment. In this respect, monetary policy complies with the Constitution and contributes to the welfare of the Colombian population.

HORIZON AND IMPLEMENTATION

The Board of Directors of Banco de la República (the Central Bank of Colombia) (BDBR) sets quantitative inflation targets for the current year and the next. BDBR policy initiatives are designed to meet each year's target and to provide for long-term inflation at around 3%. The annual change in the consumer price index (CPI) is the inflation measurement used.

THE DECISION-MAKING PROCESS

Monetary-policy decisions are based on an analysis of the current state of the economy and its prospects for the future, and on an assessment of the forecast for inflation in light of the targets. If the assessment suggests, with enough certainty, that inflation will deviate from its target under current monetary-policy conditions and deviation would not be due to temporary shocks, the BDBR modifies its policy stance. For the most part, this is accomplished by changing the reference interest rate (charged by the Central Bank of Colombia on short-term liquidity operations).

COMMUNICATION AND TRANSPARENCY

Decisions on monetary policy are announced after meetings of the Board of Directors. This is done through a press bulletin posted immediately on the Bank's website (www.banrep.gov. co). Inflation reports are published quarterly and lend transparency to the Board's decisions. They also contribute to a better understanding of monetary policy and help to enhance its credibility. Specifically, these reports: i) inform the public how the Board of Directors and the Technical Governor of the Bank view recent and anticipated changes in inflation and its short and mid-term determinants; ii) explain the implications of those determinants for monetary-policy management within the scope of inflation targeting; iii) describe the context and analysis justifying monetary-policy decisions made during the quarter; and iv) provide information that helps agents in the economy to form their own expectations about future developments with respect to inflation and growth in output.

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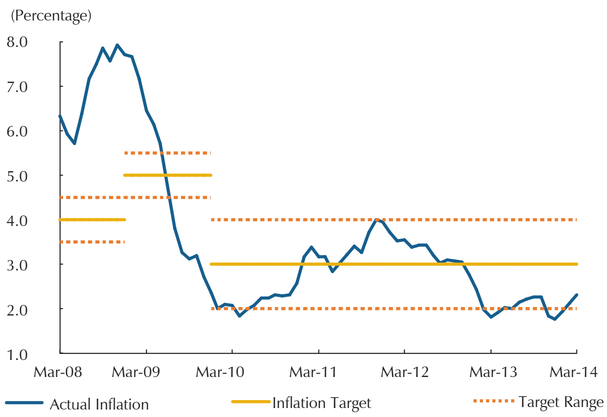
Graph A
Total Consumer Inflation



Sources: DANE and Banco de la República.

Annual inflation in the first quarter of 2014 rose slightly more than expected and was 2.51% by March (Graph A). The average of the four measures of core inflation behaved similarly, registering a rate of 2.69%. The larger increases in prices for food and regulated goods and services account for the growth in inflation.

The different measures of price increase expectations at one and five years are around 3.0%. The forecasts point to more homogeneous annual increases in the food and regulated groups, as well as in tradables and non-tradables, with a trend toward the midpoint of the target range. If so, inflation would be around 3.0% by the end of the year.

The Colombian economy grew 4.3% in 2013, with more momentum in the second half of the year than in the first, mainly due to investment performance. In every quarter, household consumption continued to grow at rates near its historical average, and public spending rose at a rate that exceeded the increase in output. On the supply side, the most growth in the second half of the year was in construction and mining. Industry was the only sector that declined.

Recent figures on growth in retail sales, consumer confidence, coffee production, energy consumption and the continued decline in unemployment suggest the momentum in the economy so far during 2014 has been strong. Weak performance by exports and the manufacturing industry are the exceptions.

Total growth in lending has accelerated slightly, following a downward trend since last August. This is due to a better momentum in commercial loans and mortgages. Real interest rates have declined as a result of the rise in inflation.

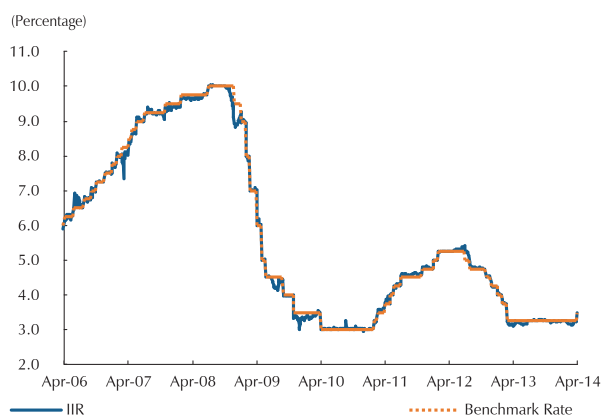
Externally, the latest figures on economic activity indicate the United States could sustain a gradual economic recovery, while the expansion in the euro area would continue at a modest pace. Growth in the key emerging countries has slowed. Therefore, the new estimates suggest the economic growth Colombia's trading partners would experience this year is likely to be similar to what it was in 2013.

The international price of oil remains high and the prices of other commodities exported by Colombia, such as nickel and coffee, rose. As such, terms of trade are expected to remain favorable in 2014; however, their contribution to national revenue could be less dynamic compared to 2013.

Liquidity levels in the United States remain less expansive. The risk premia in several emerging economies have fallen recently, financial assets in domestic currency have increased in value, and their currencies have appreciated against the dollar. These changes have been particularly pronounced in Colombia, especially in the government debt market, thanks to larger foreign capital inflows.

Considering the foregoing, the Bank's technical staff estimates first-quarter GDP growth will range between 4.2% and 5.4%, with 4.8% being the most likely figure. For all of 2014, the most feasible figure is 4.3%, within a range of 3.3% to 5.3%.

Graph B
Banco de la República Reference Rate and the Interbank Interest Rate (IIR)
(2007-2014)a/



Sources: Office of the Colombian Superintendent of Finance and Banco de la República

After assessing the risk balance, the Board of Directors decided in February and March 2014 to hold the benchmark interest rate at 3.25% (Graph B). In May of the same year, it was raised to 3.50%, inasmuch as current macroeconomic stability and the convergence of inflation towards its long-term target are consistent with a slightly less expansionary monetary-policy stance than is currently the case. The Board also decided in March to extend the Bank's international reserves purchase program for three months, which means $ 1,000 million will be accumulated between April and June.

Inflation Report

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I. The external context and balance of payments

In 2013, the economic growth of Colombia's major trading partners slowed its pace. Expansion in 2014 is expected to be similar to what it was last year for this group of countries.

During the first quarter of 2014, growth in the emerging economies was more moderate, while the signs of growth in the advanced economies were favorable.

In the early months of the year, international prices for some of the commodities exported by Colombia, such as coffee and nickel, were higher than had been forecast by Banco de la República's technical staff.

The current account deficit as a percentage of GDP rose slightly in 2013, and this trend is likely to continue in 2014.

A. THE EXTERNAL CONTEXT

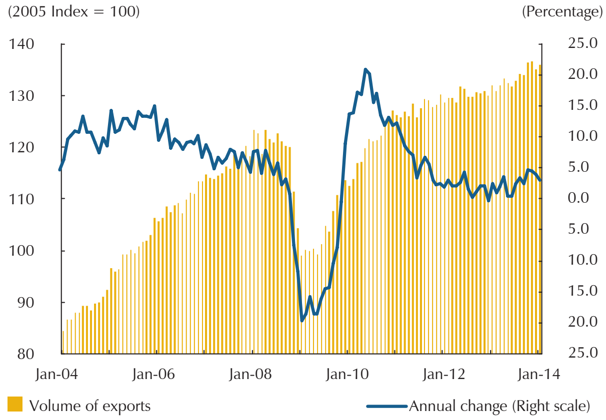
1. Productive Activity

The figures observed by the fourth quarter of 2013 indicate economic growth for Colombia's major trading partners (weighted by non-traditional trade) was consistent with the expectations in the baseline scenario presented in the December 2013 edition of the Inflation Report. Growth for this group of countries was 2.7%, which is less than in 2012, when it reached 3.5%.

The reduced momentum experienced by Colombia's trading partners during 2013 was explained by the slowdown in the Latin American economies.

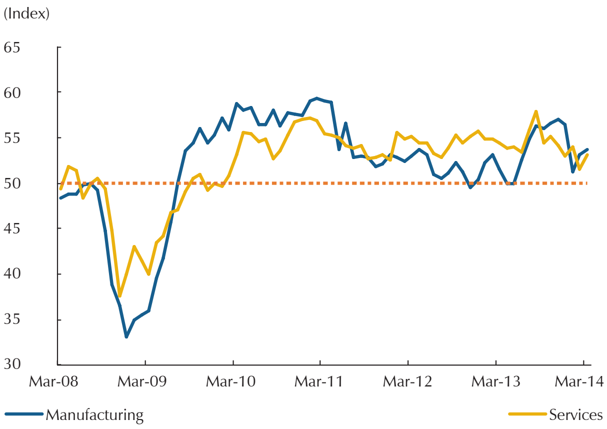
The reduced momentum experienced by Colombia's trading partners is explained by the slowdown in the Latin American economies, as well the decline in the growth rate for the United States, generated by the fiscal adjustment. Exports and domestic demand weakened in Latin America, while private spending in the United States grew at a favorable rate, especially

Graph 1
Global Export Volume (2005 Index = 100)



Source: Datastream

Graph 2
US Indexes of Productive Activity (ISM) (Index)



Source: Bloomberg

during the second half of the year, thanks to the behavior of investments and household consumption.

The reduced momentum experienced by Colombia's trading partners during 2013 was explained by the slowdown in the Latin American economies.

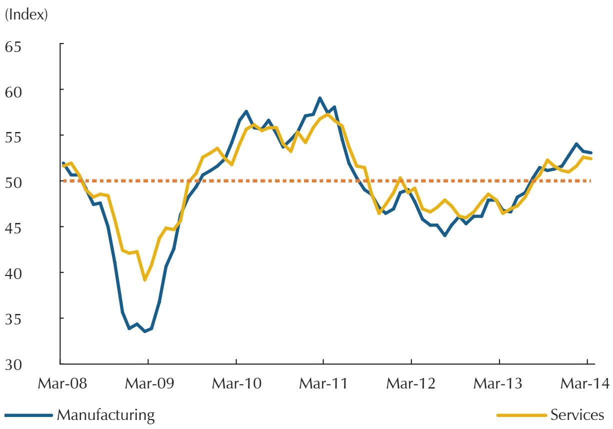
The first-quarter figures for 2014 indicate economic performance in the emerging economies continued to slow, while productive activity in the major developed countries still showed positive signs. In this context, global trade indicators point to expansion, in annual terms, although at a slower pace than in 2012 (Graph 1). For its part, the global manufacturing sentiment index remained in expansive terrain.

In the case of the United States, the extreme winter weather in January and February affected productive activity and influenced consumer confidence to some extent. As a result, retail sales and industrial manufacturing weakened during those months. However, the figures in March show some recovery, supporting expectations of stronger growth during the rest of the year (Graph 2). Similarly, part of the slowdown in the first quarter would be due to less inventory accumulation, an item that rose sharply in the second half of 2013.

Regarding the labor market, the unemployment rate continued to decline, with a few surprises in recent months. As in previous quarters, the drop in the participation rate explains much of the reduction in unemployment; however, the pace of job creation continues to be favorable. Even so, other job market indicators remain weak and at levels far from those observed prior to the crisis. For example, the average duration of unemployment and underemployment by hours is still at high levels and indicates the job market has yet to recover fully.

As for tax issues, the uncertainty in previous years concerning discussions on the budget, spending cuts and the debt ceiling seems to have declined in the short term and would not pose a drag on growth in 2014. In fact, the agreements reached earlier this year moved the tax discussions up to early 2015.

Graph 3
Euro Area Indexes of Productive Activity
(Purchasing Managers Index: PMI) (Index)



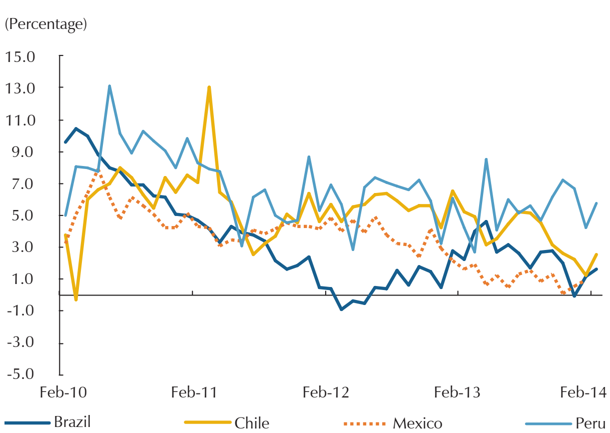
Source: Bloomberg

Meanwhile, economic activity in the euro area continued to recover at a modest pace during the final quarter of 2013, as expected, and probably did so in the early months of this year as well. The March figures still place the indicators of sentiment in the manufacturing and services sectors in expansive territory (Graph 3), as do the business and consumer confidence indicators, which again showed a positive trend. Other indicators, such as those for retail sales and industry, also exhibited favorable signs.

At country level, the German economy remains the strongest in the region, led by robust domestic demand. However, the pace of growth in indicators of productive activity is weak in the case of the peripheral countries. On the external front, exports have been at a standstill for several quarters due to weakening in the emerging economies. Consequently, the recovery of the area is supported mainly by the force of domestic spending.

As for the risks in the region, there is still financial fragmentation; however, the reduction in sovereign debt spreads between the countries at the center and those on the periphery should have some effect on the cost of internal financing and reduce this problem to some degree. By the same token, lending remains stagnant and unemployment is still at record highs in a number of economies. On the other hand, progress on financial integration issues, which would have a positive impact on reducing fragmentation, remains slow and there have been no additional announcements in recent months.

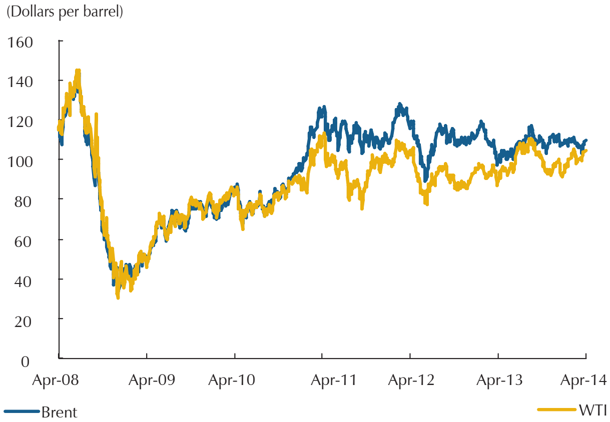
Graph 4
Annual Growth in Monthly Economic Activity Indexes for Several Latin American Economies



Source: Datastream

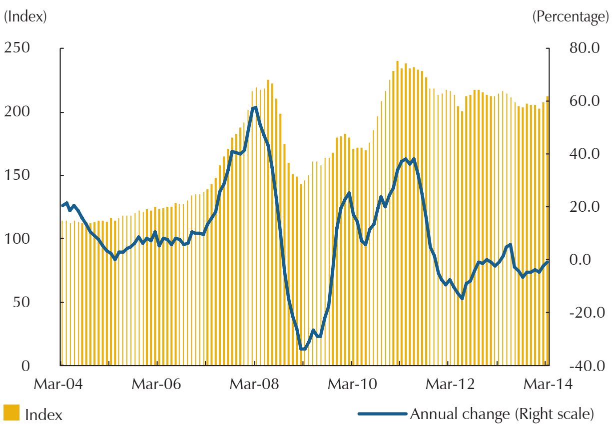
In the case of the emerging countries, the pace of economic growth continued to slow. As a result, annual gross domestic product (GDP) in China during the first quarter went from 7.7% to 7.4%, which is slightly below the target announced by the government for 2014 as a whole: 7.5%. The slowdown is explained by a slump both in domestic demand and exports. Importantly, there is still a great deal of financial vulnerability in China due to rapid growth in lending and real estate prices. The Chinese government has followed this problem closely, and the measures

Graph 5
International Oil Prices (Brent and WTI) (Dollars per barrel)



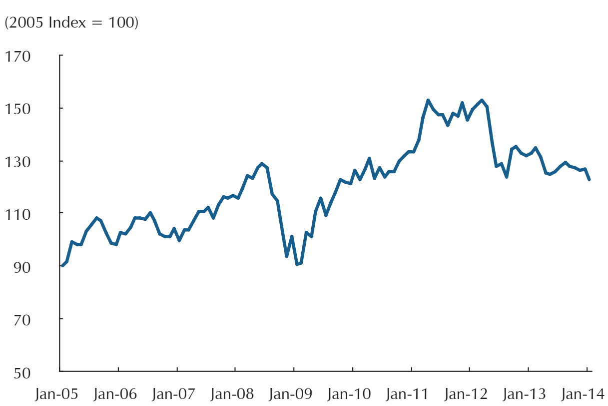
Source: Datastream

Graph 6
International Food Prices (Index)



Source: United Nations Food and Agriculture Organization

Graph 7
Index of Colombian Terms of Trade (Commercial Methodology) (2005 Index = 100)



Source: Banco de la República

adopted to counter it could affect the growth of the country's output in the coming quarters. Meanwhile, in Latin America, the increase in monthly rates of productive activity continued to be slower than in previous years (Graph 4); while export growth remained weak due to lower terms of trade and less external demand. As in China, the slowdown is associated with weaker internal and external conditions. Growth in Brazil, in particular, remains fragile and is below the average rate for the last decade. In Chile, there has been a slowdown in productive activity since the second half of 2013.

2. Commodity Prices, Inflation and Monetary Policy

As for international prices of the commodities exported by Colombia, oil prices remained at favorable levels (Graph 5), slightly below the average observed in 2013, but higher than was estimated for all of 2014 in the last Inflation Report.

During the first quarter, foreign prices for coffee and nickel rose well-above the average anticipated for the year as a whole. Adverse weather conditions in Brazil affected expectations for the coffee harvest this year, and several geopolitical events have fueled uncertainty about the conditions of the supply of nickel in the months ahead.

In the case of external food prices, some increases were evident in February and March; however, the average level in the first quarter is still below what was observed in 2013 (Graph 6). As with coffee, the weather conditions in many economies would affect the prices of these items. In this situation, the country's terms of trade fell slightly during the early months of the year and remained below those observed in 2011-2012. Yet, although this indicator has weakened in recent quarters, it remains favorable from a historical perspective (Graph 7).

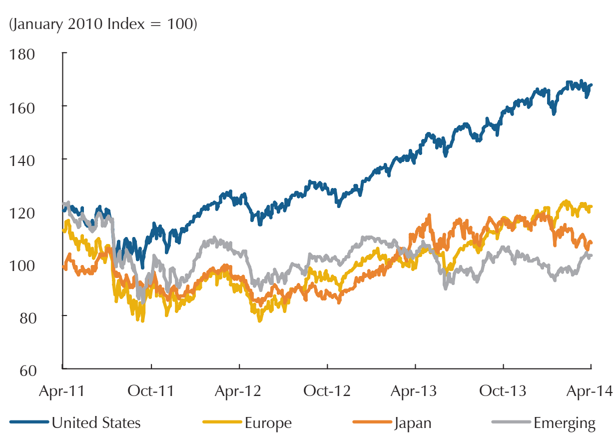
International prices for some of the commodities exported by Colombia rose during the first quarter of 2014.

Regarding inflation, the change in the general price level in the major developed economies remained below the long-term goals set by their central banks. In the particular case of the euro area, total and core inflation continued to decline during the first quarter and remained below 1%. Meanwhile, in the United States, a slight increase in these two measures of inflation was observed in March; however, the measure most closely monitored by the Federal Reserve of the United States (Fed) —the consumption deflator— is still below the long-term target. This performance was received favorably by analysts and was interpreted as a strengthening of domestic demand. In Japan, the upward trend in prices continued.

As for monetary policy, the major central banks in the developed countries kept their monetary stimulus measures in place. The Fed announced further cuts in its monthly purchases of financial assets and made it clear that the job market has yet to recover fully, despite the lower unemployment rate. In the euro area, amid fears of deflation, the possibility of further monetary stimulus, such as the purchase of financial assets, has not been ruled out.

The outlook for inflation in the emerging economies remained mixed. In Latin America, there were several surges in inflation, partly associated with currency depreciation in the early months of the year. In Brazil, inflation continued to be high, prompting the central bank to raise its benchmark rate once again. In Chile, the weakness in productive activity led that country's central bank to cut its reference rate. Meanwhile, in Asia, the annual change in consumer prices remained high in India and Indonesia, but was relatively low in other economies in the region, such as Taiwan and China. As to monetary policy, the central banks of India and Turkey raised their interest rates during the early months of the year.

Graph 8
Global Stock Indexes (January 2010 Index = 100)

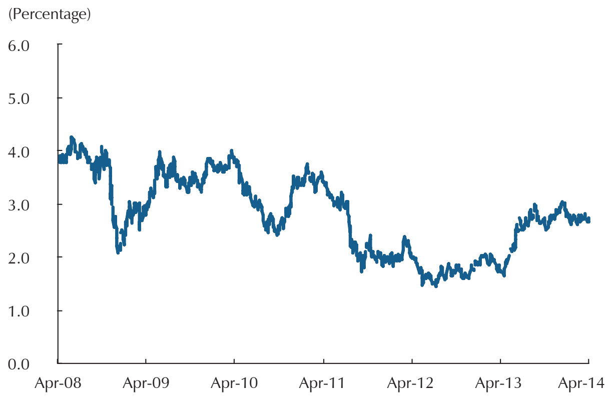


Fuente: Bloomberg.

3. Financial Markets

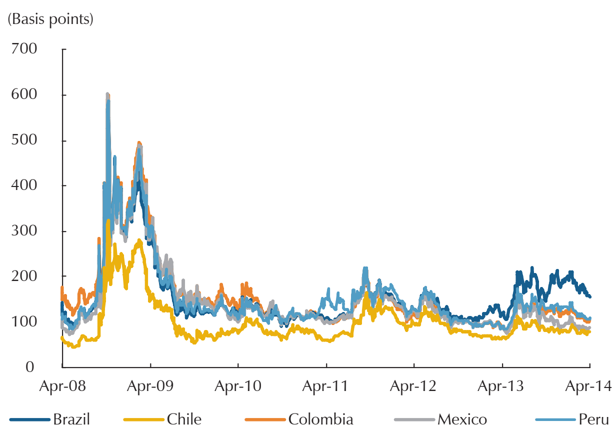
The negative trend in the global financial markets during the first weeks of the year, which would have affected the performance of stock indexes in emerging economies and their sovereign debt markets, was reversed in February and March (Graph 8). The prospects for recovery in the developed economies, as well as the adoption of various policy measures in emerging countries such as India and Turkey, helped to reduce the perception of risk. This, in turn, has favored global financial conditions. Portfolio flows continue to be determined by the differentiation between countries that are more or less vulnerable to external financial conditions.

Graph 9
Interest Rates on 10-year US Government Bonds



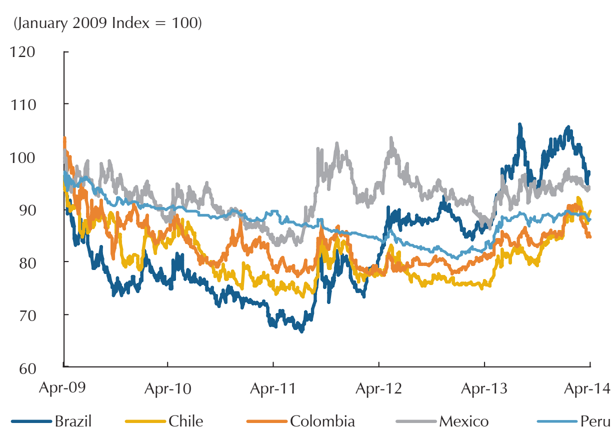
Source: St. Louis Federal Reserve

Graph 10
Credit Default Swaps (CDS) at Five Years for Several Latin American Countries (Basis points)



Source: Bloomberg

Graph 11
Exchange Rate Indexes for Several Latin American Countries (January 2009 Index = 100)



Source: Bloomberg

Meanwhile, in the United States, despite the onset of tapering, interest rates on long-term securities remained relatively stable during the first quarter and were below the levels observed in December 2013 (Graph 9). Similarly, recent announcements by the Fed changed, once again, expectations of an increase in the benchmark rate, and analysts now expect a slightly faster and stronger increase compared to three months ago.

In the case of Latin America, the normalization of external financial conditions was reflected in a reduction in risk premiums. Accordingly, the trend in credit default swaps (CDS) at five years was negative as of February (Graph 10). With regard to exchange rates in the region, they depreciated in January and February before beginning to appreciate in March, especially in Brazil (Graph 11).

Finally, it is important to note that JP Morgan announced, in mid-March, it was restructuring its benchmark index for local government bonds of emerging economies. This change would increase Colombia's participation significantly. Interest rates on the country's sovereign debt fell sharply after the announcement. In the case of the Colombian peso, appreciation was similar to that observed in other countries in the region.

4. Forecasts by Banco de la República's Technical Staff

Economic growth forecast by the technical staff for the major developed economies did not change significantly compared to the estimate in the December 2013 edition of the Inflation Report. So, for this year, 2.8% growth is expected for the country's major trading partners (non-traditional trade-weighted), which is slightly higher than the figure observed in 2013, when growth was 2.7% (Table 1).

By countries, the forecast for the United States points to an acceleration in economic growth compared to what was observed in 2013, thanks mainly to the momentum in domestic demand, as

Table 1 Growth Forecasts for Major Trading Partners

Growth forecasts for trading partners in	2013	Forecasts for 2014 Scenario			Forecasts for 2015 Scenario		
		Minimum expected	Central	Maximum expected	Minimum expected	Central	Maximum expected
Main partners							
United States	1.9	1.8	2.7	3.5	2.0	3.0	4.0
Euro Area	(0.5)	0.0	1.0	1.5	0.2	1.2	1.8
Venezuela	1.3	(3.0)	(1.0)	1.0	(1.0)	1.0	3.0
Ecuador	4.5	3.0	4.0	5.0	3.0	4.0	5.0
China	7.7	6.8	7.3	7.8	6.5	7. 1	7.7
Other partners							
Brasil	2.3	1.0	2.0	3.0	1.3	2.3	3.3
Perú	5.0	4.0	5.0	6.0	4.5	5.5	6.5
México	1.1	2.5	3.5	4.5	3.0	4.0	5.0
Chile	4.2	3.0	3.8	4.5	3.0	4.0	5.0
Total trading partners (non-traditional trade-weighted)	2.7	1.7	2.8	3.9	2.2	3.3	4.4
Developed countries[a/]	1.3		2.2			2.3	
Emerging and developing countries [a/]	4.7		4.9			5.3	
Total worldwide [a/]	3.0		3.6			3.9	

a/ IMF forecasts at April 2014
Source: Calculations by Banco de la República

well as a reduction in the contractive effects of the fiscal adjustment. Unlike the year before, 2014 would see no further cuts in public spending and the tax burden would not increase.
Moreover, fiscal uncertainty was reduced in the medium term, due to the agreements reached by Congress during the early months of the year.

As for monetary policy, the Fed's asset-buying program is expected to culminate in the third quarter and have no additional significant effect on long-term interest rates and job market recovery. The benchmark rate is expected to remain stable in 2014 and could begin to increase in 2015.

Accordingly, the forecast is for growth to increase from 1.9% in 2013 to 2.8% in 2014. The recovery in productive activity is expected to persist in 2015, and the GDP gap should continue to close. If this proves to be the case, growth that year would come to 3.0%.

In terms of the euro area, its economic recovery in 2014 will continue at a modest pace, driven by domestic demand, mainly from Germany, and by the end of the recession in some economies on the periphery. As in

Growth in the developed economies would accelerate in 2014, while the emerging economies would experience more moderate growth.

the United States, the contractive effects of the fiscal adjustment would be less than in 2013. On the other hand, new monetary stimulus measures to reduce deflationary risks in the region should not be ruled out. Growth in 2015 is expected to be 1.2%. The latest measures concerning financial regulation should have a positive effect on lending, although still slight.

With respect to the emerging economies, the change in China's GDP during 2014 would be slightly under the target set by its government. This would be due to readjustment in the sources of growth and to the measures adopted to make the financial system less vulnerable, which were not offset by a slightly expansionary fiscal policy. This decline in performance would have an important impact on global external demand and could reduce international prices for certain commodities.

In the case of Latin America, some economies, such as those of Chile and Peru, would be affected by this situation and would grow at a slower pace than in 2013. The moderation in domestic demand, mainly for investment, also would impact their momentum. Other economies in the region, such as the one in Venezuela, have structural problems that would hamper their growth this year and the next. Finally, although the Brazilian economy would accelerate compared to 2013, its performance would continue to be mediocre.

For 2015, the slowdown in China is expected to continue, while there should be some recovery in Latin America.

As in previous quarters, the central scenario continues to show appreciable risks to the downside. This time, they are associated mainly with performance of the emerging economies, which could expand at a slower pace due to worsening conditions inside China and increased outflows that might destabilize their financial systems. Moreover, a setback in the recovery of the euro area cannot be ruled out, given the vulnerability of its financial systems and job markets. There is also the risk posed by the geopolitical situation involving Russia and Ukraine, which could threaten growth in Europe and in other economies linked financially and commercially to the region.

The downward risks for 2014 associated with the performance of the emerging economies are identified in this report.

Finally, in a situation where external demand is increasing at a modest pace and production is growing favorably, international prices for some commodities exported by the country should decline (Table 2). In particular, the increase in the supply of crude oil due to the implementation of unconventional techniques ought to bring downward pressure to bear on oil prices in the years ahead. Moreover, the slowdown in China, which is one of the world's major coal buyers, would be reducing international prices for this input. Prices for other commodities, such as coffee and nickel, have benefitted from severe weather conditions in some producing countries or from geopolitical uncertainty.

Table 2
Reference Price Forecasts for the Commodities Exported by Colombia

Major products	2013	Forecasts for 2014			Forecasts for 20155		
		Scenario			Scenario		
		Minimum forecast	Central forecast	Maximum forecast	Minimum forecast	Central forecast	Maximum forecast
Colombian coffee (ex dock; dollars per pound)	1.48	1.40	1.80	2.20	1.10	1.60	2.20
Brent crude (dollars per barrel)	108.7	98	105	110	90	102	110
Coal (dollars per ton)	88.0	72	80	88	75	85	95
Nickel – London exchange (dollars per ton)	15,091	13,779	15.,747	17,716	14,435	17,059	19,684
Gold[a/] (dollars per troy ounce)	1,411	1,350	1,200	1,050	1,300	1,100	900

a/ This is assumed to be a haven value, because the price of gold increases when there is more uncertainty (a pessimistic scenario).
Source: Bloomberg; calculations by Banco de la República

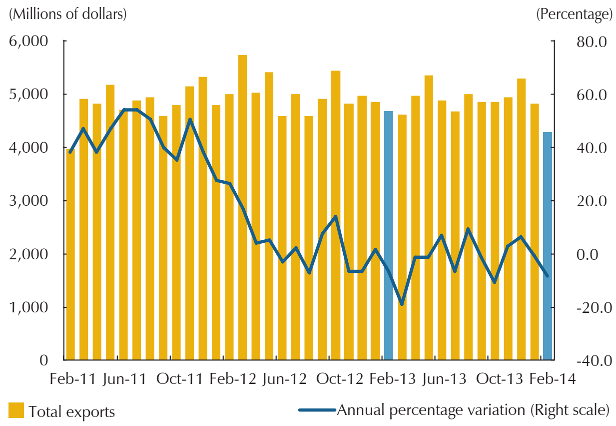
B. BALANCE OF PAYMENTS

In 2013, Colombia posted a current account deficit equal to 3.4% of GDP (US$12,722 million [m]), which was higher than in 2012 (3.2% of GDP; that is, US $ 11,834 m). The increase in the deficit was due largely to a significant reduction in the merchandise trade surplus, which declined by 40% in relation to the previous year. This reflects the behavior of the country's exports (measured in dollars), which dropped 3% annually in a context marked by declining prices for the major products and external demand that remained weak throughout the year, coupled with slightly higher imports than in 2012. The resulting trade balance was offset partly by a 6.4% reduction in factor income, particularly fewer profits remitted by coal exporting companies, owing to the various supply shocks that affected the sector. On the other hand, net income from transfers was similar to the levels observed in 2012.

In 2013, the current account deficit increased from 3.2% to 3.4% of GDP, due to the sharp drop in the trade balance during that period.

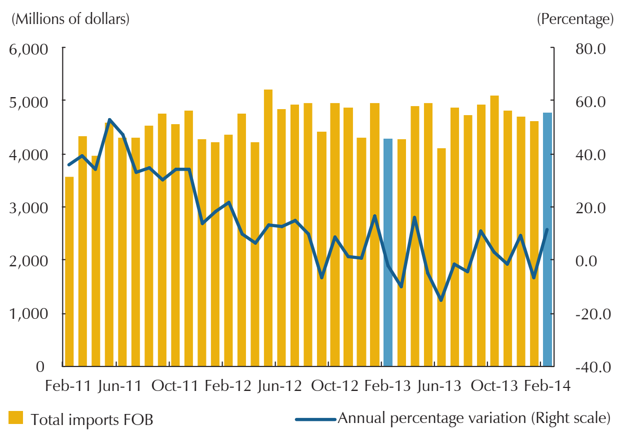
As to external deficit financing, the capital and financial account registered a surplus of US $19,174 m (5.1% of GDP), which was more than the year before (US $17,395 m; that is, 4.7% of GDP). Foreign direct investment (FDI) was still the main source of external financing, having increased 8% in 2013 to US $16,772 m. The annual rise in FDI flows to sectors other than oil and mining was significant (14.7%) and accounted for 53.3% of those resources. In addition, 2013 witnessed an increase in net capital inflows for portfolio investment from foreign sources (US $11,073 m), bolstered particularly by more resources for the public sector, and by income from short and long-term foreign borrowing (loans) by the private sector. These inflows were offset by an increased amount of direct investment by Colombians abroad, with reported outlays of US $7,652 m in 2013, and net outflows associated with portfolio investments by residents (US $4,126 m), especially from the private sector.

Graph 12
Total Exports
(Monthly)



Source: DANE; Calculations by Banco de la República

Graph 13
Total Imports FOB
(Monthly)



Source: DANE; Calculations by Banco de la República

The current account deficit is expected to continue to grow during the first quarter of 2014. In fact, available information on foreign trade in goods for the January-February two-month period indicates that the trade balance continued to deteriorate. Indeed, total exports in dollars fell by 4.6% on average during this period, compared to the previous year (Graph 12), affected by fewer exports of coal, gold and certain non-traditional products. Meanwhile, the value of imports FOB in dollars was up 1.8% in annual terms (Graph 13) (See shaded section on pg. 26).

The lower estimated trade surplus could be offset partly by lower net outlays from the remuneration of lower factors compared to those in the first quarter of 2013, given that the value of coal exports is expected to be less, which could affect remittances of profits and dividends in the sector. Moreover, net income from transfers would be slightly higher than it was during the same period last year. This is consistent with a modest recovery in workers[1]' remittances, which were up by 1.4% annually at February, on average.

For 2014 to date, the available information on capital flows in the foreign exchange balance[2] shows a slowdown in the influx of FDI, particularly associated with different sectors of the oil industry, while the inflow of resources for financial or portfolio investment by the private sector has increased with respect to what it was a year ago. Added to this are the resources registered for the public sector in the first quarter, due to the sale of $2,000 m in Colombian sovereign bonds.

The forecast for the balance of payments in 2014 implies a current account deficit that could be somewhere between 3.5% and 4.3% of GDP, with a

1 Unlike the measurement of the balance of payments, which takes into account the value of imports FOB (free on board), the calculation of GDP according to the national accounts considers imports CIF (cost, insurance and freight), which include the value of freight and insurance. The average total dollar value of the latter was US $ 4,924 m during January and February 2014, with 1.7% annual growth.

2 Although the capital flows registered in the foreign exchange balance do not pertain exactly to what is entered in the balance of payments, since the former refer to the entry and outflow of foreign exchange, they give some idea of the trend.

central scenario in excess of the value for 2013 (Table 3). This would be consistent with a slightly improved external outlook, fueled by recovery in the advanced economies, mainly better than expected results in the United States and the end of the recession in the euro area, but overshadowed by a possible slowdown in the growth of emerging economies. All of the foregoing would lead to a slight build-up in demand for Colombian exports. This scenario would be accompanied by very little change in prices for the major export products, resulting in the increase anticipated in coffee and nickel prices compared to the reduction in oil and coal prices.

The country's total exports are expected to recover in this context, thanks to the estimated growth in commodity exports (particularly due to the anticipated increase in production), as well as a slight improvement in market conditions for non-traditional exports. The rise in revenue would be accompanied by more import growth than in 2013, owing to better performance forecast for industry, added purchases of transportation equipment, and a build-up in the consumption of durable goods, as explained in Chapter II of this report.

Table 3
Forecast for Colombia's Balance of Payments

	(Millions of dollars)				(Percentage of GDP)[d/] (prelim.) (fcst.) 2013			
	2011	2012 (pr)	2013 (pr)	2014 (proy)	2011	2012 (pr)	2013 (pr)	2014 (proy)
I. Current Account	(9,854)	(11,834)	(12,722)	(15,444)	(2.9)	(3.2)	(3.4)	(3.9)
A. Non-factor goods and services [a/]	1,353	(759)	(2,638)	(5,310)	0.4	(0.2)	(0.7)	(1.3)
B. Factor income	(16,042)	(15,654)	(14,656)	(14,818)	(4.8)	(4.2)	(3.9)	(3.7)
C. Transfers	4,834	4,579	4,572	4,684	1.4	1.2	1.2	1.2
II. Capital and Financial Account	12,976	17,395	19,174	17,594	3.9	4.7	5.1	4.4
A. Private sector: Net direct investment and other capital flows[b/]	10,791	14,255	10,704	13,026	3.2	3.9	2.8	3.3
B. Public sector	2,184	3,141	8,471	4,568	0.7	0.8	2.2	1.2
III. Errors and omissions	623	(139)	505	0	0.2	(0.0)	0.1	0.0
IV. Change in gross international reserves[c/]	3,744	5,423	6,957	2,150	1.1	1.5	1.8	0.5

(prelim.): preliminary.
((fcst.): forecast.
a/ Includes the balance for non-factor goods and services and special trade operations.
b/ Takes into account the net flows from foreign direct investment, lending and net external borrowing operations.
c/ The change in gross international reserves includes the contributions made to the Latin American Reserve Fund (FLAR).
d/ The figure for real GDP growth in 2014 is an estimate developed by the Division of Economic Studies. Source: Banco de la República.

Estimated net outlays of factor remuneration should increase moderately in 2014, given a better than anticipated performance by the sectors that remit profits abroad, particularly mining. By the same token, net transfers are expected to be similar to what they were in 2013, with a modest recovery in

The balance of payments forecast for 2014 implies a current account deficit that could be somewhere between 3.5% and 4.3% of GDP, with a central scenario in excess of the amount observed in 2013.

worker's remittances, thanks to more growth in the economies where these resources originate.

The current account deficit in 2014 would be financed largely with FDI inflows, which are expected to be slightly below last year's levels, given the relative improvement in economic conditions in the developed countries compared to the emerging economies. This could affect decisions to reinvest in Colombia. Foreign direct investment would continue to be supported by the major oil, mining and infrastructure projects that are underway in Colombia (See Box 1, pg. 26). At the same time, Colombian investment abroad is expected to be less than it was in 2013, which implies an increase in net FDI income for 2014 This would be accompanied by less long-term external financing, particularly in the public sector, which would be offset, in part, by net short-term capital inflows, fueled largely by the announcement by JP Morgan[3] and less momentum in short-term foreign asset formation, particularly in the private sector. Finally, it is important to note the forecast for the balance of payments reflects a change in international reserves that is consistent with the intervention announced by Banco de la República[4] and the financial returns associated with those reserves.

3 In March, JP Morgan announced it will introduce five new references for Colombian government bonds (TES) in its GBI-EM Global Diversified and GBI-EM Global, as of May 30.

4 This takes into account the purchase of US$1 billion in foreign currency between April and June 2014.

EXPORTS AND IMPORTS IN US DOLLARS FOR 2013 AND 2014 TO DATE

Total exports were down by 2.2% in 2013 compared to the previous year. This was due to fewer mining and agricultural exports, which fell by 3.6% and 0.5% annually, in that order. This outcome was associated with a general decline in international prices for the major products, coupled with lower export volumes in the case of coal, ferronickel and gold. On the other hand, industrial exports rose by 2.2%, thanks to added sales of these products to Ecuador and other destinations, which were offset in part by reductions in exports to the US and Venezuelan markets. Imports rose 0.9% annually, posting an increase in all product groups, according to economic use and destination. Hence, the annual increase in foreign purchases of consumer goods, intermediate goods and capital goods came to 1.8%, 1.0% and 0.4%, respectively.

The performance of exports in dollars during the two-month period from January to February 2014 reflects the drop in foreign sales of industrial and mining products. The latter were down by 5.3% annually during that period, on average, while the decline in industrial exports[1] came to 8.7%. The reduction in mining exports is associated with the decline in sales of gold, with respect to export volume and price, and fewer nickel and coal exports, given low international prices

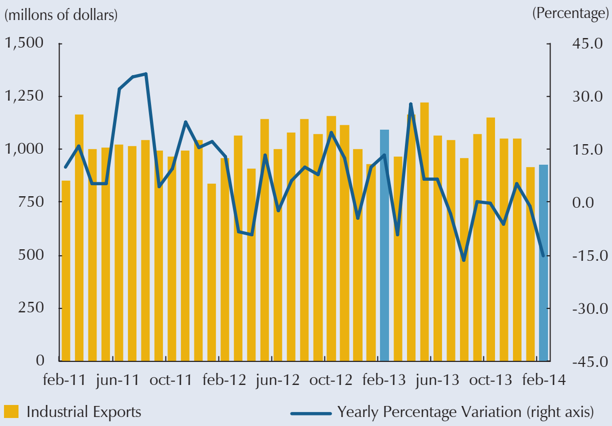
1 These exports do not include petroleum and petroleum by-products, coal, ferronickel, gold, coffee, bananas and flowers, and represent 20% of total exports in that period. Industrial exports accounted for 96% of this group.

for these products. In contrast, exports of oil and petroleum by-products rose at an average annual rate of 0.2% during those two months, given a combination of higher export volumes and lower prices. The drop in industrial exports1 between January and February (Graph A) reflects fewer sales to the United States and all other destinations, with respective average annual reductions of 7.7% and 16.5% for the two-month period. In contrast, sales of industrial goods to Venezuela and Ecuador during the same period were up by 14.7% and 0.3% annually (Graph B). It is important to note the decline in exports to other destinations mainly reflects the drop in vehicle sales to Mexico and Argentina.

Agricultural exports increased during January-February at an annual rate of 15.7%, due to the sizable rise in exported volumes of coffee, bananas and flowers during that period (34%, 72% and 21% annually, in that order).

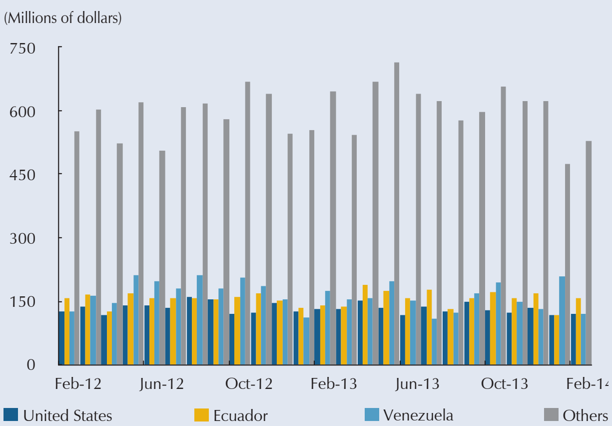
Imports FOB in dollars rose during the same period, largely owing to 10% annual average growth in intermediate goods, bolstered by improved purchases of fuel and related products. Added to this was a slight average annual increase in imports of consumer goods during the period (0.4%). On the other hand, purchases of capital goods and consumer goods contracted during those two months, posting average annual declines of 5.8% and 2.4%, given fewer imports of transportation equipment and non-durable goods, in each case (Graph C).

Graph A
Industrial Exports and Others[a/]
(Monthly)



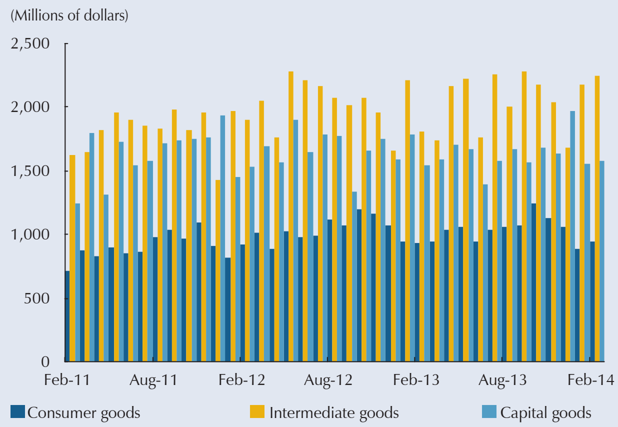
a/ Excluding petroleum and derivatives thereof, coal, nickel, gold, coffee, bananas and flowers.Including other mining and agricultural products.
Source: DANE; Calculations by Banco de la República

Graph B
Industrial Exports, Minus Commodities, to the United States, Ecuador, Venezuela and All Other Destinations[a/]
(Monthly)



a/ Does not include coffee, petroleum derivatives, nickel or gold.
Source: DANE; Calculations by Banco de la República

Graph C
Imports, by Type (FOB)
(Monthly)



Source: DANE; Calculations by Banco de la República

Box 1
FOREIGN DIRECT INVESTMENT IN COLOMBIA: DEVELOPMENTS AND PROSPECTS

Aarón Garavito
Celina Gaitán
Diego Sandoval
Adrián Martinez*

Foreign direct investment (FDI) becomes a major source of long-term financing in economies with technological and capital constraints. Countries with limited savings capacity or underdeveloped financial markets do not have enough resources to expand their production frontier (Chenery and Srinivasan, 1989). In this sense, FDI channels foreign savings into the productive projects the country needs to develop its economy (FEDESARROLLO, 2007). This has potentially positive effects on economic growth, employment, gross capital formation and tax revenue, among other aspects. FDI also can lead to improvements in the production process through technology transfer (Haddad and Harrison, 1993), since multinational companies use skills, knowledge and procedures aimed at optimizing production, which can be transmitted to domestic companies.

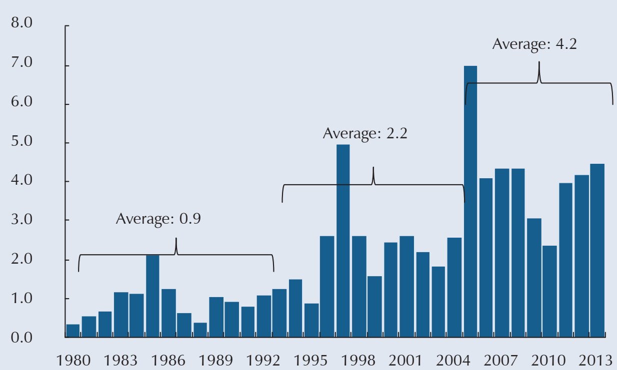
Considering how important this capital is to the Colombian economy, the developments in FDI as of the 1980s and the outlook for investments of this type are outlined in the following section.

1. Developments in Foreign Direct Investment in Colombia (1980-2013)

The regulatory framework for FDI was highly restrictive up until the late eighties, limiting the entry of this type of capital into the country. The legislation of the time banned foreign ownership in certain sectors of the economy and placed restrictions on remittance of earnings and access to domestic borrowing (Urrutia, 1996). This was reflected in relatively low levels of FDI: less than 1% of gross domestic product (GDP) in the 1980-1992 period (Graph B1.1, panels A and B).[1] It was concentrated on the extraction of natural resources and, to a lesser extent, on existing manufacturing industries (Graph B1.2).

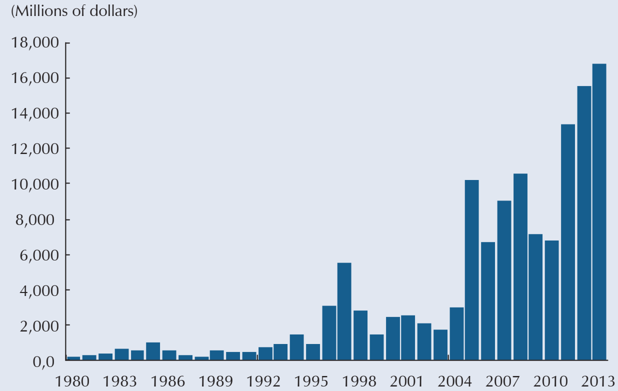
Graph B1.1

A. Foreign Direct Investment in Colombia (Percentage of GDP)



Sources: Banco de la República (Investment records, 1980-1993; Balance of payments, 1994-2013)

B. Foreign Direct Investment in Colombia



Sources: Banco de la República (Investment records, 1980-1993; Balance of payments, 1994-2013).

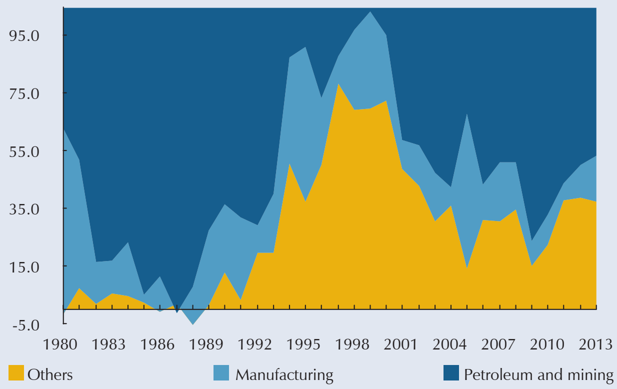
PBy the early nineties, a number of restrictions on FDI had been eliminated due to external financing needs in the context of a more open economy, relatively low terms of trade and restricted access to international borrowing. Significant changes to the international investment regime were made in this sense so as to allow equal treatment for nationals and foreigners, to give foreigners access to almost all economic activities, and to remove certain restrictions on the movement of capital. Sometime later, Proexport was created as the agency to promote FDI, and bilateral agreements were signed (Garavito et al., 2013). These positive changes in the

[1] An estimate was done for the 1980-1992 period, based on the currency investment records of Banco de la República.

* The authors are, in the order listed, an expert and professional with the Department of Programming and Inflation, and professionals with the Technical and Economic Information Department. The opinions expressed in this section imply no commitment on the part of Banco de la República or its Board of Directors.

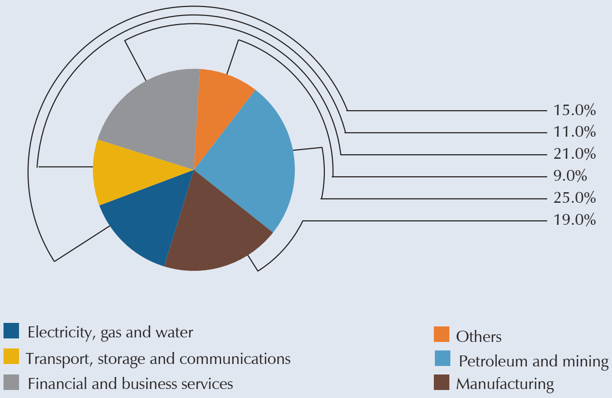
Graph B1.2
Distribution of Foreign Direct Investment in Colombia, by Sectors

(Percentage)



Source: Banco de la República

Graph B1.3
Distribution of FDI Flows, by Sector (1993-2004 Cumulative)



Source: Banco de la República.

investment regime with respect to FDI were observed worldwide as a strategy for countries to attract this type of capital (UNCTAD, 2000).

The more favorable environment for FDI, coupled with other structural changes in the economy (labor market flexibility, economic liberalization and the privatization policy) and a growing, captive domestic demand, was reflected in an increase in this type of capital and its sector diversification. In fact, during 1993-2004, FDI accounted for 2.3% of GDP on average, with some significant reductions, especially in the years close to the economic crisis in the late nineties (Graph B1.1, panels A and B).

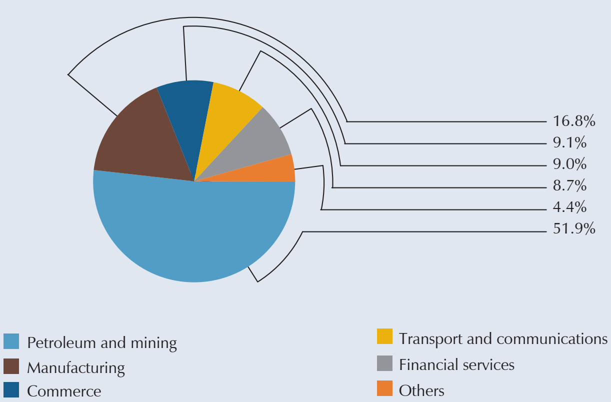
These resources were channeled towards different productive activities (Graphs R1.2 and R1.3), mainly those focused on the domestic market (public utilities, financial services and telecommunications) and, to a lesser extent, the industrial sector (some of these firms used the country as an export platform for the region) and the exploitation of natural resources (coal and oil). The added share of FDI in the delivery of services followed international trends, in which this sector gained participation. The recent influx of FDI into this business is due partly to the fact that services are delivered locally, so investments must shift geographically.

Although FDI increased during those years as compared to the eighties, FDI flows could have been affected by various factors, including low international prices for oil and some minerals, the macroeconomic instability generated during the economic crisis in the late nineties, the deterioration in domestic security, the lack of infrastructure and the lag in education, among others (Garavito et al., 2013).

In the years thereafter (2004-2013), FDI gained force in Colombia as a result of stability in the regulatory environment, growth in the domestic market and increased profitability in the extraction of natural resources. In fact, during this period, FDI was above 4% of GDP and was concentrated mainly in the mining and petroleum sector, followed by manufacturing (Graph B1.4). The increase of FDI in mining and oil was associated with higher international prices for raw materials, tax benefits, better safety conditions, and, in the case of oil, a more favorable tax treatment for investors (Lopez et al., 2012).

As for the other sectors of the economy, one sees the consolidation of companies with FDI in Colombia, mainly to serve the domestic market and, to a lesser extent, the foreign market. Manufacturing firms are the most predominant in this segment, followed by transport and communications (Graph B1.4). For companies of this type, reinvestment of earnings has been an important financing tool. In fact, these resources have come to represent about 30% of their income from FDI (Graph B1.5). This has allowed for a number of things, such as financing companies during the financial crisis in 2008 amid a context of declining international liquidity.

Graph B1.4
Distribution of FDI Flows, by Sector (2004-2013 Cumulative)



Source: Banco de la República.

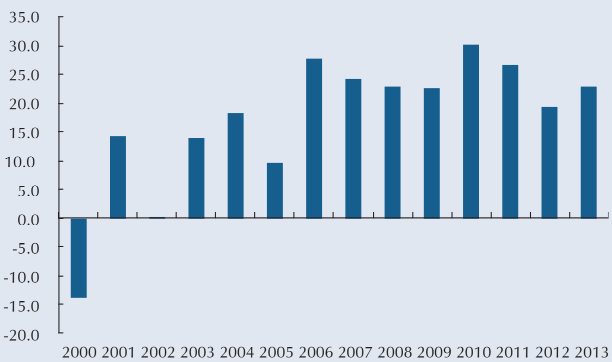
Although the country has been successful in attracting FDI to exploit natural resources and for activities focused chiefly on the domestic market, there is room for improvement in the influx of investment to create companies that export goods and services with more technological content, so as to enhance the positive impact of FDI on the rest of the economy and to increase the amount of such capital as a source of long-term outside funding. In this sense, several studies (Kalin, 2009 and FEDESARROLLO 2007) indicate the country must improve its transportation infrastructure, ensure the quality of higher education, increase spending on science and technology, improve the links between firms with FDI and domestic enterprises, and further simplify the tax system and the regulations to operate in Colombia.

2. The Outlook for FDI

As noted, the significant increase in FDI in recent years, particularly for sectors other than petroleum, is associated not only with the arrival of new capital into the country, but also with decisions to reinvest the earnings from foreign capital in Colombia. This trend is related to external factors that stimulated those decisions in a context of low interest rates in the advanced countries and the relative reduction in risk in emerging economies, especially with regard to the Latin

Graph B1.5
Reinvestment of Profits in Sectors Other than Mining and Petroleum

(Percentage of total income from FDI)



Source: Balance of payments, Banco de la República.

American countries. Accordingly, it is important to point out that prospects for recovery in the advanced economies, mainly the US economy, can involve changes in the availability of FDI resources.

First, one would expect a less uncertain outlook and a recovery in the major advanced economies to imply an increase in the relative perception of risk in emerging markets, thereby reducing inflows of foreign capital into those economies. Furthermore, the best prospects for the developed countries would be accompanied, in the coming years, by a return to normal in their monetary policy stance, which would have implications for global liquidity and for expectations regarding investment returns. These factors also could affect the arrival of investment flows into the country.

Even so, a number of analysts agree that changes in the international environment could have different effects within the group of emerging economies, considering their exposure to international financial flows varies, as does the magnitude of their macroeconomic imbalances. In this sense, Colombia appears to be in a relatively favorable position to deal with the anticipated changes. This situation is confirmed not only by the moderate response witnessed in the country's indicators, but also by JP Morgan's recent announcement that it intends to increase the share of Colombian government debt in several of its investment portfolio indexes. These factors could be playing an important role in maintaining investor interest in the country.

One aspect that must be considered to ascertain the outlook for FDI is the existence or not of large investment projects. The country recently structured a number of projects that will be linked necessarily to the arrival of foreign capital. On the one hand, it is hoped the entire process to structure and develop the works in the government's plan for fourth-generation infrastructure will attract foreign investors to supplement domestic financing capacity and the technology necessary to carry out these projects.

Moreover, the start-up of 4G telecommunications technology will be associated with increased capitalization by companies in the sector, most of which are backed by foreign capital. These resources would be focused on developing the infrastructure required to deliver the new services. However, this does not mean investments in the oil sector would be neglected. In fact, it is estimated they will continue to represent an important source of foreign resources for the country, insofar as expectations for exploration and the development of new production areas are maintained. Added to this, the definition of parameters for unconventional hydrocarbon exploration will bring incentives.

Also important are the anticipated effects on FDI resulting from the free trade agreements (FTAs) that were signed recently by the country or are being processed and will take effect shortly. In this sense, an increase in FDI has been identified in the literature[2] on this subject as one of the most immediate outcomes of the implementation of FTAs between countries, given factors such as the possibility of accessing larger markets, leveraging advantages in terms of cost and productivity, and using economies of scale.

2 For example, these effects have been recognized widely by the WTO (1997) and in several empirical studies, such as those by Bae and Joon Jang (2013) and Worth (1998).

The experience of several countries in the region, such as Mexico, Chile and Peru, corroborates this notion. In the first case, the North American FTA (NAFTA, for its acronym in English) had a positive impact on FDI, which rose 15% annually, on average, during the first eight years of the treaty, with an increase of 150% in the first year alone. In Chile, the increase in these resources averaged 13% annually during the early years of its bilateral agreement with the United States, which meant two additional points of FDI as a percentage of GDP. In the case of Peru, one such treaty has gone hand in hand with more resources for investment, which rose 19% annually, on average, in the past two years.

All this supports the prediction that FDI flows to Colombia will remain at high levels, similar to those on record in recent years, despite the fact that changes in the international environment, namely, better investment conditions in the advanced countries, less global liquidity and reduced prospects for growth in the emerging economies, could slow foreign investment flows to the developing countries. In Colombia, circumstances as such as a better risk perception compared to other emerging markets, the infrastructure and telecommunications projects that have been announced, the momentum in the oil sector, and the signing of free trade agreements could more than outweigh the aforementioned effect.

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II. Domestic growth: the current situation and short-term outlook

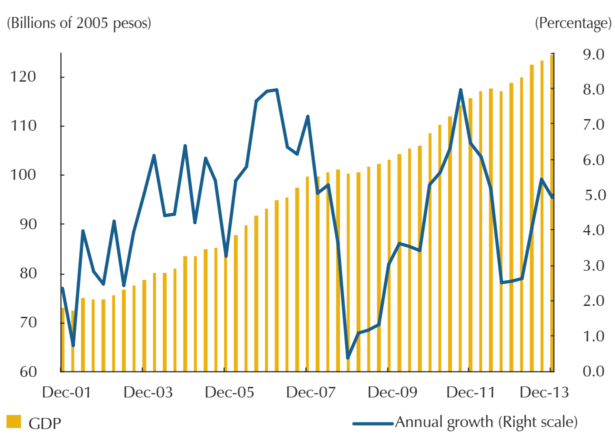
In the fourth quarter of 2013, the Colombian economy grew 4.9% as opposed to 4.3% for the year as a whole. Buoyancy of domestic demand explains most of this outcome.

During the first quarter of 2014, GDP would have continued to expand at a good pace, also similar to the rate on record towards the end of last year. Private consumption and investment would have contributed actively to the performance of domestic demand.

A. GDP in the fourth quarter of 2013 and all of 2013

According to the National Bureau of Statistics (DANE), the Colombian economy grew by 4.9% in the last quarter of 2013 compared to the same period the year before. With this, the annual increase in GDP for all of 2013 came to 4.3% (Graph 14). Both figures were in the upper part of the forecast intervals outlined in the previous edition of the Inflation Report. It should be noted that DANE revised the growth rate for 2012 downward slightly, from 4.2% to 4.0%.

Graph 14
Gross Domestic Product
(Seasonally adjusted)



Source: DANE; Calculations by Banco de la República

The momentum in GDP was uneven between the first and second half of the year. The first six months were marked by several negative supply shocks in the mining sector and mediocre investment performance. However, these situations were more than overcome in the second half, when the Colombian economy performed favorably thanks to construction spending (partly the result of government policies) and a macroeco-

Domestic demand made a dynamic contribution to the expansion in economic activity during 2013.

nomic environment with ample conditions for liquidity, lending and low interest rates. These circumstances, together with a job market that continued to show significant improvement, helped to strengthen consumer confidence, which is significantly above the average on record since 2001, according to figures released by FEDESARROLLO.

All this allowed domestic demand to play an important role and actively contribute to the increase in economic activity. The aggregate for the entire year showed slight accelerations in the annual growth rate (from 4.6% in 2012 to 4.9% in 2013), thanks largely to the performance of gross capital formation during the second half of the year. For its part, domestic consumption exhibited stable growth throughout 2013, resulting in an annual increase of 4.7% (4.9% in the fourth quarter, Table 4).

With respect to this last component of expenditure, government consumption was particularly important, having increased at an annual rate of 6.0% in 2013, while household consumption rose 4.5%. Specifically, fourth-quarter growth came to 6.1% and 4.9%, respectively. As for the different types of goods, increases were observed in consumption of semi-durables and non-durable goods (5.1% and 3.6% in 2012 compared to 6.8% and

Table 4
Real Annual GDP Growth by Type of Spending

	2012	2013				2013
	Full year	I Qtr.	II Qtr.	III Qtr.	IV Qtr	Full year
Total consumption	**4.7**	**4.5**	**4.8**	**4.7**	**4.9**	**4.7**
Household consumption	4.4	4.2	4.6	4.5	4.9	4.5
Non-durable goods n	3.6	3.7	4.7	3.9	4.9	4.3
Semi-durable goods	5.1	6.4	6.1	7.1	7.5	6.8
Durable goods	7.6	2.1	4.4	5.5	3.8	3.9
Services	4.5	4.2	4.3	4.3	4.4	4.3
Government consumption	5.7	5.9	5.9	6.1	6.1	6.0
Gross capital formation	**4.5**	**1.5**	**-2.4**	**11.7**	**9.9**	**4,9**
Gross fixed capital formation	4.6	3.2	0.6	11.3	8.0	5.7
Agriculture, forestry, hunting and fishing	(13.5)	(1.0)	(6.7)	(9.5)	(11.7)	(7.3)
Machinery and equipment	13.1	0.7	4.2	4.6	4.6	3.6
Transport equipment	(11.0)	(10.8)	(10.2)	(1.5)	11.8	(3.0)
Construction and structures	5.1	9.8	8.0	27.0	(2.0)	9.8
Civil works	5.3	6.9	(1.7)	19.1	20.4	10.4
Services	7.2	4.2	(2.0)	12.9	3.4	4.4
Domestic demand	**4.6**	**3.7**	**3.2**	**6.3**	**6.2**	**4.9**
Total exports	**6.1**	**0.6**	**10.5**	**2.4**	**7.9**	**5.3**
Total imports	**8.9**	**-0.3**	**1.9**	**2.2**	**4.5**	**2.1**
GDP	**4.0**	**2.6**	**4.0**	**5.4**	**4.9**	**4.3**

Source: DANE; Calculations by Banco de la República

Private consumption continued to grow at an acceptable rate during 2013, slightly above its average since 2000.

4.3% in 2013), in contrast to the slowdown in consumption of durable goods (Table 4).

Overall, private consumption maintained an acceptable rate of growth throughout the year, benefitting mainly from the increased purchasing power of household income due to inflation, which was down to 2.0% at year's end, coupled with working conditions that showed an improvement in the job market, a relatively high level of consumer confidence, and good growth in lending, with low interest rates.

In terms of gross fixed capital formation (GFCF), the momentum in this aggregate throughout 2013 was mixed. The first half of the year was marked by mediocre annual growth rates (1.9% on average), while the second half showed significant recovery (9.7%). The movement in this item was determined largely by the performance of investment in construction (both structures and civil works). In the first case, the expansion witnessed during the first half the year came to 8.9% annually, then accelerated to 12.5% in the second half. As for civil works, the build-up was more evident, with respective increases of 2.6% and 19.8%. Accordingly, the components of investment in construction showed better results compared to those on record for 2012 (Table 4).

Other items comprising GFCF slowed. In 2013, investment spending on machinery and equipment rose by only 3.6%, as opposed to 13.1% in 2012. This happened in the first half of the year; in the second, the aggregate accelerated. Meanwhile, investment in transportation equipment fell 3.0% during the year; this contraction could have been higher had it not been for the good performance of this item in the fourth quarter (11.8%), related primarily to fleet renewal efforts by several companies in the air cargo and passenger transport sector. Investment in agriculture and services was weak as well.

With respect to foreign trade, 2013 led to a reduction in the rate of export and import growth, although more so for the latter compared to exports. Imports slowed (8.9% in 2012, 2.1% in 2013) in the context of a declining investment in machinery and equipment, transport equipment and consumption of durable goods. Exports, which went from 6.1% growth in 2012 to 5.3% in 2013, facing several supply shocks in the mining sector (especially in the coal production chain) that caused reductions in export volume. Sales of agricultural and industrial goods partially offset the foregoing result.

Construction, social services and agriculture were the most dynamic sectors in 2013.

On the supply side, higher growth rates were observed for construction, social, community and personal services, and the agricultural sector (Table 5). Industrial activity was the only major branch to post an annual contraction.

Table 5
Real Annual GDP Growth, by Branches of Economic Activity

Branches of activity	2012	2013				2013
		I Qtr.	II Qtr.	III Qtr.	III Qtr.	
Agriculture, forestry, hunting and fishing	2.5	3.5	7.2	4.8	5.2	5.2
Mining and quarrying	5.6	0.8	4.3	6.7	7.7	4.9
Manufacturing industry	(1.1)	(5.0)	0.9	(0.5)	(0.1)	(1.2)
Electricity, gas and water	2.1	4.5	5.8	4.0	5.4	4.9
Construction	6.0	8.2	2.4	21.7	8.2	9.8
Buildings	5.9	9.0	7.4	25.1	(1.6)	9.2
Civil works	6.0	7.4	(1.5)	20.1	18.1	10.4
Commerce, repairs, restaurants and hotels	4.3	2.9	4.3	4.7	5.5	4.3
Transport, storage and communication	4.9	2.4	3.1	3.4	3.6	3.1
Financial, real estate and company services	5.0	3.7	4.2	5.7	4.9	4.6
Social, community and personal services	5.0	4.7	5.2	5.0	6.3	5.3
Subtotal –aggregate value	3.9	2.5	4.0	5.4	5.0	4.2
Taxes minus subsidies	5.1	3.8	4.6	5.6	4.1	4.5
GDP	**4.0**	**2.6**	**4.0**	**5.4**	**4.9**	**4.3**

Source: DANE; Calculations by Banco de la República

The other sectors expanded at rates above those for total GDP, except transportation. Mining showed some recovery towards the end of the year.

The best performing sector in 2013 was construction, both in terms of civil works (10.4%) and buildings (9.2%). In the first case, the performance was linked to good momentum for the group that includes waterways, ports, dams, water and sewage facilities, and for railways, runways and mass transit systems. The behavior of building construction was explained by the effect of a low base of comparison in relation to last year, higher execution in stages of the construction process with more aggregate value, and accomplishment of the first stages of the government's "priority interest" housing program, especially in the second half of the year. Towards the end of the year, between October and December, the construction sector posted 8.2% growth, largely because of the increase in civil works (18.1%).

The main impulse in the agricultural sector came from coffee, which was up by 22.3% during the year as a whole.

In the case of agriculture, a major contribution to growth came from coffee production, which increased by 22.3% during the year as a whole. The consolidation of all hectares with productive capacity for coffee, coupled with an increase in productivity[5] through the crop renewal program, allowed for significant expansion and sustained production during 2013 Apart froms

5 According to the Federación Nacional de Cafeteros, plantation renovation undertaken by the Federation has allowed not only for younger trees that are more resistant to disease (such as rust fungus), apart from the effects of the weather, but also has been instrumental to increasing productivity per hectare, which went from 11.1 sacks of green coffee per hectare in 2012 to about 14.5 sacks in 2013. More than 460,000 hectares planted in coffee have been renovated in the last five years.

Although mining grew in excess of GDP (4.9%), this is a long way from the significant expansion witnessed in the past five years (10.2% on average).

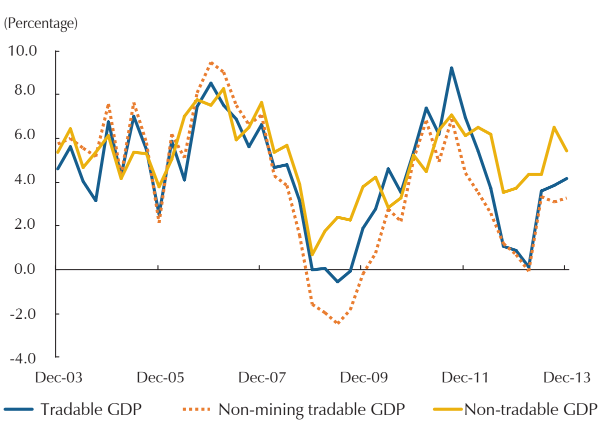
coffee, other sub-branches with good performance were temporary crops and, to a lesser extent, the slaughter of livestock.

Social, community and personal services accelerated in the second half of the year, increasing at an annual rate of 5.7% as opposed to 5.0% in the first six months. This is explained, in part, by the expectation of certain expenses before the start of the Assurances Act in January 2014. The increase in all of 2013 was 5.3%, compared to 5.0% in 2012, primarily because of sustained growth since April in items related to government administration and defense, and health and social assistance.

As in the past five years, mining continued to grow in excess of the economy as a whole (4.9%). However, this outcome is a long way from the expansion observed in the last five years (10.2%). Performance within the sub-branches was mixed: while there were significant increases in the production in the oil and gas group (7.8%) and non-metallic minerals (8.6%), the production of coal (-4.0%) and metallic minerals (-4.2%) went down. Specifically, in the case of coal, the paralysis in production during the first and third quarters of the year was associated with strikes and problems with transporting coal to the port. However, the fourth quarter witnessed a significant recovery (16.7%). In the case of oil, annual production averaged 1,005,000 barrels per day, which was not enough to meet the target set by the authorities at the beginning of the year (approximately 1,040,000 barrels a day). Oil production slowed during the latter part of the year, but continued to grow at a rate above total GDP (5.7%).

The decline in industry for the second year in a row is due to weak external demand, growing international competition, and several supply shocks. This major branch of economic activity posted a decline of 1.2% in aggregate value in 2013, after falling 1.1% in 2012. Performance differed within the sector, with sharp declines in sub-branches such as yarn and thread, transport equipment, leather and footwear, and printing and publishing. Others expanded, such as food and beverages, coffee processing, tobacco, and oil refining.

Graph 15
GDP for Tradables, Non-mining Tradables and Non-tradables
(Annual growth)



Source: DANE; Calculations by Banco de la República

The information available for the first quarter of 2014 suggests GDP would have grown at a rate similar to the one on record towards the end of last year.

B. EL PIB DEL PRIMER TRIMESTRE DE 2014

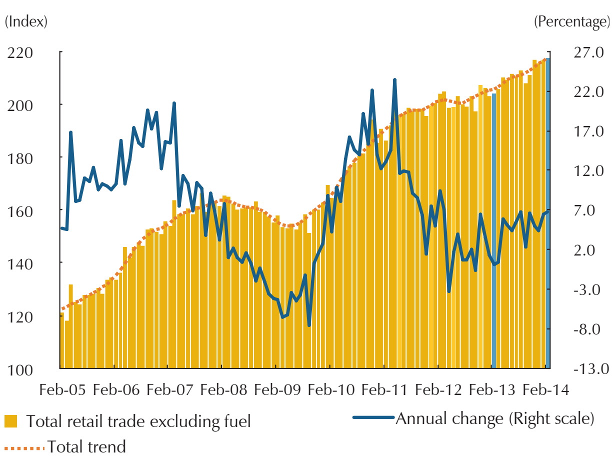
The decline in industry for the second year in a row is due to weak external demand, growing international competition, and several supply shocks. This major branch of economic activity posted a decline of 1.2% in aggregate value in 2013, after falling 1.1% in 2012. Performance differed within the sector, with sharp declines in sub-branches such as yarn and thread, transport equipment, leather and footwear, and printing and publishing. Others expanded, such as food and beverages, coffee processing, tobacco, and oil refining.

GDP for tradables rose 2.9% in all of 2013, as opposed to 2.7% in 2012. The increase in GDP for non-mining tradables was similar. The non-tradable sectors grew by 5.2% in 2013, following an increase of 4.9% in 2012 (Graph 15). In quarterly terms, the acceleration in both sectors came during the second half of the year; the period from October to December ended with 4.2% and 5.4% GDP growth for tradables and non-tradables, in that order.

B. GDP: FIRST QUARTER OF 2014

The information available for the first quarter suggests GDP would have grown at a rate similar to the one on record towards the end of last year, in a context where activity overall continued to expand at a moderate pace, terms of trade remained relatively stable, and perceived risk to the economies of Latin America declined. It is important to point out that good performance by the Colombian economy would have been influenced by a higher number of working days, due to Easter week in April (not March, as was the case in 2013).

Graph 16
Monthly Retail Sample
(Total retail trade excluding fuel, seasonally adjusted)

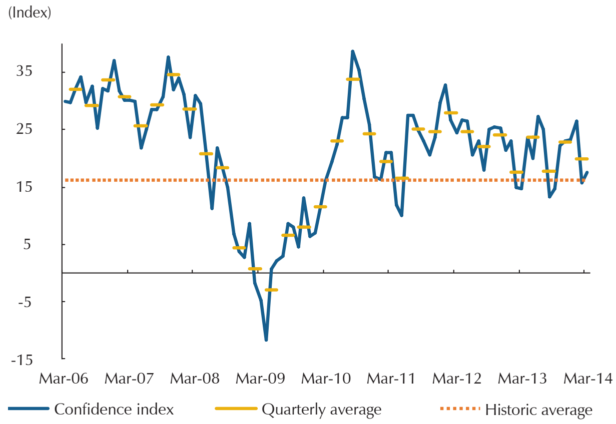


Source: DANE; Calculations by Banco de la República

Because of this, private consumption would have grown at a healthy pace during the first quarter, as is apparent in the momentum observed in indicators of household spending, income and financing. For its part, government consumption would have continued to contribute to economic expansion, although less so than at the end of last year. The Assurances Act would have slowed this item. In contrast, the momentum in investment, particularly in transportation equipment and the construction of civil works, would have been more moderate.

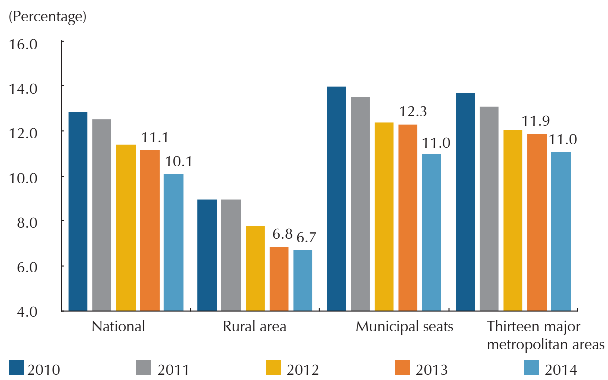
The latest results of the Monthly Retail Sample (MMCM) published by DANE are among the most important spending indicators and confirm

Graph 17
Consumer Confidence Index and Quarterly Average



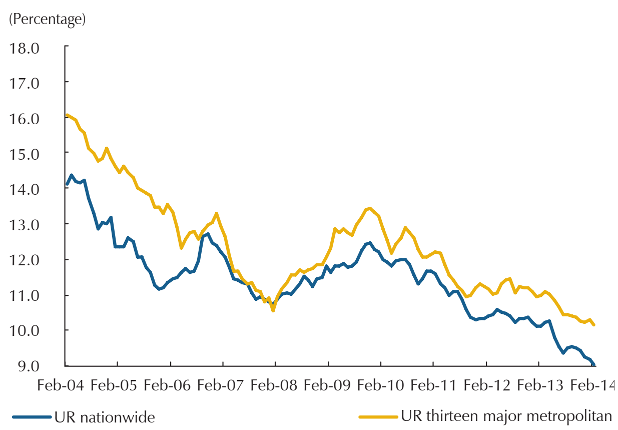
Source: Fedesarrollo

Graph 18
Unemployment Rate
(Quarterly Moving Average: December-January-February)



Source: DANE (GEIH); Calculations by Banco de la República

Graph 19
Unemployment Rate (UR)
(Quarterly moving average, seasonally adjusted)



Fuente: DANE (GEIH); Calculations by Banco de la República

good prospects for household consumption. According to this information, in the two-month period from January to February, the retail sales index rose 6.6%, on average, compared to the same period in 2013. Specifically, it was up 6.7% annually in February, which is one of the highest figures in the last 24 months (Graph 16). The trend component of this series continues to exhibit robust behavior, as it has for the past two years. Discounting vehicle sales, the increase was 4.6% annually during the first two months of the year and 5.2% annually in February.

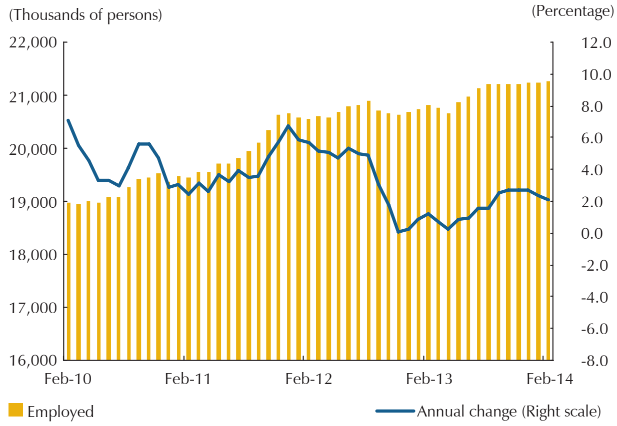
With respect to consumption of durable goods, significant increases were reported in vehicle sales. According to the figures published by DANE, retail automobile sales rose 16.3% during the first two months (13.2% in February). The momentum is confirmed by the figures published by FEDESARROLLO, which show 11.1% growth during the first quarter. This implies a considerable build-up compared to the figure for the last quarter of 2013, when these sales fell by 1.1%. The number of cars sold was higher by about 7,400 units compared to the same quarter last year.

Another indicator that sheds light on the performance of household consumption is the consumer confidence index published by FEDESARROLLO. Although in the first three months of this year it was, on average, slightly below the figure for the fourth quarter of 2013 (Graph 17), its level remained above the historic average on record since 2001. This suggests the momentum in household consumption would have continued during the first part of 2014.

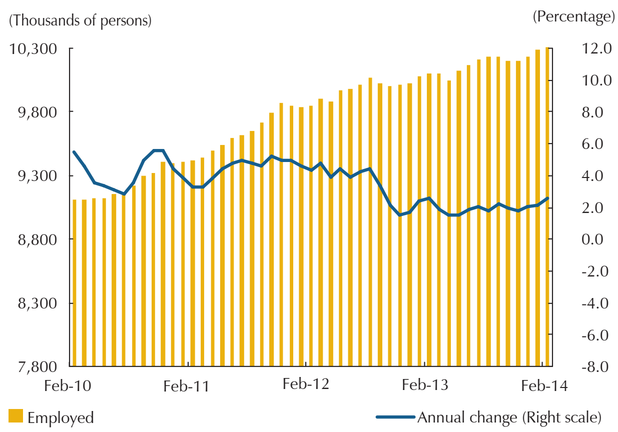
In addition to household confidence, the job market indicators also suggest consumption behaved well during the first half of the year. With the information at February, the unemployment rate in all geographic domains continued to fall, although at a slower pace. It was 10.1% nationwide and 11.0% for the thirteen major metropolitan areas (Graph 18). When adjusting for seasonality, the

Graph 20
Number of Employed and Annual Change

A. Nationwide total



B. Thirteen major metropolitan areas



Source: DANE (GEIH); Calculations by Banco de la República

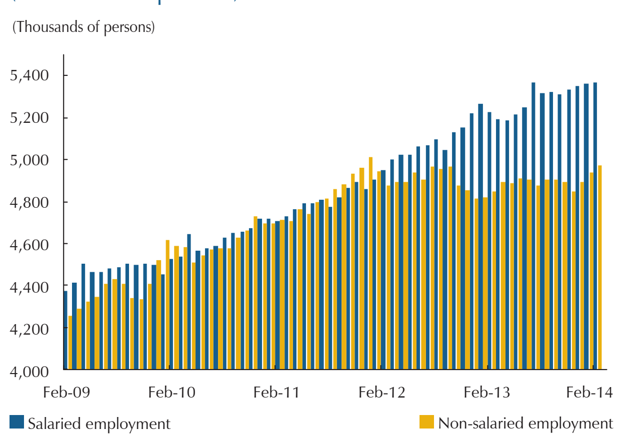
series follows a downward trend in the national total and the rate for the thirteen major metropolitan areas (Graph 19).

This is largely the result of additional growth in the number of employed, which was up by 2.1% annually nationwide in the December-February moving-average quarter and 2.6% in the thirteen major metropolitan areas (Graph 20, panels A and B). These increases were mainly among workers classified as salaried employees, which would be associated with better working conditions and income. In the thirteen areas, employees of this type increased by 2.8% during the same period, while non-salaried employment rose 2.4% (Graph 21).

Lending in the first quarter continued to favor household spending. Consumer loans were up by 8.9% in real terms. This is still a high rate, although lower than in the fourth quarter of last year (9.8%) and for all of 2013 (11.4%). Real interest rates for households also were lower during the first quarter of 2014, due to higher inflation rates in recent months (Graph 22).

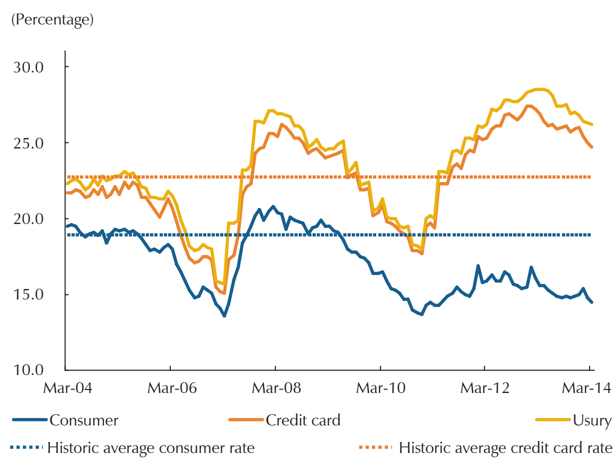
Investment growth in the first quarter is expected to be good, but below what it was in late 2013. This slowdown would be due to less growth in the

Graph 21
Employment, by Type of Occupation
(Thirteen areas, seasonally adjusted moving quarter)
(Thousands of persons)



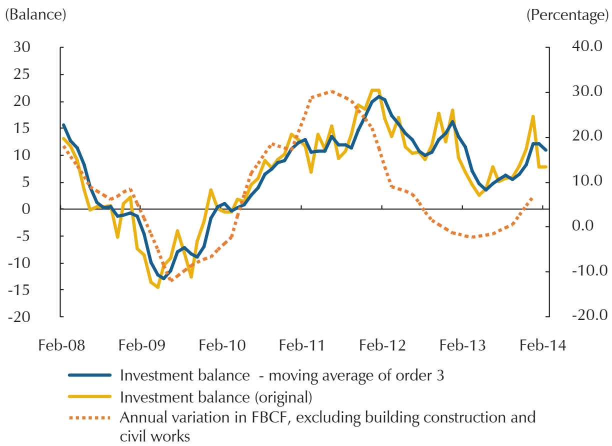
Source: DANE (GEIH); Calculations by Banco de la República

Graph 22
Real Interest Rates for Households
(Non-food CPI deflated)



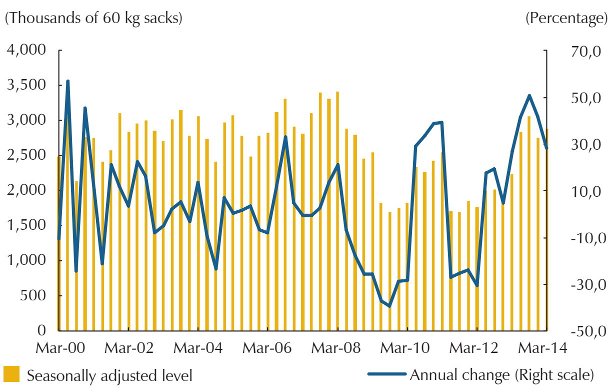
Source: Office of the Colombian Superintendent of Finance; Calculations by Banco de la República

Graph 23
Balance of Investment Expectations (EMEE) vs. Annual Variation in GFCF Excluding Building Construction and Civil Works
(Order 3 moving quarter, annual variation)



Source: DANE and Banco de la República (*Monthly Survey of Economic Expectations – EMEE*)

Graph 24
Coffee Production
(Quarterly and Annual Growth)



Source: Federación Nacional de Cafeteros; Calculations by Banco de la República

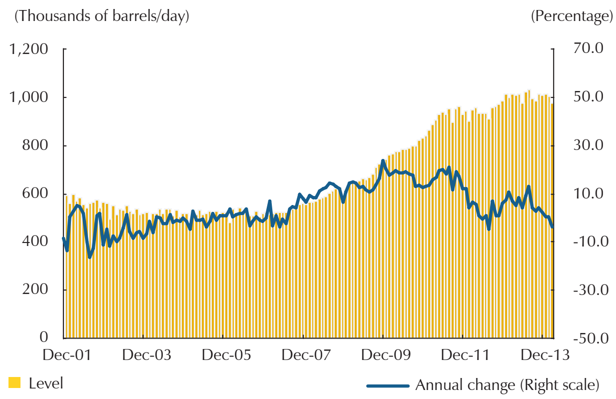
items pertaining to civil works and transportation equipment, which have not been offset entirely by the good performance of investment in machinery and equipment. One of the indicators supporting this performance is the balance of investment expectations in the Monthly Survey of Economic Expectations (EMEE), which suggests that gross capital formation, excluding civil works and construction, would have maintained its momentum during the first quarter (Graph 23). Meanwhile, imports of capital goods, in real terms, continued to expand at a favorable pace during that quarter, which would also be reflected in the figures for the national accounts.

On the supply side, the balance of the various indicators of activity is mixed and suggests the Colombian economy would grow at a similar rate in the fourth quarter. On the one hand, there is encouraging news in areas such as trade, construction, coffee and, to a lesser extent, industry (which shows some recovery). On the other hand, oil production slowed substantially and coal production is not expected to be as dynamic as it was in the fourth quarter of 2013, due to the problems Drummond has encountered with transporting the product to the port. Drummond is one of the largest companies in the country.

The coffee sector reported an increase of 28.0% in production during the first quarter of 2014, following the 41.2% in the fourth quarter of 2013. This is according to figures released by the Federación Nacional de Cafeteros (National Federation of Coffee Growers). The momentum is ratified by the export figures published by the Federation and by DANE in February 2014. According to the Federation, the renewal of approximately 460,000 hectares under cultivation in the past five years has resulted in an increase in the average plantation productivity, as was mentioned in previous reports (Graph 24).

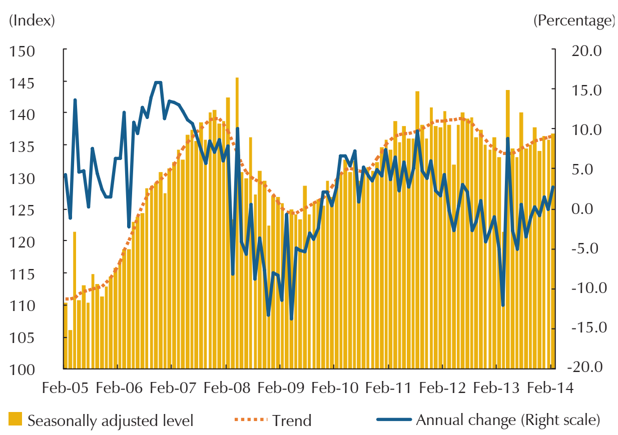
As for commerce, the growth rate is expected to remain favorable, based on the good performance of retail sales, as mentioned already. Consistent with this, the annual rise in employment generated by this branch came to 2.9% in February 2014, given an increase in the recruitment of permanent staff

Graph 25
Oil Production
(Level and Annual Growth)



Source: National Hydrocarbon Agency (ANH); Calculations by Banco de la República

Graph 26
Industrial Production Index, Excluding Coffee Processing
(Seasonally adjusted series, trend component and annual growth)



Source: DANE; Calculations by Banco de la República

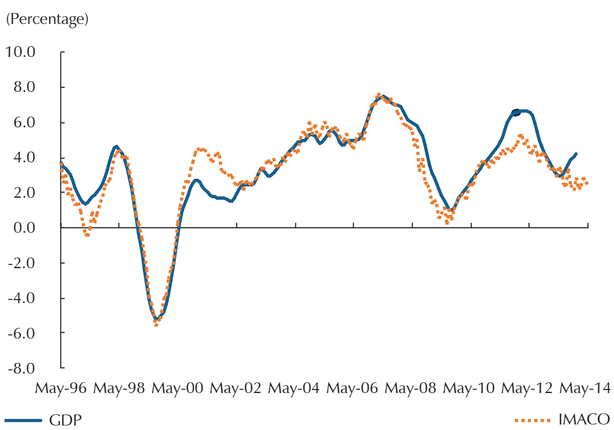
(5.2%) as opposed to a decline in temporary staff recruited through agencies (-4.0%).
The few available indicators for construction suggest first-quarter performance would continue to be favorable, but less dynamic than the fourth quarter of 2013, at least in the case of building construction. The information by February shows cement production and sales rose 10.2% and 11.7%, respectively. Building permits performed well, but less so than in previous quarters, exhibiting 2.55% annual growth and a cumulative twelve-month increase of 9.6% by February (having been 15.9% by December). As noted, despite the slowdown, the sector is expected to post significant figures, supported by government stimulus ("priority-interest" housing and subsidized interest rates on mortgage loans) and good performance in building permits. As for civil works, according to the foregoing, the supply side also is expected to see positive growth, similar what was registered in the previous quarter

In mining, the scenario is less favorable compared to three months ago. Oil production slowed significantly and the performance of the coal sector is highly uncertain. In March, oil production dropped below one million barrels per day (mbd 977), resulting in a contraction of 3.5%. Production during the first quarter averaged 997 mbd, which was a long way from what was anticipated by the sector and the goals set by economic policymakers (Graph 25). The slowdown could be attributed to the security problems that affected infrastructure in March 2014. As for coal, although production is expected to increase in relation to the previous quarter, there is a great deal of uncertainty about its performance, and we cannot rule out the effects the shutdown of activities by Drummond might have during the quarter.

Manufacturing showed some recovery in the first two months of 2014, after falling last year. According to figures from the Monthly Manufacturing Sample (MMM), the DANE industrial production index, excluding coffee processing, rose 2.8% in February 2014, bringing cumulative growth for the year to date to a modest 1.3% (Graph 26). Results within this branch of activity remained quite mixed. While subsectors such sugar mills (23.5%), other foods (9.9%), other types of transportation (14.8%), the manufacture of beverages (6.2%) and chemicals (6.1%) posted significant growth, other subsectors, such as publishing and printing (-18.3%), automotive vehicles (-5.7%) and rubber products (-29.0%), reported significant declines. This makes it difficult to diagnose the aggregate behavior of the sector.

According to the Colombian Association of Industrialists (ANDI), although employers have seen an increase in competition from imports in the domestic market throughout the year, there has been an improvement in the perception of the demand for their products. Also, with the information from the same month, the FEDESARROLLO survey reported a slight drop in inventory indicators, while the indicator of orders stayed at favorable levels. The trend components suggest industry would be starting to recover, although slowly.

Graph 27
Imaco Leading Indicator for 5 Months of GDP [a/]



a/ 12-month cumulative annual growth
Source: Calculations by Banco de la República

It should be noted that the effect of fewer working days, which influenced industrial performance in the first quarter of 2013, would have had a positive impact during the same period this year, since Easter was in April. This is confirmed by the demand for unregulated energy on the part of industry, which rose from 5.0% in the fourth quarter of 2013 to 13.2% in the first three months of 2014. In March, the increase in this variable, highly correlated with industrial production, was 22.1%, suggesting industry could see important positive growth during that month. However, this temporary phenomenon would be reversed in April, when production is expected to decline as a result of fewer working days because of the Easter holiday.

Considering all this, growth in Colombia's GDP during first quarter of 2014 is expected to be somewhere between 4.2% and 5.4%, with the most likely scenario being near the midpoint of the range. As for the different branches of economic activity, agriculture and construction still will be the most dynamic. Industry should continue see important growth, but it will be temporary, due to the number of business days. The forecast range contemplates considerable uncertainty about the ultimate performance of investment in public works and government consumption.

Importantly, the Imaco leading indicator (Graph 27), calculated using several sector variables with information at February, shows a twelve-month cumulative figure below the central forecast. This situation is illustrated in the GDP fan chart, discussed in Chapter IV. It is relevant to bear in mind that this methodology does not contain indicators for sectors such as construction, which are contributing significantly to growth; however, they are considered in the central forecast. So, that indicator might be underestimating GDP growth in Colombia.

III. Recent developments in inflation

Annual consumer inflation returned to the target range and ended the quarter at 2.51%, which was higher than expected.

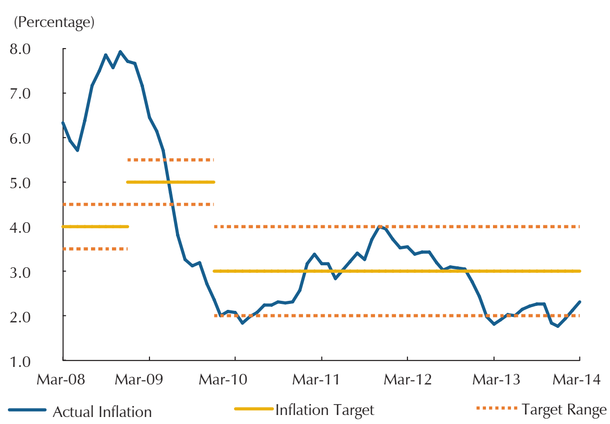
Average core inflation also rose during the first quarter and approached the center of the target range set by the Board of Directors of Banco de la República.

In the first three months of 2014, there was upward pressure from accumulated appreciation of the peso, and the downward supply shocks that occurred in 2013 were reversed.

Demand pressures on inflation still were limited.

After 2013 ended with 1.94% annual inflation, the consumer price index (CPI) continued on an upward trend during the first quarter of this year, posting 2.51% annual growth in March 2014 (Graph 28 and Table 6). So far in 2014, annual consumer inflation has returned to the target range set by the Board of Directors of Banco de la República (between 2.0% and 4.0%), gradually approaching the midpoint thereof. The March figure was slightly higher than expected by the market at the beginning of this year and was more than anticipated in the last edition of the Inflation Report.

Graph 28
Total Consumer Inflation



Sources: DANE and Banco de la República.

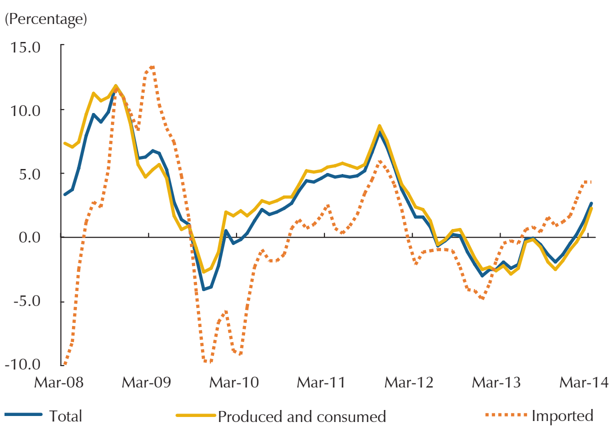
Last year, including the fourth quarter, annual inflation was affected by several downward shocks. They were regarded as temporary and accounted for this decline to levels below 2.0%. As forecast, those shocks, largely to food and regulated prices, began to be reversed in early 2014. This explains most of the increases observed so far this year.

As noted in previous reports, last year saw a decline in certain indirect taxes on fuel, raw materials, vehicles and certain foods; this led to a few price adjustments or reductions for several of these items. In addition, some local authorities froze or reduced prices on regulated services. These effects, which had a one-time impact on prices, are no longer present in 2014, so annual inflation would tend to return to its previous level. Added to this are the exceptional weather conditions that allowed for a major expansion in agricultural supply, with declines in the relative prices for food, which should reverse this year, as seems to be the case.

A second factor that has contributed to the build-up in inflation during the first three months of the year has been depreciation of the peso since late 2013 through mid-March of this year. Higher increases in prices for tradable goods than were observed in past quarters are a reflection of this fact.

The greater accumulated depreciation so far this year also would be leading to a rise in non-labor cost pressures, following the significant declines observed in this front over the past year. The annual change in the producer price index (PPI), which approximates the behavior of costs, rose continuously and to a significant degree in recent months, from -0.5% in December 2013 to 2.9% in March. In large part, this build-up is due to increases in the imported IPP associated with accumulated depreciation of the peso, although this also contributed to the rise in prices for various agricultural products, including coffee prices, which have been driven higher by international prices (Graph 29).

Graph 29
PPI by Origin
(Annual change)

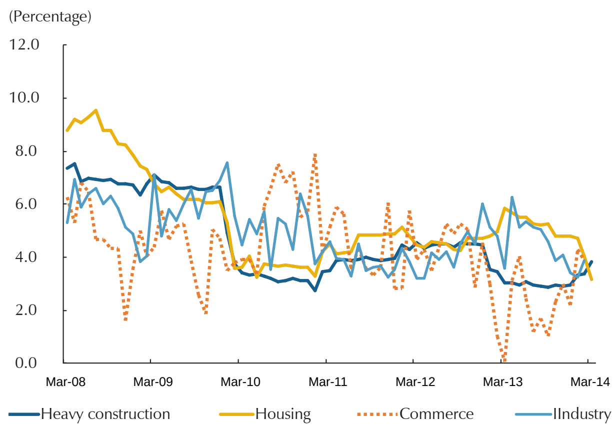


Source: DANE

In contrast, wage costs tended to decline, offsetting somewhat the added upward pressure brought to bear on the rest of the production cost structure. This is explained, in part, by elimination of the employer contribution to health care, effective as of January, which should reduce payroll costs by approximately 8.0%. In addition, wage indexes for sectors such as industry and trade show wage adjustments at about 4.0%; given the normal gains in labor productivity, this could be considered compatible with meeting the inflation target for this year (Graph 30).

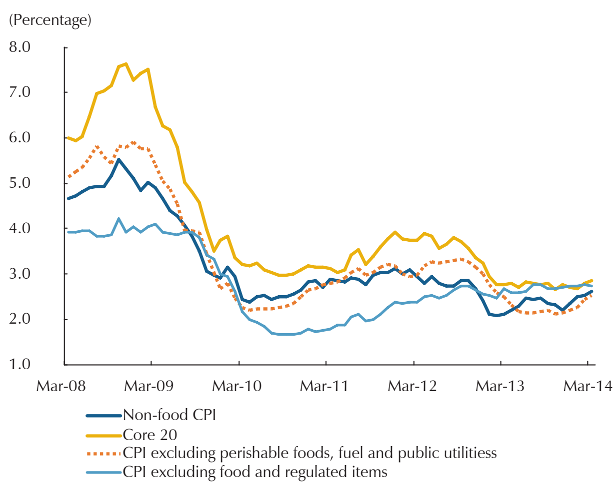
Demand pressures on consumer prices remained limited in the early months of this year, as suggested by the relatively stable non-tradable component of CPI performance. In this sense, the new estimates on output gap present-

Graph 30
Nominal Wages
(Annual percentage change)



Source: DANE; Calculations by Banco de la República

Graph 31
Core Inflation Indicators



Source: DANE; Calculations by Banco de la República

ed in the current report stayed in slightly negative territory for the end of last year and early 2014, as described later (see Chapter IV).

A. CORE INFLATION

The average of the four core inflation indicators monitored regularly by Banco de la República increased 20 basis points in the first three months of the year and was 2.7% in March 2014. All the core inflation indicators remained below the specific target for inflation, with the CPI core 20 being the highest (2.9%), followed by the CPI excluding food and regulated items (2.8%), which was quite stable throughout the quarter. The non-food CPI had increased by 26 basis points since December and closed at 2.6% in March, a figure slightly higher than the one forecast in the Inflation Report at the end of last year (Graph 31, Table 6).

Within the non-food CPI, regulated items are the component with the largest increases, having gone from 1.1% in December 2013 to 2.2% in March 2014 (Graph 32). In fact, all the components of this sub-basket gained significantly, with the largest contribution coming from prices for public utilities (which went from 1.4% in December to 3.0% in March).

An important part of the rise in public utility rates is a low base of comparison in the first quarter of last year, following the reductions in domestic gas rates. At the time, these were due to lower international fuel prices and a trend towards appreciation of the exchange rate. Both these effects were reversed in early 2014. In particular, depreciation of the peso since the middle of last year and during the first quarter of this year would be pushing those rates higher. Then, there is the effect of changes in the tariff regulation formula, which were implemented earlier this year and not anticipated in previous reports. The price of domestic gas accumulated an adjustment of 9.6% during the first quarter, with an annual variation of 12.9% by March.

The fuel CPI also added to the build-up in annual consumer inflation. The cumulative increase so far this year is more than 2.0%, which was partly

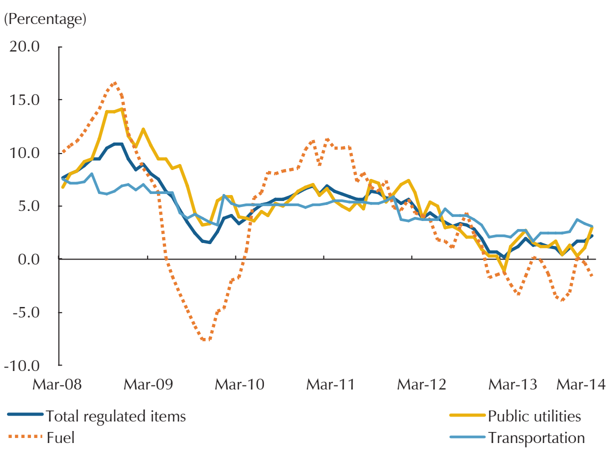
Table 6
Consumer Inflation Indicators
(At March 2014)

Description	Dec-12	Mar-13	Jun-13	Sep-13	Dec-13	Jan-14	Feb-14	Mar-14
Total	**2.44**	**1.91**	**2.16**	**2.27**	**1.94**	**2.13**	**2.32**	**2.51**
Excluding food	**2.40**	**2.11**	**2.48**	**2.36**	**2.36**	**2.49**	**2.53**	**2.62**
Tradables	0.77	1.13	1.10	1.34	1.40	1.57	1.61	1.65
Non-tradables	3.92	3.85	3.78	3.70	3.76	3.61	3.61	3.55
Regulated items	1.91	0.20	1.98	1.24	1.05	1.66	1.76	2.21
Food	**2.52**	**1.41**	**1.34**	**2.05**	**0.86**	**1.20**	**1.78**	**2.23**
Perishables	(3.90)	(1.86)	2.44	5.94	-0.16	2.13	2.61	3.17
Processed	2.83	1.25	(0.11)	0.18	-0.24	-0.18	0.40	0.92
Meals outside the home	4.90	3.22	3.51	3.74	3.26	3.29	3.88	4.13
Core inflation indicators								
Excluding food	2.40	2.11	2.48	2.36	2.36	2.49	2.53	2.62
Core 20	3.23	2.78	2.83	2.79	2.72	2.69	2.79	2.86
CPI excluding perishable foods, fuel and public utilities	3.02	2.51	2.14	2.19	2.19	2.19	2.27	2.43
Inflation excluding food and regulated items	2.55	2.67	2.63	2.69	2.74	2.74	2.74	2.76
Average of all the indicators	**2.80**	**2.52**	**2.52**	**2.51**	**2.51**	**2.55**	**2.63**	**2.69**

Source: DANE; Calculations by Banco de la República

anticipated in the previous edition of this report and was associated with depreciation of the peso in recent months up to March. Given this adjustment, coupled with the decline in the price of gasoline during early 2013 (owing to the reduction in indirect taxes ordered in the latest tax reform), the annual variation in this indicator increased significantly in the first quarter, but remained negative (-3.2% in December to 1.6% in March)[6].It is important to remember the international price of oil is a key determinant of the domestic price of gasoline, and the former has stayed above the price anticipated in the December edition of this report (see Chapter I herein).

Graph 32
CPI for Regulated Items and Components Thereof
(Annual change)



Source: DANE; Calculations by Banco de la República

On the other hand, the volatility in the energy CPI continued during the first months of the year and passed through, in part, to the CPI for public utilities. As illustrated in previous reports, this volatility is attributable to the noise imprinted on rates by the distribution charge,

6 At the end of March, when this report was written, a new adjustment in gasoline prices was announced for April.

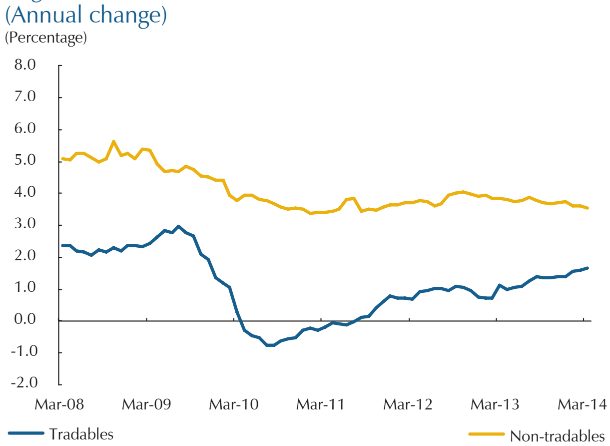
The average of the inflation indicators (2.7%) increased with respect to the previous quarter.

which oscillated sharply in the western part of the country during several quarters, particularly affecting users in the city of Cali.[7]

In the case of the CPI for transport (3.1% in March), its annual variation accelerated by 50 bp in recent months as a result of the adjustment in urban public transport fares in cities across the country. However, this increase did not include rates for the mass transit system in Bogotá; their adjustment would be pending.

The performance of the other two segments of the non-food CPI; that is, tradables and non-tradables, was mixed during the first quarter of 2014. The annual change in the CPI for tradables, excluding food and regulated items, rose by 25 bp in relation to the end of the previous year and came to 1.7%, which is more than was anticipated in the December report (Graph 33). The depreciation that had accumulated for several months was a determining factor in this respect and led, with a lag, to a price increase at the start of the year for goods such as vehicles. The prices of vehicles, which are the third most important item in the CPI (4.35%), began to rise as of the second half of last year, following significant accumulated declines during the course of several quarters. Added to this are the protectionist measures in some sectors of industry (footwear and apparel),[8] which could also be contributing to the hikes witnessed in their price indexes in recent months, as was the case during part of 2013.

Graph 33
Tradable and Non-tradable CPI Excluding Food and Regulated Items
(Annual change)



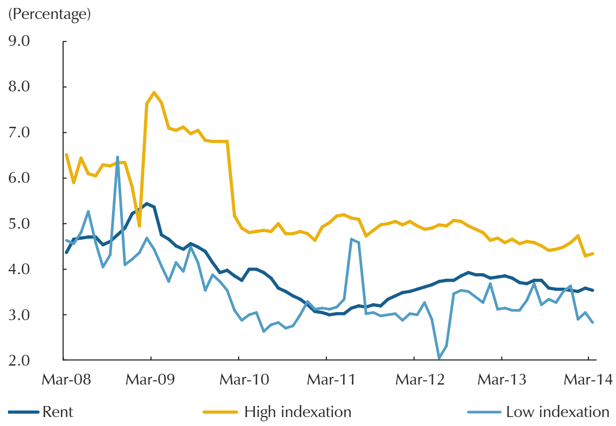
Source: DANE; Calculations by Banco de la República

On the other hand, the non-tradable component of the CPI excluding food and regulated items declined by 21 bps from the previous quarter, posting an annual increase of 3.5% by March 2014. The downward trend in the non-tradable CPI throughout 2013 and so far this year reflects the limited demand pressure perceived in recent months, which coincides with the estimates of the output gap mentioned earlier. It also suggests there is very little pressure from costs and inflationary expectations. The latter are in line with the midpoint of the long-term target range set by the Board of Directors (shown in Chapter 4 of this report). The annual change in the items subject to high and low indexation decreased over the quarter and rentals experienced slight

7 See Box 3 in the September edition of the Inflation Report: "Why the Volatility in the CPI for Electrical Energy?"

8 See Decree 0074 issued by the Ministry of Commerce, Industry and Tourism on January 23, 2013.

Graph 34
Non-tradable CPI
(Annual change)

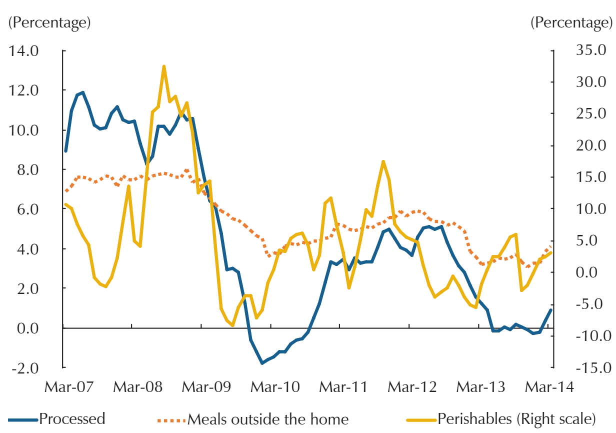


Source: DANE; Calculations by Banco de la República

Graph 35
Food CPI
(Annual change)

Source: DANE; Calculations by Banco de la República

Graph 36
Food CPI, by Groups
(Annual change)



Source: DANE; Calculations by Banco de la República

increases in the first two months of the year, but pulled back in March (3.5%) (Graph 34).

B. FOOD INFLATION

Annual food inflation accelerated in the first quarter to an extent that was stronger than expected. The March figure was 2.2%, which is 140 basis points more than observed in December and also the highest on record in the last fifteen months (Graph 35). During the second half of 2013 up to November, inflation fell to very low levels, given the history of the series, and was accompanied by significant reductions in food prices due to various factors, such as exceptional weather conditions, extremely low international prices, little pressure from the exchange rate and increased foreign competition. Several of these factors would have tended to normalize in recent months, stabilizing supply and producing price hikes.

So, in the first quarter of 2014, contrary to what was observed in 2013, the annual price adjustment rate accelerated for all the major food groups. This trend has been particularly strong in the CPI for perishable foods (Graph 36, Table 6), particularly with respect to products such as potatoes and fruits. Their supply would be declining in response to the low prices in 2013.

The annual change in prices for processed goods also rose significantly, reaching 0.92% in March 2014, after being in negative terrain for several months in 2013. Accumulated depreciation of the peso, along with hikes in international prices for oils, cereals and coffee, began to pass through to domestic prices for the consumer. This also was much the case with meals outside the home, the second item with the most weight in the consumer basket (8.1% of the weight); the annual variation went from 3.2% in December to 4.1% in March, returning to the levels that were observed twelve months earlier (Graph 36).

Prices for all the major food groups accelerated, but particularly for perishables.

Finally, the increase in the annual change in the CPI for the three groups in question during the last quarter also can be attributed to the finalization of the downward effect generated by the reduction in the value added tax (VAT) on many end user products, on meals outside the home and on a range of agricultural input. This reduction was derived from the tax reform that took effect last year. These measures often have an impact on annual price changes for a year and for one time only, which partly explains the recovery in prices for these products perceived in recent months.

IV. Medium-term forecasts

The Colombian economy in 2014 is expected to grow at a pace similar to the rate observed in 2013, combined with a good degree of expansion in domestic demand.

In 2014, household consumption should increase at a rate similar to the one last year, bolstered by a loose monetary policy and other factors.

The central inflation forecast for this report increased again.

Annual consumer inflation is expected to be around 3% by the end of the year and in 2015.

A. ECONOMIC GROWTH

The medium-term economic forecasts outlined in this report are not significantly different from those published in the previous edition. The estimates for growth in the Colombian economy during 2014 suggest GDP would expand at an annual rate similar to the one observed in all of 2013. These forecasts take into account the difference scenarios in the international context described in Chapter I of this report, which suggest better results for the developed countries in terms of their growth. This, in turn, would largely offset the expected slowdown in growth of some of the major Latin American countries. Even so, there are still risks associated with China and the possible effects of the normalization of monetary policy in the United States, which continues to generate uncertainty when constructing forecasts (although less than on previous occasions).

The forecast for GDP growth in 2014 was maintained in this report.

Two to six quarters is anticipated as the time it would take for economy activity in Colombia to respond to changes in the stance of monetary policy.

Generally speaking, the improved performance in the international macroeconomic environment suggests more dynamic external demand for the country, which would be favorable to non-traditional exports. Additionally, better prospects for the advanced economies would allow for better performance with respect to income received through remittances from abroad, which would grow in excess of the 1.1% annual increase observed for 2013.

International prices for export commodities are expected to be slightly lower, on average, than they were last year, but still would be relatively high. Lower prices for oil and coal would be offset, only in part, by the recovery in coffee and nickel prices. As such, terms of trade are expected to be high, but slightly below the average for last year. The latter could have an effect on the nation's tax revenue and partly limit possibilities for further growth in public and private spending. Despite the indicated changes in the international macroeconomic environment, the recent announcements by JP Morgan assume inflows of capital into the Colombian economy during the remainder of the year. Combined with abundant generous income from FDI, these would continue to favor an expansion in Colombia's productive structure during 2014.

Domestic demand is expected to increase at a rate similar to the one on record for 2013. In principle, the loose monetary policy stance maintained for several quarters would continue to have a positive impact on productive activity, providing liquidity to market and ensuring financing for spending in the economy. Two to six quarters is anticipated as the time it would take for economy in Colombia to respond to changes in the stance of monetary policy. Moreover, a change in the price level is anticipated, but it would be low and would converge towards the end of the year around the midpoint of the target range. The foregoing would favor household purchasing power, which would be reflected, as a result, in good performance by private consumption.

Household consumption would grow at a good pace, as inferred from the latest results for the labor market and consumer expectations.

On the other hand, the job market would continue to show considerable momentum, given, among other things, lower hiring costs thanks to the reduction in contributions companies are required to pay for health care. This would be consistent with good performance in household consumption throughout the year, similar to what is on record for all of 2013. In this regard, the expectation component of the confidence index suggests there would be no deterioration in household's willingness to purchase during subsequent semesters, which is why the course of growth in private consumption is expected to see no major adjustments in 2014.

As for the performance of end consumption by the government, the expectation in this report is that growth rates would remain favorable, although less than those on record for all of 2013. According to the latest forecasts

Investments in the construction of buildings and civil works would expand at a good pace, but not as much as last year.

by the Ministry of Finance and Public Credit (MHCP),[9] current central government spending as a percentage of GDP (in current pesos) would continue in 2014 at the levels observed a year ago, which is consistent with the structural deficit target in the Medium-term Fiscal Framework (-2.3%). Even so, spending on other items related to investments in social areas and infrastructure would be above average for the last two decades. On the other hand, spending by regional and territorial entities would increase at a higher rate than in the two years before, because local government administrations entering their third year in office already have development plans set up.

As for investment, the forecasts in this report suggest it will expand at a rate similar to the one on record in 2013; however, there is expected to be a shift in the items comprising it. While the pace of growth in investment in the construction of buildings and civil works would be slower than during the past year (due to the statistical effect of a high base of comparison), investment in transportation equipment and in machinery and equipment would accelerate. In the first case, the momentum from the government's low-income housing programs should continue to bear fruit, and part of the impact from the construction of important facilities such as roads, airports and water and sewer systems would continue. In the second case, the momentum would come from the efforts of several air carriers to renovate their fleets and from the anticipated recovery in the industrial sector. Moreover, the various free trade agreements signed recently could favor imports of capital goods, which would help the momentum in this type of investment.

As for international trade, better external demand, the expected recovery in coffee and coal production, and accumulated exchange-rate depreciation would favor an expansion in real exports. The forecast for imports indicates that good performance on the part of domestic demand and recovery in the industrial sector will enable purchases of consumer goods, capital goods and raw materials from abroad to remain at important levels.

The most dynamic sectors in 2014 should be construction and social, personal and community services. Industry, on the other hand, will experience positive growth, but less than the overall increase in the economy.

From the standpoint of supply, the most dynamic sectors in 2014 should be construction and social services, both with higher rates of growth than the economy as a whole. For other sectors, such as trade, financial services and taxes, significant rates of expansion are forecast as well. Mining would grow at a rate similar to the one in 2013. Lastly, the forecast is for industry to show a positive rate, after two consecutive years of decline; however, it will be below the growth rate for the economy as a whole.

9 MHCP, Macroeconomic Policy Office (2014), "Actualización Plan Financiero 2014" (2014 Financial Plan Update), Document 002/2014, February 6.

GDP would begin to reflect the impact of the fourth-generation infrastructure projects as of 2015.

Prospects for construction remain favorable. As explained, they are based on continuation of the momentum originating with the "priority interest" housing program and the subsidies in mortgage interest rates. The projects for road infrastructure and telecommunications also will make an important contribution to growth. As for the fourth-generation road infrastructure projects, although the procurement process would have been ongoing so far this year, the impact on GDP would begin as of 2015.

With respect to social, personal and community services, the momentum in government expenditure is expected to continue to play an important role in the sources of growth for 2014, especially in the areas associated with health and public administration and social assistance.

The tax sector would accelerate compared to 2013 if the target set by the government for the current year, which amounts to $ 111.8 billion (b) and implies that an increase of 11.3% is met. According to economic policymakers, tax revenues were 19% higher in the first three months of the year than during the same period in 2013. This performance would allow them to be fairly certain the target will be met.

Good growth is expected for the agricultural sector in 2014, although less than in 2013. Again, the leading sub-branch would be coffee, with production forecast at 11.4 million 60-kilo sacks, according to the Federación Nacional de Cafeteros, assuming that weather conditions are suitable. This implies an increase of 4.6% over the previous year, when production totaled 10.9 million 60-kilo sacks.

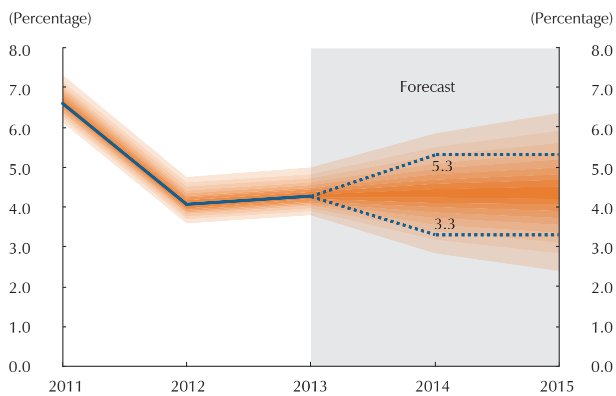
In mining, coal is expected to recover. After problems with law and order and transport issues that complicated the production chain in 2013, this sub-branch would grow by about 7% in 2014. This figure takes into account the paralysis in the production and export activities during the first quarter by one of the two major companies in the sector, while it adapts its loading facilities to minimize the environmental impact. According to the Asociación Colombiana de Petróleo (ACP, Colombian Petroleum Association), crude oil production is expected to average of 1,030,000 barrels per day this year, which is 2.4% more than in 2013. However, the figures observed in the first three months of the year indicate production has been significantly less than expected (997 mbd). In all, the rate of growth in mining is expected to be less than for the economy as a whole and would not reach the high rates posted in previous years (above 10%).

Coffee would lead the expansion in the agricultural sector, while the performance of mining will depend largely on how coal and crude oil production play out.

Finally, the GDP forecast for 2014 assumes a recovery in industry based on investment made in past years and on diversification of products and export t markets. However, some branches of industry will continue to face stiff competition from imports; this is according to the perception reported by employers in the ANDI surveys. In other cases, such as publishing, printing and related industries, the setback could continue, due to the major deep structural changes that are affecting this sector worldwide.

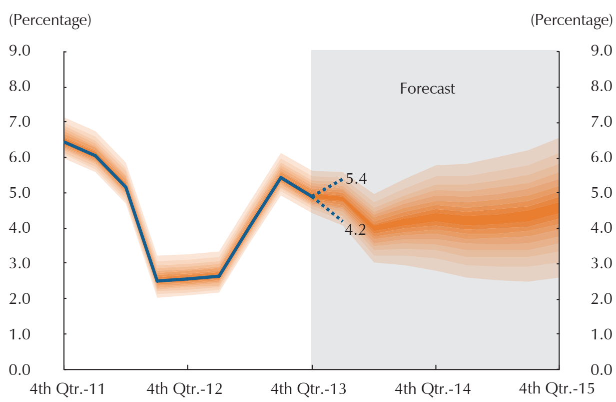
Based on the foregoing, the forecast for GDP growth in the most likely scenario is about 4.3% for 2014, within a forecast range of 3.3% to 5.3%. This is similar to the forecast in the last quarterly report. Although the extent of this range remains broad, since there is still a great deal of uncertainty, both internally and externally, this time the risk balance is more even keeled. The floor and ceiling of the forecast range are associated with the low and high scenario of the international context, as presented in Chapter I.

Graph 37
Fan Chart of Annual GDP Growth



Source: DANE; Calculations by Banco de la República.

Graph 38
Fan Chart of Quarterly GDP Annual Growth



Source: DANE; Calculations by Banco de la República

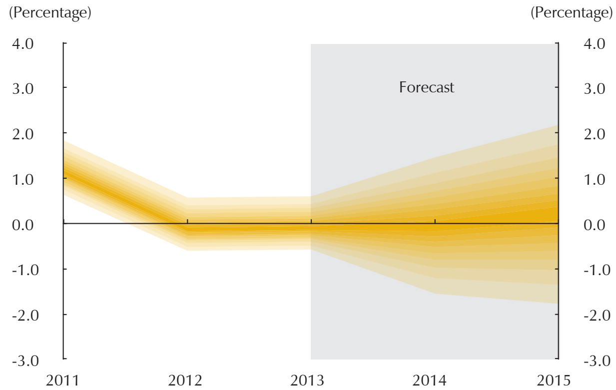
The risk balance is shown in the growth fan chart (Graphs 37 and 38). The main downside risks are associated with lower levels of consumption and public investment, as well as less dynamic behavior from our trading partners. As for the domestic factors, the anticipated slowdown in government consumption might be more than expected, due to the Assurances Act and the uncertainty sparked during elections. In terms of the external factors, Colombia's trading partners, particularly those in the region, could grow less than expected. Moreover, some of them could establish trade restrictions; Venezuela is an example.

On the other hand, the main upside risk is related to more-than-expected momentum in private consumption and investment due to possibly increased access to external financing, accompanied by less perception of risk, which would generate flows of capital into the Colombian economy. This could occur if foreign investors decide to significantly increase the share of Colombian government debt in their portfolios.

The latest estimates of the output gap for the central forecast suggest this variable will remain close to zero, on average, during 2014 and would be slightly above this level in 2015.

As always, it is important to bear in mind there is a great deal of uncertainty associated with these estimates. According to the risk balance shown in Graph

Graph 39
Fan Chart of the Output Gap



Source: DANE; Calculations by Banco de la República

39, the gap is expected to be somewhere between -1.5% and 1.4% in 2014, on average, with a high probability. This balance has less of a downward bias than the one presented in the previous report.

Banco de la República's models suggest the unemployment rate in 2013 was very close to the non-accelerating inflation rate of unemployment (NAIRU). The data at hand for 2014 indicates the gap in the labor market would continue to close. Coupled with elimination of the contribution to health care payable by employers (contemplated in the recent tax reform), this suggests inflationary pressures from the job market would continue to be low for all of 2014.

B. INFLATION

1. Forecasts

The medium and long-term Inflation forecasts increased on this occasion, compared to those in the December edition of the Inflation Report. Currently, the forecasts of the two main models used by Banco de la República show annual consumer inflation ending 2014 near the center of the target range set by the Board of Directors for this year (from 2% to 4%) and remaining there throughout 2015. Earlier forecasts showed a slower convergence to 3%, which was not the case in 2014, strictly speaking

The increase in the forecasts is due to three factors, the first being food. The annual inflation figures in March, which exceeded the forecasts developed over three months ago for three of the four key baskets into which the CPI is divided in this report, hinted that some of the previously identified upside risks to these prices might emerge. This is due to a more pronounced agricultural cycle than usual, as a result of the very low relative prices observed in the second half of last year, coupled with less favorable weather conditions.

The medium and long-term forecasts for inflation were increased in this report.

The unanticipated international price hikes observed in recent months for a range of raw materials and foods imported by Colombia stem from supply reductions in several producing areas of major global importance, such as Brazil. Added to this is accumulated depreciation of the peso, which accelerated at the start of the year, leading to more of an upward effect on domestic prices in the coming quarters than was anticipated earlier, not only for finished goods, but also for production costs in the agricultural

The prospect of further adjustments in regulated prices was one factor that explains the increase in the inflation forecast.

sector. Although this trend was reversed in March, the exchange rate stayed above the levels witnessed in the second half of last year.

The prospect of further adjustments in regulated prices was the second factor that prompted significant increases in the inflation forecasts, given the higher than expected rise in prices for gasoline and domestic natural gas during the first quarter of the year. In recent months, the international price of oil stayed above the projections outlined in the December edition of this report, raising the forecasts for the price of gasoline, domestic gas and electricity, considering these sources of energy are, to some degree, substitutes.

Part of the sharp increases in domestic gas observed so far this year is also attributable to a change in the regulatory framework ordered in resolutions 137 and 138 issued by the Comisión de Regulación de Energía y Gas (CREG, Energy and Gas Regulatory Commission) in October 2013. These hikes, which were not included in the December edition of the Inflation Report, raise the annual variation for the item in question and the regulated CPI during an entire year.

Moreover, the central forecast in this report contemplates energy price increases during the rest of the year that are slightly higher than was expected, considering that 2014 might be a year with less rainfall than normal. This would intensify the use of thermal power plants to supplement energy that would not be available from hydroelectric plants, which tends to raise production costs and customer fees.

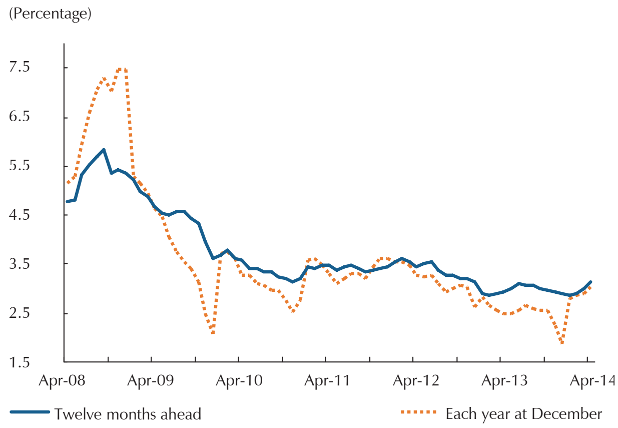
The third factor behind the increase in forecasts is the behavior predicted for inflation expectations, pursuant to the models used by Banco de la República. As mentioned in Chapter III of this report, the acceleration in inflation so far during 2014 was more than the market anticipated. This fact would tend to raise the medium and long-term expectations of consumers and businesses, which still have an important adaptive component in Colombia.

In the models being used, the main effect of an increase in inflation expectations would materialize in the annual change in the CPI for non-tradables, which usually have highly indexed prices. Rental fees and services for health and education are a case in point. Their price adjustments in the medium and long term would be higher than was forecast earlier, if inflation expectations remain at 3% or above. Accordingly, the forecast for non-tradables in the coming quarters was increased, even though there were no substantial changes in the other major determinant of these prices (the output gap).

An increase in inflation expectations would affect, above all, prices for non-tradable services such as rent, health and education.

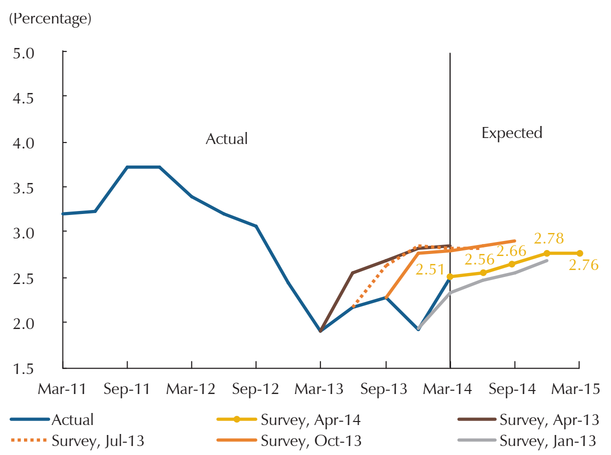
It is important to note, however, that inflation expectations were at around 3% until early April, but had increased slightly compared to the measure-

Graph 40
Annual Inflation Forecasts by Banks and Stock Brokers



Source: Banco de la República.

Graph 41
Actual Inflation and Inflation Expectations
(At three, six, nine and twelve months)
(Annual inflation)



Sources: DANE and Banco de la República.

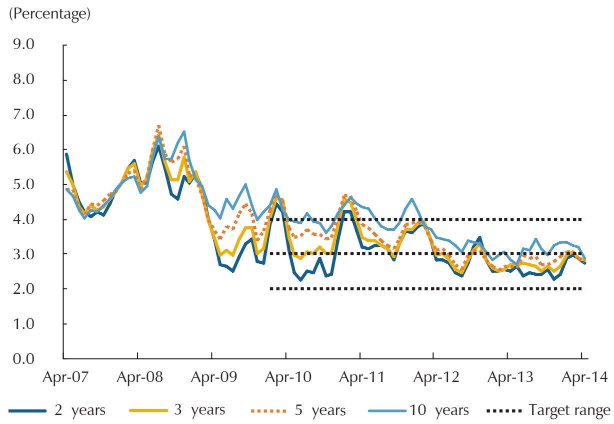
ments three months earlier. Those obtained from the monthly survey of financial market analysts conducted by Banco de la República were at 3.0% for December and 3.1% for a twelve-month horizon (Graph 40). In the case of the Bank's quarterly survey of entrepreneurs, the same indicators were 2.8% in both cases (Graph 41). The measurements based on the TES yield curve are near 3% for horizons of two, three and five years (Graph 42).

There was little or no change in this report with respect to the other factors that could affect consumer inflation in Colombia during the remainder of 2014 and in 2015. The pass-through of accumulated depreciation to prices was somewhat less than expected, and the models capture this fact in the medium and long-term forecasts. Moreover, situations such as higher oil and coffee prices so far this year, with notably higher forecasts in the second case, point to slightly less pressure towards depreciation than was contemplated in December. Added to this is the announcement by JP Morgan (discussed in previous sections), which could spark a larger influx of capital. All this led to a moderate decline in the forecasts for annual changes in the tradable CPI versus what was noted in the previous quarterly report.

Demand pressures will remain moderate during the rest of the year and in 2015, as was predicted in previous reports. The outcome for GDP by the end of 2013 was slightly higher than anticipated, but the forecasts for 2014 did not change. The central forecast for inflation contemplates an increase for this year and the next that is not far from what is regarded as the economy's potential for expansion. So, the output gap, which was near zero in 2013, would remain at that level for the next few quarters.

As for labor costs, the job market gap would remain balanced in 2014, provided the current pace of job creation and unemployment reduction is maintained. Therefore, the expectation is that wage adjustments will continue to be within the target range for inflation. Furthermore, the reduction in certain payroll taxes last year and the cutback in health contributions by employers allow firms to absorb wage increases without passing them on to prices.

Graph 42
Inflation Expectations Derived from TES
(At two, three, five and ten years)
(Monthly average)[a/]



a/ Nelson and Siegel method
Sources: Banco de la República

No strong pressures on the other costs are expected in the medium term, although accumulated depreciation and the return to normal in agricultural prices make the adjustments higher in 2014 than in 2013. A slight drop in prices for oil and certain raw materials, as contemplated in the central forecast for this year and the next, should reduce the risk of upward pressure on this front.

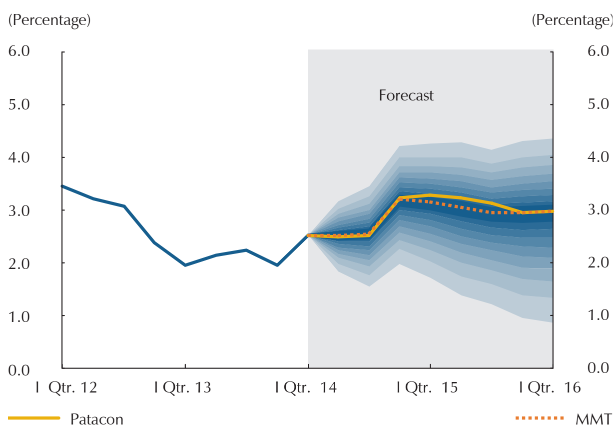
As such, the two models used by the Bank predict an increase in annual consumer inflation throughout 2014, but with more force in the second half of the year. In the exercise presented here, inflation would be near the midpoint of the target range by the end of 2014, due to price the increases anticipated for food and regulated items. Afterwards, inflation would remain relatively anchored at 3%, although above the forecast noted in the previous report.

Although the build-up in annual changes in food and regulated items has a temporary component, it does exert a permanent impact on inflation to the extent that it affects expectations, particularly through prices for non-tradables. Accordingly, the annual variation for this basket was raised in this report compared to the earlier prediction.

C. RISK BALANCE

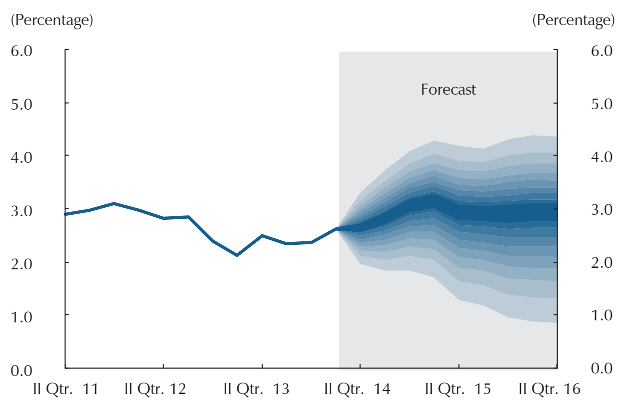
The risk balance estimated for total consumer and non-food inflation is shown in the fan charts in Graphs 40 and 41. Slightly more uncertainty is

Graph 43
Fan Chart of Total Inflation



MMT: Pass-Through Mechanisms Model
Patacon: Policy Analysis Tool Applied to Colombian Needs (Dynamic stochastic general equilibrium model)
Source: Banco de la República

Graph 44
Fan Chart of Non-food Inflation



Source: Banco de la República.

Both the uncertainty and the central forecast are higher in this report.

contemplated in this report, as opposed to the one in December, owing to developments in the exchange rate. This perception is justified, for example, by circumstances such as normalization of monetary policy in the United States, which could imply a reduced influx of capital, versus a possible increase in demand for domestic financial assets by foreign investors, since one of the local debt indexes most commonly used has been rebalanced in favor of Colombia.

The uncertainty associated with factors such as the evolution in prices for food and regulated items and the momentum in external demand was maintained in this report. These circumstances have broadened the scope of the fan chart for inflation, as shown below.

On this occasion, the bias around the central forecast in the fan chart is trending lower. However, it is important to point out that the inflation forecast in this central scenario is significantly higher than the forecast in the previous quarter.

The following are the main downward risks contemplated in this report.

Less global growth than anticipated in the central forecast:

The developed countries have shown signs of acceptable recovery and momentum in recent months, amid a less uncertain context with respect to monetary and fiscal policy. However, a setback in global economic performance compared to what is contemplated in the central forecast cannot be ruled out. Additionally, there is the risk of a larger slowdown than expected in the emerging countries, with China at the forefront. Its recent economic performance has been affected by a slowdown in demand (internal and external), and the risks to its financial stability persist. Any weakening of the Chinese economy beyond what is anticipated could impact Latin America via a sharper decline in its terms of trade. Moreover, in the euro area, the fragility of its financial system continues to pose a problem that generates uncertainty when trying to predict the pace and dynamics of recovery. Lastly, although the risk is less, there is still the possibility that gradual dismantling of the monetary stimulus program might have more adverse effects on global growth than those contemplated, both in the developed countries and particularly in emerging markets that are highly susceptible to movement in capital flows.

The forecast for inflation in 2014 is around 3.0%.

In the case of the Colombian economy, the emergence of these risks could translate into weaker external demand, less investor and consumer confidence, and more of a drop in international prices for raw materials. These risks combined could result in fewer exports and lower terms of trade, creating downward pressure on inflation that is not contemplated in the central

There is still the possibility that dismantling the monetary stimulus program in the United States could have an adverse effect on global growth.

forecast, provided these downside trends are not offset by possible pressure for depreciation in the exchange rate.

Less domestic demand than is anticipated in the central forecast:

The increase in investment during 2014, particularly investment in civil works, might be less than expected, considering the problems encountered in the past when implementing major projects, such as those announced. This demand exerts considerable influence on the rest of the economy; were it not to occur, it could mean GDP growth will be less than is forecast. Furthermore, there are downside risks looming in 2014 due to the poor performance in public spending, partly because of the restrictions imposed by the Assurances Act. All this could eventually lead to less domestic demand, which would imply, in turn, a more negative output gap and less pressure on consumer prices than those contemplated in the central forecast.

Lower price adjustments for certain services due to regulatory changes:

A reduction in fixed charges for certain public utilities possibly will be authorized in 2014, when Bill 101/2012 takes effect (it was approved already in the first debate). Moreover, a new rate scale for garbage collection is due to begin this year, as announced in June by the Ministry of Housing, City and Territory. More than 80% of the population in approximately 350 municipalities throughout the country[10] will benefit from these reductions, which were not contemplated fully in the central forecast.

The following are the main upside risks.

Depreciation in the exchange rate that is more than contemplated:

Full dismantling of the Fed's monetary stimulus program and particularly an interest rate hike by the Fed that is faster than the markets expect could still affect capital flows to emerging economies and the performance of their exchange rates. Although the Colombian economy is less vulnerable than the economies of other emerging countries – given relatively low external imbalances and less dependence on external borrowing to finance those imbalances- we cannot rule out the effect of contagion that might pummel the sovereign risk premium and lead to higher depreciation than projected in the baseline scenario. If this were to occur, additional upward pressure would be brought to bear on the cost of raw materials and imported foods, and on the prices of tradable goods and regulated items in general.

The risk of further depreciation in the exchange rate is considerably less than before.

10 See Resolution CRA 643/2013 (New Rate Scale for Garbage Collection)

There might be upward pressures on food prices in the coming months.

Even so, it is important to note that the risk contemplated in this report is considerably less than the risk taken into account three months ago, due to recent appreciation in the exchange rate. In particular, the change in the JP Morgan emerging market index– where Colombia saw its percentage share more than double (from 3.2% to 8.0%) - has an impact with uncertain time-horizon effects that could slow average depreciation anticipated for 2014 as a whole.

Significant increases in the price of food produced in the country:

The climate changes expected this year and the conditions surrounding agricultural supply pose the risk of a sharp hike in food prices that is more pronounced in this report than was the case last quarter. The prospect of strong upward pressure on food prices in the coming months cannot be ruled out, especially considering the recent increase in the likelihood of El Niño weather and adverse climate conditions that could affect food crops. Upward effects from shocks to production amid continuation of the agricultural supply cycle that was at a high point in earlier quarters and would be less this year cannot be disregarded either. This takes into account cases such as meat, where there has been a recent decline in the herd. On the other hand, the protective steps and the measures on minimum purchase prices for crops that were implemented recently for certain products, or are in the process of being applied (within the framework of the agreements resulting from the agricultural strike) also can lead to higher prices than were anticipated. These circumstances might not have been covered completely in the central forecast, given the complexity of determining the exact effect on prices. In principle, all these shocks are expected to be temporary. However, to the extent they influence on expectations, their impact on inflation might be more lasting.

Higher international prices for raw materials than were contemplated in the central forecast:

In contrast to the previous report, international commodity prices generate an upside risk.

In contrast to the previous report, this edition perceives the risk of an increase in international commodity prices, given the levels contemplated in the central forecast. Stable raw material prices or with slight declines in 2014 were taken into account as well. One of the major exceptions was gold, in which case the momentum depends on speculative aspects. Another was coffee, which is presumed to be higher due to the serious shocks experienced by other producers, such as Brazil. However, the recent momentum in raw material prices has shown these commodities are staying at higher levels than expected, which represents an upward risk to domestic inflation, should this situation continue. In this respect, prices for oil and other commodities have remained consistently above the central forecast so far this year; therefore, it might be underestimating the pressures they

The probability that inflation will be within the target range is still high.

are bringing to bear on inflation in Colombia. There are also geopolitical risks to consider. Although they are less in the case of oil, on this occasion (given the situation in Ukraine and Russia) they affect food prices, particularly oils and grains.

There are, however, several factors that temper the upside influence of these international prices. Specifically, on the side of agricultural commodities, the investment made in recent years by a number of countries in response to the boom in bio-fuels means it is possible to count on a larger global supply with gains in productivity, which would offset some of the adverse effects of the climate shocks that are occurring in several producing areas.[11]

Additionally, the hikes in market interest rates anticipated for 2014, due to the normalization of monetary policy in the United States, can bring down raw material prices. This is an important point to keep in mind. It also is worth noting that goods of this type became an attractive investment alternative in recent years, given the low returns on most financial assets.

In the case of Colombia, higher raw material prices would imply price increases for tradable goods and regulated items. They would also lead to higher transportation and production costs for a wide range of consumer goods. In principle, all this would have a temporary upward effect on consumer price inflation in Colombia, although it could be more prolonged if has an important impact on expectations.

Finally, after considering the weight of the different risks in the fan chart, the probability that total inflation in 2014 and 2015 will be within the range of 2% to 4% is still high. It is important to remember that the forecast in this report assumes an active monetary policy, with interest rates that are adjusted to ensure compliance with the long-term target for inflation.

The purpose of monetary policy in Colombia, in addition to keeping the inflation rate low and stable, is to ensure sustainable growth in output. Accomplishing the first of these objectives is a necessary condition, but not enough to achieve the second, as evidenced during the latest international crisis. For this reason, the importance of monitoring the formation of possible imbalances that can lead the country into a vulnerable position in the event of a negative shock has been emphasized.

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11 See the Economist Intelligence Unit (2014). "World Commodity Forecast: Foods, Foodstuffs and Beverages," May.

V. Risks to long-term macroeconomic stability

During 2013, the current account deficit widened, the real exchange rate depreciated and lending continued to slow. Housing prices posted new records, although their growth rate declined in the second half of the year.

The information at hand for the first quarter of 2014 shows real depreciation in the exchange rate and evidence of a widening current account deficit. In the meantime, bank lending accelerated.

The years following the international financial crisis have been characterized by a very lenient monetary policy stance in the advanced economies, which has encouraged capital inflows to emerging countries, including Colombia. This context of broad global liquidity, coupled with country-specific factors, has led some variables to deviate from their long-term trend. Therefore, normalization of monetary policy in the advanced countries should help to adjust these deviations; nevertheless, a sharp correction could prompt significant losses in output, employment and well-being.

Normalization of monetary policy in the advanced countries should help to adjust some of the country's macroeconomic variables.

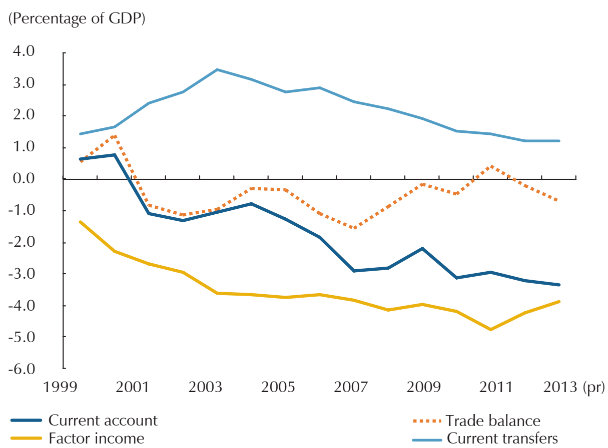
Recent developments in the current account, the real exchange rate (RER), as well as lending and housing prices are described in this section, and comparisons are made to their long-term trends and their prospects for 2014. The macroeconomic imbalance index (MII) is presented as well. It combines, into a single indicator, the results obtained with respect to the gaps for each of the aforementioned variables.

A. THE CURRENT ACCOUNT AND THE REAL EXCHANGE RATE

By the end of 2013, the current account deficit (3.4% of GDP) had grown compared to the increase observed in 2012 (3.2% of GDP). This is due to deterioration in the trade balance, given the lackluster performance of exports. Factor income and current transfers offset some of this performance and implied a smaller deficit (Graph 45).

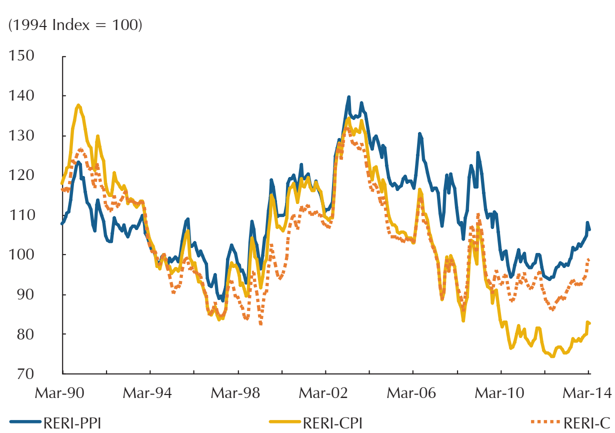
As for 2014, buoyant domestic demand and extensive foreign borrowing would contribute to a larger current account deficit. As to its outcome, the figures available for the first two months of the year indicate the trade balance continued to worsen (see Chapter I). With regard to financing, risk premiums have remained low, but are higher on average than those registered in 2013. At the same time, there has been a recent increase in demand for domestic financial assets on the part of foreign investors, which has reduced the cost of financing for the public and private sectors. Furthermore, the major advanced economies are expected to maintain an expansionary monetary stance throughout the year, despite the dismantling of the Fed's asset purchase program, which would continue to favor good conditions for financing the external deficit.

Graph 45
Current Account Components



(pr): preliminary
Source: Banco de la República

Graph 46
Real Exchange Rate Indexes (RERI)



Source: Banco de la República

As for the real exchange rate (RER), there has been a trend towards depreciation since mid-2012. In March 2014, it reached levels similar to those on record at the end of 2009 (Graph 46). The increase in the RER is more a question of nominal devaluation than changes in Colombia's relative prices compared to those of its major trading partners. This performance reflects recent developments in the fundamentals, such as lower terms of trade for the country in the last two years, the decline in the international investment position, and the standstill in the productivity of tradable sectors in Colombia.

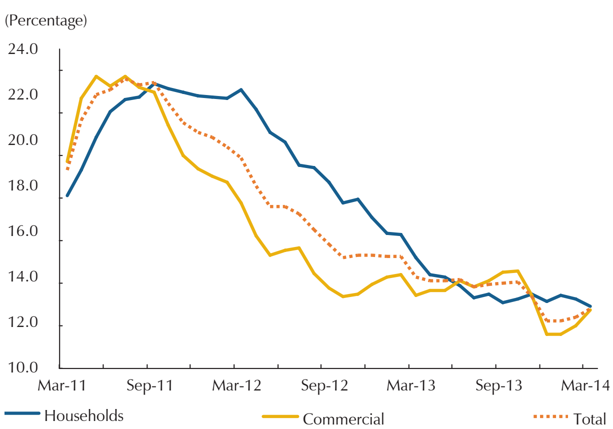
Although the peso has appreciated in real terms so far during the second quarter of 2014, no significant changes in the main variables driving the long-term trend in the RER are expected during the rest of the year. To begin with, the Assurances Act would restrict the momentum in government consumption, at least for the first half of the year, *Buoyant domestic demand and extensive foreign borrowing would contribute to a larger current account deficit in 2014.*

and most of the large-scale public investment projects would not get underway until 2015. While the spending planned for roads should have a positive impact on the country's productivity, the effect will be observed only insofar as these works are completed. Terms of trade, on average, are expected to be slightly below those registered in 2013, despite the rise in coffee prices during the early months of 2014, due to drought in Brazil, and high oil prices. In this context, the long-term trend towards real depreciation should continue.

Certain risks to external variables are looming in the medium term, above and beyond lower levels of global liquidity due to normalization of monetary policy in the advanced economies, which might imply higher funding costs for Colombia. The first is a sharp decline in terms of trade, generated, for example, by a drop in oil prices. Apart from reducing national revenue, this could have a negative impact on the country's risk premiums, the cost of external financing and the momentum in FDI. Another factor that could lead to difficulties on the external front is a higher than expected deterioration in economic activity for the countries in the region. In a context of this sort, Colombia's risk measurements might be subject to contagion and translate into higher financing costs. Lastly, if the current account deficit continues to grow, the country would become more vulnerable to negative global shocks; if they were to materialize, they could have serious adverse consequences for output and employment.

B. LENDING

Graph 47
Bank Lending (Annual change in the average monthly amount outstanding)

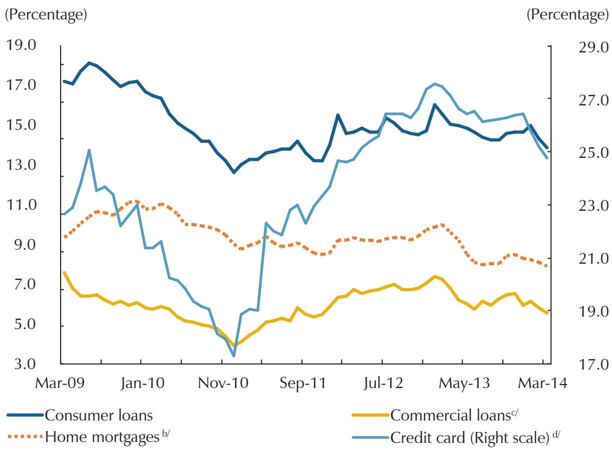


Note: Pertains to the annual change in the average outstanding monthly balance. For the loan portfolio in foreign currency, the fixed exchange rate based on December 2012 is COP$1.795/USD. Includes mortgage-loan securitization.
Source: Office of the Colombian Superintendent of Finance; Calculations by Banco de la República.

Bank lending accelerated during the first quarter of 2014, due to an increase in the growth of commercial loans (which account for approximately 65% of the total). This expansion was offset, to some degree, by less momentum in loans to households (Graph 47). The sharp increase in household mortgages continued, as did the slowdown in consumer lending.

The momentum in borrowing occurred in an environment of real interest rates that were lower during the year to April, on average, than those observed in 2013 (Graph 48). Real interest rates on consumer loans and mortgages have been below their historical average for several months.

Graph 48
Real Interest Rates on Lending a/



a/ The CPI was used as a deflator.
b/ Average, weighted by the amount of the rates on ordinary, treasury and preferred loans.
c/ Average, weighted by the amount of the rate on disbursements in pesos and in UVR for the purchase of non-low-income housing .
d/ Does not include consumption at one month or advances.
Source: Banco de la República

This has allowed the financial burden on households to remain at low levels.[12]

As to the level of indebtedness, the calculations for the corporate sector, including the banking portfolio, bonds and obligations contracted directly with entities abroad, are higher than they were prior to the crisis in 1999.[13] In the case of households, the ratio of loans from lending institutions to GDP was 15.3% in 2013, similar to what it was in 1997. This last outcome is even higher when taking into account broader indicators that include loans from the National Savings Fund, credit unions, employee funds and other entities that supply some of the financial needs of families (see Box 2, p. 69).

Although no abrupt changes in private sector borrowing are anticipated for the rest of the year, the latest edition of the Quarterly Survey of Credit Conditions in Colombia shows two factors that act in opposite directions. On the one hand, banks perceive less demand for loans of all types, with the exception of mortgages; on the other, the requirements for awarding new loans have been reduced slightly. Accordingly, the way the gross loan portfolio of banks performs in the coming months will depend on which of these factors predominates.

High levels of lending can place borrowers in a vulnerable position.

Some of the trends that could make the financial system and the economy as a whole more vulnerable to adverse shocks, if they were to become more pronounced, should be monitored in the medium term. On the one hand, household debt to the financial system has been growing at a faster rate than household income and, as mentioned earlier, this variable relative to GDP is already at historically high levels. On the other hand, the solidarity sector (credit unions, employee funds, etc.), which are subject to more lenient regulations and supervision than the financial system,[14] also have contributed to the increase in that debt. This being the case, high levels of lending can place borrowers in a position where they are vulnerable to negative shocks, such as a decline in income or the loss of a job.

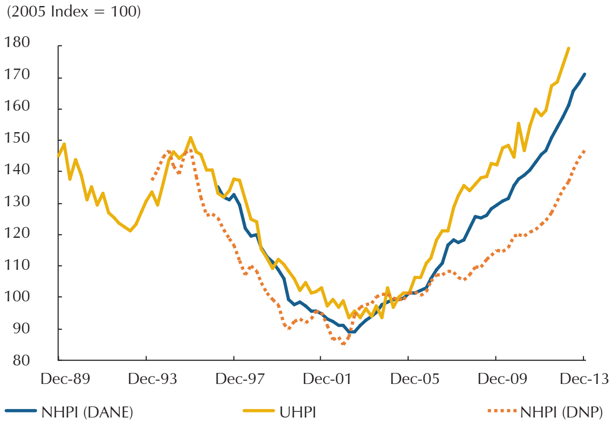
12 See the March 2014 edition of the Financial Stability Report.

13 For 2013, corporate sector indebtedness is estimated at around 35% of GDP, which is about 4 percentage points higher than the figure registered in 1997.

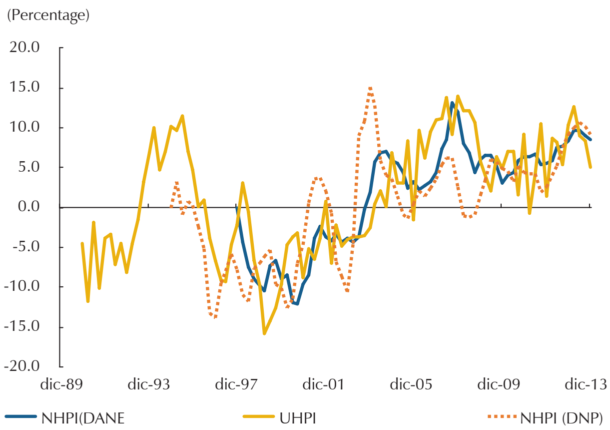
14 Credit unions and employee funds, among others, are monitored by the Office of the Superintendent of the Solidarity Economy.

Graph 49
Housing Prices Relative to the CPI

A. Indexes

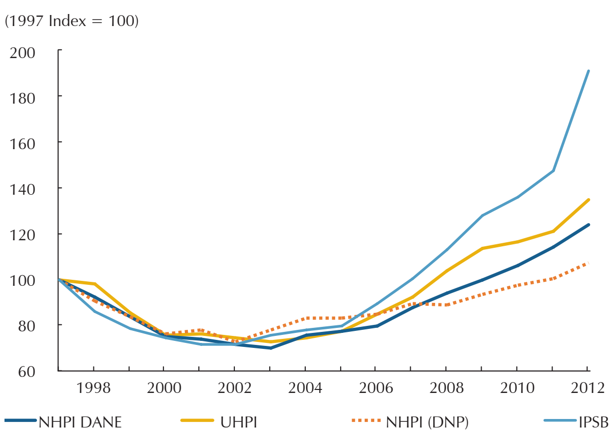


B. Annual percentage change



Sources: DANE, DNP and Banco de la República

Graph 50
Housing Price Indexes and the Price Index for Urban Residential Land in Bogota (IPSB)
(Relative to the CPI)



Sources: DANE, DNP, Lonja de Bogotá and Banco de la República

C. HOUSING

During 2013, housing prices continued to increase at elevated rates (around 10% annually, after inflation), starting from high levels and posting new records as a result (Graph 49, panel A). However, the second half of the year witnessed less growth than in the first six months (Graph 49, panel B).

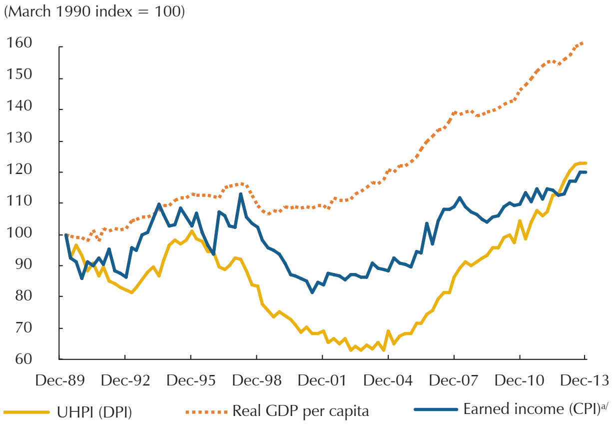
Among the arguments put forth to explain the recent trend in housing prices are factors involving both supply and demand. On the supply side, the main argument has been the shortage of land. Graph 50 shows how prices for urban residential land in Bogotá have evolved. They have risen significantly, and the figures at 2012 indicate the respective hikes had yet to pass through entirely to housing prices.

On the demand side, in addition to the various policies favorable to home construction and acquisition, another factor driving growth is the purchasing power of households during the last decade. In real terms, the accumulated increases in GDP per capita and earned income as of December 2003 are close to 40% (Graph 51). Similarly, the housing deficit, demographic changes[15] and mortgage interest rates that have stayed low by historical standards also are mentioned as some of the determinants of the high demand for housing (Graph 52).

Prudent measures were taken in the housing sector after the 1999 crisis in Colombia. These include, among others: i) limits on the percentage of financing awarded to households for the purchase of a home; ii) limits on the amount of the first installment in relation to income, and iii) restrictions on builders to ensure the financial viability of a project before work begins. These

15 The Colombian Construction Industry Chamber (Camacol) mentions, for example, the increase in the urban population and the smaller size of households, among other factors. See Economic Report No. 28, July 2011.

Graph 51
Housing Prices, GDP per Capita and Earned Income[a/]



a/ Pertains to average earned income (total of seven cities), CPI deflated.
Sources: DANE and Banco de la República

Graph 52
Real Interest Rates on Mortgages[a/]

a/ Average weighted by the amount of the rate of disbursements in pesos and UVR for the purchase of non-low-income housing. The CPI was used as the deflator.
Source: Banco de la República

measures, intended to avoid over-indebtedness on the part of households and companies in the construction sector, could help to reduce the impact that might come from a change in the housing market cycle. However, the rise in housing prices observed in recent years should continue to be monitored; if they move away from the behavior of their fundamentals, a reversal of possible overvaluation could have serious negative consequences for household wealth.

SEVERAL STUDIES ON HOUSING PRICES IN COLOMBIA

The fact that the various housing price indicators in Colombia show sustained appreciation for several years has prompted an analysis of the aspects that might be supporting this development and has sparked discussion on the possible existence of a bubble in the housing sector.

In this sense, several studies based on statistical tests[1] (Gomez et al., 2013; Hernandez and Piraquive, 2014) have detected an explosive pattern in the housing price series, which they see as an indication the country could be in the midst of a real estate bubble. Other analysists[2] claim Colombia currently is experiencing a mortgage bubble with characteristics different from the bubble in the nineties. When evaluating the performance of residential investment (measured as the rent-to-price ratio), Corficolombiana[3] found this variable is

1 Gómez, J.; Ojeda, J.; Rey, C.; Sicard, N. (2013). "Testing for Bubbles in Housing Markets: New Results Using a New Method," Borradores de Economía, no. 753, Banco de la República; Hernández, G.; Piraquive, G. (2014). "Evolución de los precios de la vivienda en Colombia," Archivos de Economía, no. 407, National Department of Planning.

2 Salazar, N.; Steiner, R.; Becerra, A.; Ramírez, J. (2012). "¿Qué tan desalineados están los precios de la vivienda en Colombia?", Fedesarrollo.

3 Corficolombiana. "Auge inmobiliario," Informe Semanal, February 17, 2014.

below its historical average, which could indicate housing in Colombia has been overvalued recently.

On the other hand, some argue the behavior of housing prices in the country is the result of the evolution in fundamentals, such as income growth, the momentum in land prices, demographic aspects and changes in the composition of the supply.[4] It also has been implied that a correction in the sharp decline in prices following the crisis in 1999, an increase in income and the wealth effect are behind the recent momentum in prices (Piraquive and Hernández, 2014).

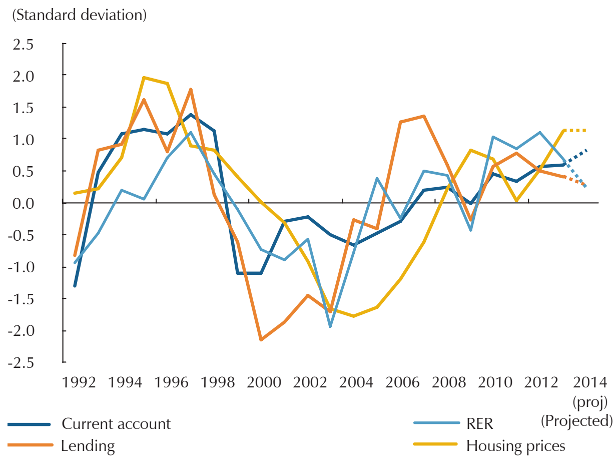
Finally, other studies[5] indicate housing prices are associated with "historically high land prices" and, therefore, are not out of line with respect to their fundamentals.

4 See Camacol (2011). "¿Todo aumento de precios es burbuja? Hacia una mejor comprensión de la información contenida en los índices de precios de la vivienda nueva," Informe Económico, no. 28, July and "Heterogeneidad inter e intrarregional de los precios de la vivienda nueva: evolución reciente y tendencias de largo plazo," Informe Económico, no. 57, April 2014.

5 Salazar, N.; Steiner, R.; Becerra, A.; Ramírez, J. (2012). "¿Qué tan desalineados están los precios de la vivienda en Colombia?" Fedesarrollo.

D. LONG-TERM ESTIMATES AND THE MACROECONOMIC IMBALANCE INDEX (MII)

Graph 53
Gaps in the Current Account, the Real Exchange Rate, Housing Prices and Lending



(proj) (Projected)
Source: Banco de la República

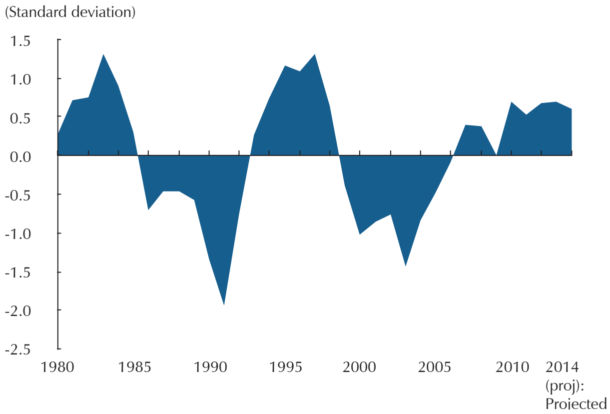
A comparison between the results posted in 2013 for the variables presented and their long-term estimates suggests the imbalances[16] continue. Specifically, the imbalance with respect to the current account and lending would have been similar to the situation in 2012. There would have been a correction for the RER, and the imbalance in housing prices would have increased (Graph 53).

The combination of these standardized gaps into a single indicator (MII)[17] suggests the aggregate imbalance increased slightly in 2013 with respect to 2012. As for 2014, the current account gap is expected to widen (given a larger deficit), and a correc-

16 Positive values indicate an imbalance. This is calculated for the RER as the long-term level minus the observed value.

17 See Arteaga, C.; Huertas, C.; Olarte, S. (2012). "Índice de desbalance macroeconómico," Borradores de Economía, no. 744, Banco de la República.

Graph 54
Macroeconomic Imbalance Index (MII)



(proj): Projected
Source: Banco de la República

tion in the RER and lending is anticipated. In terms of housing prices, the imbalance is not expected to increase. Accordingly, at the aggregate level, the MII suggests a slight reduction in the vulnerability of the economy to adverse shocks (Graph 54).

Importantly, the Colombian economy has several factors that enable it to adjust to negative shocks and leave it in a better position than other emerging countries that face similar vulnerabilities. For example, inflation expectations are anchored to a long-term target, which provides leeway for monetary policy; government debt is at manageable levels; the exchange rate is flexible, allowing it to absorb external shocks; the balance of international reserves has increased fivefold in the last decade; and there is an active set of macro-prudential measures.[18]

18 The countercyclical provisions, the measures concerning a credit institution's own position, the maximum limits on home financing through mortgages, and the value of the first installment on the purchase of housing are further examples.

Box 2
AN EXPANDED INDICATOR OF HOUSEHOLD FINANCING

Natalia Solano Rojas
Luis H. Calderón L.*

Loans awarded by lending institutions[1] for consumption and the purchase of housing, hereinafter referred to as bank loans, constitute the current measurement of household indebtedness. The indicator presented below expands the coverage of sources and types of financing. Sources include the Fondo Nacional del Ahorro (FNA, National Savings Fund) and the "solidarity" sector; the types of lending include residential lease agreements.

The FNA, created by Special Decree 3118/ 1968, manages the severance pay of public employees. Act 432/ 1998 extended this faculty to include the severance pay of private employees, as well as the capacity to receive savings deposits, which can be used to award loans for housing and education. These loans are relevant, particularly those to purchase a home, since they accounted for 15.7% of the adjusted mortgage portfolio of lending institutions by the end of 2013.[2]

The "solidarity" sector, according to Act 454/ 1998, includes the cooperatives, mutual associations and employee funds supervised by the Superintendencia de la Economía Solidaria (Supersolidaria, Office of the Colombian Superintendent of the Solidarity Economy).[3] These institutions focus on extending credit to their members as a means of development. The share of loans made by the sector on its assets increased from 45.9% to 55.3% between 2002 and 2013. During that same period, consumer loans accounted for 85.3% of all loans in the sector, with a balance at the close of 2013 equivalent to 15.1% of the consumer loans awarded by lending institutions.

Recently, with Decree 777 of Act 795/ 2003, commercial banks and commercial finance companies received permission to provide financing through residential lease agreements.[4] Although classified as commercial loans by the Office of the Colombian Superintendent of Finance (SFC), the objective of these loans is to purchase a home. In 2013, the annual increase in financing of this type was 47.3%, with a balance that represented 23.6% of the mortgage portfolio.

The expanded household financing indicator for 2013, with the aforementioned additions, showed a balance of $ 132.1 billion (b). This represents an increase of $ 24.1 b with respect to bank loans to households ($ 108.0 b). $ 12.8 b of this increase pertains to the "solidarity" sector[5] [6]and was used mainly for consumer loans (93.6%). The remaining $ 11.3 b was awarded through leasing and by the FNA for home purchases (Graph B2.1).

With calculation of extended indicator, as shown in Graph B2.2, financing awarded to households in 2013 came to 18.69% in relation to gross domestic product (GDP), which is 3.41 percentage points (pp) above the bank indicator (15.28%). Both these indicators exhibited an upward trend between 2004 and 2013, a period when the expanded indicator rose 92.4% (up from 9.7% of GDP) and bank indicator, 102.3% (starting at 7.55% of GDP). The bank indicator is now at levels similar to those on record in 1997, close to the start of the financial crisis in the nineties. How-

* The authors are a student intern and an expert on the financial system, in that order. They work with the Department of Programming and Inflation. The opinions expressed in this article imply no commitment on the part of Banco de la República or its Board of Directors.

1 Banks, finance corporations, commercial finance companies and credit unions.

2 Includes the loan portfolio for home purchase and respective securitizations.

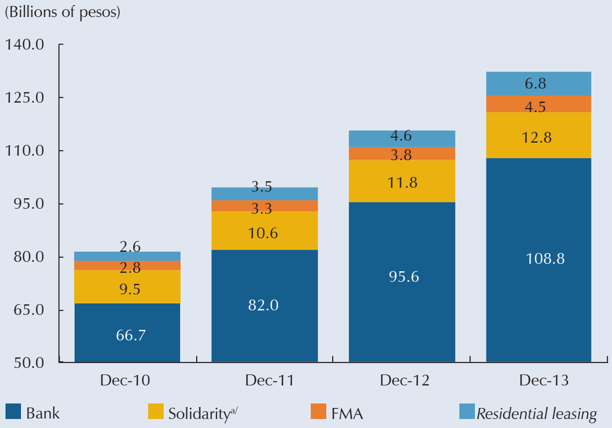
3 Therefore, "solidarity" organizations that provide services related to health, transport, private security and education are not included. They report to other supervisory bodies and their loans to households account for just under 4% of the "solidarity" sector. This is according to preliminary calculations obtained through a comparison of data with the Colombian Confederation of Cooperatives.

4 Through a residential lease agreement, the lending institution turns over the possession of residential real estate to a user in exchange for the regular payment of a rental fee for an agreed term. Upon the expiration of that period, the user may exercise the option to purchase the home, if he so desires, for which the payments made would be recognized and the user assumes a commitment to pay the remaining value (see http: //www.construdata. com / BancoConocimiento / L / leasingabc / leasingabc.asp).

5 The amount of "solidarity" sector loans between 2012 and 2013 approximated the growth of a population of entities that represented 94.44% of the loans to the total population in 2011.

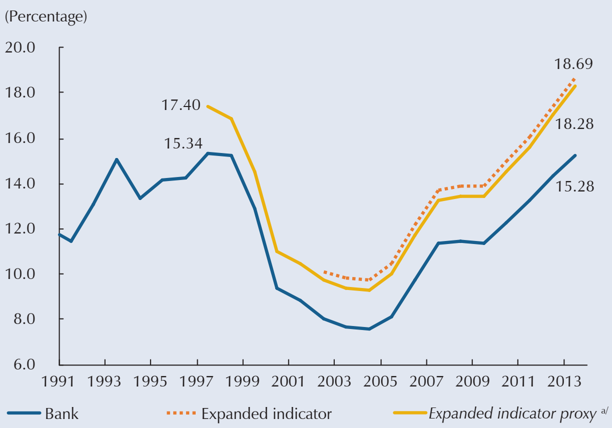
6 The amount of loans from the "solidarity" sector totaled $ 14.3 b in 2013, including $ 1.6 b for commercial micro-loans.

Graph B2.1
Household Financing



a/ Cooperatives, mutual associations and employee funds supervised by the Office of the Superintendent of the Solidarity Economy
Sources: Office of the Superintendent of the Solidarity Economy (financial statements) and the Office of the Colombian Superintendent of Finance (financial statements); Calculations by Banco de la República

Graph B2.2
Household Financing as a Share of GDP



a/ Does not include employee funds (See note 7.)
Sources: Office of the Superintendent of the Solidarity Economy (financial statements) and the Office of the Colombian Superintendent of Finance (financial statements); Calculations by Banco de la República

ever, if a proxy of the expanded indicator is used,[7] the current level exceeds that of 1997 by 88 basis points (bp) (18.28% vs. 17.40%).[8]

In terms of the momentum in household financing, both indicators follow a similar path, as illustrated in Graph B2.3, with bank credit displaying a bit more volatility. The increase in these two indicators as of 2008, with respect to the consumption component, is very much alike, but one sees an earlier gap in favor of bank lending. This is because several financial cooperatives converted from closed[9] to open[10] institutions, prompting entities in the "solidarity" sector to reorganize as lending institutions (Graph B2.4).

In the home purchase component, the path of growth was similar as well, the difference being that the expanded indicator always outperformed the bank loan indicator. Moreover, the gap between the two has widened since 2009. Specifically, in 2013, the annual rate of growth in the expanded indicator reached 19.9%, compared to 15.5% in the bank loan indicator, as a reflection of the annual increase in residential leasing (47.4%) and mortgages from the FNA (18.2%) (Graph B2.5).

According to analysts in the sector, the important increase in the residential leasing, with an annual growth rate of 34.8% in the last four years, can be explained by several factors. Namely, a) these contracts allow for a higher percentage of financing (80%) in excess of the limit on ordinary mortgages

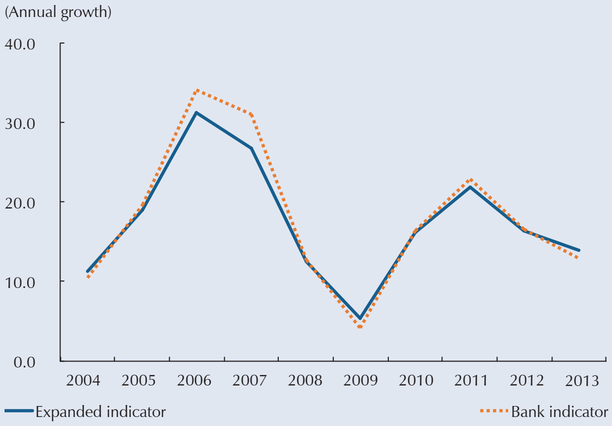
7 Since there is no information on employee funds during 1997-2001, or a breakdown of households for the rest of the "solidarity" sector, the indicator was reconstructed as the aggregate of bank credit, FNA, residential leasing and total lending by the "solidarity" sector. This approximation is reasonable when considering that 92.2% of "solidarity" sector loans between 2002 and 2012, on average, went to households, while employee funds destined more than 98% for households during the same period.

8 It is important to note that the current macroeconomic context is very different from the late nineties. The financial, external, public and real sectors were highly vulnerable at that time, and the economy was more likely to be affected by an adverse external shock. In that context, the extent of borrowing was just one of the factors that explained the presence of the crisis.

9 Deposit-taking and lending operations are authorized only for members; namely, those who make capital contributions. These entities are supervised by Supersolidaria.

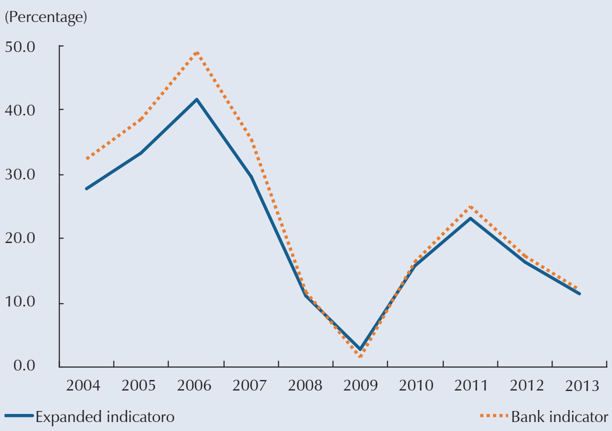
10 Entities that, in compliance with the requirements of the SFC, were subject to its surveillance, and were authorized to take deposits from and grant loans to non-members.

Graph B2.3
Household Financing



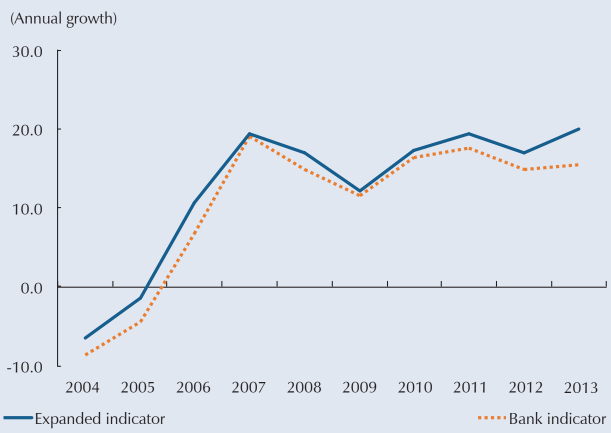
Sources: Office of the Superintendent of the Solidarity Economy (financial statements) and the Office of the Colombian Superintendent of Finance (financial statements); Calculations by Banco de la República

Graph B2.4
Consumer Financing



Sources: Office of the Superintendent of the Solidarity Economy, Office of the Colombian Superintendent of Finance, and the Colombian Confederation of Cooperatives; Calculations by Banco de la República

Graph B2.5
Mortgages



Sources: Office of the Superintendent of the Solidarity Economy, Office of the Colombian Superintendent of Finance and the Colombian Confederation of Cooperatives; Calculations by Banco de la República

(70%); b) intermediaries offer lower interest rates, partly because the income from these agreements is exempt; c) in 2013, according to Decree 0701 and Resolution 1263, residential leasing also was included in the interest rate coverage initially applicable only to home mortgages; and d), unlike mortgages, no stamp tax is charged to authenticate a lease agreement.

In conclusion, the expanded indicator of financing achieves an approximation that could be useful as a reference to estimate how the financial burden of households has evolved. The calculation proposed for financing to purchase a home shows higher growth, which could explain the increase in demand, as opposed to looking only at the bank loan indicator.

Attachment

Macroeconomic forecasts by local and foreign analysts

The latest forecasts by local and foreign analysts with respect to the major variables in the economy for 2014 and 2015 are summarized in this section. At the time they were consulted, the analysts had data up to April 2014.

1. Forecasts for 2014

The local analysts, on average, expect 4.6% economic growth, which is the same as the estimate in the previous edition of the Inflation Report. The foreign agencies that were consulted expect GDP growth to average 4.5%.

Table A1
Macroeconomic Forecasts by Local and Foreign Analysis for 2014

	Real GDP Growth (Percentage)	CPI Inflation (Percentage)	Nominal exchange rate end of:	Nominal DTF (Percentage)	Fiscal deficit (Percentage of GDP)	Unemployment Rate in Thirteen Cities (Percentage)
Local Analysts						
Alianza Valores	4.8	3.5	2,100	4.90	2.3	8.1
Anif	4.6	3.00	n. d.	4.70	1.3	10.0
Banco de Bogotá	4.5	2.90	2,000	4.50	n. d.	9.7
Bancolombia [a/]	4.4	2.80	2,025	4.13	2.4	8.1
BBVA Colombia [a/]	4.7	3.14	1,960	4.63	2.3	9.5
BGT Pactual	4.5	3.16	2,050	n. d.	1.2	9.4
Corficolombiana	5.0	3.00	1,875	5.00	1	9.1
Corpbanca [b/, c/]	4.7	3.10	2,000	5.00	2.4	8.4
Corredores Asociados	4.5	3.17	2,040	4.51	2.3	8.4
Correval	4.6	3.00	1,950	5.04	1	9.7
Davivienda [a/]	4.5	3.53	1,900	4.40	2.3	8.5
Fedesarrollo [a/]	4.3	3.3	1,980	4.80	2.3	9.2
Ultrabursátiles	4.2	3.03	2,000	4.36	n. d.	8.9
Average	**4.6**	**3.1**	**1,990**	**4.7**	**1,9**	**9.0**
Foreign Analysts						
Citi [a/]	4.6	3.00	2,075	5.05	1.3	8.7
Deutsche Bank	4.5	3.00	1,970	n. d.	2.30	n. d.
Goldman Sachs	4.4	3.00	2,150	n. d.	2.30	n. d.
JP Morgan	4.6	2.90	n. d.	n. d.	1.20	n. d.
Average	**4.5**	**3.0**	**2,065**	**5.1**	**1.8**	**8.7**

n. d.: Not available
a/ The deficit forecasts pertains to the national government
b/ Average unemployment rate for the year
c/ Formerly Banco Santander
Source: Banco de la República (electronic survey)

Table A2
Macroeconomic Forecasts by Local and Foreign Analysis for 2015

	Real GDP Growth	CPI Inflation	Nominal Exchange Rate
	(Percentage)		End of:
Local Analysts			
Alianza Valores	5.0	3,8	2,250
Anif	4.5	3.0	n. d.
Banco de Bogotá	5.0	3.0	2,050
Bancolombia	4.6	3.4	2,150
BBVA Colombia	4.8	3,2	1,980
BGT Pactual	4.5	3.3	2,100
Corficolombiana	5.0	3.0	1,975
Corpbanca [a/]	5.0	3.2	2,050
Corredores Asociados	4.8	3.3	2,040
Correval	5.1	3.4	1,950
Davivienda	n. d.	n. d.	n. d.
Fedesarrollo	4.6	3.0	2,015
Ultrabursátiles	4.5	3.0	2,200
Average	4.8	3.2	2,069
Foreign Analysts			
Citi	5.0	3.50	2,150
Deutsche Bank	4.3	3.6	n. d.
Goldman Sachs	4.5	3.0	2,204
JP Morgan	4.5	3.0	n. d.
Average	**4.6**	**3.3**	**2,177**

n. d.: not available
a/ Formerly Banco Santander
Source: Banco de la República (electronic survey)

As for the exchange rate, the local analysts expect the representative market exchange rate (TRM) to average COP$1,990 by the end of the year, compared to COP$1,991 estimated in the survey referred to in the previous edition of this report. The foreign analysts expect the TRM to be near COP$2,065 by the end of the year.

With respect to the rate on time deposits (DTF), the local analysts forecast 4.7%, on average. They also expect 9.0% unemployment.

2. Forecasts for 2015

The local analysts forecast 4.8% growth in 2015; the foreign analysts expect 4.6%. As for inflation, the local and foreign analysts are forecasting 3.2% and 3.3%, respectively. In terms of the exchange rate, the local analysts expect it to average $2.069, while the foreign analysts anticipate $2,177, on average.

This report was coordinated, edited and designed by the Publishing Division of the Administrative Services Department, using font Times New Roman 10.5. Banco de la República.

Published by Nomos.

Septembre 2015